

Condensed Consolidated  
Interim Financial Statements  
Unaudited

Three months ended 31 March 2014

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

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The unaudited Condensed Consolidated Interim Financial Statements of Íslandsbanki hf. for the period 1 January to 31 March 2014 comprise the Condensed Interim Financial Statements of Íslandsbanki hf. and its subsidiaries, together referred to as “the Bank”.

## Accounting convention

The unaudited Condensed Consolidated Interim Financial Statements for the period 1 January to 31 March 2014 have been prepared on a going concern basis in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). The Financial Statements are presented in accordance with the International Accounting Standard (IAS) 34 Interim Financial Reporting.

Profit from the Bank's operations for the period 1 January to 31 March 2014 amounted to ISK 8,296 million, which corresponds to a 19.3% annualised return on equity. Bank equity, according to the Consolidated Financial Position, amounted to ISK 175,373 million at 31 March 2014. According to the Act on Financial Undertakings no. 161/2002 the official capital ratio of the Bank shall be based on audited own funds. Since the interim financial statements for the first three months of the year are not audited the official capital ratio is based on audited own fund items at 31 December 2013 and risk weighted assets at 31 March 2014. The official capital ratio at 31 March 2014 was 29.1% and the Tier 1 ratio was 25.7%. The capital ratio, based on the reported own fund items at 31 March 2014, was 30.3% and the corresponding Tier 1 ratio was 27.0%. The Board of Directors refers to Note 57 for further understanding of the capital requirements of the Bank. The Bank's total assets amounted to ISK 884,043 million at the end of the period.

The Board of Directors draws special attention to the risks relating to the political and legal environment in Iceland where capital controls are still in place. The Bank has made appropriate provisions to reflect the risk associated with court rulings. The Board also notes that the Bank maintains a strong capital base and is therefore well positioned to meet future risks and challenges. The Board refers to Notes 2 and 38 for the principal risks and uncertainties currently faced by the Bank.

To the best of our knowledge the Condensed Consolidated Interim Financial Statements provide a true and fair view of the Bank's operating profits and its financial position as at 31 March 2014.

The Board of Directors and the CEO of Íslandsbanki hf. hereby confirm the Bank's Condensed Consolidated Interim Financial Statements for the period 1 January to 31 March 2014 by means of their signatures.

Reykjavík, 21 May 2014

## Board of Directors:

Fridrik Sophusson, Chairman  
John E. Mack, Vice-Chairman  
Árni Tómasson  
Daniel Levin  
Helga Valfells  
María E. Ingvadóttir  
Marianne Økland  
Neil Graeme Brown  
Þórunna Jónsdóttir

## Chief Executive Officer:

Birna Einarsdóttir

## Condensed Consolidated Income Statement for the three months ended 31 March 2014

	Notes	2014 1.1-31.3	2013 1.1-31.3
Interest income .....		12,862	15,573
Interest expense .....		( 6,216)	( 8,100)
<b>Net interest income</b>	10	6,646	7,473
Fee and commission income .....		4,517	3,855
Fee and commission expense .....		( 1,663)	( 1,403)
<b>Net fee and commission income</b>		2,854	2,452
Net financial income .....	11-12	863	881
Net foreign exchange loss .....	13	( 291)	( 1,563)
Share of profit of associates net of tax .....		-	3
Other net operating income .....	14	1,113	412
<b>Other net operating income</b>		1,685	( 267)
<b>Total operating income</b>		11,185	9,658
Administrative expenses .....	15-16	( 5,909)	( 6,236)
Contribution to the Depositors' and Investors' Guarantee Fund .....		( 258)	( 246)
Bank tax .....		( 592)	( 67)
<b>Total operating expenses</b>		( 6,759)	( 6,549)
<b>Profit before loan impairment charges and net valuation changes</b>		4,426	3,109
Loan impairment charges and net valuation changes .....	17	1,520	2,993
<b>Profit before tax</b>		5,946	6,102
Income tax .....	18	( 1,394)	( 1,448)
<b>Profit for the period from continuing operations</b>		4,552	4,654
Profit (loss) from discontinued operations, net of income tax .....		3,744	( 69)
<b>Profit for the period</b>		8,296	4,585

The notes on pages 8 to 47 are an integral part of these Condensed Consolidated Interim Financial Statements

## Condensed Consolidated Statement of Comprehensive Income for the three months ended 31 March 2014

	Notes	2014 1.1-31.3	2013 1.1-31.3
<b>Other comprehensive income</b>			
Foreign currency translation differences for foreign operations .....		( 144)	( 144)
<b>Other comprehensive income for the period</b>		( 144)	( 144)
<b>Total comprehensive income for the period</b>		8,152	4,441
<b>Attributable to:</b>			
Equity holders of Íslandsbanki hf. ....		8,219	4,600
Non-controlling interests .....		77	( 15)
<b>Profit for the period</b>		8,296	4,585
Basic earnings per share .....	19	0.82	0.46
Diluted earnings per share .....	19	0.82	0.46

The notes on pages 8 to 47 are an integral part of these Condensed Consolidated Interim Financial Statements

## Condensed Consolidated Statement of Financial Position as at 31 March 2014

	Notes	31.3.2014	31.12.2013
<b>Assets</b>			
Cash and balances with Central Bank .....	6,20	136,735	111,779
Derivatives .....	6,21	1,328	843
Bonds and debt instruments .....	6	76,165	75,186
Shares and equity instruments .....	6	11,795	9,208
Loans to credit institutions .....	6,22	47,895	44,078
Loans to customers .....	6,23-24	565,952	554,741
Investments in associates .....	26	1,556	1,563
Property and equipment .....		8,691	8,772
Intangible assets .....		292	299
Deferred tax assets .....		1,155	1,275
Non-current assets and disposal groups held for sale .....	29	24,116	47,106
Other assets .....	30	8,363	11,159
<b>Total Assets</b>		<b>884,043</b>	<b>866,009</b>
<b>Liabilities</b>			
Derivative instruments and short positions .....	6,21	8,806	11,176
Deposits from Central Bank .....	6,31	32	63
Deposits from credit institutions .....	6,31	26,815	29,626
Deposits from customers .....	6,32-33	502,925	489,331
Debt issued and other borrowed funds .....	6,34	95,035	89,193
Subordinated loans .....	6	21,437	21,890
Current tax liabilities .....		11,652	10,806
Deferred tax liabilities .....		20	20
Non-current liabilities and disposal groups held for sale .....	29	3,447	9,456
Other liabilities .....	35	38,501	37,130
<b>Total Liabilities</b>		<b>708,670</b>	<b>698,691</b>
<b>Equity</b>			
Share capital .....	36	10,000	10,000
Share premium .....	36	55,000	55,000
Other reserves .....		2,327	2,471
Retained earnings .....		106,767	98,548
<b>Total equity attributable to the equity holders of Íslandsbanki hf.</b>		<b>174,094</b>	<b>166,019</b>
Non-controlling interests .....		1,279	1,299
<b>Total Equity</b>		<b>175,373</b>	<b>167,318</b>
<b>Total Liabilities and Equity</b>		<b>884,043</b>	<b>866,009</b>

The notes on pages 8 to 47 are an integral part of these Condensed Consolidated Interim Financial Statements

## Condensed Consolidated Statement of Changes in Equity for the three months ended 31 March 2014

	Attributable to equity holders of Íslandsbanki hf.				Total	Non- controlling interests	Total equity
	Share capital	Share premium	Other reserves	Retained earnings			
<b>Equity at 1.1.2013</b>	10,000	55,000	2,834	78,571	146,405	1,255	147,660
Translation differences for foreign operations .....			( 144)		( 144)		( 144)
Net expense recognised directly in equity .....	-	-	( 144)	-	( 144)	-	( 144)
Profit for the period .....				4,600	4,600	( 15)	4,585
Total comprehensive income for the period .....	-	-	( 144)	4,600	4,456	( 15)	4,441
Change in non-controlling interests .....					-	-	-
<b>Equity at 31.3.2013</b>	10,000	55,000	2,690	83,171	150,861	1,240	152,101
<b>Equity at 1.1.2014</b>	10,000	55,000	2,471	98,548	166,019	1,299	167,318
Translation differences for foreign operations .....			( 144)		( 144)		( 144)
Net income recognised directly in equity .....	-	-	( 144)		( 144)	-	( 144)
Profit for the period .....				8,219	8,219	77	8,296
Total comprehensive income for the period .....	-	-	( 144)	8,219	8,075	77	8,152
Change in non-controlling interests .....					-	( 97)	( 97)
<b>Equity at 31.3.2014</b>	10,000	55,000	2,327	106,767	174,094	1,279	175,373

The notes on pages 8 to 47 are an integral part of these Condensed Consolidated Interim Financial Statements

## Condensed Consolidated Statement of Cash Flows for the three months ended 31 March 2014

	Notes	2014 1.1-31.3	2013 1.1-31.3
<b>Cash flows from operating activities:</b>			
Profit for the period .....		8,296	4,585
<b>Adjustments to reconcile profit for the period to cash flows by operating activities:</b>			
Non-cash items included in profit for the period and other adjustments .....		( 2,871)	913
Changes in operating assets and liabilities .....		8,372	( 24,903)
Income tax paid .....		( 767)	( 397)
<b>Net cash provided by (used in) operating activities</b>		<b>13,030</b>	<b>( 19,802)</b>
<b>Net cash (used in) investing activities</b>		<b>( 109)</b>	<b>( 323)</b>
<b>Net cash provided by financing activities</b>		<b>5,352</b>	<b>375</b>
Changes in cash and cash equivalents .....		18,273	( 19,750)
Effects of exchange rate changes on cash and cash equivalents .....		( 202)	( 66)
Cash and cash equivalents at the beginning of the period .....		138,433	112,810
<b>Cash and cash equivalents at the end of the period</b>		<b>156,504</b>	<b>92,994</b>
<b>Reconciliation of cash and cash equivalents:</b>			
Cash on hand .....	20	2,402	1,950
Cash balances with Central Bank and certificates of deposit .....	20	125,637	54,766
Bank accounts .....	22	28,465	36,278
<b>Total cash and cash equivalents</b>		<b>156,504</b>	<b>92,994</b>

Interest received from 1 January to 31 March 2014 amounted to ISK 13,210 million (2013: ISK 11,419 million) and interest paid in the same period 2014 amounted to ISK 5,371 million (2013: ISK 7,201 million). Interest is defined as having been paid when it has been deposited into the customer account and is available for the customer's disposal.

The notes on pages 8 to 47 are an integral part of these Condensed Consolidated Interim Financial Statements



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# Notes to the Condensed Consolidated Financial Statements

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## Accounting policies

### General information

#### 1. The reporting entity

Íslandsbanki hf. is a limited company incorporated and domiciled in Iceland. The unaudited Condensed Consolidated Interim Financial Statements for the three months ended 31 March 2014 comprise Íslandsbanki hf. (the parent) and its subsidiaries (together referred to as "the Bank").

The Condensed Consolidated Interim Financial Statements were authorised for issue by the Board of Directors of Íslandsbanki hf. on 21 May 2014.

#### 2. Basis of preparation

##### 2.1 *Statement of compliance*

The unaudited Condensed Consolidated Interim Financial Statements for the three months ended 31 March 2014 have been prepared on a going concern basis in accordance with the International Financial Reporting Standards (IFRS), as adopted by the European Union. The Interim Financial Statements are presented in accordance with the International Accounting Standard (IAS) 34 Interim Financial Reporting.

The Condensed Consolidated Interim Financial Statements do not include all the information required for annual financial statements and should be read in conjunction with the Consolidated Financial Statements of the Bank and the Risk Report for the year ended 31 December 2013, available at the Bank's website [www.islandsbanki.is](http://www.islandsbanki.is).

##### 2.2 *Basis of measurement*

The unaudited Condensed Consolidated Interim Financial Statements have been prepared on an historical cost basis except for the following items in the statement of financial position: bonds and debt instrument which are measured at fair value, shares and equity instruments which are measured at fair value, derivative financial instruments which are measured at fair value and non-current assets and disposal groups classified as held for sale which are measured at the lower of cost and fair value less cost to sell.

The Condensed Consolidated Interim Financial Statements are presented in Icelandic krona (ISK), which is the functional currency of the Bank, rounded to the nearest million.

##### 2.3 *Significant accounting judgements and estimates*

The preparation of the unaudited Condensed Consolidated Financial Statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses recognised in the Condensed Consolidated Financial Statements. The accounting estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

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

##### 2.4 *Going concern*

The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has adequate resources to continue its operations for the foreseeable future. Therefore, the financial statements are prepared on a going concern basis.

##### 2.5 *Changes in presentation*

The Bank no longer uses the term latent impairment allowance and now presents provision for impairment losses for loans in two categories, individually assessed and collectively assessed. Individually assessed allowance comprises impairment for financial assets that are assessed individually and collectively assessed allowance comprises estimates of impairment losses that have been incurred but not identified in the reporting period for a group of loans that have similar credit risk characteristics (see Notes 24 and 25).

## Notes to the Condensed Consolidated Financial Statements

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### 2.5 Cont'd

The Bank has added a separate column in note 45 for unrated loans. These are loans without a formal risk rating or with an expired rating which were previously included in risk class 9. Comparable figures have been adjusted accordingly.

### 3 Significant accounting policies

The same accounting policies, presentation and methods of computation have been followed in these Condensed Consolidated Interim Financial Statements as were applied in the preparation of the Bank's Consolidated Financial Statements for the year ended 31 December 2013.

New or amended accounting standards or interpretations that entered into force for the Condensed Consolidated Interim Financial Statement are described below.

#### *IFRS 10 Consolidated Financial Statements*

The Bank has adopted IFRS 10 Consolidated Financial Statements which includes a revised definition of control and requires parent companies which are investment entities to measure investments at fair value through profit or loss instead of consolidating those subsidiaries. The application of IFRS 10 did not have a material impact on the consolidated financial statements.

#### *IAS 28 Investments in Associates and Joint Ventures*

The Bank has adopted IAS 28 Investments in Associates and Joint Ventures which incorporates requirements for joint ventures into the standard and contains more specific provision with respect to investments in associates and joint ventures which meet the criteria to be classified as held for sale in accordance with IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations. The application of IAS 28 did not have a material impact on the consolidated financial statements.

# Notes to the Condensed Consolidated Financial Statements

## Business combination

### 4. Changes within the group

#### 4.1 Loss of control of a subsidiary

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

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

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

## Quarterly statements

### 5. Operations by quarters:

	Q1*	Q4*	Q3*	Q2*	Q1*
	2014	2013	2013	2013	2013
Net interest income .....	6,646	6,547	7,365	7,045	7,473
Net fee and commission income .....	2,854	2,849	2,462	2,670	2,452
Net financial income .....	863	2,747	315	669	881
Net foreign exchange (loss) gain .....	( 291)	( 1,117)	409	( 152)	( 1,563)
Share of profit of associates .....	-	-	-	-	3
Other net operating income .....	1,113	100	314	716	412
Administrative expenses .....	( 5,909)	( 7,928)	( 5,208)	( 6,179)	( 6,236)
Contribution to the Depositors' and Investors' Guarantee Fund .....	( 258)	( 262)	( 252)	( 256)	( 246)
Bank tax .....	( 592)	( 2,113)	( 76)	( 65)	( 67)
Loan impairment charges and net valuation changes .....	1,520	7,894	555	4,857	2,993
Profit before tax .....	5,946	8,717	5,884	9,305	6,102
Income tax .....	( 1,394)	( 2,501)	( 1,570)	( 2,347)	( 1,448)
Profit for the period from continuing operations .....	4,552	6,216	4,314	6,958	4,654
Profit (loss) for the period from discontinued operations .....	3,744	1,456	( 125)	( 335)	( 69)
<b>Profit for the period</b>	<b>8,296</b>	<b>7,672</b>	<b>4,189</b>	<b>6,623</b>	<b>4,585</b>

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

## Notes to the Condensed Consolidated Financial Statements

### Financial assets and liabilities

6. The following tables show the carrying value of financial assets and financial liabilities according to their IAS39 classification.

#### At 31 March 2014

	Notes	Held for trading	Designated at fair value through P&L	Loans & receivables	Other amortised cost	Total carrying amount
Cash and balances with Central Bank .....	20	-	-	136,735	-	136,735
<i>Loans and receivables</i>						
Loans to credit institutions .....	22	-	-	47,895	-	47,895
Loans to customers .....	23-24	-	-	565,952	-	565,952
<b>Loans and receivables</b>		-	-	750,582	-	750,582
<i>Bonds and debt instruments</i>						
Listed .....		42,924	31,355	-	-	74,279
Unlisted .....		-	1,886	-	-	1,886
<b>Bonds and debt instruments</b>		42,924	33,241	-	-	76,165
<i>Shares and equity instruments</i>						
Listed .....		4,846	5,095	-	-	9,941
Unlisted .....		-	1,854	-	-	1,854
<b>Shares and equity instruments</b>		4,846	6,949	-	-	11,795
Derivatives .....	21	1,328	-	-	-	1,328
Other financial assets .....		-	-	5,697	-	5,697
<b>Total financial assets</b>		49,098	40,190	756,279	-	845,567
Derivative instruments and short positions .....	21	8,806	-	-	-	8,806
Deposits from Central Bank .....	31	-	-	-	32	32
Deposits from credit institutions .....	31	-	-	-	26,815	26,815
Deposits from customers .....	32-33	-	-	-	502,925	502,925
Debt issued and other borrowed funds .....	34	-	-	-	95,035	95,035
Subordinated loans .....		-	-	-	21,437	21,437
Other financial liabilities .....		-	-	-	25,427	25,427
<b>Total financial liabilities</b>		8,806	-	-	671,671	680,477

## Notes to the Condensed Consolidated Financial Statements

6. Cont'd

**At 31 December 2013**

	Notes	Held for trading	Designated at fair value through P&L	Loans & receivables	Other amortised cost	Total carrying amount
Cash and balances with Central Bank .....	20	-	-	111,779	-	111,779
<i>Loans and receivables</i>						
Loans to credit institutions .....	22	-	-	44,078	-	44,078
Loans to customers .....	23-24	-	-	554,741	-	554,741
<b>Loans and receivables</b>		-	-	710,598	-	710,598
<i>Bonds and debt instruments</i>						
Listed .....		41,311	31,598	-	-	72,909
Unlisted .....		-	2,277	-	-	2,277
<b>Bonds and debt instruments</b>		41,311	33,875	-	-	75,186
<i>Shares and equity instruments</i>						
Listed .....		3,095	3,322	-	-	6,417
Unlisted .....		-	2,791	-	-	2,791
<b>Shares and equity instruments</b>		3,095	6,113	-	-	9,208
Derivatives .....	21	843	-	-	-	843
Other financial assets .....		-	-	9,036	-	9,036
<b>Total financial assets</b>		45,249	39,988	719,634	-	804,871
Derivative instruments and short positions .....	21	11,176	-	-	-	11,176
Deposits from Central Bank .....	31	-	-	-	63	63
Deposits from credit institutions .....	31	-	-	-	29,626	29,626
Deposits from customers .....	32-33	-	-	-	489,331	489,331
Debt issued and other borrowed funds .....	34	-	-	-	89,193	89,193
Subordinated loans .....		-	-	-	21,890	21,890
Other financial liabilities .....		-	-	-	22,561	22,561
<b>Total financial liabilities</b>		11,176	-	-	652,664	663,840

# Notes to the Condensed Consolidated Financial Statements

## Fair value information for financial instruments

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

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

### Financial instruments at amortised cost

#### Assets

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

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

Loans in category 1) are specifically valued each quarter and therefore their fair value is fully represented by their carrying amount. The fair value of the loans in category 2) may differ from their carrying amount because the interest rate they carry may not reflect the interest rate that similar new loans would carry. This difference stems from two sources:

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

The Bank calculates the fair value of loans in category 2) by discounting from the carrying amount the resulting interest rate difference from 31 March 2014 to the loan's next interest reset or maturity.

For "Cash and balances with Central Bank" and "Loans to credit institutions" the carrying value is very well approximated by the carrying amount since they are short term in nature.

#### Liabilities

On the liabilities side most deposits are on demand or carry floating interest rates and as such their fair value equals their carrying amount. For longer term, fixed rate deposits the Bank calculates the fair value with a duration approach, using the difference in each liability's current rate from the rate that a similar deposit would carry today. For the fair value of "Debt issued and other borrowed funds" the Bank uses an observed market value where it is available. If there is no observable market value the fair value of the debt is valued in the same manner as deposits if it carries a fixed rate and is estimated by comparing the debt's margin with the Bank's current funding premium on similar debt if it is based on a floating rate. The Bank estimates its funding premium based on the interest margin on its issued papers including covered bonds, commercial papers as well as foreign currency denominated bonds.

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

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

	Carrying amount	Fair value	Carrying amount	Fair value
	31.3.2014	31.3.2014	31.12.2013	31.12.2013
<b>Financial assets:</b>				
Cash and balances with Central banks .....	136,735	136,735	111,779	111,779
Loans to credit institutions .....	47,895	47,895	44,078	44,078
Loans to customers .....	565,952	566,880	554,741	556,068
<b>Total financial assets</b>	<b>750,582</b>	<b>751,510</b>	<b>710,598</b>	<b>711,925</b>
<b>Financial liabilities:</b>				
Deposits from Central Bank .....	32	32	63	63
Deposits from credit institutions .....	26,815	26,816	29,626	29,626
Deposits from customers .....	502,925	503,090	489,331	489,430
Debt issued and other borrowed funds .....	95,035	95,541	89,193	89,723
Subordinated loans .....	21,437	21,416	21,890	21,880
<b>Total financial liabilities</b>	<b>646,244</b>	<b>646,895</b>	<b>630,103</b>	<b>630,722</b>

## Notes to the Condensed Consolidated Financial Statements

### 8. Financial instruments at fair value

The following table shows financial instruments carried at fair value, by valuation method, categorised as at 31 March 2014. The different levels have been defined as follows:

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

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

Level 3: Inputs for the assets or liabilities that are not based on observable market data (unobservable inputs, e.g. internal assumptions).

#### At 31 March 2014

<b>Financial assets:</b>	Level 1	Level 2	Level 3	Total
Bonds and debt instruments .....	43,696	31,249	1,220	76,165
Shares and equity instruments .....	9,941	-	1,854	11,795
Derivative instruments .....	-	1,328	-	1,328
<b>Total financial assets</b>	<b>53,637</b>	<b>32,577</b>	<b>3,074</b>	<b>89,288</b>
<b>Financial liabilities:</b>	Level 1	Level 2	Level 3	Total
Short positions .....	6,923	209	-	7,132
Derivative instruments .....	-	1,587	87	1,674
<b>Total financial liabilities</b>	<b>6,923</b>	<b>1,796</b>	<b>87</b>	<b>8,806</b>

The following table shows financial instruments carried at fair value, by valuation method, categorised as at 31 December 2013.

#### At 31 December 2013

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



## Notes to the Condensed Consolidated Financial Statements

8. Cont'd

### Reconciliation of financial instruments in level 3

	Bonds and debt instruments	Shares and equity instruments	Derivatives
Recorded value at 1 January 2014 .....	1,279	2,791	( 85)
Sales .....	( 33)	( 33)	-
Net gains on financial instruments .....	( 26)	( 144)	( 2)
Transfers to level 1 or 2 .....	-	( 760)	-
<b>Recorded value at 31 March 2014</b>	<b>1,220</b>	<b>1,854</b>	<b>( 87)</b>

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

Level 3 assets contain primarily unlisted and illiquid equities and bonds and one bond option.

The valuation of level 3 assets is done on a case-by-case basis when the book value exceeds ISK 50 million. The valuation methods are presented in the table below.

One equity instrument, a total of ISK 760 million, was transferred from level 3 to level 1 because it was listed on the domestic market in Q1 2014. Transfers of assets from level 3 to level 1 or 2 are done at the transaction price.

### Valuation techniques used in the fair value measurement of level 3 assets and liabilities

Valuation method	Bonds and debt instruments	Shares and equity instruments	Derivatives	Significant unobservable input	Range of estimates (weighted average) for unobservable inputs	Fair value measurement sensitivity to unobservable inputs
Expected recovery	1,220	551	-	Value of assets	Bonds: 0-73% (28%) Shares: 0-100% (77%)	An increase or decrease in the expected recovery would result in a similar change in the fair value
Discounted cash flow model	-	1,117	-	Weighted average cost of capital (WACC)	6-13% (8%)	An increase in the WACC would result in a lower fair value and a decrease would result in a higher fair value
Multipliers	-	186	-	Original investment multiplier	2 (2)	An increase in the multiplier would result in a higher fair value and a decrease would result in a lower fair value
Other	-	-	( 87)	Bond price volatility	6% (6%)	An increase in the volatility would result in a lower fair value and a decrease would result in a higher fair value
<b>Total assets</b>	<b>1,220</b>	<b>1,854</b>	<b>( 87)</b>			

# Notes to the Condensed Consolidated Financial Statements

## Offsetting financial assets and financial liabilities

### 9. Offsetting financial assets and financial liabilities

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

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

	Financial assets subject to netting arrangements			Amounts not set off but subject to master netting arrangements and similar agreements					
	Gross recognised financial assets before balance sheet netting	Balance sheet netting with gross recognised financial liabilities	Financial assets recognised on the balance sheet, net	Recognised financial liabilities	Cash collateral received	Financial instruments collateral received	Net amount after consideration of potential effect of netting arrangements	Assets outside the scope of offsetting disclosure requirements	Total assets recognised on the balance sheet
<b>At 31 March 2014</b>									
Derivatives	1,328	-	1,328	(151)	(101)	(137)	939	-	1,328
<b>Total assets</b>	<b>1,328</b>	<b>-</b>	<b>1,328</b>	<b>(151)</b>	<b>(101)</b>	<b>(137)</b>	<b>939</b>	<b>-</b>	<b>1,328</b>
<b>At 31 December 2013</b>									
Derivatives	843	-	843	(60)	(98)	(152)	534	-	843
<b>Total assets</b>	<b>843</b>	<b>-</b>	<b>843</b>	<b>(60)</b>	<b>(98)</b>	<b>(152)</b>	<b>534</b>	<b>-</b>	<b>843</b>

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

	Financial liabilities subject to netting arrangements			Amounts not set off but subject to master netting arrangements and similar agreements					
	Gross recognised financial liabilities before balance sheet netting	Balance sheet netting with gross recognised financial assets	Financial liabilities recognised on the balance sheet, net	Recognised financial assets	Cash collateral pledged	Financial instruments collateral pledged	Net amount after consideration of potential effect of netting arrangements	Liabilities outside the scope of offsetting disclosure requirements	Total liabilities recognised on the balance sheet
<b>At 31 March 2014</b>									
Derivative instruments and short positions	1,674	-	1,674	(151)	(60)	-	1,463	7,132	8,806
<b>Total liabilities</b>	<b>1,674</b>	<b>-</b>	<b>1,674</b>	<b>(151)</b>	<b>(60)</b>	<b>-</b>	<b>1,463</b>	<b>7,132</b>	<b>8,806</b>
<b>At 31 December 2013</b>									
Derivative instruments and short positions	1,714	-	1,714	(60)	-	-	1,654	9,462	11,176
<b>Total liabilities</b>	<b>1,714</b>	<b>-</b>	<b>1,714</b>	<b>(60)</b>	<b>-</b>	<b>-</b>	<b>1,654</b>	<b>9,462</b>	<b>11,176</b>

## Notes to the Condensed Consolidated Financial Statements

### Net interest income

10. Net interest income is specified as follows:	2014	2013
	1.1-31.3	1.1-31.3
<b>Interest income:</b>		
Cash and balances with Central Bank .....	1,683	954
Loans and receivables .....	10,318	14,067
Financial assets held for trading .....	393	40
Financial assets designated at fair value through profit or loss .....	415	511
Other assets .....	53	1
<b>Total interest income</b>	<b>12,862</b>	<b>15,573</b>
<b>Interest expense:</b>		
Deposits from credit institutions and Central Bank .....	( 139)	( 154)
Deposits from customers .....	( 4,276)	( 5,588)
Borrowings .....	( 1,389)	( 1,978)
Subordinated loans .....	( 230)	( 223)
Other financial liabilities .....	( 93)	( 112)
Other interest expense .....	( 89)	( 45)
<b>Total interest expense</b>	<b>( 6,216)</b>	<b>( 8,100)</b>
<b>Net interest income</b>	<b>6,646</b>	<b>7,473</b>

### Net financial income

11. Net financial income is specified as follows:	2014	2013
	1.1-31.3	1.1-31.3
Net (loss) gain on financial instruments held for trading .....	( 93)	226
Net gain on financial instruments designated at fair value through P&L .....	956	655
<b>Net financial income</b>	<b>863</b>	<b>881</b>
12. Net gain (loss) on financial instruments designated at fair value through profit or loss is specified as follows:		
Shares .....	978	806
Bonds .....	( 22)	( 151)
<b>Net gain on financial instruments designated at fair value through P&amp;L</b>	<b>956</b>	<b>655</b>

## Notes to the Condensed Consolidated Financial Statements

### Net foreign exchange loss

13. Net foreign exchange loss is specified as follows:	2014 1.1-31.3	2013 1.1-31.3
<b>Assets:</b>		
Cash and balances with Central Bank .....	( 58)	( 66)
Financial assets held for trading .....	( 279)	2,246
Loans to credit institutions .....	( 813)	( 3,401)
Loans to customers .....	( 1,652)	( 6,735)
Other assets .....	( 14)	( 74)
<b>Total assets</b>	<b>( 2,816)</b>	<b>( 8,030)</b>
<b>Liabilities:</b>		
Deposits from credit institutions .....	81	109
Deposits from customers .....	1,626	4,437
Subordinated loan .....	453	1,436
Other liabilities .....	365	101
<b>Total liabilities</b>	<b>2,525</b>	<b>6,083</b>
<b>Unadjusted net foreign exchange loss</b>	<b>( 291)</b>	<b>( 1,947)</b>
Foreign exchange reversal on loans to customers with ISK cash flow (see Note 17) .....	-	384
<b>Net foreign exchange loss</b>	<b>( 291)</b>	<b>( 1,563)</b>

### Other net operating income

14. Other net operating income is specified as follows:	2014 1.1-31.3	2013 1.1-31.3
Service level agreement fees .....	71	79
Legal cost and fees .....	36	24
Rental income .....	31	58
Rental income on foreclosed mortgages .....	92	63
Other net operating income .....	883	188
<b>Other net operating income</b>	<b>1,113</b>	<b>412</b>

### Administrative expenses

15. Administrative expenses are specified as follows:	2014 1.1-31.3	2013 1.1-31.3
Salaries and related expenses .....	3,439	3,468
Other administrative expenses .....	2,273	2,523
Depreciation and amortisation .....	197	245
<b>Administrative expenses</b>	<b>5,909</b>	<b>6,236</b>

### Salaries and related expenses

16. Salaries and related expenses are specified as follows:	2014 1.1-31.3	2013 1.1-31.3
Salaries .....	2,660	2,645
Pension and similar expenses .....	382	361
Social security charges and financial activities tax .....	362	391
Other .....	35	71
<b>Salaries and related expenses</b>	<b>3,439</b>	<b>3,468</b>

## Notes to the Condensed Consolidated Financial Statements

### Loan impairment charges and net valuation changes

17. Loan impairment charges and net valuation changes:	2014	2013
	1.1-31.3	1.1-31.3
<b>Impairment charged to the income statement:</b>		
Specific impairment losses on financial assets .....	( 5)	( 878)
Impairment of foreign exchange loss .....	-	384
Net specific impairment losses on financial assets	( 5)	( 494)
Collective impairment .....	456	( 124)
Total impairment charged to the income statement (see note 25)	451	( 618)
<b>Net valuation changes on loans:</b>		
Income due to revised estimated future cash flow from loans .....	1,069	3,995
Net specific impairment losses on financial assets .....	( 5)	( 494)
Foreign exchange loss * .....	-	( 384)
<b>Net valuation changes on loans</b>	1,064	3,117
Collective impairment .....	456	( 124)
<b>Loan impairment charges and net valuation changes</b>	1,520	2,993

\* In 2013 foreign exchange gain on foreign currency loans to customers with revenue and cash flows in ISK was impaired and offset against total foreign exchange gain as per Note 13.

### Effective income tax rate

18. Income tax for the three month period ended 31 March 2014 is calculated at 20%. Special financial activities tax (FAT) is calculated as 6% of taxable profits above ISK 1 billion. The effective income tax rate in the Bank's income statement is 23.4% for the three months ended 31 March 2014. The difference is specified as follows:

	2014		2013	
	1.1-31.3		1.1-31.3	
Profit before tax.....	5,946		6,102	
Income tax calculated on the profit for the period.....	1,189	20.0%	1,220	20.0%
Special financial activities tax.....	244	4.1%	316	5.2%
Non-deductible expenses.....	147	2.4%	25	0.4%
Income not subject to tax .....	( 792)	(13.3%)	( 177)	(2.9%)
Correction in accordance with ruling on prior years' taxable income .....	-	0.0%	27	0.4%
Other differences.....	606	10.2%	37	0.6%
<b>Effective income tax</b>	1,394	23.4%	1,448	23.7%

### Earnings per share

19. Earnings per share are specified as follows:

	2014	2013
	1.1-31.3	1.1-31.3
Net profit of the equity holders of the parent, according to the statement of comprehensive income .....	8,219	4,600
Average outstanding shares:		
Weighted average number of outstanding shares for the period, million .....	10,000	10,000
<b>Average outstanding shares, million</b>	10,000	10,000
<b>Basic earnings per share</b>	0.82	0.46
<b>Diluted earnings per share</b>	0.82	0.46

## Notes to the Condensed Consolidated Financial Statements

### Cash and balances with Central Bank

20. Specification of cash and balances with Central Bank:

	31.3.2014	31.12.2013
Cash on hand .....	2,402	2,472
Balances with Central Bank other than mandatory reserve deposits .....	14,346	6,619
Certificates of deposit .....	111,291	99,085
<b>Included in cash and cash equivalents</b>	<b>128,039</b>	<b>108,176</b>
Mandatory reserve deposits with Central Bank .....	8,696	3,603
<b>Cash and balances with Central Bank</b>	<b>136,735</b>	<b>111,779</b>

The average balance of the Central bank current account for each month must be equivalent to at least mandatory reserve deposits, which amounted to ISK 8,696 million for March 2014 (December 2013: ISK 8,153 million).

Certificates of deposit (CDs) are a 28-day promissory notes issued by the Central Bank at fixed rates. The CD auction process is only for financial institutions with accounts at the Central Bank. The CDs may be used as collateral in collateralised lending transactions with the Central Bank.

### Derivative instruments and short positions

21. Derivative instruments and short positions:

#### At 31 March 2014

	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps .....	51	6,250	1,418	16,150
Cross currency interest rate swaps .....	899	32,255	70	10,489
Equity forwards .....	114	1,199	74	675
Foreign exchange forwards .....	76	3,882	0	151
Foreign exchange swaps .....	143	7,200	21	488
Bond forwards .....	45	2,829	4	996
Bond options .....	-	-	87	25,000
<b>Derivatives held for trading</b>	<b>1,328</b>	<b>53,615</b>	<b>1,674</b>	<b>53,949</b>
Short positions in listed bonds .....	-	-	7,132	-
<b>Total</b>	<b>1,328</b>	<b>53,615</b>	<b>8,806</b>	<b>53,949</b>

#### At 31 December 2013

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

## Notes to the Condensed Consolidated Financial Statements

### Loans

22. Loans to credit institutions:	31.3.2014	31.12.2013
Money market loans .....	19,430	13,821
Bank accounts .....	28,465	30,257
<b>Loans to credit institutions</b>	<b>47,895</b>	<b>44,078</b>

23. Loans to customers:	31.3.2014	31.12.2013
Loans to customers at amortised cost .....	565,952	554,741
<b>Loans to customers</b>	<b>565,952</b>	<b>554,741</b>

24. Loans to customers at amortised cost:

At 31 March 2014

	Gross amount	Specific impairment allowance	Loans less impairment allowance
Loans to customers:			
Individuals .....	261,807	( 7,180)	254,627
Commerce and services .....	78,535	( 3,880)	74,655
Construction .....	20,030	( 1,758)	18,272
Energy .....	3,578	-	3,578
Financial services .....	188	-	188
Industrial and transportation .....	51,915	( 1,513)	50,402
Investment companies .....	16,410	( 3,151)	13,259
Public sector and non-profit organisations .....	11,292	( 21)	11,271
Real estate .....	77,160	( 3,309)	73,851
Seafood .....	69,800	( 725)	69,075
Loans to customers before collective impairment allowance			569,178
Collective impairment allowance .....			( 3,226)
<b>Loans to customers</b>	<b>590,715</b>	<b>( 21,537)</b>	<b>565,952</b>

## Notes to the Condensed Consolidated Financial Statements

### 24. Cont'd

At 31 December 2013

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

### 25. Financial assets - impairments

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

	Individually assessed	Collectively assessed	Total
At 1 January 2014 .....	24,234	3,682	27,916
Amounts written-off .....	( 2,433)	-	( 2,433)
Recoveries of amounts previously written-off .....	537	-	537
Principal credit adjustment .....	( 806)	-	( 806)
Charged to the income statement .....	5	( 456)	( 451)
<b>At 31 March 2014</b>	<b>21,537</b>	<b>3,226</b>	<b>24,763</b>

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

	2014 1.1-31.3	2013 1.1-31.3
<b>Impairment charged to the income statement:</b>		
Loans to customers .....	( 451)	618
<b>Impairment charged to the income statement (see Note 17)</b>	<b>( 451)</b>	<b>618</b>

Individually assessed allowance comprises impairment for financial assets that are assessed individually and collectively assessed allowance comprises estimates of impairment losses that have been incurred but not identified in the reporting period for a group of loans that have similar credit risk characteristics (see Note 2.5).



# Notes to the Condensed Consolidated Financial Statements

## Investment in associates

	31.3.2014	31.12.2013
26. Changes in investments in associates:		
Investment in associates at the beginning of the year .....	1,563	503
Additions during the period .....	-	37
Transfers .....	-	1,020
Revaluation .....	(7)	-
Share of results .....	-	3
<b>Investments in associates at the end of the period</b>	<b>1,556</b>	<b>1,563</b>

## Investment in subsidiaries

27. Significant subsidiaries:

	Location	Owner-ship
Borgun hf., Ármúla 30, 108 Reykjavík .....	Iceland	62.2%
Íslandssjódir hf., Kirkjusandi 2, 105 Reykjavík .....	Iceland	100%
Midengi ehf., Lækjargötu 12, 155 Reykjavík .....	Iceland	100%
Hringur eignarhaldsfélag ehf., Digranesvegi 1, 200 Kópavogur .....	Iceland	100%
Allianz Ísland hf., Digranesvegi 1, 200 Kópavogur .....	Iceland	100%
D-1 ehf., Kirkjusandi 2, 105 Reykjavík .....	Iceland	100%
Geysir Green Investment Fund slhf., Hafnargötu 90, 230 Reykjanesbæ .....	Iceland	100%
Fergin ehf., Hesthálsi 6-8, 110 Reykjavík .....	Iceland	80%
Frumherji hf., Hesthálsi 6-8, 110 Reykjavík .....	Iceland	80%
29 other subsidiaries (SME) .....		

## Related party disclosures

28. Ultimate controlling party

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

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

Related party transactions

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

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

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

	31.3.2014			31.12.2013		
	Assets	Liabilities	Total	Assets	Liabilities	Total
CEO and Man. Directors (incl. Comp. owned by them) ...	171	(106)	65	178	(285)	(107)
Members of the Board (incl. Comp. owned by them) .....	471	(397)	74	462	(2,393)	(1,931)
Associated companies and other related parties .....	327	(4,410)	(4,083)	288	(3,824)	(3,536)
<b>Total</b>	<b>969</b>	<b>(4,913)</b>	<b>(3,944)</b>	<b>928</b>	<b>(6,502)</b>	<b>(5,574)</b>

	31.3.2014	31.12.2013
Guarantees .....	469	478
Loan commitments, overdraft and credit card commitments .....	304	124

There were no impairment allowances recognised in the period against balances outstanding with related parties (same period 2013: ISK 11 million).

No share option programmes were operated during the reporting period 1 January - 31 March 2014.

## Notes to the Condensed Consolidated Financial Statements

### Non-current assets and disposal groups held for sale

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

	31.3.2014	31.12.2013
Repossessed collateral .....	9,003	10,722
Assets of disposal groups classified as held for sale .....	15,113	36,384
<b>Total</b>	<b>24,116</b>	<b>47,106</b>
Repossessed collateral:		
Land and property .....	8,250	8,544
Industrial equipment and vehicles .....	76	34
Shares and equity instruments .....	677	2,144
<b>Total</b>	<b>9,003</b>	<b>10,722</b>
Assets of disposal groups classified as held for sale:		
Cash .....	530	535
Equity instruments .....	744	775
Properties and equipment .....	976	954
Receivables .....	253	785
Tax assets .....	77	225
Properties .....	2,016	13,001
Assets classified as held for sale .....	6,370	14,727
Other assets .....	4,147	5,382
<b>Total</b>	<b>15,113</b>	<b>36,384</b>
Liabilities associated with assets classified as held for sale:		
Payables .....	217	502
Deferred tax liabilities .....	118	644
Income tax payable .....	52	416
Borrowings .....	2,789	7,148
Other liabilities .....	271	746
<b>Total</b>	<b>3,447</b>	<b>9,456</b>

### Other assets

	31.3.2014	31.12.2013
30. Other assets are specified as follows:		
Receivables .....	2,963	4,816
Unsettled securities transactions .....	3,560	5,099
Accruals .....	805	731
Prepaid expenses .....	336	200
Other assets .....	699	313
<b>Other assets</b>	<b>8,363</b>	<b>11,159</b>

## Notes to the Condensed Consolidated Financial Statements

### Deposits from Central Bank and credit institutions

	31.3.2014	31.12.2013
31. Deposits from Central Bank and credit institutions are specified as follows:		
Repurchase agreements with Central Bank .....	32	63
Deposits from credit institutions .....	26,815	29,626
<b>Deposits from Central Bank and credit institutions</b>	<b>26,847</b>	<b>29,689</b>

### Deposits from customers

	31.3.2014	31.12.2013
32. Deposits from customers are specified by type as follows:		
Demand deposits .....	417,808	394,345
Time deposits .....	85,117	94,986
<b>Deposits from customers</b>	<b>502,925</b>	<b>489,331</b>

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

	31.3.2014		31.12.2013	
	Amount	% of total	Amount	% of total
Central government and state-owned enterprises.....	5,790	1%	5,086	1%
Municipalities.....	5,677	1%	4,193	1%
Companies.....	303,403	60%	292,792	60%
Individuals.....	188,055	38%	187,260	38%
<b>Deposits from customers</b>	<b>502,925</b>	<b>100%</b>	<b>489,331</b>	<b>100%</b>

### Debt issued and other borrowed funds

	31.3.2014	31.12.2013
34. Specification of debt issued and other borrowed funds:		
Non-listed issued bonds .....	44,570	46,758
Listed issued bonds .....	48,956	41,006
Loans from credit institutions .....	11	2
Other debt securities .....	1,498	1,427
<b>Debt issued and other borrowed funds</b>	<b>95,035</b>	<b>89,193</b>

## Notes to the Condensed Consolidated Financial Statements

### Other liabilities

35. Specification of other liabilities:	31.3.2014	31.12.2013
Accruals .....	3,368	3,163
Liabilities to retailers for credit card provision .....	19,850	20,563
Provision for effects of court rulings* .....	4,169	4,699
Provision for estimated losses from guarantees and others** .....	1,715	2,211
Capital gains tax .....	739	1,816
Unsettled securities transactions .....	4,976	840
Deferred income .....	193	206
Sundry liabilities .....	3,491	3,632
<b>Other liabilities</b>	<b>38,501</b>	<b>37,130</b>

	Provision for effects of court rulings*	Provision for estimated losses from guarantees and others**	Total
At 1 January 2014 .....	4,699	2,211	6,910
Provision used during the year .....	( 530)	-	( 530)
New provisions and reversed provisions during the year .....	-	( 496)	( 496)
<b>At 31 March 2014</b>	<b>4,169</b>	<b>1,715</b>	<b>5,884</b>

### Equity

36. Authorised share capital of the Bank is 10,000m ordinary shares of ISK 1 each. At 31.3.2014 paid up share capital totalled ISK 65,000m which is the total stated share capital of the Bank.

Total share capital:

	31.3.2014	31.12.2013
Ordinary share capital .....	10,000	10,000
Share premium account .....	55,000	55,000
<b>Total share capital</b>	<b>65,000</b>	<b>65,000</b>

### Balance of custody assets

37. Balance of custody assets:

	31.3.2014	31.12.2013
Custody assets .....	653,972	754,166

# Notes to the Condensed Consolidated Financial Statements

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## Contingencies

### 38. Litigation threats

Several former customers of Glitnir private banking services have threatened litigation against the Bank in order to claim compensation for alleged mistakes made by former employees of Glitnir. A few of those customers have already filed lawsuits against the Bank with the Reykjavík District Court. The Bank has not accepted liability and will challenge these lawsuits on the grounds that these claims relate to events that happened prior to the incorporation of the Bank and the assignment of related liabilities and assets and are therefore not the responsibility of the Bank. The District Court has now ruled in favour of the Bank in one of these cases stating that the Bank cannot be held responsible for a mistake made by a former employee of Glitnir. This ruling was not appealed. The Bank estimates the total amount of compensation liabilities currently claimed by customers of Glitnir to be ISK 5.5 billion.

#### Netting agreement

When certain assets and obligations were transferred from Glitnir to the Bank, the FME (Financial Supervisory Authority) ruled that customers would, upon liquidation of Glitnir, maintain their right to claim netting of assets and liabilities held by Glitnir prior to the Bank's acquisition.

The Bank made an agreement with Glitnir that the latter will compensate the Bank for any losses incurred as a result of netting of assets and liabilities. The claims in question are unlikely to affect either the net asset value or the earnings of the Bank.

Following the Bank's acquisition of Byr hf. the Bank may also be in the position of having to honour a clients' right to claim netting of assets and liabilities held by Byr sparisjóður, prior to the founding of Byr hf., as later acquired by the Bank. Arrangements, comparable to the agreement between the Bank and Glitnir, have been made between Byr sparisjóður and the Bank.

#### Allocation of liens, guarantees and comparable rights

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

The Bank should, however, be accountable to Glitnir for specific collateral of its customers, as applicable, due to claims and derivatives which were not transferred to the Bank. The Bank has, in accordance with this decision, transferred to Glitnir certain collateralised obligations of customers. One customer filed a lawsuit against the Bank with the Reykjavík District Court challenging the Bank's decision to transfer the customer's money market deposit to Glitnir which the Bank, in good faith, identified as collateral for a foreign exchange future contract. The claim was for approximately ISK 450 million. The District Court ruled in favour of the Bank and the ruling was confirmed by the Iceland Supreme Court after appeal. Any future allocation of collaterals will be made under an agreement with Glitnir, whereby Glitnir indemnifies the Bank against any future claims arising from the transfer of such rights.

#### Indexed loans

Two court cases have been filed against the Bank and Landsbankinn, challenging the legality of fixing the principal of a mortgage to the consumer price index (CPI). Such indexation has been the industry standard for at least 30 years. However, the method of calculating the index has changed over the years, with the most recent change introduced in 1995.

As far as the case against the Bank is concerned, it is based on the indexation being in violation of the EU directive 93/13/EU on unfair terms in consumer loan contracts. The directive does not prohibit the use of price indexation, mainly to the effect that the consumer is adequately informed about the method by which prices vary. Thus, the case does not challenge the indexation as such, but only the context in which it is deployed. It will not affect corporate customers. Being a directive that does not require full harmonisation, the directive was not adopted by Iceland in its entirety. Instead, the existing contract law was amended by adding 4 articles. In this context, the Supreme Court accepted the motion introduced by the plaintiff on seeking the opinion of the EFTA court on the implications of the differences between the directive and the local law. The case was heard on the 9 of April and the opinion is expected in the third quarter of this year. Icelandic courts will subsequently process the case (estimated late next year). Domestic courts are not obliged to follow an opinion of the EFTA court in any way.

The possible effect on the Bank has only been estimated on very broad terms, but clearly, any downgrading of the indexation would affect the Bank and other home mortgage lenders in Iceland.

The Landsbankinn case was based on the argument that CPI indexation makes a mortgage a complex financial instrument as defined in the Act on Securities Transactions no. 108/2007 (MiFid Directive) and therefore unsuitable for retail customers. However, the Supreme Court has recently sustained a motion previously mentioned on seeking the opinion of the EFTA court on several issues relating to the implementation of both the directive on consumer loans (90/88/EEC) and on unfair terms in consumer loan contracts. The court also commented on the MiFID argument stating that the loan instrument could not be categorised as a derivative. Thus the courts have more or less dismissed the original argument, making the case very similar to the one the Bank is defending.

## Notes to the Condensed Consolidated Financial Statements

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### 38. Cont'd

The Consumer Agency (the "Agency") has published its decision on a matter regarding the terms of, and information relating to the granting of, a consumer price indexed ("CPI Indexed") mortgage by Íslandsbanki in 2005. A year after the loan was granted it was taken over by the person bringing the matter before the Agency. Although the Agency considers the granting of CPI Indexed mortgages to be legal, it found that the procedures applied by Íslandsbanki, and its predecessor, in calculating the annual percentage rate of charge (APRC) in the payment plan to be in breach of Article 12 of Act no. 121/1994 on Consumer Credit, as well as Article 6 of the same Act and moreover Article 5 of Act no. 57/2005, on the surveillance of unfair business practices and market transparency. The Agency believed the breach to have occurred as the calculation of the APRC assumed that the CPI would remain unchanged until the end of the contract.

Íslandsbanki disagrees with the Agency's decision on this point. According to Article 12 of the Consumer Credit Act, such an assumption is permissible in the case of loans with variable interest rates, and states that the annual percentage rate of charge shall be calculated on the assumption that the price level, interest rate and other charges will remain unchanged until the end of the credit agreement. Before the enactment of the new Act on Consumer Credit in 2013, Íslandsbanki's procedures in these instances were based on the interpretation of the words "remain unchanged", in Article 12 of the Act on Consumer Credit, meaning that an unaltered consumer price index should be assumed. A quick survey of the market showed that all major lenders applied the same method. The Agency has taken the Article's wording to mean that the same level of inflation as in the month at the time of the granting of the loan should be assumed. The bank disagrees with the Agency's decision in this respect. Act No. 121/1994 on Consumer Credit has been replaced with Act no. 33/2013 as of 1 November 2013. The procedure in question has been upgraded. Íslandsbanki has appealed the Agency's decision to the Consumer Appeals Committee. A final decision is expected late in the summer of 2014, but recent court judgements seem to agree with the opinion of the lenders. The ruling of the Consumers Appeals Committee can be referred to the courts.

#### **Foreign currency loans**

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

The effects of these rulings and the subsequent corrections to the recalculations of illegal foreign currency-linked loans are reflected in the value of the loans in the Bank's consolidated financial statements. The amount owed to customers with regards to paid-up loans is reflected in the Bank's provisions, see Note 35.

The court rulings combined have effectively reduced the uncertainty regarding which foreign currency loans are illegal and how they should be recalculated. The Bank made an announcement to the effect that it would recalculate illegally foreign currency-linked loans, outstanding as well as paid-up loans, in line with the instructions given by the rulings. This process is in its final stages. However, the rulings are based on the Bank being the dominant and expert party in the contractual relationship. Another ruling dictates that former rulings do not necessarily apply to other financial institutions or large companies as counterparties, especially if those conduct their business in part abroad or deal in foreign currency contracts on a regular basis. Moreover, the Supreme Court found in favour of a bank in a case in which a customer did not pay instalments on a regular basis and deviated significantly from the original payment schedule. Consequently, the Bank revised its categorisation on which loans should be recalculated. The result did only slightly differ from the previous categorisation.

The uncertainty that still exists is more or less embedded in two court cases in which the plaintiffs contest the legality of three corporate Glitnir/Íslandsbanki loan contracts. Although such contracts are not great in numbers, they carry the greatest sums. Thus, the value of the precedent is significant (approx. 3-5 billion ISK in the two cases). The Bank argues that the contracts differ from those previously ruled on by way of the method by which the loan was disbursed. If the contract says that the debtor can explicitly request payment in any currency and the contract is fulfilled in that manner, the maximum contract amount can be presented in ISK without offsetting the foreign currency loan validity of the contract. The judicial process has been interrupted by the district court judge on the grounds that the Supreme Court was trying a similar case, making it a precedent. The latter court has now passed a judgement on that case in favour of the lender. Due to procedural rules, the Bank's cases must be heard again on 13 and 15 May which means a ruling can be expected three weeks later. A final judgement on these cases is expected from the Supreme Court in the fourth quarter of 2014 (if appealed).

#### **Settlement of the 2011 Byr acquisition**

The Bank acquired Byr (a former Savings Bank) in 2011 from the Bank's Winding-up Committee (the "Committee") and the Icelandic Ministry of Finance and Economic Affairs (the "Ministry"). According to standard practice, the Bank retained the right to re-evaluate the value of the assets acquired and subsequently to demand a refund if the assets did not live up to expectations. A claim was filed with the Committee in June 2013 amounting to ISK 6,943 million plus interest. The claim is filed as a priority claim, according to Article 110 of Law 21/1991, to be set off against the bond the Bank owes Byr amounting to ISK 5,834 million (due in November 2014 and 2015). The Committee rejected the claim with a letter dated 30 September. It was decided at a creditors meeting in December 2013 that the Committee would refer the dispute to the District Court of Reykjavík. A formal claim amounting to ISK 911 million plus interest was filed with the Ministry on 24 September. The claim on the Ministry has been filed with the District Court of Reykjavík and the claim on the Committee will be filed with the District Court of Reykjavík in May 2014. Furthermore, a request for court appointed evaluators for a formal evaluation of the Bank's claim has been filed with the District Court. Any possible revenues relating to this claim have as yet not been incorporated into the Bank's financial statements.

## Notes to the Condensed Consolidated Financial Statements

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38. Cont'd

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

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

The ICA has requested and received information from Íslandsbanki and have, following their review, sent the Bank an opposition document. It is alleged that the Bank has violated Articles 10, 11 and 12 of the Competition Act, i.e. Act no. 44/2005 and Articles 53 and 54 of the EEA Agreement. The ICA considers the violations to be extensive, to have been in existence for a considerable period of time and to concern important markets. The opposition document is one stage in the processing of the case and does not comprise a final administrative decision.

The Bank has presented its observations on the opposition document and will further cooperate with the ICA to resolve the case. However, should the ICA's findings be final, significant sanctions may come into consideration, as per Article 37 of the Competition Act. The Bank has made appropriate provision for the ICA's sanctions as a result of the alleged violations of the Competition Act.

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

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

The Icelandic authorities are requested to submit all information and relevant observations to ESA, in order to determine whether or not the measures complained of involve state aid in the meaning of Article 61 of the EEA Agreement or qualify for an exemption under Article 61(2) or (3) of the EEA Agreement.

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

The possible effect on the bank, should ESA decide that the measures constitute unlawful state aid, has not been determined. At present, no timeframe has been given as to when the Icelandic authorities may expect ESA's decision.

### **The Depositors' and Investors' Guarantee Fund**

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

## Events after the end of the reporting period

39. No events have arisen after the reporting period that require amendments or additional disclosures in the condensed consolidated interim financial statements for the three months ended 31 March 2014.

# Notes to the Condensed Consolidated Financial Statements

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## Risk Management

### 40. Risk governance

The Bank is exposed to various risks and managing these risks is an integral part of the Bank's operations. More information about the Bank's risk management and risk assessment processes is available in the Risk Report 2013. The English and Icelandic versions are available at the Bank's homepage under investor relations: [www.islandsbanki.is/ir](http://www.islandsbanki.is/ir).

## Credit risk

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

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

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

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

### 42. Maximum credit exposure

The Bank's credit risk exposure comprises both on-balance sheet and off-balance sheet items. Maximum exposure to credit risk for on-balance sheet assets is the net carrying amount as reported in the statement of financial position before the collective impairment allowance is subtracted, see note 24. The maximum exposure for off-balance sheet items is the amount that the Bank might have to pay out against financial guarantees and loan commitments, less provisions the Bank has made because of these items. The maximum credit exposure for a derivative contract is calculated by adding future credit exposure to the market value of the contract as described in Annex III of the European Parliament directive 2006/48/EC (Basel II).

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

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



## Notes to the Condensed Consolidated Financial Statements

### Credit risk exposure

42. Cont'd

Maximum credit exposure 31.3.2014

	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrials and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	136,735	-	-	-	-	-	-	-	-	-	136,735
Derivatives	19	1,424	61	-	623	617	111	52	-	41	96	3,044
Bonds and debt instruments	-	68,655	101	-	54	5,744	-	928	349	334	-	76,165
Loans to credit institutions	-	-	-	-	-	47,895	-	-	-	-	-	47,895
Loans to customers:	254,627	-	74,655	18,272	3,578	188	50,402	13,259	11,271	73,851	69,075	569,178
Overdrafts	14,619	-	9,217	3,836	1	171	4,977	352	1,720	2,513	2,089	39,495
Credit cards	13,647	-	1,237	141	6	17	393	32	167	50	42	15,732
Mortgages	178,968	-	-	-	-	-	-	-	-	-	-	178,968
Leases	9,507	-	14,791	2,467	8	-	5,488	215	285	1,278	238	34,277
Other loans	37,886	-	49,410	11,828	3,563	-	39,544	12,660	9,099	70,010	66,706	300,706
Off-balance sheet items:												
Financial guarantees	1,480	-	2,205	2,059	-	1,500	1,459	24	36	162	627	9,552
Undrawn loan commitments	-	-	328	1,135	9,002	-	2,932	-	-	5,691	1,276	20,364
Undrawn overdraft	8,610	-	6,267	1,198	222	1,853	2,329	166	1,413	670	1,456	24,184
Credit card commitments	24,593	-	3,269	448	28	73	835	118	874	163	139	30,540
<b>Total maximum credit exposure</b>	<b>289,329</b>	<b>206,814</b>	<b>86,886</b>	<b>23,112</b>	<b>13,507</b>	<b>57,870</b>	<b>58,068</b>	<b>14,547</b>	<b>13,943</b>	<b>80,912</b>	<b>72,669</b>	<b>917,657</b>

## Notes to the Condensed Consolidated Financial Statements

### 42. Cont'd

Maximum exposure 31.12.2013

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

## Notes to the Condensed Consolidated Financial Statements

### 43. Credit exposure covered by collateral

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

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

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

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

#### At 31 March 2014

	Real estate	Fishing vessels	Cash & securities	Vehicles & equipment	Other collateral	Credit exposure covered by collateral
Derivatives .....	-	-	1,936	-	-	1,936
Loans and commitments to customers:	339,402	60,013	7,330	29,065	17,703	453,513
Individuals .....	204,817	30	906	8,514	5	214,272
Commerce and services .....	36,739	218	1,136	11,717	7,287	57,097
Construction .....	9,237	132	107	3,921	1,419	14,816
Energy .....	2,871	-	457	-	117	3,445
Financial services .....	4	-	-	-	-	4
Industrial and transportation .....	19,743	-	100	4,384	5,888	30,115
Investment companies .....	4,221	-	3,333	42	204	7,800
Public sector and non-profit organisations .....	1,485	2	8	159	-	1,654
Real estate .....	55,451	24	472	123	50	56,120
Seafood .....	4,834	59,607	811	205	2,733	68,190
<b>Total</b>	<b>339,402</b>	<b>60,013</b>	<b>9,266</b>	<b>29,065</b>	<b>17,703</b>	<b>455,449</b>

#### At 31 December 2013

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

## Notes to the Condensed Consolidated Financial Statements

### 44. Credit quality of financial assets

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

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

#### At 31 March 2014

	Neither past due nor impaired	Past due but not impaired	Classified as impaired	Total carrying amount
Cash and balances with Central Bank.....	136,735	-	-	136,735
Derivatives .....	3,044	-	-	3,044
Bonds and debt instruments .....	76,165	-	-	76,165
Loans to credit institutions .....	47,895	-	-	47,895
Loans to customers:	500,111	38,531	30,536	569,178
Individuals .....	221,232	25,070	8,325	254,627
Commerce and services .....	62,328	4,993	7,334	74,655
Construction .....	15,976	1,501	795	18,272
Energy .....	3,578	-	-	3,578
Financial services .....	185	3	-	188
Industrial and transportation.....	47,108	1,364	1,930	50,402
Investment companies .....	12,377	363	519	13,259
Public sector and non-profit organisations .....	11,072	181	18	11,271
Real estate .....	61,540	2,877	9,434	73,851
Seafood .....	64,715	2,179	2,181	69,075
<b>Total</b>	<b>763,950</b>	<b>38,531</b>	<b>30,536</b>	<b>833,017</b>

#### At 31 December 2013

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

## Notes to the Condensed Consolidated Financial Statements

### 45. Neither past due nor impaired loans

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

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

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

The table below shows loans that are neither past due nor impaired aggregated in five customer groups based on the default probability. Group 1-4 represents low risk, group 5-6 moderate risk, group 7-8 increased risk, risk class 9 high risk, and risk class 10 represents customers in default.

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

#### At 31 March 2014

	Risk class 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Unrated	Total
Loans to customers							
Individuals.....	8,679	79,689	80,579	42,092	7,176	3,017	221,232
Commerce and services.....	13,422	14,780	27,111	2,731	1,789	2,495	62,328
Construction.....	-	3,535	11,257	595	370	219	15,976
Energy.....	2,143	1,414	21	-	-	-	3,578
Financial services.....	157	4	14	7	-	3	185
Industrial and transportation.....	19,479	17,173	8,293	1,045	438	680	47,108
Investment companies.....	652	5,726	3,555	989	205	1,250	12,377
Public sector and non-profit organisations.....	5,822	4,006	796	94	5	349	11,072
Real estate.....	125	35,300	11,916	1,484	8,005	4,710	61,540
Seafood.....	27,027	22,742	10,577	1,147	1,252	1,970	64,715
<b>Total</b>	<b>77,506</b>	<b>184,369</b>	<b>154,119</b>	<b>50,184</b>	<b>19,240</b>	<b>14,693</b>	<b>500,111</b>

#### At 31 December 2013

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

## Notes to the Condensed Consolidated Financial Statements

### 46. Restructuring and forbearance

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

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

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

### 47. Past due but not impaired loans

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

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

#### At 31 March 2014

	Past due 4-30 days	Past due 31-60 days	Past due 61-90 days	Past due more than 90 days	Total past due loans
Loans to customers:					
Individuals .....	9,514	4,473	2,019	9,064	25,070
Commerce and services .....	2,281	1,584	272	856	4,993
Construction .....	500	460	137	404	1,501
Energy .....	-	-	-	-	-
Financial services .....	-	3	-	-	3
Industrial and transportation .....	353	386	48	577	1,364
Investment companies .....	150	51	33	129	363
Public sector and non-profit organisations .....	173	7	-	1	181
Real estate .....	1,512	472	178	715	2,877
Seafood .....	490	34	126	1,529	2,179
<b>Total</b>	<b>14,973</b>	<b>7,470</b>	<b>2,813</b>	<b>13,275</b>	<b>38,531</b>

#### At 31 December 2013

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

## Notes to the Condensed Consolidated Financial Statements

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### 48. Large exposure disclosure

When the Bank's total exposure to a group of connected clients is 10% or higher of the Bank's capital base it is considered a large exposure. Both on-balance sheet and off-balance sheet items from all types of financial instruments are included in the exposure as defined by FME rules 625/2013. The Bank has internal criteria that define connections between clients. These criteria reflect the Bank's interpretation of Article (1)(a) of law 161/2002 on Financial Undertakings, where groups of connected clients are defined. In line with the law, the capital base from 31 December 2013 is used.

The exposure is evaluated both gross and net of credit risk mitigating effects eligible according to the FME rules. Net of mitigating effects, the Bank has currently no large exposure above 10% of its capital base. In particular, no large exposure is above the maximum 25% single large exposure limit set by the law.

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

	31.3.2014	
<b>Client groups</b>	Gross	Net
Group 1 .....	92%	0%

	31.12.2013	
<b>Client groups</b>	Gross	Net
Group 1 .....	78%	0%

# Notes to the Condensed Consolidated Financial Statements

## Liquidity Risk

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

### Liquidity risk management

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

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

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

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

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

In the table below the total amount for loans to customers is shown before latent impairment allowance and is therefore higher than the total amount shown in the financial statement.

### Maturity analysis 31 March 2014

	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Financial liabilities</b>							
Short positions .....	-	126	688	7,167	824	-	8,805
Deposits from Central Bank .....	32	-	-	-	-	-	32
Deposits from credit institutions .....	22,910	3,599	310	-	-	-	26,819
Deposits from customers .....	347,910	67,785	49,477	23,782	29,406	-	518,360
Debt issued and other borrowed funds .....	11	6,467	15,386	72,878	15,269	-	110,011
Subordinated loans .....	-	-	719	6,210	23,541	-	30,470
Other financial liabilities .....	35,294	3,752	9,112	1,772	-	-	49,930
<b>Total financial liabilities</b>	<b>406,157</b>	<b>81,729</b>	<b>75,692</b>	<b>111,809</b>	<b>69,040</b>	<b>-</b>	<b>744,427</b>

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

	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Off-balance sheet liabilities</b>							
Financial guarantees .....	9,552	-	-	-	-	-	9,552
Undrawn loan commitments .....	20,364	-	-	-	-	-	20,364
Undrawn overdrafts .....	24,184	-	-	-	-	-	24,184
Credit card commitments .....	30,540	-	-	-	-	-	30,540
<b>Total</b>	<b>84,640</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>84,640</b>

### Total non-derivative financial liabilities

and off-balance sheet liabilities .....	490,797	81,729	75,692	111,809	69,040	0	829,067
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The table below shows the contractual cash flow of the Bank's derivative liabilities, i.e. derivatives that have a negative carrying amount at the date of reporting. Derivatives with a positive carrying amount are detailed separately. For derivatives settled on a gross basis, the cash flow for both legs of the derivative is shown, since netting cannot be applied upon settlement.



## Notes to the Condensed Consolidated Financial Statements

49. Cont'd

<b>Derivative financial liabilities</b>	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
<b>Gross settled derivatives</b>							
Inflow .....	-	618	907	74,751	-	-	76,276
Outflow .....	-	( 639)	( 718)	( 78,724)	-	-	( 80,081)
Total	-	( 21)	189	( 3,973)	-	-	( 3,805)
Net settled derivatives .....	-	( 78)	-	-	-	-	( 78)
<b>Total</b>	-	( 99)	189	( 3,973)	-	-	( 3,883)

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

<b>Financial assets</b>	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Cash and balances with Central Bank .....	25,445	111,290	-	-	-	-	136,735
Bonds and debt instruments .....	-	34,933	2,501	34,581	4,150	-	76,165
Shares and equity instruments .....	-	-	9	250	10,515	1,021	11,795
Loans to credit institutions .....	27,585	20,147	163	-	-	-	47,895
Loans to customers .....	6,981	70,194	44,130	157,319	290,554	-	569,178
Other financial assets .....	4,626	1,061	79	87	-	2,995	8,848
<b>Total financial assets</b>	64,637	237,625	46,882	192,237	305,219	4,016	850,616

### Derivative financial assets

<b>Gross settled derivatives</b>	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Inflow .....	-	8,135	3,363	19,778	2,548	-	33,824
Outflow .....	-	( 7,963)	( 3,227)	( 19,213)	( 2,828)	-	( 33,231)
Total	-	172	136	565	( 280)	-	593
Net settled derivatives	-	160	-	-	-	-	160
<b>Total</b>	-	332	136	565	( 280)	-	753

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

### Maturity analysis 31 December 2013

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

## Notes to the Condensed Consolidated Financial Statements

49. Cont'd

<b>Off-balance sheet liabilities</b>	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees .....	9,574	-	-	-	-	-	9,574
Undrawn loan commitments .....	19,401	-	-	-	-	-	19,401
Undrawn overdrafts .....	23,671	-	-	-	-	-	23,671
Credit card commitments .....	28,487	-	-	-	-	-	28,487
<b>Total</b>	<b>81,133</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>81,133</b>

Total non-derivative financial liabilities and off-balance sheet liabilities ..... 497,392 61,361 79,031 89,780 82,819 - 810,383

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

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

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

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

<b>Composition and amount of liquidity back-up</b>	31.3.2014	31.12.2013
Cash and balances with Central Bank .....	136,735	111,779
Domestic bonds eligible as collateral against borrowing at Central Bank .....	23,996	20,873
Foreign government bonds .....	36,176	34,618
Short-term placements with credit institutions .....	42,214	41,192
<b>Composition and amount of liquidity back-up</b>	<b>239,121</b>	<b>208,462</b>

# Notes to the Condensed Consolidated Financial Statements

## Market risk

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

### Market risk management

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

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

## Interest rate risk

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

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

52. Interest rate risk in trading portfolios

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

Note that in the table below the total market value of long and short positions may not be exactly the same as reported in note 6. The reason for this difference is that Note 6 sums up the net positions in each security while the table below ignores both netting of long and short positions in specific securities between different portfolios and hedge positions against derivative contracts.

Trading bonds and debt instruments, long positions	31.3.2014			31.12.2013		
	MV	Duration	BPV	MV	Duration	BPV
Indexed .....	4,288	7.39	(3.17)	3,282	7.41	(2.43)
Non-indexed .....	37,311	0.20	(0.76)	35,848	0.32	(1.13)
<b>Total</b>	<b>41,599</b>	<b>0.94</b>	<b>(3.93)</b>	<b>39,130</b>	<b>0.91</b>	<b>(3.56)</b>

  

Trading bonds and debt instruments, short positions	31.3.2014			31.12.2013		
	MV	Duration	BPV	MV	Duration	BPV
Indexed .....	-	-	-	291	6.39	0.19
Non-indexed .....	4,516	1.44	0.65	2,878	2.23	0.64
<b>Total</b>	<b>4,516</b>	<b>1.44</b>	<b>0.65</b>	<b>3,169</b>	<b>2.61</b>	<b>0.83</b>

  

<b>Net position of trading bonds and debt instruments</b>	<b>37,083</b>	<b>0.88</b>	<b>(3.28)</b>	<b>35,961</b>	<b>0.76</b>	<b>(2.73)</b>
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## Notes to the Condensed Consolidated Financial Statements

### 53. Interest rate risk in the banking book

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

The Bank holds a government bond designated at fair value amounting to ISK 30.6 billion (31 December 2013: ISK 30.8 billion). The bond pays floating rates and carries relatively low interest rate risk.

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

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

Banking book interest rate adjustment periods on 31 March 2014

	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
<b>Assets</b>							
Cash and balances with Central Bank .....	136,735	-	-	-	-	-	136,735
Bonds and debt instruments .....	30,654	645	10	1,287	278	367	33,241
Loans to credit institutions .....	47,732	163	-	-	-	-	47,895
Loans to customers .....	422,287	48,840	45,766	38,990	1,374	11,921	569,178
<b>Total assets</b>	<b>637,408</b>	<b>49,648</b>	<b>45,776</b>	<b>40,277</b>	<b>1,652</b>	<b>12,288</b>	<b>787,049</b>
Off-balance sheet items.....	19,197	40,105	942	4,501	-	-	64,745
<b>Liabilities</b>							
Short positions .....	-	200	-	852	-	-	1,052
Deposits from Central Bank .....	32	-	-	-	-	-	32
Deposits from credit institutions .....	26,517	298	-	-	-	-	26,815
Deposits from customers .....	490,566	2,151	-	2,924	7,284	-	502,925
Debt issued and other borrowed funds .....	25,247	4,302	3,187	52,650	9,649	-	95,035
Subordinated loans .....	21,437	-	-	-	-	-	21,437
<b>Total liabilities</b>	<b>563,799</b>	<b>6,951</b>	<b>3,187</b>	<b>56,426</b>	<b>16,933</b>	<b>-</b>	<b>647,296</b>
Off-balance sheet items .....	25,787	28,312	4,156	6,895	498	498	66,146
<b>Net interest gap on 31 March 2014</b>	<b>67,019</b>	<b>54,490</b>	<b>39,375</b>	<b>( 18,543)</b>	<b>( 15,779)</b>	<b>11,790</b>	<b>138,352</b>

## Notes to the Condensed Consolidated Financial Statements

### 53. Cont'd

Banking book interest rate adjustment periods 31 December 2013

	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
<b>Assets</b>							
Balances with Central Bank.....	111,779	-	-	-	-	-	111,779
Bonds and debt instruments .....	31,302	632	20	1,275	154	493	33,876
Loans to credit institutions .....	43,917	161	-	-	-	-	44,078
Loans to customers .....	397,719	46,565	57,552	38,803	1,586	12,516	554,741
<b>Total assets</b>	<b>584,717</b>	<b>47,358</b>	<b>57,572</b>	<b>40,078</b>	<b>1,740</b>	<b>13,009</b>	<b>744,474</b>
Off-balance sheet items .....	19,191	30,980	1,001	4,733	-	-	55,905
<b>Liabilities</b>							
Short positions .....	2,439	399	-	832	-	-	3,670
Deposits from Central Bank .....	63	-	-	-	-	-	63
Deposits from credit institutions .....	29,225	401	-	-	-	-	29,626
Deposits from customers .....	476,312	2,944	-	2,885	7,190	-	489,331
Debt issued and other borrowed funds .....	20,518	4,369	2,450	45,263	7,208	9,386	89,194
Subordinated loans .....	21,890	-	-	-	-	-	21,890
<b>Total liabilities</b>	<b>550,447</b>	<b>8,113</b>	<b>2,450</b>	<b>48,980</b>	<b>14,398</b>	<b>9,386</b>	<b>633,774</b>
Off-balance sheet items .....	20,046	23,638	5,338	8,195	-	-	57,217
<b>Net interest gap on 31 December 2013</b>	<b>33,415</b>	<b>46,587</b>	<b>50,785</b>	<b>( 12,364)</b>	<b>( 12,658)</b>	<b>3,623</b>	<b>109,388</b>

## Notes to the Condensed Consolidated Financial Statements

### Currency risk

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

The off-balance sheet amounts below represent the notional amounts of derivatives and unsettled spot agreements. The tables below summarise the Bank's exposure to currency risk at 31 March 2014 and 31 December 2013, based on contractual currencies, off-balance sheet items, but excluding assets categorised as held-for-sale.

#### Currency analysis 31 March 2014

<b>Assets</b>	EUR	USD	GBP	CHF	JPY	Other	Total
Cash and balances with Central Bank.....	348	207	91	24	13	237	920
Bonds and debt instruments.....	5,439	17,523	1,875	-	-	11,958	36,795
Shares and equity instruments.....	283	253	11	1	-	-	548
Loans to credit institutions.....	10,529	22,795	1,808	286	1,649	3,952	41,019
Loans to customers.....	57,128	12,298	4,526	6,213	7,045	7,402	94,612
Other assets.....	372	1,512	151	-	28	73	2,136
<b>Total assets</b>	<b>74,099</b>	<b>54,588</b>	<b>8,462</b>	<b>6,524</b>	<b>8,735</b>	<b>23,622</b>	<b>176,030</b>
<b>Liabilities</b>							
Deposits from credit institutions .....	113	51	2	-	13	-	179
Deposits from customers .....	40,451	24,876	5,104	1,641	1,210	9,483	82,765
Debt issued and other borrowed funds .....	9	-	-	-	-	14,006	14,015
Subordinated loans .....	21,463	-	-	-	-	-	21,463
Other liabilities.....	2,227	5,907	751	1	45	221	9,152
<b>Total liabilities</b>	<b>64,263</b>	<b>30,834</b>	<b>5,857</b>	<b>1,642</b>	<b>1,268</b>	<b>23,710</b>	<b>127,574</b>
On-balance sheet imbalance	9,836	23,754	2,605	4,882	7,467	( 88)	48,456
<b>Off balance sheet items</b>							
Off-balance sheet assets .....	12,398	14,131	647	-	677	10,991	38,844
Off-balance sheet liabilities .....	12,636	34,699	797	4,460	7,320	3,087	62,999
Net off-balance sheet items	( 238)	( 20,568)	( 150)	( 4,460)	( 6,643)	7,904	( 24,155)
Net currency imbalance							
on 31 March 2014.....	9,598	3,186	2,455	422	824	7,816	24,301

## Notes to the Condensed Consolidated Financial Statements

54. Cont'd

### Currency analysis 31 December 2013

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

## Derivatives

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

## Inflation risk

56. The Bank is exposed to inflation risk since the value of CPI-indexed assets exceeds CPI-indexed liabilities. The value of these assets and liabilities changes according to changes in the CPI at any given time and all changes in the CPI index affect profit and loss. On 31 March 2014 the CPI gap amounted to ISK 4.6 billion (31 December 2013: ISK 6.4 billion). Thus, a 1% increase in the index would lead to an ISK 46 million increase in the balance sheet and a 1% decrease would lead to a corresponding decrease, other risk factors held constant.

# Notes to the Condensed Consolidated Financial Statements

## Capital management

### 57. Risk exposure and capital base

The table below shows the capital base, risk weighted assets and the resulting capital ratios of the Bank at 31 March 2014 and 31 December 2013. In addition, the table shows the official capital ratios based on audited own fund items at 31 December 2013.

According to the Act on Financial Undertakings no. 161/2002 the official capital ratio of the Bank shall be based on audited own funds. Since the interim accounts for the first three months of the year are not audited, the official capital ratio is based on audited own fund items at 31 December 2013 and risk weighted assets at 31 March 2014. The official capital ratio at 31 March 2014 was 29.1% and the Tier 1 ratio was 25.7%.

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

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

	31.3.2014	31.12.2013
<b>Tier 1 capital</b>		
Ordinary share capital .....	10,000	10,000
Share premium .....	55,000	55,000
Other reserves .....	2,327	2,471
Retained earnings .....	106,767	98,548
Non-controlling interests .....	1,279	1,299
Tax assets .....	( 1,155)	( 1,275)
Intangible assets .....	( 292)	( 299)
Other regulatory adjustments .....	( 160)	( 159)
<b>Total Tier 1 capital</b>	<b>173,766</b>	<b>165,585</b>
<b>Tier 2 capital</b>		
Other regulatory adjustments .....	( 160)	( 160)
Qualifying subordinated liabilities .....	21,437	21,890
<b>Total regulatory capital</b>	<b>195,043</b>	<b>187,315</b>
<b>Risk weighted assets</b>		
- due to credit risk .....	533,186	551,938
- due to market risk: .....	32,278	28,849
Market risk, trading book .....	7,950	5,105
Currency risk foreign exchange .....	24,328	23,744
- due to operational risk .....	78,970	78,970
<b>Total risk weighted assets</b>	<b>644,434</b>	<b>659,757</b>
<b>Capital ratios</b>		
Tier 1 ratio .....	27.0%	25.1%
Total capital ratio .....	30.3%	28.4%
Official Tier 1 ratio.....	25.7%	25.1%
Official capital ratio.....	29.1%	28.4%