

Interim Consolidated Financial Statements

1 January - 30 June 2015

CONTENTS

	page
Endorsement and Statement by the Board of Directors and the CEO	3
Report on review of Interim Consolidated Financial Statements	6
Interim Consolidated Statement of Comprehensive Income	7
Interim Consolidated Statement of Financial Position	8
Interim Consolidated Statement of Changes in Equity	9
Interim Consolidated Statement of Cash Flows	10
Notes to the Interim Consolidated Financial Statements	12

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

The Interim Financial Statements of Arion Bank for the period ended 30 June 2015 include the Interim Financial Statements of Arion Bank ("the Bank") and its subsidiaries, together referred to as "the Group".

Outlook

The outlook for the Icelandic economy is positive. Economic growth is now expected to be 3.7% this year and around 3.5% over the coming two years. Unemployment remains low at 2.9% and is expected to remain at this level. Inflation is currently 1.9% but is expected to rise to 3.5% next year, following a new wage round between employers and the major labour unions in Iceland, which is partially concluded. Some uncertainties, however, still remain in this respect. A major milestone was reached on 8 June when the government introduced a plan to lift the capital controls which have been in place in Iceland since 2008. This represents a significant step towards removing the main area of uncertainty relating to the economy. The rating agencies reacted positively to the plan and upgraded the rating on the Republic of Iceland. Standard and Poor's states that the plan will address Iceland's sizable balance of payments vulnerability by relieving the latent pressure on the Icelandic krona exchange rate, thus strengthening the sentiment of foreign investors and improving access of non-sovereign borrowers to the international markets. Following the ratings upgrade of Iceland, S&P's credit rating for Arion Bank was raised from BB+ (positive outlook) to BBB- (stable outlook).

Arion Bank is a leading universal bank on the Icelandic market and has as such actively contributed to the recovery of the Icelandic economy. In recent years Arion Bank has systematically reduced risk in the Bank's loan portfolio by increasing the proportion of loans to individuals, most of which have been first lien mortgages. Loans are now evenly split between individuals and corporate. Furthermore, the distribution of the corporate loan book reflects the relative size of sectors in the Icelandic economy. The quality of the loan portfolio has continued to improve and the ratio of problem loans is now close to levels seen at banks in the other Nordic countries, especially when measured as a proportion of equity.

The Bank has strategically positioned itself as a market leader in Iceland in loans to new businesses in the export sector, health care and energy-intensive industries. The Bank aims to further strengthen its position in these areas. The Bank has also augmented its international loan portfolio by lending to businesses involved in fish-processing and the fisheries in neighboring countries, thus supporting growth while at the same time reducing geographical risk.

The Bank has successfully sold a number of shareholdings acquired by the Bank while restructuring the finances of some of its corporate clients. The Bank has, furthermore, actively managed a small number of such holdings and now aims to concentrate on selling them. During 2015 Arion Bank has sold a large part of its shareholding in real estate companies Reitur fasteignafélag hf. and Eik fasteignafélag hf. in relation to the listing of the companies on NASDAQ Iceland in April. The Bank furthermore sold part of its direct and indirect shareholding in Refresco Gerber, also in relation to the listing of the company. Furthermore, the shareholding in the telecommunications company Síminn hf. is expected to be sold in the second half of 2015 in relation to the listing of the company on NASDAQ Iceland. The Bank is financially robust as demonstrated by the new leverage ratio of 15.4% (see Note 41). The Bank's capital strength, the upgraded rating of S&P from BB+ to BBB- and new funding enables Arion Bank to provide financial backing for its retail and corporate customers as their business expands, both domestically and internationally.

Operations during the period

Net earnings amounted to ISK 19,326 million for the period ended 30 June 2015. The Group's equity amounted to ISK 168,445 million at period end. The capital adequacy ratio of the Group, calculated according to the Financial Undertakings Act, was 23.2%, following the prepayments of subordinated liabilities, and Tier 1 ratio was 21.8%, which comfortably meets the requirements set by law and the Financial Supervisory Authority (FME). The liquidity position was also strong at period end and well above the regulatory minimum.

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

The Group performed well during the period and operations were characterized by greater stability. Net interest income increased by 10% compared to the same period in 2014. Net commission income increased substantially between years, or by 13%, and the increase was generated across the Bank. Net financial income totalled ISK 9,723 million.

Net earnings in the first quarter were positively affected by the sale and listing of the Group's direct and indirect shareholding in Refresco Gerber and Reitir fasteignafélag hf. The net earnings in the second quarter were, furthermore, negatively affected by an impairment of the loan portfolio of AFL - sparisjóður, a subsidiary of the Bank. Historically the Bank was only allowed to appoint independent members to the Board of Directors of AFL - sparisjóður but this changed in April following approval by the Icelandic authorities. The loan portfolio of AFL - sparisjóður was subsequently revalued by external party. Net impairment by AFL - sparisjóður for the period amounts to ISK 1,749 million. Net valuation change of other loans in the Group was positive by ISK 1,668 million during the first half of 2015 which bears witness to the successful restructuring of the loan portfolio. Thus net impairment during the period amounts to ISK 81 million.

The main change on the Balance Sheet from year end 2014 is related to the funding of the Bank, i.e. the issue of bonds and an increase in the deposit base after a slight reduction at the end of 2014. This increase is reflected on the asset side by an increase in Bank accounts and Loans to customers. Loans to customers increased by ISK 19,621 million during the period. The increase is partly related to new lending to businesses in the real estate and service sectors. In April Arion Bank paid a dividend to its shareholders amounting to ISK 12,809 million.

In March Arion Bank launched its inaugural euro senior unsecured benchmark transaction, when the Bank sold EUR 300 million, ISK 45 billion, 3-year fixed rate bonds to around 100 international investors. The Bank's inaugural bond is the first EUR public transaction and the single largest transaction, and the most important step taken by an Icelandic bank to re-enter the international capital markets since 2008.

At the end of June Arion Bank completed a bond issue in Norwegian kroner, when issuing NOK 500 million (approximately ISK 8 billion) of 5-year instruments. The bonds bear floating NIBOR +2.95% interest. Arion Bank simultaneously entered a swap agreement, whereby part of the interest and principal are in euros. Interest in euros is floating EURIBOR +2.74%. The issue was oversubscribed and sold to investors in the Nordics and continental Europe. At the same time, Arion Bank bought back NOK 260 million of bonds from a 2013 issue and has now bought back NOK 319 million of a NOK 500 million issue.

At the end of June Arion Bank paid ISK 10 billion of the subordinated loan from the Icelandic treasury before the due date and has now paid a total of ISK 20 billion in 2015 of approximately ISK 30 billion. The loan was granted at the beginning of 2010 in connection with the recapitalization of the Bank. The Bank also continued the regular issuance of domestic covered bonds and commercial paper.

The Group had 1,123 full-time equivalent positions at the end of the period, compared with 1,120 at the end of 2014; 840 of these positions were at Arion Bank, compared with 865 at the end of 2014.

Group ownership

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

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

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

Endorsement of the Board of Directors and the Chief Executive Officer

The Interim Financial Statements of Arion Bank for the period ended 30 June 2015 have been prepared in accordance with International Financial Reporting Standards (IAS 34 Interim Financial Reporting) as adopted by the European Union and additional requirements in the Icelandic Act on Financial Statements, Act on Financial Undertakings and Rules on Accounting for Credit Institutions.

It is our opinion that the Interim Financial Statements give a true and fair view of the financial performance of the Group for the period ended 30 June 2015 and its financial position as at 30 June 2015.

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

The Board of Directors and the CEO have today discussed the Interim Financial Statements of Arion Bank for the period ended 30 June 2015 and confirm them by means of their signatures.

Reykjavík, 26 August 2015

Board of Directors



Monica Caneman
Chairman



Benedikt Olgeirsson



Guðrún Johnsen



Måns Höglund



Brynjólfur Bjarnason



Kírstín Þ. Flygenring



Þóra Hallgrímsdóttir

Chief Executive Officer



Höskuldur H. Ólafsson

REPORT ON REVIEW OF INTERIM CONSOLIDATED FINANCIAL STATEMENTS

To the Board of Directors and Shareholders of Arion Bank.

We have reviewed the accompanying Interim Consolidated Statement of Financial Position of Arion Banki hf. and its subsidiaries (the "Group") as of 30 June 2015 and the related Interim Consolidated Statement of Comprehensive Income, Interim Consolidated Statement of Changes in Equity and Interim Consolidated Statement of Cash Flows for the six months then ended and a summary of significant accounting policies and other explanatory notes.

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

The Board of Directors and management are responsible for the preparation and fair presentation of this Interim Consolidated Financial Statements in accordance with International Financial Reporting Standards for Interim Financial Reporting, IAS 34, as adopted by the EU.

Auditor's Responsibility

Our responsibility is to express a conclusion on this Interim Consolidated Financial Statements based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements, ISRE 2410. A review of Interim Consolidated Financial Statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying Interim Consolidated Financial Statements do not give a true and fair view of the financial position of the Bank as at 30 June 2015, and of its financial performance and its cash flows for the six month period then ended in accordance with International Financial Reporting Standards for Interim Financial Reporting, IAS 34, as adopted by the EU and additional requirements in the Icelandic Act on Financial Statements, Act on Financial Undertakings and Rules on Accounting for Credit Institutions.

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

Pursuant to the requirement of Paragraph 2 Article 104 of the Icelandic Act on Financial Statements 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 Act on Financial Statements that is not disclosed elsewhere in the Interim Consolidated Financial Statements.

Kópavogur, 26 August 2015

Deloitte ehf.


Páll Grétar Steingrímsson
State Authorised Public Accountant


Gunnar Þorvarðarson
State Authorised Public Accountant

INTERIM CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE PERIOD FROM 1 JANUARY TO 30 JUNE 2015

	Notes	2015 1.1.-30.6.	2014 1.1.-30.6.	2015 1.4.-30.6.*	2014 1.4.-30.6.*
Interest income		27,660	26,881	16,016	13,990
Interest expense		(14,485)	(14,915)	(8,624)	(7,507)
Net interest income	6	<u>13,175</u>	<u>11,966</u>	<u>7,392</u>	<u>6,483</u>
Fee and commission income		10,236	8,917	5,179	4,653
Fee and commission expense		(2,802)	(2,324)	(1,502)	(1,208)
Net fee and commission income	7	<u>7,434</u>	<u>6,593</u>	<u>3,677</u>	<u>3,445</u>
Net financial income	8	9,723	3,867	2,184	4,439
Other operating income	9	5,740	3,274	1,038	2,356
Operating income		<u>36,072</u>	<u>25,700</u>	<u>14,291</u>	<u>16,723</u>
Salaries and related expense	10	(7,167)	(7,164)	(3,675)	(3,714)
Other operating expense	11	(6,004)	(5,811)	(3,108)	(3,064)
Bank levy	12	(1,389)	(1,375)	(659)	(715)
Net impairment	13	(81)	2,001	(1,863)	34
Earnings before tax		<u>21,431</u>	<u>13,351</u>	<u>4,986</u>	<u>9,264</u>
Income tax expense	14	(2,367)	(2,467)	(647)	(1,152)
Net earnings from continuing operations		<u>19,064</u>	<u>10,884</u>	<u>4,339</u>	<u>8,112</u>
Net gain from discontinued operations, net of tax	15	262	6,525	79	6,433
Net earnings		<u>19,326</u>	<u>17,409</u>	<u>4,418</u>	<u>14,545</u>
Attributable to					
Shareholders of Arion Bank		19,297	17,263	4,433	14,455
Non-controlling interest		29	146	(15)	90
Net earnings		<u>19,326</u>	<u>17,409</u>	<u>4,418</u>	<u>14,545</u>
Other comprehensive income					
Exchange difference on translating foreign subsidiaries	32	(230)	(2)	(225)	(4)
Total comprehensive income for the period		<u>19,096</u>	<u>17,407</u>	<u>4,193</u>	<u>14,541</u>
Earnings per share from continuing operations					
Basic and diluted earnings per share attributable to the shareholders of Arion Bank (ISK)	16	9.52	5.37	2.18	4.01

* The quarterly statements and the split between quarters were not audited or reviewed by the Bank's auditors.

The notes on pages 12 to 55 are an integral part of these Interim Financial Statements.

INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2015

Assets	Notes	30.6.2015	31.12.2014
Cash and balances with Central Bank	17	33,189	21,063
Loans to credit institutions	18	103,815	108,792
Loans to customers	19	667,129	647,508
Financial instruments	20-22	111,419	101,828
Investment property	22	7,851	6,842
Investments in associates	24	13,987	21,966
Intangible assets	25	9,353	9,596
Tax assets	26	891	655
Other assets	27	27,177	15,486
Total Assets		<u>974,811</u>	<u>933,736</u>
Liabilities			
Due to credit institutions and Central Bank	21	13,961	22,876
Deposits	21	472,304	454,973
Financial liabilities at fair value	21	4,145	9,143
Tax liabilities	26	6,203	5,123
Other liabilities	28	56,989	47,190
Borrowings	21,29	241,880	200,580
Subordinated liabilities	21,30	10,884	31,639
Total Liabilities		<u>806,366</u>	<u>771,524</u>
Equity			
Share capital and share premium	32	75,861	75,861
Other reserves	32	1,402	1,632
Retained earnings		89,706	83,218
Total Shareholders' Equity		<u>166,969</u>	<u>160,711</u>
Non-controlling interest		1,476	1,501
Total Equity		<u>168,445</u>	<u>162,212</u>
Total Liabilities and Equity		<u>974,811</u>	<u>933,736</u>

The notes on pages 12 to 55 are an integral part of these Interim Financial Statements.

INTERIM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE PERIOD 1 JANUARY TO 30 JUNE 2015

	Share capital and share premium	Other reserves	Retained earnings	Total Share- holders' equity	Non- controlling interest	Total equity
Equity 1 January 2015	75,861	1,632	83,218	160,711	1,501	162,212
Total comprehensive income for the period	-	(230)	19,297	19,067	29	19,096
Dividend paid	-	-	(12,809)	(12,809)	-	(12,809)
Acquisition of non-controlling interest	-	-	-	-	(54)	(54)
Equity 30 June 2015	<u>75,861</u>	<u>1,402</u>	<u>89,706</u>	<u>166,969</u>	<u>1,476</u>	<u>168,445</u>
Equity 1 January 2014	75,861	1,637	62,591	140,089	4,858	144,947
Total comprehensive income for the period	-	(2)	17,263	17,261	146	17,407
Dividend paid	-	-	(7,811)	(7,811)	-	(7,811)
Equity 30 June 2014	<u>75,861</u>	<u>1,635</u>	<u>72,043</u>	<u>149,539</u>	<u>5,004</u>	<u>154,543</u>

The notes on pages 12 to 55 are an integral part of these Interim Financial Statements.

INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE PERIOD 1 JANUARY TO 30 JUNE 2015

	2015 1.1.-30.6.	2014 1.1.-30.6.
Operating activities		
Net earnings	19,326	17,409
Non-cash items included in net earnings and other adjustments	(16,460)	(19,812)
Changes in operating assets and liabilities	6,422	(3,881)
Interest received	18,542	16,852
Interest paid*	(6,507)	(7,539)
Dividend received	6,798	658
Income tax and Bank levy paid	(1,523)	(1,192)
Net cash from operating activities	<u>26,598</u>	<u>2,495</u>
Investing activities		
Net investment in associated companies	8,259	16
Net investment in property and equipment and intangible assets	(614)	(865)
Net cash from (used in) investing activities	<u>7,645</u>	<u>(849)</u>
Financing activities		
Payment of subordinated liabilities	(19,883)	-
Dividend paid to shareholders of Arion Bank	(12,809)	(7,811)
Acquisition of non-controlling interest	(58)	-
Net cash used in financing activities	<u>(32,750)</u>	<u>-</u>
Net increase (decrease) in cash and cash equivalents	1,493	(6,165)
Cash and cash equivalents at beginning of the period	91,715	99,683
Effect of exchange rate changes on cash and cash equivalents	535	(623)
Cash and cash equivalents at the end of the period	<u>93,743</u>	<u>92,895</u>
Non-cash investing transactions		
Assets acquired through foreclosure on collateral from customers with view to resale	691	644
Settlement of loans through foreclosure on collateral from customers with view to resale	(691)	(644)
Changes due to the sale of Landfestar		
Changes in investment property	-	(23,131)
Changes in investment in associates	-	7,242
Changes in borrowings	-	14,769
Changes in tax liabilities	-	1,120

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

The notes on pages 12 to 55 are an integral part of these Interim Financial Statements.

NOTES TO THE INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE PERIOD 1 JANUARY TO 30 JUNE 2015

	2015 1.1.-30.6.	2014 1.1.-30.6.
Non-cash items included in net earnings and other adjustments		
Net interest income	(13,175)	(11,966)
Net impairment	81	(2,001)
Income tax expense	2,367	2,467
Bank levy	1,389	1,375
Net foreign exchange gain	(622)	(152)
Net gain on financial instruments	(2,303)	(3,057)
Depreciation and amortisation	834	669
Share of (profit) loss of associates and fair value change	(4,217)	80
Net gain from discontinued operations, net of tax	(262)	(6,290)
Other changes	(552)	(938)
Non-cash items included in net earnings and other adjustments	(16,460)	(19,812)
Changes in operating assets and liabilities		
Mandatory reserve with Central Bank	(51)	(230)
Loans to credit institutions, excluding bank accounts	(5,117)	(24,173)
Loans to customers	(9,876)	5,507
Financial instruments and financial liabilities at fair value	(14,397)	(8,084)
Investment property	(457)	310
Other assets	(1,889)	10,737
Due to credit institutions and Central Bank	(8,778)	1,269
Deposits	13,017	40
Borrowings	33,123	8,555
Other liabilities	847	2,188
Changes in operating assets and liabilities	6,422	(3,881)
Cash and cash equivalents		
Cash in hand and demand deposits	33,189	17,361
Due from credit institutions	69,540	84,751
Mandatory reserve with Central Bank	(8,986)	(9,217)
Cash and cash equivalents	93,743	92,895

The notes on pages 12 to 55 are an integral part of these Interim Financial Statements.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

CONTENTS

	page		page
General information	13	Offsetting financial assets and financial liabilities	30
Operating Segment Reporting	15	Investment in associates	31
Quarterly statements	17	Intangible assets	32
Notes to the Interim Consolidated Statement of Comprehensive Income		Tax assets and tax liabilities	32
Net interest income	18	Other assets	32
Net fee and commission income	18	Other liabilities	33
Net financial income	19	Borrowings	33
Other operating income	19	Subordinated liabilities	33
Personnel and salaries	19	Pledged assets	34
Other operating expense	20	Equity	34
Bank levy	20	Off Balance Sheet information	
Net impairment	20	Obligations	35
Income tax expense	20	Assets under management and under custody	35
Net gain from discontinued operations, net of tax	21	Legal matters	35
Earnings per share	21	Events after Balance Sheet date	37
Notes to the Interim Consolidated Statement of Financial Position		Related party	38
Cash and balances with Central Bank	22	Risk Management Disclosures	
Loans to credit institutions	22	Risk Management	39
Loans to customers	22	Credit risk	39
Financial instruments	23	Market risk	44
Financial assets and financial liabilities	24	Liquidity risk	50
Fair value hierarchy	26	Capital management	53
		Significant Accounting Policies	55

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

GENERAL INFORMATION

Arion banki hf., the Parent Company, was established 18 October 2008 and is incorporated and domiciled in Iceland. The registered office of Arion banki hf. is located at Borgartún 19, Reykjavík. The Interim Financial Statements for the period ended 30 June 2015 comprise the Parent Company and its subsidiaries (together referred to as "the Group").

1. Basis of preparation

Statement of compliance

The Interim Financial Statements are consolidated and have been prepared in accordance with International Financial Reporting Standard IAS 34, Interim Financial Reporting, as adopted by the European Union and additional requirements in the Icelandic Act on Financial Statements, Act on Financial Undertakings and rules on Accounting for Credit Institutions. The Interim Financial Statements do not include all the information and disclosures required in the Annual Financial Statements, and should be read in conjunction with Arion Bank's Annual Financial Statements for the year 2014. The statements are available at Arion Bank's website www.arionbanki.is.

The Interim Financial Statements were approved and authorised for issue by the Board of Directors of Arion Bank on 26 August 2015.

Basis of measurement

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

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

Functional and presentation currency

The Interim Financial Statements are presented in Icelandic Krona (ISK), which is the Parent Company's functional currency, rounded to the nearest million, unless otherwise stated. At the end of the period the exchange rate of the ISK against the USD was 132.09 and 147.20 for the EUR (31.12.2014: USD 127.46 and EUR 154.28).

2. Significant accounting estimates and judgements in applying accounting policies

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

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

The key sources of estimation uncertainty are within:

- impairment losses and reversal of impairment losses on loans; and
- investments in associates.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

3. The Group

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

	Operating activity	Currency	Equity interest	
			30.6.2015	31.12.2014
AFL - sparisjóður ses., Aðalgata 34, Siglufjörður, Iceland	Retail banking	ISK	99.3%	99.3%
Arion Bank Mortgages Instit. Investor Fund, Borgartún 19, Reykjavík, Iceland	Retail banking	ISK	100.0%	100.0%
BG12 slhf., Katrínartún 2, Reykjavík, Iceland	Holding company	ISK	62.0%	62.0%
EAB 1 ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Eignabjarg ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Eignarhaldsfélagið Landey ehf., Grófinni 1, Reykjavík, Iceland	Real estate	ISK	100.0%	100.0%
Okkar líftryggingar hf., Laugavegi 182, Reykjavík, Iceland	Life insurance	ISK	100.0%	100.0%
Stefnir hf., Borgartún 19, Reykjavík, Iceland	Asset management	ISK	100.0%	100.0%
Valitor Holding hf., Dalshraun 3, Hafnarfjörður, Iceland	Payment solutions	ISK	99.4%	98.8%

In April 2015 the Bank increased its shareholding in Valitor Holding hf. when it purchased 0.6% shareholding from a non-controlling party Landsbankinn hf.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

OPERATING SEGMENT REPORTING

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

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

Operating segments

The Group comprises six main operating segments:

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

Corporate Banking provides comprehensive financial services and customized solutions to larger corporate clients in Iceland. Corporate Banking provides a full range of conventional lending products, deposit accounts as well as value added electronic corporate solutions to meet the needs of each customer.

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

Retail Banking, including Arion Bank Mortgages Institutional Investor Fund and AFL - sparisjóður, provides a comprehensive range of services. This includes among other advice on deposits and loans, savings, payment cards, pension savings, insurance, securities and funds. To maximize operational efficiency the branch network is divided into six clusters, with the smaller branches capitalizing on the strength of larger units within each cluster. Retail Banking's 25 branches all around Iceland have a total of more than 100,000

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

Other divisions and Subsidiaries include market making in domestic securities and currencies. The subsidiaries are Eignabjarg ehf., Eignarhaldsfélagið Landey ehf., Okkar líftryggingar hf., Valitor Holding hf., BG12 sIhf., EAB 1 ehf. and other smaller entities of the Group.

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

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

4. Operating segments

	Asset Manage- ment and Stefnir	Corporate Banking	Investment Banking	Retail Banking	Treasury	Other divisions and Sub- sidiaries	Head- quarters and Elimination	Total
1.1.-30.6.2015								
Net interest income	213	2,780	(62)	6,832	3,216	199	(3)	13,175
Other income	2,056	561	9,496	1,547	(170)	4,103	5,304	22,897
Operating income	2,269	3,341	9,434	8,379	3,046	4,302	5,301	36,072
Operating expense	(732)	(262)	(544)	(2,922)	(131)	(2,797)	(5,783)	(13,171)
Bank levy	-	-	-	-	-	-	(1,389)	(1,389)
Net impairment	(3)	1,455	1,494	(2,342)	11	(743)	47	(81)
Earnings before tax	1,534	4,534	10,384	3,115	2,926	762	(1,824)	21,431
Net seg. rev. from ext. customers	1,032	7,131	9,860	14,754	(6,551)	4,539	5,299	36,072
Net seg. rev. from other segments	1,237	(3,790)	(426)	(6,375)	9,597	(237)	(6)	-
Operating income	2,269	3,341	9,434	8,379	3,046	4,302	5,293	36,072
Depreciation and amortisation	-	-	-	147	-	289	398	834
30.6.2015								
Total assets	5,129	247,406	46,901	420,226	190,676	46,336	18,137	974,811
Total liabilities	114	193,314	23,636	373,373	181,480	27,088	7,361	806,366
Allocated equity	5,015	54,092	23,265	46,853	9,196	19,248	10,776	168,445
1.1.-30.6.2014								
Net interest income	307	3,546	117	6,361	2,322	(670)	(17)	11,966
Other income	1,859	772	5,485	1,292	(990)	4,358	958	13,734
Operating income	2,166	4,318	5,602	7,653	1,332	3,688	941	25,700
Operating expense	(719)	(321)	(375)	(2,951)	(140)	(2,560)	(5,909)	(12,975)
Bank levy	-	-	-	-	-	-	(1,375)	(1,375)
Net impairment	-	2,214	(8)	(885)	691	(44)	33	2,001
Earnings before tax	1,447	6,211	5,219	3,817	1,883	1,084	(6,310)	13,351
Net seg. rev. from ext. customers	1,096	8,376	5,752	12,686	(7,745)	4,618	917	25,700
Net seg. rev. from other segments	1,070	(4,058)	(150)	(5,033)	9,077	(930)	24	-
Operating income	2,166	4,318	5,602	7,653	1,332	3,688	941	25,700
Depreciation and amortisation	-	-	-	143	-	158	368	669
30.6.2014								
Total assets	4,858	238,184	30,783	401,183	191,420	60,121	22,444	948,993
Total liabilities	2,466	200,072	25,858	359,370	155,015	30,174	21,495	794,450
Allocated equity	2,392	38,112	4,925	41,813	36,405	29,947	949	154,543

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

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

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

QUARTERLY STATEMENTS

5. Operations by quarters

2015	Q2*	Q1*	Total
Net interest income	7,392	5,783	13,175
Net fee and commission income	3,677	3,757	7,434
Net financial income	2,184	7,539	9,723
Other operating income	1,038	4,702	5,740
Operating income	14,291	21,781	36,072
Salaries and related expense	(3,675)	(3,492)	(7,167)
Other operating expense	(3,108)	(2,896)	(6,004)
Bank levy	(659)	(730)	(1,389)
Net impairment	(1,863)	1,782	(81)
Earnings before tax	4,986	16,445	21,431
Income tax expense	(647)	(1,720)	(2,367)
Net earnings from continuing operations	4,339	14,725	19,064
Net gain from discontinued operations, net of tax	79	183	262
Net earnings	4,418	14,908	19,326
2014			
Net interest income	6,483	5,483	11,966
Net fee and commission income	3,445	3,148	6,593
Net financial income	4,439	(572)	3,867
Other operating income	2,356	918	3,274
Operating income	16,723	8,977	25,700
Salaries and related expense	(3,714)	(3,450)	(7,164)
Other operating expense	(3,064)	(2,747)	(5,811)
Bank levy	(715)	(660)	(1,375)
Net impairment	34	1,967	2,001
Earnings before tax	9,264	4,087	13,351
Income tax expense	(1,152)	(1,315)	(2,467)
Net earnings from continuing operations	8,112	2,772	10,884
Net gain from discontinued operations, net of tax	6,433	92	6,525
Net earnings	14,545	2,864	17,409

* The quarterly statements and the split between quarters were not audited or reviewed by the Bank's auditors.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTES TO THE INTERIM CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

6. Net interest income

	2015 1.1.-30.6.	2014 1.1.-30.6.	2015 1.4.-30.6.	2014 1.4.-30.6.
<i>Interest income</i>				
Cash and balances with Central Bank	284	332	142	154
Loans	25,301	24,274	14,792	12,657
Securities	1,609	1,979	777	1,008
Other	466	296	305	171
Interest income	27,660	26,881	16,016	13,990
<i>Interest expense</i>				
Deposits	(7,460)	(8,784)	(4,313)	(4,336)
Borrowings	(6,494)	(5,463)	(4,100)	(2,834)
Subordinated liabilities	(503)	(650)	(197)	(326)
Other	(28)	(18)	(14)	(11)
Interest expense	(14,485)	(14,915)	(8,624)	(7,507)
Net interest income	13,175	11,966	7,392	6,483
Net interest income from assets and liabilities at fair value	1,609	1,979	777	1,008
Interest income from assets not at fair value	26,051	24,902	15,239	12,983
Interest expense from liabilities not at fair value	(14,485)	(14,915)	(8,624)	(7,508)
Net interest income	13,175	11,966	7,392	6,483
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	3.0%	2.8%	3.3%	3.1%

7. Net fee and commission income

	Net Income Expense income		Net Income Expense income			
	1.1.-30.6.2015		1.1.-30.6.2014			
Asset management	2,071	(123)	1,948	1,980	(90)	1,890
Cards	5,306	(2,499)	2,807	4,152	(1,725)	2,427
Collection and payment services	661	(42)	619	599	(42)	557
Investment banking	1,094	(21)	1,073	1,052	(24)	1,028
Lending and guarantees	682	-	682	615	-	615
Other	422	(117)	305	519	(443)	76
Net fee and commission income	10,236	(2,802)	7,434	8,917	(2,324)	6,593
	1.4.-30.6.2015		1.4.-30.6.2014			
Asset management	1,060	(51)	1,009	971	(7)	964
Cards	2,816	(1,398)	1,418	2,146	(917)	1,229
Collection and payment services	332	(22)	310	322	(17)	305
Investment banking	419	(11)	408	660	(10)	650
Lending and guarantees	375	-	375	387	-	387
Other	177	(20)	157	167	(257)	(90)
Net fee and commission income	8,917	(2,324)	6,593	4,653	(1,208)	3,445

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

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

8. Net financial income

	2015 1.1.-30.6.	2014 1.1.-30.6.	2015 1.4.-30.6.	2014 1.4.-30.6.
Dividend income	6,798	658	6,754	59
Net gain (loss) on financial assets and financial liabilities classified as held for trading ..	86	(373)	142	(12)
Net gain (loss) on financial assets and financial liabilities designated at fair value through profit or loss	2,217	3,430	(5,026)	3,764
Net foreign exchange gain	622	152	314	628
Net financial income	9,723	3,867	2,184	4,439

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

Equity instruments designated at fair value	2,118	4,058	(5,096)	4,311
Interest rate instruments designated at fair value	99	(628)	70	(547)
Net gain (loss) on financial assets and financial liabilities designated at fair value through profit or loss	2,217	3,430	(5,026)	3,764

9. Other operating income

Share of profit of associates and reversal of impairment	4,217	(80)	6	(16)
Rental income from investment property	17	1,171	7	583
Fair value changes on investment property	426	932	387	932
Realised gain on investment property	126	6	126	5
Earned premiums, net of reinsurance	530	492	286	265
Other income	424	753	226	587
Other operating income	5,740	3,274	1,038	2,356

10. Personnel and salaries

Number of employees

Average number of full time equivalent positions during the period	1,118	1,133	1,123	1,128
Full time equivalent positions at the end of the period	1,123	1,118	1,123	1,118

The Bank's number of employees

Average number of full time equivalent positions during the period	850	900	849	893
Full time equivalent positions at the end of the period	840	887	840	887

Salaries and related expense

Salaries	5,530	5,521	2,842	2,863
Defined contribution pension plans	789	777	405	402
Salary related expense	848	866	428	449
Salaries and related expense	7,167	7,164	3,675	3,714

Salaries and related expense for the Bank

Salaries	4,074	4,323	2,082	2,230
Defined contribution pension plans	588	590	297	295
Salary related expense	622	723	322	383
Salaries and related expense	5,284	5,636	2,701	2,908

During the period the Group made a provision of ISK 131 million (H1 2014: ISK 159 million) for performance plan payments, including salary related expense, thereof the Bank made a provision of ISK 80 million (H1 2014: ISK 131 million). Forty percent of the payment is deferred for three years in accordance with FME rules on remuneration policy for financial undertakings. At the end of the period the Group's accrual for performance plan payments amounts to ISK 579 million (31.12.2014: ISK 741 million), thereof the Bank's accrual amounts to ISK 473 million (31.12.2014: ISK 639 million).

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

11. Other operating expense	2015	2014	2015	2014
	1.1.-30.6.	1.1.-30.6.	1.4.-30.6.	1.4.-30.6.
Administration expense	4,573	4,271	2,431	2,258
Depositors' and investors' guarantee fund	420	415	203	212
Depreciation of property and equipment	460	470	286	249
Amortisation of intangible assets	374	199	103	101
Direct operating expense derived from rental-earning investment properties	-	280	-	143
Claims incurred, net of reinsurance	142	173	68	100
Other expense	35	3	17	1
Other operating expense	6,004	5,811	3,108	3,064

12. Bank levy

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

13. Net impairment	2015	2014	2015	2014
	1.1.-30.6.	1.1.-30.6.	1.4.-30.6.	1.4.-30.6.
Increase in book value of loans to corporates	2,024	1,654	65	1,066
Increase in book value of loans to individuals	988	310	590	107
Increase in book value of other assets	-	683	-	-
Net change in impairment of loans to corporates	519	227	125	(1,167)
Net change in impairment of loans to individuals	(2,287)	(935)	(1,346)	89
Net change in collective impairment on loans	(1,300)	62	(1,297)	(61)
Impairment of intangible assets	(25)	-	-	-
Net impairment	(81)	2,001	(1,863)	34

14. Income tax expense

Current tax expense	2,420	2,074	1,196	967
Deferred tax expense	(53)	393	(549)	185
Income tax expense	2,367	2,467	647	1,152

Reconciliation of effective tax rate	1.1.-30.6.2015		1.1.-30.6.2014	
	Earnings before tax		21,431	
Income tax using the Icelandic corporation tax rate	20.0%	4,286	20.0%	2,670
Additional 6% tax on financial institutions	2.7%	569	3.7%	490
Non-deductible expenses	1.3%	281	2.3%	308
Tax exempt revenue	(12.9%)	(2,761)	(6.9%)	(920)
Other changes	(0.0%)	(8)	(0.6%)	(81)
Effective tax rate	11.0%	2,367	18.5%	2,467

Financial institutions pay 6% additional tax on taxable profit exceeding ISK 1 billion.

Tax exempt revenues consist mainly of profit from equity positions.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

15. Net gain from discontinued operations, net of tax

	2015 1.1.-30.6.	2014 1.1.-30.6.	2015 1.4.-30.6.	2014 1.4.-30.6.
Net gain from associated companies	-	6,290	-	6,290
Net gain from real estates and other assets	262	235	79	143
Net gain from discontinued operations, net of tax	262	6,525	79	6,433

16. Earnings per share

	Discontinued operations			
	Excluded		Included	
	2015 1.1.-30.6.	2014 1.1.-30.6.	2015 1.1.-30.6.	2014 1.1.-30.6.
Net earnings attributable to the shareholders of Arion Bank	19,035	10,738	19,297	17,263
Weighted average number of outstanding shares for the period, million	2,000	2,000	2,000	2,000
Basic earnings per share	9.52	5.37	9.65	8.63

There were no instruments at the end of the period that could potentially dilute basic earnings per share (2014: none).

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTES TO THE INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION

17. Cash and balances with Central Bank	30.6.2015	31.12.2014
Cash on hand	6,423	5,255
Cash with Central Bank	17,780	6,873
Mandatory reserve deposit with Central Bank	8,986	8,935
Cash and balances with Central Bank	33,189	21,063

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

18. Loans to credit institutions

Bank accounts	69,540	79,587
Money market loans	30,677	23,007
Other loans	3,598	6,198
Loans to credit institutions	103,815	108,792

19. Loans to customers

30.6.2015	Individuals	Corporates	Total
Overdrafts	18,062	25,272	43,334
Credit cards	10,650	997	11,647
Mortgage loans	264,681	11,990	276,671
Capital lease	2,905	5,438	8,343
Other loans	31,537	322,786	354,323
Provision on loans	(12,431)	(14,758)	(27,189)
Loans to customers	315,404	351,725	667,129
31.12.2014			
Overdrafts	17,955	24,420	42,375
Credit cards	11,065	943	12,008
Mortgage loans	271,639	10,406	282,045
Capital lease	2,469	3,607	6,076
Other loans	31,294	300,391	331,685
Provision on loans	(13,111)	(13,570)	(26,681)
Loans to customers	321,311	326,197	647,508

The total book value of pledged loans that were pledged against amounts borrowed was ISK 186 billion at the end of the period (31.12.2014: ISK 197 billion). Pledged loans comprised mortgage loans to individuals, loans to real estate companies, wholesale and retail and industry and energy companies.

Further analysis of loans is provided in Risk Management Disclosures.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

19. Loans to customers, continued

Changes in the provision for losses on loans to customers

1.1.-30.6.2015	Specific	Collective	Total
Balance at the beginning of the year	22,214	4,467	26,681
Provision for losses	1,768	1,300	3,068
Write-offs	(2,755)	-	(2,755)
Payment of loans previously written off	195	-	195
Balance at the end of the period	21,422	5,767	27,189
1.1.-30.6.2014			
Balance at the beginning of the year	25,126	4,100	29,226
Provision for losses	740	(94)	646
Write-offs	(3,339)	(16)	(3,355)
Payment of loans previously written off	804	-	804
Balance at the end of the period	23,331	3,990	27,321

Significant accounting estimates and judgements

Key sources of estimation uncertainty are impairment losses on loans.

The Group reviews its loan portfolios to assess impairment at least quarterly as further described in Note 53 in the Annual Financial Statements for 2014. The specific component of the total allowance for impairment applies to financial assets evaluated individually for impairment and is based on management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a debtor's financial situation and the net realisable value of any underlying collateral. Each impaired asset is assessed on its merits, the workout strategy and estimate of cash flows considered recoverable are independently reviewed by the Credit Risk function.

20. Financial instruments

	30.6.2015	31.12.2014
Bonds and debt instruments	68,878	66,466
Shares and equity instruments with variable income	28,257	25,232
Derivatives	1,842	1,026
Securities used for hedging	12,442	9,104
Financial instruments	111,419	101,828

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

21. Financial assets and financial liabilities

30.6.2015	Amortised cost	Trading	Designated at fair value	Total
<i>Loans</i>				
Cash and balances with Central Bank	33,189	-	-	33,189
Loans to credit institutions	103,815	-	-	103,815
Loans to customers	667,129	-	-	667,129
Loans	804,133	-	-	804,133
<i>Bonds and debt instruments</i>				
Listed	-	1,200	66,202	67,402
Unlisted	-	99	1,377	1,476
Bonds and debt instruments	-	1,299	67,579	68,878
<i>Shares and equity instruments with variable income</i>				
Listed	-	3,539	10,354	13,893
Unlisted	-	1,601	11,997	13,598
Bond funds with variable income, unlisted	-	549	217	766
Shares and equity instruments with variable income	-	5,689	22,568	28,257
<i>Derivatives</i>				
OTC derivatives	-	1,842	-	1,842
Derivatives	-	1,842	-	1,842
<i>Securities used for hedging</i>				
Bonds and debt instruments, listed	-	4,367	-	4,367
Shares and equity instruments with variable income, listed	-	7,829	-	7,829
Shares and equity instruments with variable income, unlisted	-	246	-	246
Securities used for hedging	-	12,442	-	12,442
Other financial assets	15,321	-	-	15,321
Financial assets	819,454	21,272	90,147	930,873
<i>Liabilities at amortised cost</i>				
Due to credit institutions and Central Bank	13,961	-	-	13,961
Deposits	472,304	-	-	472,304
Borrowings	241,880	-	-	241,880
Subordinated liabilities	10,884	-	-	10,884
Liabilities at amortised cost	739,029	-	-	739,029
<i>Financial liabilities at fair value</i>				
Short position in bonds	-	2,717	-	2,717
Derivatives	-	1,428	-	1,428
Financial liabilities at fair value	-	4,145	-	4,145
Other financial liabilities	48,766	-	-	48,766
Financial liabilities	787,795	4,145	-	791,940

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

21. Financial assets and financial liabilities, continued

31.12.2014	Amortised cost	Trading	Designated at fair value	Total
<i>Loans</i>				
Cash and balances with Central Bank	21,063	-	-	21,063
Loans to credit institutions	108,792	-	-	108,792
Loans to customers	647,508	-	-	647,508
Loans	777,363	-	-	777,363
<i>Bonds and debt instruments</i>				
Listed	-	3,157	61,421	64,578
Unlisted	-	36	1,852	1,888
Bonds and debt instruments	-	3,193	63,273	66,466
<i>Shares and equity instruments with variable income</i>				
Listed	-	1,538	7,079	8,617
Unlisted	-	1,613	13,901	15,514
Bond funds with variable income, unlisted	-	928	173	1,101
Shares and equity instruments with variable income	-	4,079	21,153	25,232
<i>Derivatives</i>				
OTC derivatives	-	1,026	-	1,026
Derivatives	-	1,026	-	1,026
<i>Securities used for hedging</i>				
Bonds and debt instruments, listed	-	3,212	-	3,212
Shares and equity instruments with variable income, listed	-	4,911	-	4,911
Shares and equity instruments with variable income, unlisted	-	981	-	981
Securities used for hedging	-	9,104	-	9,104
Other financial assets	3,514	-	-	3,514
Financial assets	780,877	17,402	84,426	882,705
<i>Liabilities at amortised cost</i>				
Due to credit institutions and Central Bank	22,876	-	-	22,876
Deposits	454,973	-	-	454,973
Borrowings	200,580	-	-	200,580
Subordinated liabilities	31,639	-	-	31,639
Liabilities at amortised cost	710,068	-	-	710,068
<i>Financial liabilities at fair value</i>				
Short position in bonds	-	8,238	-	8,238
Derivatives	-	905	-	905
Financial liabilities at fair value	-	9,143	-	9,143
Other financial liabilities	39,032	-	-	39,032
Financial liabilities	749,100	9,143	-	758,243

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

21. Financial assets and financial liabilities, continued

<i>Bonds and debt instruments designated at fair value specified by issuer</i>	30.6.2015	31.12.2014
Financial and insurance activities	10,815	3,403
Public sector	55,588	58,730
Corporates	1,176	1,140
Bonds and debt instruments designated at fair value	67,579	63,273

The total amount of pledged bonds at the end of the period was ISK 12.2 billion (31.12.2014: ISK 18.0 billion). Pledged bonds comprise Icelandic Government Bonds that were pledged against funding received and included in Due to credit institutions and Central Bank as well as short positions included in Financial liabilities at fair value.

22. Fair value hierarchy

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

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: valuation techniques for which all significant inputs are market observable, either directly or indirectly; and

Level 3: valuation techniques which include significant inputs that are not based on observable market data.

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

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

30.6.2015	Level 1	Level 2	Level 3	Total
<i>Assets at fair value</i>				
Bonds and debt instruments	29,620	39,081	177	68,878
Shares and equity instruments with variable income	13,416	14,776	65	28,257
Derivatives	-	1,842	-	1,842
Securities used for hedging	11,879	563	-	12,442
Investment property	-	-	7,851	7,851
Assets at fair value	54,915	56,262	8,093	119,270
<i>Liabilities at fair value</i>				
Short position in bonds	2,717	-	-	2,717
Derivatives	-	1,428	-	1,428
Liabilities at fair value	2,717	1,428	-	4,145

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

22. Fair value hierarchy, continued

31.12.2014	Level 1	Level 2	Level 3	Total
<i>Assets at fair value</i>				
Bonds and debt instruments	26,677	38,611	1,178	66,466
Shares and equity instruments with variable income	8,072	17,062	98	25,232
Derivatives	-	1,026	-	1,026
Securities used for hedging	7,789	1,315	-	9,104
Investment property	-	-	6,842	6,842
Assets at fair value	42,538	58,014	8,118	108,670
<i>Liabilities at fair value</i>				
Short position in bonds	8,238	-	-	8,238
Derivatives	-	905	-	905
Liabilities at fair value	8,238	905	-	9,143

There were transfers from Level 2 to Level 1 of ISK 6,799 million related to listing of companies on NASDAQ Iceland during the period (2014: none). There have been no transfers from Level 1 to Level 2 during the period (2014: none)

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

<i>Movements in Level 3 assets measured at fair value</i>	Investment property		Financial assets		Total	
	30.6.2015	31.12.2014	30.6.2015	31.12.2014	30.6.2015	31.12.2014
Balance at the beginning of the year	6,842	28,523	1,276	1,667	8,118	30,190
Recognised in Statement of Comprehensive Income	426	1,091	3	(373)	429	718
Additions	1,790	2,148	77	5	1,867	2,153
Disposal	(1,207)	(25,503)	(1,114)	(23)	(2,321)	(25,526)
Transfers into Level 3	-	583	-	-	-	583
Balance at the end of the period	7,851	6,842	242	1,276	8,093	8,118

<i>Line items where effects of Level 3 assets are recognised in the Statement of Comprehensive Income</i>	2015		2014	
	1.1.-30.6.	1.1.-30.6.	1.1.-30.6.	1.1.-30.6.
Net interest income	18	34		
Net financial income	(15)	(189)		
Other operating income	552	932		
Effects recognised in the Statement of Comprehensive Income	555	777		

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

22. Fair value hierarchy, continued

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

30.6.2015	Carrying value	Fair value	Unrealised gain (loss)
<i>Financial assets not carried at fair value</i>			
Cash and balances with Central bank	33,189	33,189	-
Loans to credit institutions	103,815	103,815	-
Loans to customers	667,129	674,956	7,827
Other financial assets	15,321	15,321	-
Financial assets not carried at fair value	819,454	827,281	7,827
<i>Financial liabilities not carried at fair value</i>			
Due to credit institutions and Central bank	13,961	13,961	-
Deposits	472,304	471,271	1,033
Borrowings	241,880	243,913	(2,033)
Subordinated loans	10,884	10,884	-
Other financial liabilities	48,766	48,766	-
Financial liabilities not carried at fair value	787,795	788,795	(1,000)
31.12.2014			
<i>Financial assets not carried at fair value</i>			
Cash and balances with Central bank	21,063	21,063	-
Loans to credit institutions	108,792	108,792	-
Loans to customers	647,508	657,261	9,753
Other financial assets	3,514	3,514	-
Financial assets not carried at fair value	780,877	790,630	9,753
<i>Financial liabilities not carried at fair value</i>			
Due to credit institutions and Central bank	22,876	22,876	-
Deposits	454,973	455,133	(160)
Borrowings	200,580	197,115	3,465
Subordinated loans	31,639	31,639	-
Other financial liabilities	39,032	39,032	-
Financial liabilities not carried at fair value	749,100	745,795	3,305

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

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

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

22. Fair value hierarchy, continued

<i>Derivatives</i>	Fair value	
	Assets	Liabilities
30.6.2015		
Forward exchange rate agreements, unlisted	447	320
Interest rate and exchange rate agreements, unlisted	683	375
Bond swap agreements, unlisted	32	8
Share swap agreements, unlisted	206	705
Options - purchased agreements, unlisted	474	20
Derivatives	1,842	1,428
31.12.2014		
Forward exchange rate agreements, unlisted	63	172
Interest rate and exchange rate agreements, unlisted	215	271
Bond swap agreements, unlisted	40	34
Share swap agreements, unlisted	230	397
Options - purchased agreements, unlisted	478	31
Derivatives	1,026	905

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

23. Offsetting financial assets and financial liabilities

Financial assets subject to enforceable master netting arrangements and similar arrangements

	Assets subject to netting arrangements			Netting potential not recognized in the balance sheet		Assets after consideration of netting potential	Assets not subject to enforceable netting arrangements	Total assets recognised on balance sheet
	Gross assets before balance sheet nettings	Balance sheet nettings with gross liabilities	Assets recognised on balance sheet, net	Financial liabilities	Collateral received			
30.6.2015								
Reverse repurchase agreements	4,269	-	4,269	(2,716)	-	1,553	-	4,269
Derivatives	795	-	795	(128)	-	667	1,047	1,842
Total assets	5,064	-	5,064	(2,844)	-	2,220	1,047	6,111
31.12.2014								
Reverse repurchase agreements	10,044	-	10,044	(8,238)	-	1,806	-	10,044
Derivatives	117	-	117	(1)	-	116	909	1,026
Total assets	10,161	-	10,161	(8,239)	-	1,922	909	11,070

Financial liabilities subject to enforceable master netting arrangements and similar arrangements

	Liabilities subject to netting arrangements			Netting potential not recognized in the balance sheet		Liabilities after consideration of netting potential	Liabilities not subject to enforceable netting arrangements	Total liabilities recognised on balance sheet
	Gross liabilities before balance sheet nettings	Balance sheet nettings with gross assets	Liabilities recognised on balance sheet, net	Financial assets	Collateral pledged			
30.6.2015								
Repurchase agreements	2,717	-	2,717	(2,717)	-	-	-	2,717
Derivatives	158	-	158	(128)	-	30	1,270	1,428
Total liabilities	2,875	-	2,875	(2,845)	-	30	1,270	4,145
31.12.2014								
Repurchase agreements	8,238	-	8,238	(8,238)	-	-	-	8,238
Derivatives	1	-	1	(1)	-	-	904	905
Total liabilities	8,239	-	8,239	(8,239)	-	-	904	9,143

Accounting policies for offsetting are provided in Note 53 in the Annual Financial Statements for 2014.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

24. Investments in associates

<i>The Group's interest in its principal associates</i>	30.6.2015	31.12.2014
Auðkenni hf., Borgartún 31, Reykjavík, Iceland	20.9%	20.9%
Bakkavör Group Ltd., West Marsh Road, Spalding, Lincolnshire, United Kingdom	45.8%	45.8%
Farice ehf., Smáratorg 3, Kópavogur, Iceland	39.3%	39.3%
Klakki ehf., Ármúli 1, Reykjavík, Iceland	31.8%	31.8%
Reiknistofa bankanna hf., Katrínartúni 2, Reykjavík, Iceland	21.7%	21.7%
Reitir fasteignafélag hf., Kringlan 4-12, Reykjavík, Iceland	-	25.6%
Síminn hf., Ármúla 25, Reykjavík, Iceland	38.3%	38.3%
Urriðaland ehf., Laugavegi 182, Reykjavík, Iceland	41.4%	41.4%
<i>Investments in associates</i>		
Carrying amount at the beginning of the year	21,966	17,929
Acquisitions	115	7,557
Dividend received	(506)	(16)
Transfers	(4,203)	(2,636)
Disposals	(7,868)	(4,603)
Exchange difference	266	237
Share of profit of associates and reversal of impairment	4,217	3,498
Investment in associates	13,987	21,966

In January the Bank sold 3.5% shareholding in Reitir fasteignafélag hf. and 13.3% shareholding was sold in connection with the listing of the company on NASDAQ Iceland in April. The total effects on the Statement of Comprehensive Income is ISK 4,224 million. The remaining shareholding in Reitir fasteignafélag hf. is classified as Financial instruments at period end.

Significant accounting estimates and judgements

The Group accounts for investments in associates based on the equity method less applicable impairment. The impairment testing uses management valuation techniques and assumptions such as EBITDA multiples. Alternative assumptions could potentially result in significantly different carrying values but management considers that the impaired value is based on the most probable outcomes under current market conditions.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

25. Intangible assets

Intangible assets comprise four categories: Goodwill, Infrastructure, Customer relationship and related agreements and Software. Goodwill arises on the acquisition of subsidiaries. Infrastructure and Customer relationship and related agreements originate as a premium in connection with the acquisition of business activities in subsidiaries, while Software originates from the acquisition of software licenses and the introduction of the software into the Group's operations.

	Goodwill	Infra- structure	Customer relation- ship and related agreements	Software	Total
30.6.2015					
Balance at the beginning of the year	2,171	3,046	1,539	2,840	9,596
Additions	-	-	-	324	324
Exchange difference	(168)	-	-	-	(168)
Impairment	-	(25)	-	-	(25)
Amortisation	-	-	(100)	(274)	(374)
Intangible assets	2,003	3,021	1,439	2,890	9,353
31.12.2014					
Balance at the beginning of the year	-	3,075	1,144	1,164	5,383
Acquisition through business combination	2,171	-	598	1,448	4,217
Additions	-	-	-	603	603
Impairment	-	(29)	-	-	(29)
Amortisation	-	-	(203)	(375)	(578)
Intangible assets	2,171	3,046	1,539	2,840	9,596

26. Tax assets and tax liabilities

	30.6.2015		31.12.2014	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	5,396	-	4,499
Deferred tax	891	807	655	624
Tax assets and tax liabilities	891	6,203	655	5,123

27. Other assets

	30.6.2015	31.12.2014
Non-current assets and disposal groups held for sale	3,752	3,958
Property and equipment	6,910	7,080
Accounts receivable	3,113	2,474
Unsettled securities trading	10,778	138
Sundry assets	2,624	1,836
Other assets	27,177	15,486

Vast majority of the Non-current assets and disposal groups held for sale consist of real estates that are generally the result of foreclosures on companies and individuals.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

28. Other liabilities	30.6.2015	31.12.2014
Accounts payable	24,331	20,909
Provision for settled FX loans	2,840	2,791
Unsettled securities trading	5,582	217
Depositors' and investors' guarantee fund	2,873	2,880
Insurance claim	2,391	2,402
Withholding tax	2,886	1,507
Bank levy	4,077	2,688
Sundry liabilities	12,009	13,796
Other liabilities	56,989	47,190

29. Borrowings	Issued	Maturity	Maturity type	Terms of interest	30.6.2015	31.12.2014
Covered bond in ISK	2012	2015	At maturity	Fixed, 6.50%	-	14,493
Covered bond in ISK	2013	2019	At maturity	Fixed, CPI linked, 2.50%	4,590	4,508
Covered bond in ISK	2014	2021	At maturity	Fixed, CPI linked, 3.50%	3,089	1,134
Covered bond in ISK	2014	2029	At maturity	Fixed, CPI linked, 3.50%	10,723	5,232
Covered bond in ISK	2005	2033	Amortizing	Fixed, CPI linked, 3.75%	17,396	17,428
Covered bond in ISK	2012	2034	Amortizing	Fixed, CPI linked, 3.60%	2,538	2,541
Covered bond in ISK	2008	2045	Amortizing	Fixed, CPI linked, 4.00%	6,218	6,165
Covered bond in ISK	2006	2048	Amortizing	Fixed, CPI linked, 3.75%	78,298	77,557
Covered bonds					122,852	129,058
Senior unsecured bond in NOK	2013	2016	At maturity	Floating, NIBOR +5.00%	3,012	8,478
Senior unsecured bond in EUR	2009	2018	Amortizing	Floating, EURIBOR +1.00%	1,431	1,714
Senior unsecured bond in ISK	2010	2018	Amortizing	Floating, REIBOR +1.00%	1,865	2,130
Senior unsecured bond in EUR	2015	2018	At maturity	Fixed, 3.125%	44,446	-
Senior unsecured bond in NOK	2015	2020	At maturity	Floating, NIBOR +2.95%	8,406	-
Bonds issued					59,160	12,322
Central Bank, secured, various curr. ...	2010	2022	At maturity	Floating, LIBOR + 3.00%	57,639	55,102
Bills issued					1,909	3,186
Other					320	912
Other loans/bills					59,868	59,200
Borrowings					241,880	200,580

Book value of listed bonds was ISK 180,625 million at the end of the period (31.12.2014: ISK 140,721 million). Market value of those bonds was ISK 182,573 million (31.12.2014: ISK 137,715 million).

The Group repurchased own debts during the period for the amount of ISK 8 billion (2014: 20 billion) with minor effects on the Statement of Comprehensive Income.

30. Subordinated liabilities	Issued	Maturity	Maturity type	Terms of interest	30.6.2015	31.12.2014
Tier II capital in various currencies	2010	2020	At maturity	Floating, EURIBOR/LIBOR + 5.00%	10,884	31,639
Subordinated liabilities					10,884	31,639

At the end of March Arion Bank prepaid ISK 10 billion of the subordinated liabilities with the Ministry of Finance. Additional prepayment was made at end of June for the same amount. Arion Bank aims to pay the remaining subordinated liability before year end if conditions are favourable.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

31. Pledged assets

<i>Pledged assets against liabilities</i>	30.6.2015	31.12.2014
Assets, pledged as collateral against borrowings	202,826	233,191
Assets, pledged as collateral against loans from credit institutions and short positions	12,198	17,973
Pledged assets against liabilities	<u>215,024</u>	<u>251,164</u>

The Group has pledged assets against borrowings, both issued covered bonds and other issued bonds and loan agreements. The total value of those pledged assets was ISK 203 billion at the end of the period (31.12.2014: ISK 233 billion). Those assets were mainly pool of mortgage loans to individuals, loans to real estate companies, wholesale and retail and industry and energy companies. The book value of those borrowings was ISK 180 billion at the end of the period (31.12.2014: ISK 184 billion).

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

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

32. Equity

Share capital and share premium

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

	Number (million)	30.6.2015	Number (million)	31.12.2014
Issued share capital	2,000	75,861	2,000	75,861

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

<i>Other reserves</i>	30.6.2015	31.12.2014
Statutory reserve	1,632	1,637
Foreign currency translation reserve	(230)	(5)
Other reserves	<u>1,402</u>	<u>1,632</u>

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

OFF BALANCE SHEET INFORMATION

33. Obligations

	30.6.2015	31.12.2014
<i>Guarantees, unused overdraft and loan commitments the Group has granted its customers</i>		
Guarantees	15,850	9,542
Unused overdrafts	38,681	38,890
Loan commitments	67,215	56,363

Depositors' and Investors' Guarantee fund

The Icelandic parliament has discussed a bill on a new Depositors' and Investors' Guarantee Fund, without conclusion of the matter. Even though the law has not been amended Icelandic bank's have made quarterly payments to a separate division within the fund since 2010. Despite this change in execution and due to uncertainty of the shape of future legislation the liability brought forward from previous years is not changed from the balance of ISK 2,669 million. The Group has granted the Fund a guarantee for obligations amounting to ISK 3,210 million.

34. Assets under management and under custody

30.6.2015 31.12.2014

Assets under management	948,739	923,599
Assets under custody	1,420,403	1,337,561

35. Legal matters

The Group has formal controls and policies for managing legal claims. Once professional advice has been obtained and the amount of loss reasonably estimated, the Group makes adjustments, if appropriate, to account for any adverse effects which the claims may have on its financial standing. When the Group is of the opinion that it is to the detriment of the Group's case to disclose potential amounts relating to legal claims, it elects not to do so. At the end of the period, the Group had several unresolved legal claims.

Contingent liabilities

Investigation and legal proceedings regarding alleged breaches of competition law

The Bank and Valitor hf. reached a settlement with the Icelandic Competition Authority (ICA) in December 2014 concerning an investigation into the structure of the payment card system. The central issue in the settlement concerned changes to the way in which interchange fees, which card companies pay to the banks, are decided and the awarding of customer loyalty points. The Bank has already implemented the agreed changes. As part of the settlement the Bank paid a fine of ISK 450 million and Valitor hf. ISK 220 million. The ICA Decision was published in May 2015. Further, under the settlement changes were made to the ownership of Valitor hf., with acquisition by the Bank of Landsbankinn's hf. stake in Valitor Holding hf. In June 2013 Kortþjónustan hf. filed a suit, against the Bank and Valitor hf., as well as Landsbankinn hf., Íslandsbanki hf. and Borgun hf., claiming damages for the alleged loss suffered by Kortþjónustan hf. in relation to the above case. The case is being contested before the District Court of Reykjavík.

The ICA has also opened a formal investigation into the alleged abuse of an alleged collective dominant position by the three largest retail banks in Iceland, including Arion Bank. The investigation was initiated by separate complaints from BYR hf. and MP banki hf. made in 2010. The complaints from BYR hf. and MP banki hf. concern the terms of the banks' mortgage arrangements, which, according to the complaint, deter individuals from moving their business to other banks and thereby restrict competition. The extent of the investigation and outcome is still uncertain as any effect on the Group. However, if the Bank were deemed to have violated the Competition Act, it could result in a fine or restrictions by the ICA.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

35. Legal matters, continued

In April 2013 the ICA imposed a ISK 500 million fine on Valitor hf. for abusing its dominant position on the payment card market and violating conditions set in an earlier decision of the Authority. Valitor hf. appealed the decision to the Competition Appeals Committee. In October 2013 the Committee confirmed the decision of the Competition Authority. Valitor hf. referred the case to the courts. In May 2015 the District Court of Reykjavik confirmed the decision but lowered the fine to ISK 400 million. The case has been appealed to the Supreme Court. The final judgement of the Supreme Court is expected in 2016.

Legal proceedings regarding damages

The former chairman of the Board of BM Vallá hf., together with Lindarflöt ehf., has filed two cases against the Bank claiming damages in the amount more than ISK 4 billion plus interest. The plaintiffs claim that the Bank caused them, as shareholders of BM Vallá hf. and Fasteignafélagið Ártún ehf., damage by not allowing the companies to be financially restructured and thereby forcing the companies into bankruptcy. The Bank believes it likely that it will be acquitted of the plaintiff's claims in both cases and hasn't therefore made any provision.

Other legal matters

Legal proceedings regarding CPI loans

Recently, there were three cases being heard by the Icelandic courts for the purpose of verifying the legitimacy of loans linked to the Consumer Price Index (CPI). In short, these three cases revolve around whether, on the one hand, the provisions contained in the debt instrument, as regards the increase of the principal of the loan due to linkage to the CPI, is an unfair contractual condition within the meaning of the Act No 7/1936 on contracts and, on the other hand, whether the presentation of the price indexation was in accordance with the Act No 121/1994 on consumer loans, i.e. whether the loan provider was authorised to take "0% inflation" into account when calculating borrowing costs. The courts requested an advisory opinion from the EFTA Court as regards certain issues in two of the cases. The EFTA Court delivered two advisory opinions on 9 April 2014 and on 24 November 2014. By the decisions of the District Court of Reykjavik issued on 6 February 2015, the district court resolved two of the above cases, where the lender's reasoning was upheld in both cases. One of these cases was appealed to the Supreme Court which issued its decision on 13 May 2015. In its decision, the Supreme Court stated that there were no grounds to consider the price indexation terms of the debt instrument to be unfair within the meaning of Article 36c of Act No. 7/1936 on contracts, as the provision is clarified to accord with the first and second paragraph of Directive 93/13/EEC. The Supreme Court, moreover, was of the opinion, taking into account the payment schedule signed by the borrower in conjunction with the bond and the overview attached to it, that the lender had fulfilled its duty to provide information as provided for in the then effective Act No. 121/1994 on consumer loans. The Supreme Court, therefore, upheld the lender's reasoning as regards both issues that the borrowers contested as regards the price indexation. The Bank is unaware of the status of the other two cases that were brought before the District Court or whether the borrowers in those cases intend to refer them further.

The Bank made no provision due to court cases regarding the CPI as it considered the likelihood of the courts finding with the plaintiffs in the cases to be remote.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

35. Legal matters, continued

The uncertainty regarding the book value of foreign currency loans

In recent years there has been considerable uncertainty over the legality of foreign currency loans to individuals and companies and the recalculation of those loans which are clearly currency-linked loans in Icelandic krona. Firstly, there has been uncertainty over which loans are considered legal foreign currency loans and which loans are considered currency-linked loans in Icelandic krona, and secondly over how loans in the latter category should be recalculated. The Bank has been required to recalculate numerous loans which are considered currency-linked loans in Icelandic krona on the basis of the Interest and Indexation Act No. 38/2001 and after examining the judgments passed by the Supreme Court which were considered to set a precedent for the Bank's loans.

The uncertainty of legality of FX loans has continued in 2015 and the Group constantly monitors judgments involving itself and others to refine its provisions on foreign currency loans.

Although there is more clarity in the matters of FX loans there still remains uncertainty regarding foreign currency linked loans in three respects. Firstly, there is uncertainty over the legality of certain loans. Secondly, there is disagreement over the recalculation and settlement of the loans, i.e. what interest rates should be used when recalculating the periods when the borrower did not actually pay any interest, for example during so-called "freeze-periods". Thirdly, there is uncertainty over which interest rate should apply to currency-linked loans in the future, i.e. whether they should bear the Central Bank's non-indexed rate or the contractual interest rate for each loan.

Nevertheless, the Group considers its portfolio of foreign currency linked loans fully provisioned for the most likely outcome.

Legal matters concluded

In 2012 Kortabjónustan hf. filed a suit against Valitor hf., Borgun hf. and Greiðsluveitan ehf., claiming damages for the alleged loss suffered by Kortabjónustan hf. due to alleged breaches of competition law based on a settlement made by Valitor hf., Borgun hf. and Greiðsluveitan ehf. with the ICA, published in an ICA Decision No 4/2008. The case was dropped in September 2014, and a new claim filed based on the findings of a court appointed evaluators on Kortabjónustan hf.'s alleged damage. The case was settled in early March 2015 with a payment of ISK 250 million to Kortabjónustan hf.

36. Events after Balance Sheet date

In August Arion Bank sold 5% shareholding in its associated company Síminn hf. After the sale the Bank's shareholding is 33%. The shares are to be listed on NASDAQ Iceland this fall. Prior to the listing the Bank will further reduce its shareholding in a public offering. A considerable profit from the sale as well as fair value changes on the remaining 33% shareholding will be recognised in the Statement of Comprehensive Income in the third quarter of 2015.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

RELATED PARTY

37. Related party

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

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

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

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

Balances with related parties

	Assets	Liabilities	Net balance
30.6.2015			
Shareholders with control over the Group	246	(59,560)	(59,314)
Board of Directors and key Management personnel	241	(94)	147
Associates and other related parties	19,784	(15,631)	4,153
Balances with related parties	20,271	(75,285)	(55,014)
31.12.2014			
Shareholders with control over the Group	577	(53,970)	(53,393)
Board of Directors and key Management personnel	260	(67)	193
Associates and other related parties	20,060	(22,861)	(2,801)
Balances with related parties	20,897	(76,898)	(56,001)

Through the ownership of ISFI the Group has a related party relationship with Landsbankinn hf. Landsbankinn hf. provides banking services to the Bank's subsidiary Valitor hf. and has a traditional bank to bank relationship with Arion Bank hf. The Group holds assets amounting to ISK 20,105 million (31.12.2014: ISK 28,881 million) by Landsbankinn hf. and liabilities amounting to ISK 1,402 million at the end of the period (31.12.2014: ISK 7,332 million). Those amounts are not included in the table above.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

RISK MANAGEMENT DISCLOSURES

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

Further information regarding risk management is available in the Annual Financial Statements for 2014 and in the Pillar 3 Risk Disclosures for 2014, published on the Bank's website, www.arionbanki.is. The Pillar 3 Risk Disclosures are not audited.

38. Credit risk

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

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

Maximum exposure to credit risk

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

	30.6.2015	31.12.2014
Maximum exposure to credit risk related to on-balance sheet items		
Cash and balances with Central Bank	33,189	21,063
Loans to credit institutions	103,815	108,792
Loans to corporates	351,725	326,197
Loans to individuals	315,404	321,311
Financial instruments	75,087	70,704
Other assets with credit risk	15,321	3,514
Total on-balance sheet maximum exposure to credit risk	894,541	851,581
Maximum exposure to credit risk related to off-balance sheet items		
Financial guarantees	15,850	9,542
Unused overdrafts	38,681	38,890
Loan commitments	67,215	56,363
Total off-balance sheet maximum exposure to credit risk	121,746	104,795
Maximum exposure to credit risk	1,016,287	956,376

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

38. Credit risk, continued

<i>Loans to customers specified by sectors</i>	30.6.2015	31.12.2014
Individuals	47.3%	49.6%
Real estate activities and construction	14.0%	12.5%
Fishing industry	11.1%	11.8%
Information and communication technology	3.8%	3.6%
Wholesale and retail trade	9.1%	8.5%
Financial and insurance activities	4.7%	4.3%
Industry, energy and manufacturing	3.0%	3.9%
Transportation	1.7%	0.9%
Services	3.3%	2.8%
Public sector	1.1%	1.2%
Agriculture and forestry	0.9%	0.9%
	100.0%	100.0%

Collateral and other credit enhancements

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

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

The value of collateral is based on estimated market value. The valuation of real estate is built on market price, official valuation of the Icelandic Property Registry, or the opinion of internal or external specialists. The valuation of fishing vessels takes into account related fishing quota.

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

The collateral value in the table below is capped by the exposure amount.

Collateral held by the Bank against different types of financial assets

	Cash and securities	Real estate	Fishing vessels	Other collateral	Total
30.6.2015					
Cash and balances with Central Bank	-	-	-	-	-
Loans to credit institutions	-	-	-	-	-
Loans to customers					
Individuals	266	265,768	18	1,061	267,113
Real estate activities and construction	974	76,365	113	2,493	79,945
Fishing industry	80	6,503	57,640	2,942	67,165
Information and communication technology	76	2,231	-	17,970	20,277
Wholesale and retail trade	389	19,137	5	28,210	47,741
Financial and insurance activities	14,184	1,887	-	3,484	19,555
Industry, energy and manufacturing	817	8,514	570	4,451	14,352
Transportation	52	640	165	2,180	3,037
Services	1,004	5,143	5	709	6,861
Public sector	23	3,543	-	46	3,612
Agriculture and forestry	5	2,520	-	14	2,539
Financial instruments	4,909	-	-	-	4,909
Guarantees	716	2,472	337	3,840	7,365
Collateral held against different types of financial assets	23,495	394,723	58,853	67,400	544,471

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

38. Credit risk, continued

	Cash and securities	Real estates	Fishing vessels	Other collateral	Total
31.12.2014					
Cash and balances with Central Bank	-	-	-	-	-
Loans to credit institutions	-	-	-	-	-
Loans to customers					
Individuals	440	282,871	43	1,093	284,447
Real estate activities and construction	635	66,910	11	2,976	70,532
Fishing industry	70	7,513	57,190	3,176	67,949
Information and communication technology	14	2,059	-	18,327	20,400
Wholesale and retail trade	261	16,522	5	30,173	46,961
Financial and insurance activities	12,108	2,584	-	2,886	17,578
Industry, energy and manufacturing	5,977	9,823	3	4,171	19,974
Transportation	42	587	153	3,019	3,801
Services	144	3,147	96	1,110	4,497
Public sector	18	3,700	-	152	3,870
Agriculture and forestry	5	2,546	-	124	2,675
Financial instruments	3,330	-	-	-	3,330
Guarantees	741	2,641	316	1,199	4,897
Collateral held against different types of financial assets	23,785	400,903	57,817	68,406	550,911

Information on collateral held at subsidiaries is not available.

	Neither past due nor impaired	Past due but not impaired	Individually impaired	Total
<i>Credit quality by class of financial assets</i>				
30.6.2015				
Cash and balances with Central Bank	33,189	-	-	33,189
Loans to credit institutions	103,815	-	-	103,815
Loans to customers				
Loans to corporates	313,161	36,034	2,530	351,725
Loans to individuals	273,687	33,066	8,651	315,404
Financial instruments	75,087	-	-	75,087
Other assets with credit risk	15,321	-	-	15,321
Credit quality by class of financial assets	814,260	69,100	11,181	894,541
31.12.2014				
Cash and balances with Central Bank	21,063	-	-	21,063
Loans to credit institutions	108,792	-	-	108,792
Loans to customers				
Loans to corporates	308,588	15,114	2,495	326,197
Loans to individuals	277,859	32,847	10,605	321,311
Financial instruments	70,704	-	-	70,704
Other assets with credit risk	3,514	-	-	3,514
Credit quality by class of financial assets	790,520	47,961	13,100	851,581

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

38. Credit risk, continued

Neither past due nor impaired loans

The Bank uses internal credit rating models to monitor the development of credit risk and to estimate customers' probability of default (PD). The Bank rates customers with one of three models. For large corporates the Bank uses quantitative information based on financial statements as well as qualitative data. Credit ratings of individuals and SMEs are based on statistical models using historical information which has been found to be predictive. The models are updated annually and recalibrated with current data with the aim of improving their predictive power. Year-on-year changes in risk classification of loans may in part be due to model refinement.

The table below shows loans to customers that are neither past due nor impaired, broken down by the Bank's classification scale, where 5 denotes the highest risk.

30.6.2015	Risk classification					Not rated	Total
	1	2	3	4	5		
Individuals	49,122	136,711	56,758	18,708	6,093	6,295	273,687
Real estate activities and construction	28,052	14,503	24,548	9,546	183	2,805	79,637
Fishing industry	25,341	20,194	13,117	3,427	1,387	1,161	64,627
Information and communication technology	3,525	18,863	3,125	172	-	-	25,685
Wholesale and retail trade	8,194	25,439	16,438	3,462	200	821	54,554
Financial and insurance activities	2,015	18,013	6,657	273	5	1,186	28,149
Industry, energy and manufacturing	2,023	10,445	6,606	203	107	184	19,568
Transportation	2,637	6,571	657	902	2	65	10,834
Services	1,233	3,121	9,782	750	30	3,429	18,345
Public sector	245	3,576	2,129	738	60	384	7,132
Agriculture and forestry	259	1,192	2,290	474	71	344	4,630
Neither past due nor impaired loans	122,646	258,628	142,107	38,655	8,138	16,674	586,848
31.12.2014							
Individuals	57,039	139,569	51,547	17,397	6,818	5,489	277,859
Real estate activities and construction	2,898	13,931	49,417	5,679	98	4,767	76,790
Fishing industry	25,757	26,757	13,681	2,182	1,599	1,596	71,572
Information and communication technology	371	19,469	3,205	219	-	-	23,264
Wholesale and retail trade	7,248	20,332	21,292	2,843	160	381	52,256
Financial and insurance activities	679	1,907	14,707	90	-	8,032	25,415
Industry, energy and manufacturing	7,804	8,017	6,996	517	363	621	24,318
Transportation	268	3,575	958	593	3	62	5,459
Services	820	9,848	3,577	533	13	2,571	17,362
Public sector	209	3,427	1,817	340	35	1,422	7,250
Agriculture and forestry	225	1,283	1,754	386	388	866	4,902
Neither past due nor impaired loans	103,318	248,115	168,951	30,779	9,477	25,807	586,447

Exposures that are 'Not rated' are primarily due to newly formed entities and entities for which the Bank's rating models are not applicable.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

38. Credit risk, continued

Past due but not impaired loans by class of loans

	Up to 3 days	4 to 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
30.6.2015						
Loans to corporates	17,927	11,751	2,350	1,714	2,292	36,034
Loans to individuals	4,580	11,287	6,418	2,386	8,395	33,066
Past due but not impaired loans	22,507	23,038	8,768	4,100	10,687	69,100
31.12.2014						
Loans to corporates	6,553	2,434	2,267	565	3,295	15,114
Loans to individuals	3,436	10,589	5,974	847	12,001	32,847
Past due but not impaired loans	9,989	13,023	8,241	1,412	15,296	47,961

Loans past due up to three days are mainly overdrafts that were not renewed in time. The majority of the past due but not impaired loans are considered fully secured with collateral or have been acquired at discount. Loans acquired at discount are not considered to be impaired unless the specific allowance exceeds the discount received.

Collateral repossessed

During the period the Group took possession of assets due to foreclosures. The total amount of real estates the Group took possession of during the period and still holds at period end amount to ISK 691 million (31.12.2014: ISK 1,607 million) and other assets ISK 5 million (31.12.2014: ISK 10 million). The assets are held for sale, see Note 27.

<i>Impaired loans to customers specified by sector</i>	30.6.2015		31.12.2014	
	Impair- ment amount	Gross carrying amount	Impair- ment amount	Gross carrying amount
Individuals	10,803	19,454	11,016	21,621
Real estate activities and construction	1,268	1,508	1,396	1,981
Fishing industry	921	2,250	1,115	2,366
Information and communication technology	248	248	251	251
Wholesale and retail trade	705	1,128	751	831
Financial and insurance activities	6,506	6,568	6,739	6,756
Industry, energy and manufacturing	233	302	296	474
Transportation	18	19	18	18
Services	500	663	375	641
Public sector	69	217	27	35
Agriculture and forestry	151	246	230	340
	21,422	32,603	22,214	35,314

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

38. Credit risk, continued

Large exposure

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

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

The largest exposure to a group of connected clients at the end of the period was ISK 25 billion (31.12.2014: ISK 25 billion) before taking account of eligible collateral. The Group has two large exposures at the end of the period (31.12.2014: two exposures) net of eligible collateral. Nostro accounts are excluded.

no.	30.6.2015		31.12.2014	
	Gross	Net	Gross	Net
1	15%	15%	14%	14%
2	11%	11%	11%	10%
Sum of large exposure gross and net > 10%	26%	26%	25%	24%

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

The sum of exposures exceeding 10% of capital base is 26% of the Group's capital base before collateral mitigation or 26% net of eligible collateral, which is well below the 400% legal maximum.

39. Market risk

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

Market risk arises from imbalances in the Group's balance sheet as well as in market making activities and position taking in bonds, equities, currencies, derivatives, and other commitments which are marked to market.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair value of financial instruments. The Group's operations are subject to interest rate risk associated with a mismatch between interest bearing assets and interest bearing liabilities. This mismatch is characterised by a large gap between the interest fixing period of assets and liabilities, with a large amount of liabilities being demand deposits while the interest rates of assets are generally fixed for a long period, resulting in a yield curve risk for the Group. The Group also faces interest basis risk between interest bearing assets and interest bearing liabilities due to different types of floating rate indices in different currencies, of which the largest one is EUR.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

39. Market risk, continued

Interest rate risk in the banking book

The following table shows the Group's interest bearing assets and liabilities by interest fixing periods. The figures for loans to customers and borrowings are shown on a fair value basis, see Note 22, and are therefore different from the amounts shown in the Financial Statements. Defaulted loans are presented at book value, which is based on the value of the underlying collateral, and are therefore assumed to be independent of interest adjustment periods and placed in the 'Up to 3 months' category.

The Group's interest bearing assets and liabilities by interest rate adjustment periods

30.6.2015	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Assets						
Balances with Central Bank	26,766	-	-	-	-	26,766
Loans to credit institutions	103,815	-	-	-	-	103,815
Loans to customers	371,121	51,042	100,062	3,461	149,270	674,956
Financial instruments	42,368	4,878	12,615	1,240	218	61,319
Assets	544,070	55,920	112,677	4,701	149,488	866,856
Liabilities						
Due to credit institutions and Central Bank	13,961	-	-	-	-	13,961
Deposits	467,724	1,337	3,137	-	106	472,304
Borrowings	61,964	12,208	49,083	3,181	119,703	246,139
Subordinated loans	-	10,884	-	-	-	10,884
Liabilities	543,649	24,429	52,220	3,181	119,809	743,288
Derivatives and other off-balance sheet items (net position) ..	(47,542)	(2,221)	50,170	-	-	407
Net interest gap	(47,121)	29,270	110,627	1,520	29,679	123,975
31.12.2014						
Assets						
Balances with Central Bank	15,808	-	-	-	-	15,808
Loans to credit institutions	108,792	-	-	-	-	108,792
Loans to customers	358,943	56,338	78,887	2,845	160,248	657,261
Financial instruments	39,963	1,552	12,609	4,672	1,046	59,842
Assets	523,506	57,890	91,496	7,517	161,294	841,703
Liabilities						
Due to credit institutions and Central Bank	22,876	-	-	-	-	22,876
Deposits	449,638	2,124	3,270	-	101	455,133
Borrowings	62,821	18,307	7,313	1,124	107,550	197,115
Subordinated loans	31,639	-	-	-	-	31,639
Liabilities	566,974	20,431	10,583	1,124	107,651	706,763
Derivatives and other off-balance sheet items (net position) ..	56	(2,760)	2,778	-	-	74
Net interest gap	(43,412)	34,699	83,691	6,393	53,643	135,014

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

39. Market risk, continued

Interest rate risk in the trading book

The following table shows the total basis point value (BPV) of the Group's long and short bond positions in the trading book at market value (MV). BPV denotes the change in the price of a bond given a basis point (0.01%) change in the yield of the bond.

	30.6.2015			31.12.2014		
	MV	Duration	BPV	MV	Duration	BPV
Trading financial instruments, long positions						
ISK, CPI Indexed linked	905	6.5	(0.6)	1,924	6.3	(1.2)
ISK, Non Indexed linked	9,468	(0.4)	0.4	3,353	(2.1)	0.7
FX	42,362	(0.7)	3.1	22,844	0.1	(0.2)
Total	52,735	(0.6)	2.9	28,121	0.3	(0.7)
Trading financial instruments, short positions						
ISK, CPI Indexed linked	52	8.5	(0.0)	1,003	6.1	(0.6)
ISK, Non Indexed linked	3,959	0.2	(0.1)	7,139	0.4	(0.3)
FX	46,659	(0.7)	3.1	22,243	0.1	(0.2)
Total	50,670	(0.6)	3.0	30,385	0.4	(1.1)

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

39. Market risk, continued

Indexation risk

The Group is exposed to indexation risk when there is a mismatch between index-linked assets and liabilities. The total amount of indexed assets is ISK 295.3 billion (31.12.2014: ISK 289.2 billion) and the total amount of indexed liabilities is ISK 209.1 billion (31.12.2014: ISK 204.0 billion).

Transaction maturity profile of indexed assets and liabilities

30.6.2015	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI indexed linked				
Loans to customers	12,582	75,161	198,318	286,061
Financial instruments	3,665	-	-	3,665
Off-balance sheet position	919	4,666	-	5,585
Assets, CPI indexed linked	17,166	79,827	198,318	295,311
Liabilities, CPI indexed linked				
Deposits	65,575	17,796	2,509	85,880
Borrowings	2,092	14,104	106,974	123,170
Off-balance sheet position	-	-	-	-
Liabilities, CPI indexed linked	67,667	31,900	109,483	209,050
Net on-balance sheet position	(51,420)	43,261	88,835	80,676
Net off-balance sheet position	919	4,666	-	5,585
CPI Balance	(50,501)	47,927	88,835	86,261
31.12.2014				
Assets, CPI indexed linked				
Loans to customers	9,566	74,705	200,030	284,301
Financial instruments	2,090	-	-	2,090
Off-balance sheet position	825	1,952	-	2,777
Assets, CPI indexed linked	12,481	76,657	200,030	289,168
Liabilities, CPI indexed linked				
Deposits	66,489	19,615	2,415	88,519
Borrowings	2,019	13,703	99,277	114,999
Off-balance sheet position	524	-	-	524
Liabilities, CPI indexed linked	69,032	33,318	101,692	204,042
Net on-balance sheet position	(56,852)	41,387	98,338	82,873
Net off-balance sheet position	301	1,952	-	2,253
CPI Balance	(56,551)	43,339	98,338	85,126

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

39. Market risk, continued

Currency risk

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

Breakdown of assets and liabilities by currency

30.6.2015

Assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with Central Bank	31,463	350	778	157	102	44	295	33,189
Loans to credit institutions	26,161	24,542	18,616	14,484	1,247	15,383	3,382	103,815
Loans to customers	547,640	44,418	35,750	7,239	12,530	5,790	13,762	667,129
Financial instruments	77,360	19,276	6,768	2,288	28	3,778	1,921	111,419
Investment property	7,851	-	-	-	-	-	-	7,851
Investments in associates	8,131	-	-	5,856	-	-	-	13,987
Intangible assets	5,432	-	-	-	3,921	-	-	9,353
Tax assets	891	-	-	-	-	-	-	891
Other assets	17,703	521	100	421	4	8,427	1	27,177
Assets	722,632	89,107	62,012	30,445	17,832	33,422	19,361	974,811
Liabilities and equity								
Due to credit inst. and Central Bank ..	10,999	218	232	9	4	1	2,498	13,961
Deposits	385,628	29,818	17,917	12,425	1,532	15,353	9,631	472,304
Financial liabilities at fair value	3,579	264	224	29	33	15	1	4,145
Tax liabilities	5,767	-	-	-	436	-	-	6,203
Other liabilities	42,450	3,453	3,347	971	1,262	4,744	762	56,989
Borrowings	126,946	45,878	33,951	9,209	-	11,417	14,479	241,880
Subordinated liabilities	-	4,107	2,643	4,134	-	-	-	10,884
Shareholders' equity	166,969	-	-	-	-	-	-	166,969
Non-controlling interest	1,476	-	-	-	-	-	-	1,476
Liabilities and equity	743,814	83,738	58,314	26,777	3,267	31,530	27,371	974,811
Net on-balance sheet position	(21,182)	5,369	3,698	3,668	14,565	1,892	(8,010)	
Net off-balance sheet position	14,901	(5,299)	(3,108)	(1,221)	(14,866)	(1,174)	10,767	
Net position	(6,281)	70	590	2,447	(301)	718	2,757	

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

39. Market risk, continued

31.12.2014

Assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with Central Bank	19,472	5	904	178	107	46	351	21,063
Loans to credit institutions	35,076	16,570	13,141	13,646	2,946	11,084	16,329	108,792
Loans to customers	538,828	40,526	27,606	6,605	14,734	5,376	13,833	647,508
Financial instruments	73,851	14,963	7,776	3,436	47	1,736	19	101,828
Investment property	6,842	-	-	-	-	-	-	6,842
Investments in associates	16,052	-	-	5,914	-	-	-	21,966
Intangible assets	5,469	-	-	-	4,127	-	-	9,596
Tax assets	655	-	-	-	-	-	-	655
Other assets	14,665	485	128	123	26	52	7	15,486
Assets	710,910	72,549	49,555	29,902	21,987	18,294	30,539	933,736
Liabilities and equity								
Due to credit inst. and Central Bank ..	16,752	2,103	958	5	1	-	3,057	22,876
Deposits	374,063	25,949	16,247	11,348	9,306	8,075	9,985	454,973
Financial liabilities at fair value	8,971	43	127	-	1	-	1	9,143
Tax liabilities	4,642	-	-	-	481	-	-	5,123
Other liabilities	37,336	2,217	3,470	975	2,199	174	819	47,190
Borrowings	135,285	1,714	22,475	8,812	-	8,478	23,816	200,580
Subordinated liabilities	-	25,133	2,550	3,956	-	-	-	31,639
Shareholders' equity	160,711	-	-	-	-	-	-	160,711
Non-controlling interest	1,501	-	-	-	-	-	-	1,501
Liabilities and equity	739,261	57,159	45,827	25,096	11,988	16,727	37,678	933,736
Net on-balance sheet position	(28,351)	15,390	3,728	4,806	9,999	1,567	(7,139)	
Net off-balance sheet position	9,454	(9,065)	(397)	56	(8,963)	-	8,915	
Net position	(18,897)	6,325	3,331	4,862	1,036	1,567	1,776	

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

40. Liquidity risk

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

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

30.6.2015	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity
Assets							
Cash and balances with Central Bank	33,189	24,349	-	8,840	-	-	-
Loans to credit institutions	103,815	44,403	59,412	-	-	-	-
Loans to customers	667,129	9,763	45,774	90,726	248,017	272,849	-
Financial instruments	111,419	5,744	1,814	4,915	57,049	5,564	36,333
<i>Derivatives - assets leg</i>	42,200	-	22,013	749	18,894	544	-
<i>Derivatives - liabilities leg</i>	(40,358)	-	(20,859)	(714)	(18,284)	(501)	-
Investment property	7,851	-	-	-	-	-	7,851
Investments in associates	13,987	-	-	-	-	-	13,987
Intangible assets	9,353	-	-	-	-	-	9,353
Tax assets	891	-	-	-	891	-	-
Other assets	27,177	213	13,677	476	800	155	11,856
Assets	974,811	84,472	120,677	104,957	306,757	278,568	79,380
Liabilities							
Due to credit institutions and Central Bank	13,961	11,694	271	1,971	25	-	-
Deposits	472,304	282,891	99,943	69,398	16,798	3,274	-
Financial liabilities at fair value	4,145	-	3,603	167	375	-	-
<i>Derivatives - assets leg</i>	(24,877)	-	(18,565)	(1,453)	(4,859)	-	-
<i>Derivatives - liabilities leg</i>	26,305	-	19,451	1,620	5,234	-	-
<i>Short position bonds and derivatives</i>	1,510	-	1,510	-	-	-	-
<i>Short position bonds used for hedging</i>	1,207	-	1,207	-	-	-	-
Tax liabilities	6,203	-	2,698	2,698	807	-	-
Other liabilities	56,989	107	38,073	6,325	4,148	113	8,223
Borrowings	241,880	-	2,434	6,365	60,588	172,493	-
Subordinated liabilities	10,884	-	-	-	4,107	6,777	-
Liabilities	806,366	294,692	147,022	86,924	86,848	182,657	8,223
Off-balance sheet items							
Guarantees	15,850	3,148	3,037	4,710	3,359	1,596	-
Unused overdraft	38,681	852	9,698	15,101	12,974	56	-
Loan commitments	67,215	1,476	22,257	26,192	17,290	-	-
Off-balance sheet items	121,746	5,476	34,992	46,003	33,623	1,652	-
Net assets (liabilities)	46,699	(215,696)	(61,337)	(27,970)	186,286	94,259	71,157

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

40. Liquidity risk, continued

31.12.2014	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity
Assets							
Cash and balances with Central Bank	21,063	12,285	-	8,778	-	-	-
Loans to credit institutions	108,792	52,119	56,673	-	-	-	-
Loans to customers	647,508	11,678	50,642	89,332	230,055	265,801	-
Financial instruments	101,828	7,562	742	2,203	52,527	7,670	31,124
<i>Derivatives - assets leg</i>	28,234	-	6,654	15,659	5,921	-	-
<i>Derivatives - liabilities leg</i>	(27,209)	-	(5,912)	(15,524)	(5,773)	-	-
Investment property	6,842	-	-	-	-	-	6,842
Investments in associates	21,966	-	-	-	-	-	21,966
Intangible assets	9,596	-	-	-	-	-	9,596
Tax assets	655	-	-	-	655	-	-
Other assets	15,486	47	2,283	46	1,121	17	11,972
Assets	933,736	83,691	110,340	100,359	284,358	273,488	81,500
Liabilities							
Due to credit institutions and Central Bank	22,876	13,652	2,238	6,962	24	-	-
Deposits	454,973	263,899	96,009	46,412	45,102	3,551	-
Financial liabilities at fair value	9,143	-	8,663	227	253	-	-
<i>Derivatives - assets leg</i>	(15,693)	-	(4,525)	(10,504)	(664)	-	-
<i>Derivatives - liabilities leg</i>	16,598	-	4,950	10,731	917	-	-
<i>Short position bonds and derivatives</i>	5,478	-	5,478	-	-	-	-
<i>Short position bonds used for hedging</i>	2,760	-	2,760	-	-	-	-
Tax liabilities	5,123	-	1,125	3,374	624	-	-
Other liabilities	47,190	667	30,372	5,192	2,680	120	8,159
Borrowings	200,580	-	1,776	20,057	24,908	153,839	-
Subordinated liabilities	31,639	-	-	-	-	31,639	-
Liabilities	771,524	278,218	140,183	82,224	73,591	189,149	8,159
Off-balance sheet items							
Guarantees	9,542	2,373	1,234	2,389	1,753	1,793	-
Unused overdraft	38,890	658	10,163	17,738	10,273	58	-
Loan commitments	56,363	2,432	21,419	15,705	16,807	-	-
Off-balance sheet items	104,795	5,463	32,816	35,832	28,833	1,851	-
Net assets (liabilities)	57,417	(199,990)	(62,659)	(17,697)	181,934	82,488	73,341

Liquidity coverage ratio

The liquidity coverage ratio (LCR) is part of the standards introduced in the Basel III Accord and is to be implemented in 2015 on a global level. The LCR is the result of a stress test that is designed to ensure that banks have the necessary assets on hand to withstand short-term liquidity disruptions. More accurately, LCR represents the balance between highly liquid assets and the expected net cash outflow of the Group in the next 30 days under stressed conditions.

To qualify as highly liquid assets under the LCR rules, assets must be non-pledged, liquid and easily priced on the market, repoable at the Central Bank and not issued by the Group or related entities.

The Central Bank has set a guideline for minimum LCR. In 2015, the LCR requirement is 100% in foreign currency and 80% in total (ISK and foreign currency). The latter benchmark increases by 10% every year until a 100% requirement is implemented in 2017.

Liquidity coverage ratio	30.6.2015	31.12.2014
FX	255%	254%
Total	138%	174%

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

40. Liquidity risk, continued

LCR deposit categorization

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

The table below shows the breakdown of the Group's deposit base according to the LCR categorization, with the associated expected stressed outflow weights. Some similar categories are grouped together. The table contains deposits at the Bank and at banking subsidiaries. Thus, amounts due to Central Bank and amounts due to credit institutions at non-banking subsidiaries are excluded.

LCR categorization - amounts and LCR outflow weights

	Deposits maturing within 30 days				Term deposits*	Total deposits
	Less Stable	Weight (%)	Stable	Weight (%)		
30.6.2015						
Retail	77,304	10%	34,670	5%	54,837	166,811
SME	35,153	10%	4,157	5%	5,471	44,781
Operational relationship	164	25%	-	5%	105	269
Corporations	39,703	40%	842	20%	3,747	44,292
Sovereigns, central-banks and PSE	16,568	40%	-	-	2,439	19,007
Financial entities being wound up	34,560	100%	-	-	59,344	93,904
Pension funds	50,529	100%	-	-	20,179	70,708
Domestic financial entities	23,313	100%	-	-	9,080	32,393
Foreign financial entities	4,093	100%	-	-	-	4,093
Other foreign parties	3,075	100%	3,057	25%	1,905	8,037
Total	284,462		42,726		157,107	484,295
31.12.2014						
Retail	78,659	10%	36,076	5%	53,803	168,538
SME	36,060	10%	3,895	5%	6,011	45,966
Operational relationship	-	25%	-	5%	1,190	1,190
Corporations	36,961	40%	830	20%	5,873	43,664
Sovereigns, central-banks and PSE	12,196	40%	-	-	2,870	15,066
Financial entities being wound up	19,796	100%	-	-	67,105	86,901
Pension funds	36,824	100%	-	-	19,765	56,589
Domestic financial entities	22,634	100%	-	-	16,752	39,386
Foreign financial entities	4,532	100%	-	-	522	5,054
Other foreign parties	3,425	100%	3,026	25%	2,082	8,533
Total	251,087		43,827		175,973	470,887

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

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

41. Capital management

The capital base at 30 June 2015 amounts to ISK 168,477 million. The capital adequacy ratio, calculated in accordance with Article 84 of the Act on Financial Undertakings was 23.2%, exceeding the minimum legal requirement of 8%.

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

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

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

Capital Base	30.6.2015	31.12.2014
Total equity	168,445	162,212
Additional Tier 1 capital instruments included in total equity*	(1,429)	(1,385)
Intangible assets	(9,353)	(9,596)
Tax assets	(891)	(655)
Other statutory deductions	(105)	(111)
Common equity Tier 1 capital	156,667	150,465
Additional Tier 1 capital*	1,429	1,385
Tier 1 capital	158,096	151,850
Subordinated liabilities	10,884	31,639
Regulatory adjustments to Tier 2 capital**	(411)	-
Other statutory deductions	(92)	(101)
Tier 2 capital	10,381	31,538
Total Capital base	168,477	183,388
Risk weighted assets		
Credit risk	629,774	591,994
Market risk FX	6,582	18,915
Market risk other	7,299	2,890
Operational risk	82,211	82,211
Total risk weighted assets	725,866	696,010
Capital ratios		
CET1 ratio	21.6%	21.6%
Tier 1 ratio	21.8%	21.8%
Capital adequacy ratio	23.2%	26.3%

* Non-controlling interests in non-banking subsidiaries.

** Straight-line amortization for maturities within five years.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

41. Capital management, continued

Leverage ratio

As part of the Basel III regulatory framework, the leverage ratio is seen as a complementary measure to the risk-based Capital adequacy ratio.

	30.6.2015	31.12.2014
On-balance sheet exposures	958,352	912,303
Derivative exposures	3,395	1,348
Securities financing transaction exposures	4,269	10,044
Off-balance sheet exposures	60,443	59,922
Total exposure	1,026,459	983,617
Tier 1 capital	158,096	151,850
Leverage ratio	15.4%	15.4%

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

SIGNIFICANT ACCOUNTING POLICIES

The accounting policies adopted in the preparation of these Interim Financial Statements are consistent with those followed in the preparation of the Annual Financial Statements for the year 2014.

41. Going concern assumption

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

