Íslandsbanki

CONSOLIDATED INTERIM FINANCIAL STATEMENTS **1H2016**

1H16 HIGHLIGHTS

- Profit after tax was ISK 13.0bn in 1H16 compared to ISK 10.8bn in 1H15. The profit is driven by strong core income and the completion of the sale of Borgun's shares in Visa Europe
- Return on equity was 12.9% in 1H16, compared to 11.7% in 1H15
- Earnings from regular operations was ISK 8.0bn, compared to ISK 8.2bn in 1H15. Return on equity from regular operations on 14% CET1 was 11.9% in 1H16 compared to 13.9% in 1H15
- Net interest income amounted to ISK 15.9bn in 1H16 (1H15 ISK 13.6bn) up 17.3%. The net interest margin was 3.1% in 1H16 (1H15: 2.9%)
- Net fee and commission income was ISK 6.7bn in 1H16 (1H15 6.4bn), a 4.3% year on year increase; thereof 1.3% was achieved in the parent company
- A a loss of 1.2bn was recognised due to building damages in current headquarters at Kirkjusandur
- Cost to income ratio was 56.0% in 1H16 (1H15: 56.0%), the cost to income ratio excludes the Bank tax and one-off cost items
- Loans to customers grew by 5.0% in 1H16 to ISK 698.7bn, the increase is well diversified across various lending divisions
- Total assets amounted to ISK 1,030bn (Mar16: ISK 1,021bn)
- Deposits from customers decreased by 4.6% in 1H16 to ISK 566bn
- Issued two foreign denominated bond transaction in the first half of 2016 a USD 35m private placement and EUR 75m tap issue, resulting in the Bank's first EUR 300m benchmark issue
- Total capital ratio remains strong at 28.9% (Mar16: 29.7%) and CET1 ratio was 27.1% (Mar16: 28.1%)
- The liquidity position is strong and exceeds internal and external requirements. At June 2016, the Bank's liquidity coverage ratio (LCR) was 173% (Mar16: 154%) and the total net stable funding ratio (NSFR) was 117% (Mar16: 118%)
- Leverage ratio was at 18.3% at the end of June compared to 18.7% at Mar16, indicating a moderate leverage
- Ratio of loans more than 90 days past due and impaired was 2.5% (Mar16: 2.1%)
- S&P placed the Bank´s BBB-/A-3 rating on positive outlook in January 2016, and Fitch affirmed a BBB-/F3 rating with a stable outlook in April. Íslandsbanki is the only Icelandic bank to have investment grade ratings from both S&P and Fitch

2Q16 HIGHLIGHTS

- Profit after tax was ISK 9.5bn in 2Q16 (2Q15: ISK 5.4bn)
- Return on regular operations 14% CET1 was 13.9% in the quarter (2Q15: 12.8%)
- Net interest income amount to ISK 8.4bn in 2Q16 (2Q15: ISK 7.4bn)
- Net fee and commission income was ISK 3.5bn in 2Q16 (2Q15: ISK 3.5bn)

Birna Einarsdóttir, Chief Executive Officer at Íslandsbanki:

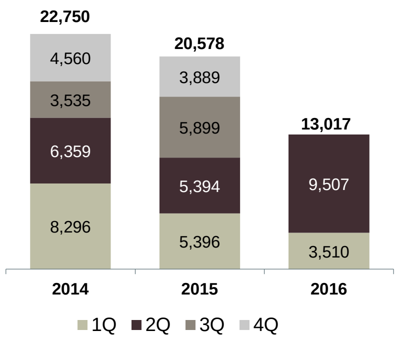
"Íslandsbanki's performance was good in the first half of 2016, and the Bank's position is strong. The profit for the period was about ISK 13bn, and return on capital was 12.9% The increased profit is due in large part to income from the Bank's subsidiary Borgun. Credit growth measured 5% to June, with loans granted to a wide variety of sectors.

The streamlining of the Bank's branch network continues, and the number of branches will be 14 at the beginning of 2017. Íslandsbanki operates the most efficient branch network in Iceland and has done so for years.

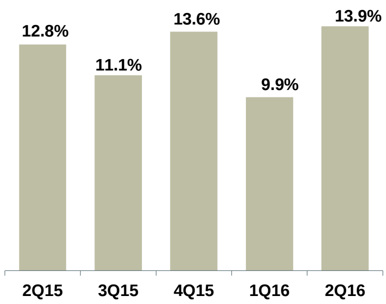
According to a new service survey, customer satisfaction has never measured higher, and satisfaction scores have risen for all service elements since last year. In addition, the Bank was named Iceland's best bank by international financial magazine Euromoney for the fourth year in a row. This confirms that Íslandsbanki's vision of providing the best banking services in Iceland is bearing fruit, both in operating results and in customer satisfaction levels.

There is good news about the liberalisation of capital controls, which is extremely beneficial for the Icelandic economy. Íslandsbanki is well prepared for the liberalisation process, and both its liquidity and its capital position are very strong. The Bank's asset management function, VÍB, has collaborated for years with several of the strongest asset management firms in the world. VÍB will continue to provide sound information about foreign markets and will assist savers with diversifying their savings, thereby reducing risk."

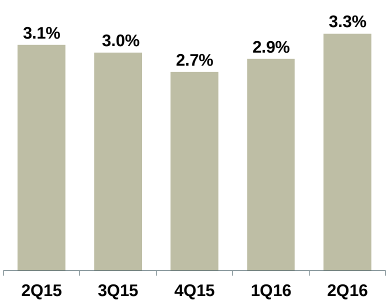
NET PROFIT
ISKm



ROE (Regular operations CET1 14%)
%



NET INTEREST MARGIN
%



Income Statement (ISKm)	1H16	1H15	Δ	2Q16	2Q15	Δ
Net interest income	**15,895**	13,550	2,345	**8,356**	7,359	998
Net fee and commission income	**6,659**	6,423	236	**3,515**	3,518	(3)
Net financial income	**6,666**	2,039	4,628	**6,062**	275	5,788
Net foreign exchange gain (loss)	**317**	(281)	597	**305**	(141)	446
Other operating income	**624**	541	83	**473**	252	221
Total operating income	**30,161**	22,272	7,888	**18,711**	11,263	7,448
Administrative expenses	**(14,116)**	(11,932)	(2,184)	**(7,599)**	(6,109)	(1,490)
Depositors´and Investors Guarantee Fund	**(528)**	(534)	6	**(267)**	(265)	(2)
Bank Tax	**(1,407)**	(1,328)	(79)	**(716)**	(710)	(6)
Total operating expenses	**(16,051)**	(13,794)	(2,256)	**(8,582)**	(7,084)	(1,498)
Profit before net loan impairment	**14,110**	8,478	5,632	**10,129**	4,179	5,950
Net loan impairment	**369**	4,308	(3,939)	**689**	1,977	(1,288)
Profit before tax	**14,479**	12,786	1,693	**10,818**	6,156	4,663
Income tax expense	**(2,586)**	(2,920)	334	**(1,720)**	(1,524)	(196)
Profit for the period from continuing operations	**11,893**	9,866	2,027	**9,098**	4,632	4,466
Profit from discontinued ops. net of income tax	**1,124**	924	200	**409**	762	(353)
Profit for the period	**13,017**	10,790	2,226	**9,507**	5,394	4,114

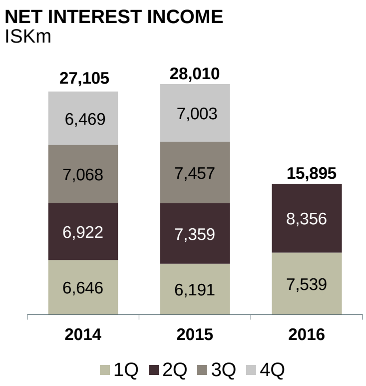
INCOME STATEMENT

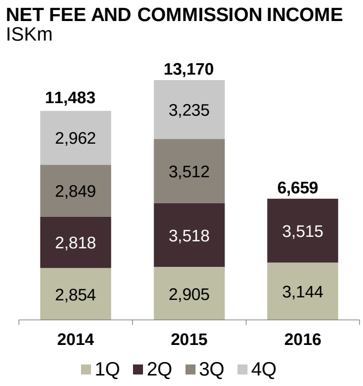
Stable recurring revenues

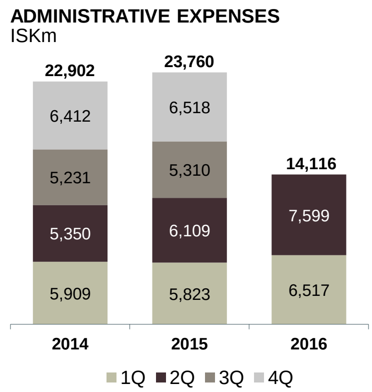
- Total operating income amounted to ISK 30.2bn in 1H16 (2Q16: ISK 18.7bn), an increase of 35.4% from 1H15.
- Net interest income totalled ISK 15.9bn (2Q16: ISK 8.4bn), an increase of 17% from the same period last year mainly due to a higher interest rate environment and higher equity level. The net interest margin was 3.1% (2Q16: 3.3%), compared to 2.9% in 1H15 (2Q15: 3.1%), and is expected to remain around 3.0% in the near to medium term.
- Net fee and commission income rose 4% YoY to ISK 6.7bn in 1H16 (2Q16: ISK 3.5bn). Net fee income benefited from fee-generating subsidiaries and increased customer activity within the parent company.
- Core income (net interest income and net fee and commission income) accounts for 75% of total operating income due to one off items. Usually, core income is over 90% of the banks earnings and in line with the Bank's focus on core earnings and objective to generate stable revenues over the long term.
- Net financial income amounted to ISK 6.7bn in 1H16 (2Q16: 6.1bn), as opposed to ISK 2.0bn in 1H15 (2Q15: 0.3bn). The income is derived from gains in equity holdings and trading of bonds and shares. The increase in net financial income is due to the sale of shares in Visa Europe which resulted in a 6.2bn charge to the income statement. The agreement was finalised in 2Q16.
- Other operating income, consisting of real estate sales, rental income, service level agreement fees, and a share in the profit or loss of associates, totalled ISK 624m in 1H16 (2Q16: ISK 473m), as opposed to ISK 541m in 1H15 (2Q15: ISK 252m).

Cost awareness

- In nominal terms, administrative expenses (excluding one-off extraordinary expenses) rose by ISK 964m year-on-year. Total salaries and related expenses grew to ISK 7.6bn (2Q16: ISK 3.7bn), a 11% increase from 1H15. The increase is primarily down to pay rises negotiated in collective bargaining agreements which came into fruition in 4Q15 and 1Q16. According to Statistics Iceland, the wage index has risen by 12.5% over the same period.
- The average number of full time equivalent (FTEs) employees in the parent company was 955, a marginal decrease of 0.3% year-on-year, and 1,116 FTEs on a consolidated basis excluding held for sale entities.
- The cost-to-income ratio for the period was 56.0%.The cost income ratio excludes the Bank tax, which is considered temporary, and other one off cost items.
- A one off loss of 1.2bn due to building damages in current headquarters at Kirkjusandur.
- This autumn, the Bank's operations will be consolidated in new headquarters at the North Tower in Kópavogur. In addition 3 branches will be merged into one, strategically located at the ground floor of the North Tower. Furthermore, the branches in Kirkjusandur and Suðurlandsbraut will merge to a new branch in Laugardalur bringing the total number of branches down from 17 to 14 in early 2017. These changes will add front end costs in 2016, but these are expected to be off-set by future cost savings.
- Investments into digital solutions such as KASS, mortgage calculators, electronic signatures, and the Sopra payment system increase the operating expenses, but are expected to be off-set by future revenues.
- The contribution to the Depositors' and Investors' Guarantee Fund in the amount of ISK 528m was comparable to that in the previous year, while the temporary bank tax increased 6%, in line with growth in total liabilities.







Net loan impairment loss

- Net loan impairment totalled ISK 0.4bn in 1H16 compared to ISK 4.3bn gain in 1H15.
- Net loan impairments have since 2008 been substantially impacted by an increase in value of loans bought at deep discount. As restructuring of the loan book has now been concluded there should be a less positive impact from net loan impairment going forward.

Taxes and levies rise temporarily

- Tax on the profit for the period amounted to ISK 2.6bn, as compared with ISK 2.9bn in 1H15. The effective tax rate was 17.9%, as opposed to 22.8% in 1H15. The temporary bank tax accounted for ISK 1.4bn in 1H16, an increase of 6% from 1H15. It is expected that the bank tax will cease by year-end 2016.
- Íslandsbanki is subject to the special financial tax of 6% on taxable profits in excess of ISK 1bn, as well as contributions to the Depositors' and Investors' Guarantee Fund, the Financial Supervisory Authority, and the Debtors' Ombudsman. Total taxes and levies amounted to ISK 5.1bn in 1H16, as opposed to ISK 5.3bn in 1H15.
- Íslandsbanki's global tax footprint was ISK 13.3bn in the first half of 2016, compared to ISK 23.3bn for the full year 2015. The Bank's global tax footprint consists of all taxes born and all taxes collected, it and thus a significant contribution to society as a whole.

Profit for the period

- The profit from discontinued operations, net of tax, was ISK 1.1bn in 1H16 (2Q16: ISK 0.4bn), compared to ISK 0.9bn in 1H15 (2Q15: ISK 0.8bn). The profit derives from the sale of foreclosed and held for sale assets.
- Profit after tax was ISK 13.0bn in 1H16 (2Q16: ISK 9.5bn) compared to ISK 10.8bn in 1H15 (2Q15: ISK 5.4bn), rendering a ROE of 12.9%. Profit is at comparable levels due to the Visa Europe payment in 2016 and the high net loan impairment gain in 2015.
- Earnings from regular operations was ISK 8.0bn (2Q16: ISK 4.5bn), compared to ISK 8.2bn in 1H15 (2Q15: ISK 3.9bn). Return on equity from regular operations on 14% CET1 was 11.9% in 1H16 compared to 13.9% in 1H15, which is above expectations.

BALANCE SHEET

Assets - building upon a strong foundation

- The balance sheet grew 0.9% in the last quarter, to ISK 1,030bn at June 2016. This is however 1.5% or ISK 16.2bn below year-end 2015´s position. This is mainly due to an decrease in deposits and cash levels resulting from the expected withdrawal of Glitnir deposits and lower cash and balances with the CBI.

Asset (ISK m)	**30.06.2016**	31.03.2016	31.12.2015
Cash and balances with CB	**182,177**	182,453	216,760
Bonds and debt instruments	**71,756**	79,873	78,606
Shares and equity instruments	**12,692**	18,664	18,320
Derivatives	**2,036**	2,759	1,981
Loans to credit institutions	**33,088**	27,811	35,534
Loans to customers	**698,669**	677,079	665,711
Investment in associates	**764**	1,009	716
Property and equipment	**5,884**	7,289	7,344
Intangible assets	**1,700**	1,471	1,331
Other assets	**11,268**	11,177	6,674
Non-current assets held for sale	**9,583**	11,190	12,792
Total assets	**1,029,617**	1,020,775	1,045,769

- Loans to customers grew 5.0%, or ISK 32.9bn, in 1H16 (2Q16: 3.2% or ISK 21.6bn). Demand for new credit was primarily from corporations and, to a lesser extent, from individuals. New lending amounted to ISK 91bn (2Q16: ISK 56.8bn), as opposed to ISK 70.0bn (2Q15: ISK 36.1bn) in the prior year. More than half of the portfolio is lending to individuals and real estate.
- The share of loans that are either 90 days in arrears or impaired was 2.5% at June 2016, up from 2.1% at March 2016. This places Íslandsbanki's credit quality securely in the top interquartile range of European banks in terms of the European Systemic Risk Board solvency indicator. A more detailed discussion of the loan portfolio and credit risks can be found in the Bank's 2015 Pillar 3 Report.
- Real estate remains Íslandsbanki´s most important type of collateral. The weighted average loan-to-value (LTV) ratio for the residential mortgage portfolio was 65.0% at June 2016, compared to 69.4% at March 2016. The decrease is mainly due to the June update in tax value of residential real estate.
- The asset encumbrance ratio was 11.6% at the end of June 2016, as opposed to 10.2% at March 2016.

Liabilities and Equity (ISK m)	30.06.2016	31.03.2016	31.12.2015
Deposits from CB and credit inst.	**14,633**	28,338	25,631
Deposits from customers	**566,220**	544,430	593,245
Derivatives and short positions	**6,079**	4,902	6,981
Debt issued and other borrowings	**163,469**	161,802	150,308
Subordinated loans	**18,886**	19,415	19,517
Tax liabilities	**9,894**	8,963	8,358
Other liabilities	**49,252**	44,170	36,677
Non-current liabilities held for sale	**2,347**	3,128	2,825
Total liabilities	**830,780**	815,148	843,542
Total equity	**198,837**	205,627	202,227
Total liabilities and equity	**1,029,617**	1,020,775	1,045,769

Liabilities – deposits still the main source of funding

- Total liabilities amounted to ISK 830.8bn at June 2016, an increase of 1.9% from March 2016.
- Deposits from customers increased by 4.0% from March 2016, to ISK 566.2bn. As a result, the ratio of customer deposits to customer loans increased to 81.0% at June 2016, compared to 80.4% at March 2016.
- Customer deposits are still Íslandsbanki's main source of funding, and concentration levels are monitored closely. At the end of June 2016, 19% of the Banks deposits belonged to the 10 largest depositors, down from 25% at year-end 2015. The drop is largely attributable to the reduction in deposits from old Glitnir following their composition agreement.
- Íslandsbanki maintained a strong liquidity position into 2016, and all regulatory and internal metrics were well above the set limits. At June 2016 its liquidity coverage ratio (LCR) was 173% (Mar16: 154%) at the group level, and the FX net stable funding ratio (NSFR) and total NSFR were 154% (Mar16: 157%) and 117% (Mar16: 118%) respectively at group level.
- Íslandsbanki´s debt issuance has continued into 2016, primarily reflecting issuance under its Global Medium Term Note Programme (GMTN) and covered bond programme, aimed at mitigating risk through diversification of funding. The Bank is the largest Icelandic Bank issuer of bonds issuing ISK 9.0bn in covered bonds in the first half of 2016 (1H15: ISK 6.8bn), bringing the total outstanding balance to ISK 60.5bn. The Bank also issues commercial paper, with an outstanding balance of just over ISK 9.7bn at June 2016. In January the Bank issued a USD 35m one-year floating-rate note paying 3 month USD LIBOR +170 bps and in May a EUR 75 million euros note maturing in 2018 with price equivalent to 247 bps over 3 month Eurobor.
- The Bank has issued a Tier 2 euro denominated subordinated loan currently totalling ISK 18.9bn which is set to mature in 2019.

Equity

- Total equity amounted to ISK 198.8bn at the end of June 2016, compared with ISK 205.6bn at March 2016. Of that total, ISK 3.7bn is attributable to minority interests. The nominal value of Íslandsbanki´s authorised share capital was ISK 10bn at June 2016, and paid-up share capital amounted to ISK 65bn.
- At June 2016, the capital ratio was 28.9%, compared to 29.7% at March 2016, well above the short to medium-term target of 23%. The Tier 1 capital ratio was 27.1% at June 2016, marginally down from 28.1% at March 2016. Íslandsbanki uses the standardised method to calculate its risk-weighted assets (RWA), which amounted to ISK 724.7bn at the end of the period, or 70% of total assets, a marginal increase from Mar16. The leverage ratio was 18.3%, compared to 18.7% in March 2016, indicating moderate leverage.

Equity (cont.)

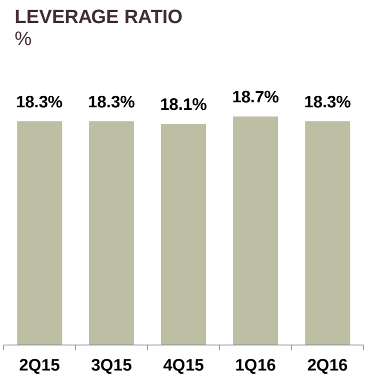
- Due to increased capital requirements, medium to long-term CET1 targets are expected to rise. The target ratio will be determined within the next 6-12 months in line with more clarity on the lifting of capital controls and regulatory capital requirements. As a guidance however, the medium to long-term CET1 target will likely be in the range of 14-16%.
- The total capital reference for Íslandsbanki is 19.9%, assuming full implementation of the Bank´s 2015 capital buffers. Based on the current risk profile, the composition of the 19.9% is subject to some restrictions, see details in the Pillar 3 Report.
- At the 19 April AGM, it was decided that ISK 10bn (just under 50% of net profit in 2015) would be paid in dividends to shareholders, but otherwise the profit would be added to the Bank's equity (the dividend pay-out date was 27th April 2016). In addition it was agreed that the Board may convene a special shareholder meeting later in the year where a proposal regarding payment of dividends of profit for the previous fiscal years could be discussed.

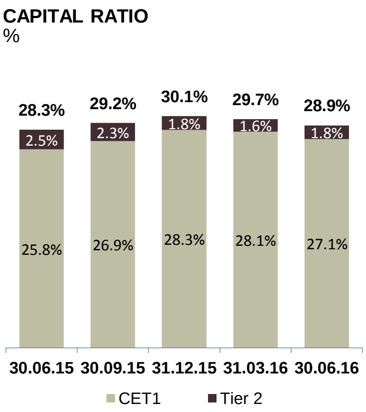
Imbalances

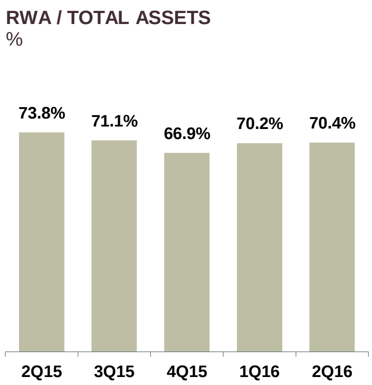
- Íslandsbanki is exposed to inflation risk as CPI-linked assets exceed CPI-linked liabilities. At June 2016, the net inflation (CPI) imbalance amounted to ISK 49.2bn (23.5% of the total capital base), compared to ISK 43.8bn at March 2016 (20.5% of the total capital base). The imbalance is managed via CPI-linked swaps, issuance of CPI-linked covered bonds, and long-term CPI-linked deposit programmes.
- The consolidated foreign exchange balance at the end of June 2016 was ISK 0.5bn (0.2% of the total capital base), compared to 9.0bn at March 2016 (4.2% of the total capital base). The Bank's imbalances are strictly monitored and are within the regulatory limits.

Ratings

- Íslandsbanki is the only bank in Iceland that is rated by two international rating agencies, Fitch and Standard & Poor's (S&P). In January 2016, S&P raised the sovereign rating to BBB+/A-2, citing further progress towards capital account liberalisation and declining debt levels. Shortly thereafter, Íslandsbanki's ratings were affirmed at BBB-/A-3 with a positive outlook. In April, Fitch Ratings affirmed the Bank's investment grade rating of BBB-/F3, with a stable outlook.







INVESTOR RELATIONS

Investor Presentation in Icelandic

On Tuesday at 11.30 pm Icelandic time, Birna Einarsdóttir, CEO of Íslandsbanki, and Jón Guðni Ómarsson, CFO, will present the 1H2016 financial results to market participants, followed by a Q&A session. The meeting is conducted in Icelandic and held at the Bank's headquarters at Kirkjusandur. Please register here.

Investor call in English

On Tuesday, the Bank will also host an investor call in English to present the results at 10 am Icelandic time. The call will start with a short macro update on the Icelandic economy, followed by a review of the financial results and Q&A. Please register by replying to ir@islandsbanki.is. Dial-in details and presentation will be sent out two hours prior to the call.

All presentation material will subsequently be available and archived on www.islandsbanki.is/ir.

Financial Calendar

Íslandsbanki plans to publish its interim and annual financial statements according to the below financial calendar.

3Q16 – 9 November 2016

4Q16 – 22 February 2017

Please note that the dates are subject to change. For information on Íslandsbanki's financial calendar and silent periods see http://www.islandsbanki.is/english/investor-relations/calendar/.