Íslandsbanki

CONSOLIDATED INTERIM FINANCIAL STATEMENTS **1Q2016**

HIGHLIGHTS

- Profit after tax was ISK 3.5bn in 1Q16 compared to ISK 5.4bn in 1Q15. The difference is mainly due to higher income from the irregular line items net loan impairment and net financial income in 1Q15.
- Return on equity was 6.9% in 1Q16, compared to 11.8% in 1Q15.
- Earnings from regular operations was 3,6bn, compared to 4,4bn in 1Q15. Return on equity from regular operations on 14% CET1 was 10.1% in 1Q16 compared to 15.0% in 1Q15.
- Net interest income amounted to ISK 7.5bn in 1Q16 (1Q15 ISK 6.2bn) up 22%. The net interest margin was 2.9% in 1Q16 (1Q15: 2.7%).
- Net fee and commission income was ISK 3.1bn in 1Q16 (1Q15 2.9bn), a 8.3% year on year increase; thereof 2.6% was achieved in the parent company.
- Cost to income ratio was 58.3% in 1Q16 (1Q15: 55.3%). The cost to income ratio excludes the Bank tax and one-off cost items.
- Loans to customers grew by 1.7% in the first quarter to 677.1bn. The increase is well diversified across various lending divisions.
- Total assets amounted to ISK 1,021bn (Dec15: ISK 1,046bn).
- Deposits from customers decreased by 8.2% in the quarter to ISK 544bn, which was in line with expectations due to the old estates' composition agreements and pay-out of stability contributions.
- The Bank issued one successful foreign denominated bond transaction during the period, a USD 35m private placement.
- Total capital ratio remains strong at 29.7% (Dec15: 30.1%) and CET1 ratio was 28.1% (Dec15: 28.3%).
- The liquidity position is strong and exceeds internal and external requirements. At March 2016, the Bank's liquidity coverage ratio (LCR) was 154% (Dec15: 143%) and the total FX net stable funding ratio (NSFR) was 118% (Dec15: 120%).
- Leverage ratio was at 18.7% at the end of March compared to 18.1% at year-end, indicating a moderate leverage.
- Ratio of loans more than 90 days past due and impaired was 2.1% (Dec15: 2.2%).
- S&P placed the Bank´s BBB-/A-3 rating on positive outlook in January 2016, and Fitch affirmed a BBB-/F3 rating with a stable outlook in April. Íslandsbanki is the only Icelandic bank to have investment grade ratings from both S&P and Fitch.

Birna Einarsdóttir, Chief Executive Officer at Íslandsbanki:

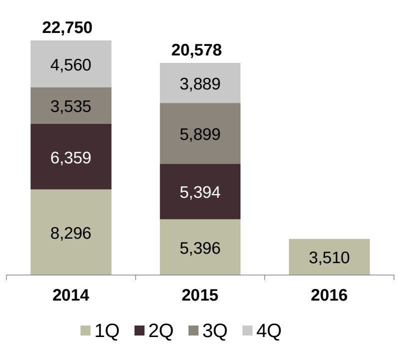
The year has begun well for Íslandsbanki, and earnings are in line with management's expectations. We see growth in net interest income and in net fee and commission income. The Bank's loan book has grown by 2 percent quarter-on-quarter. Its liquidity position is very strong, and the Bank is therefore well prepared to participate in a wide range of projects. Core operations remain strong, and efforts to simplify and strengthen the Bank's product offerings have borne fruit. Wage costs have risen in the wake of collective bargaining agreements, as they have for other companies, and are in line with the wage index.

The Bank recently announced the cancellation of borrowing fees for first-time homebuyers, in an effort to meet the needs of this rapidly growing group. At the same time, the Bank rolled out a new online credit assessment process that enables applicants to sign their applications electronically. This is part of Íslandsbanki's move towards fuller digitisation, in line with our goal of simplifying the mortgage lending process for our customers and strengthening the service we provide.

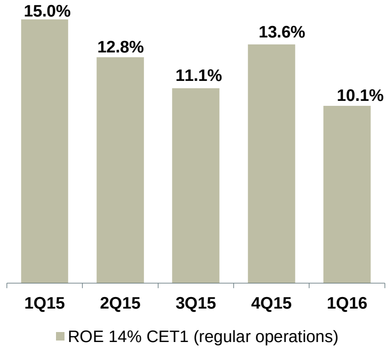
At the beginning of 2016, Íslandsbanki issued a USD 35m bond on favourable terms, after the outlook on the Bank's S&P credit rating was changed from stable to positive. The Bank has also been an active issuer of bills and covered bonds in the domestic market during the period.

This autumn, Íslandsbanki will move its headquarters to the North Tower in Kópavogur, thereby unifying its operations, which are currently in four locations. Significant streamlining will therefore take place when the Bank opens its modern and progressive headquarters.

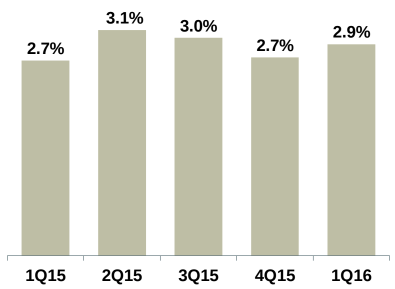
NET PROFIT
ISKm



ROE (Regular operations CET1 14%)
%



NET INTEREST MARGIN
%



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Income Statement (ISKm)	1Q16	1Q15	Δ	4Q15	Δ	2015
Net interest income	**7,539**	6,191	1,348	7,003	536	28,010
Net fee and commission income	**3,144**	2,905	239	3,235	(91)	13,170
Net financial income	**604**	1,764	(1,160)	1,455	(852)	3,881
Net foreign exchange gain (loss)	**12**	(140)	152	(137)	149	(1,490)
Other operating income	**151**	289	(138)	403	(252)	1,102
Total operating income	**11,450**	11,009	441	11,959	(509)	44,673
Administrative expenses	**(6,517)**	(5,823)	(693)	(6,518)	1	(23,760)
Depositors´and Investors Guarantee Fund	**(261)**	(269)	8	(270)	10	(1,067)
Bank Tax	**(691)**	(618)	(73)	(818)	127	(2,878)
Total operating expenses	**(7,469)**	(6,710)	(758)	(7,607)	138	(27,705)
Profit before net loan impairment	**3,982**	4,299	(317)	4,352	(371)	16,968
Net loan impairment	**(320)**	2,331	(2,651)	409	(729)	8,135
Profit before tax	**3,661**	6,630	(2,969)	4,762	(1,101)	25,103
Income tax expense	**(866)**	(1,396)	530	(1,147)	281	(5,851)
Profit for the period from continuing operations	**2,794**	5,234	(2,440)	3,615	(821)	19,252
Profit from discontinued ops. net of income tax	**715**	162	552	274	441	1,326
Profit for the period	**3,510**	5,396	(1,886)	3,889	(379)	20,578

INCOME STATEMENT

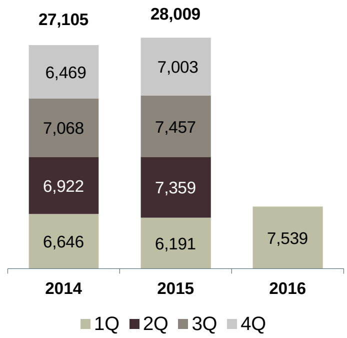
Stable recurring revenues

- Total operating income amounted to ISK 11.5bn in 1Q16, an increase of 4.3% from 1Q15. Net interest income totalled ISK 7.5bn, an increase of 22% from the same period last year party due to a higher interest rate environment and higher equity level. The net interest margin was 2.9%, compared to 2.7% in 1Q15, and is expected to remain around 3.0% in the near to medium term.
- Net fee and commission income rose 8.3% year-on year to ISK 3.1bn in 1Q16, thereof 2.6% was achieved in the parent company. Net fee income benefited from fee-generating subsidiaries and increased customer activity within the parent company.
- Core income (net interest income and net fee and commission income) accounts for 93% of total operating income, which is in line with the Bank’s focus on core earnings and its objective of generating stable revenues over the long term.
- Net financial income amounted to ISK 0.6bn in 1Q16, as opposed to ISK 1.8bn in 1Q15. The income is derived from gains in equity holdings and trading of bonds and shares. Difference between years primarily accountable to fair value gains in equity holdings which see a 1.4bn decline when compared to 1Q15.
- Other operating income, which includes gains on real estate sales, rental income, service level agreement fees, and a share in the profit or loss of associates, totalled ISK 151m in 1Q16, as opposed to ISK 289m in 1Q15.

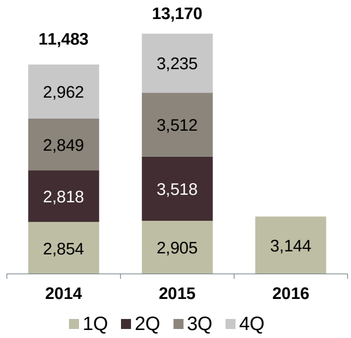
Cost awareness

- In nominal terms, administrative expenses (excluding one-off extraordinary expenses) rose by ISK 587m year-on-year. Total salaries and related expenses grew to 3.9bn, a 14% increase from 1Q15. The increase is primarily down to pay rises negotiated in collective bargaining agreements which came into fruitition in 4Q15 and 1Q16. According to Statistics Iceland, the wage index has risen by 13.3% over the same period.
- The average number of full time equivalent (FTEs) employees at the parent company was 922 in the quarter, a decrease of 1.4% year-on-year, and 1,079 FTEs on a consolidated basis.
- The cost-to-income ratio for the period was 58.3%.Cost to income-ratio excludes Bank tax and one-off cost items.
- Investments into digital solutions such as KASS, mortgage calculators, electronic signatures, and the Sopra payment system increase the operating expenses, but are expected to be off-set by future revenues.
- This autumn, the Bank's operations, now in four different locations, will be consolidated in new head quarters at the North Tower in Kópavogur. Also planned in 2016, is the merger of 3 branches into one strategically located at the ground floor of the North Tower. The merger and relocation of the Bank´s new HQ and consolidation of branch network will add front end costs in 2016, but these are expected to be off-set by future cost savings.

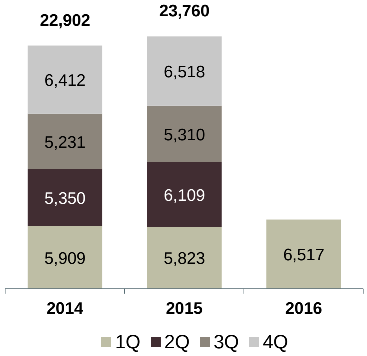
NET INTEREST INCOME
ISKm



NET FEE AND COMMISSION INCOME
ISKm



ADMINISTRATIVE EXPENSES
ISKm



Net loan impairment loss

- Net loan impairment is the main reason for the difference in profit between years, totalling ISK 0.3bn loss in 1Q16 compared to 2.3bn gain in 1Q15.
- Net loan impairments have since 2008 been substantially impacted by an increase in value of loans bought at deep discount. As restructuring of the loan book has now been concluded there should be a less positive impact from net loan impairment going forward.

Taxes and levies rise temporarily

- Tax on the profit for the period amounted to ISK 0.9bn, as compared with ISK 1.4bn in 1Q15. The effective tax rate was 23.7%, as opposed to 21.1% in 1Q15. The temporary bank tax accounted for ISK 0.7bn in 1Q16, an increase of 12% from 1Q15. It is expected that the bank tax will cease by year-end 2016.
- Íslandsbanki is subject to the special financial tax of 6% on taxable profits in excess of ISK 1bn, as well as contributions to the Depositors' and Investors' Guarantee Fund, the Financial Supervisory Authority, and the Debtors' Ombudsman. Total taxes and levies amounted to ISK 2.1bn in 1Q16, as opposed to ISK 2.5bn in 1Q15.

Profit for the period

- The profit from discontinued operations, net of tax, was ISK 0.7bn in 1Q16, compared to 0.2bn in 1Q15. The profit derives from the sale of foreclosed assets.
- Profit after tax was ISK 3.5bn in 1Q16 compared to ISK 5.4bn in 1Q15, rendering a ROE of 6.9%. The difference in profit can be explained by the irregular income item net loan impairment which is ISK 2.7bn below 1Q15. This along with the before mentioned lower fair value equity gains and greater front end costs through digital investment and collective salary agreements contribute to lower profitability between years.
- Earnings from regular operations was 3.6bn, compared to 4.4bn in 1Q15. Return on equity from regular operations on 14% CET1

BALANCE SHEET

Assets - building upon a strong foundation

- The balance sheet contracted 2.4% from year-end 2015, to ISK 1,020.8bn at March 2016, mainly due to a decrease in deposits and cash levels resulting from the expected withdrawal of Glitnir deposits and lower cash and balances with the CBI.

Asset (ISK m)	**31.03.2016**	31.12.2015	Δ
Cash and balances with CB	**182,453**	216,760	(34,307)
Bonds and debt instruments	**79,873**	78,606	1,267
Shares and equity instruments	**18,664**	18,320	344
Derivatives	**2,759**	1,981	778
Loans to credit institutions	**27,811**	35,534	(7,722)
Loans to customers	**677,079**	665,711	11,368
Investment in associates	**1,009**	716	292
Property and equipment	**7,289**	7,344	(55)
Intangible assets	**1,471**	1,331	140
Other assets	**11,177**	6,674	4,503
Non-current assets held for sale	**11,190**	12,792	(1,602)
Total assets	**1,020,775**	1,045,769	(24,993)

- Loans to customers grew 1.7%, or ISK 11.4bn, in 1Q16. Demand for new credit was primarily from corporations and, to a lesser extent, from individuals. New lending amounted to ISK 34.4bn, as opposed to ISK 31.4bn in the prior year, an increase of 10%. More than half of the portfolio is lending to individuals and real estate.
- Credit quality continues to improve, as can be seen in declining non-performing loan ratios. The share of loans that are either 90 days in arrears or impaired was 2.1% at March 2016, down from 2.2% at year-end 2015. This places Íslandsbanki's credit quality securely in the top interquartile range of European banks in terms of the European Systemic Risk Board solvency indicator. A more detailed discussion of the loan portfolio and credit risks can be found in the Bank's 2015 Pillar 3 Report.
- Real estate remains Íslandsbanki´s most important type of collateral. The weighted average loan-to-value (LTV) ratio for the residential mortgage portfolio was 69.4% at March 2016, compared to 69.2% at year-end 2015.
- The asset encumbrance ratio was 11.2% at the end of March 2016, as opposed to 10.4% at year-end 2015.

Liabilities and Equity (ISK m)	31.03.2016	31.12.2015	Δ
Deposits from CB and credit inst.	**28,338**	25,631	2,707
Deposits from customers	**544,430**	593,245	(48,815)
Derivatives and short positions	**4,902**	6,981	(2,079)
Debt issued and other borrowings	**161,802**	150,308	11,495
Subordinated loans	**19,415**	19,517	(102)
Tax liabilities	**8,963**	8,358	605
Other liabilities	**44,170**	36,677	7,494
Non-current liabilities held for sale	**3,128**	2,825	303
Total liabilities	**815,148**	843,542	(28,394)
Total equity	**205,627**	202,227	3,401
Total liabilities and equity	**1,020,775**	1,045,769	(24,993)

Liabilities – deposits still the main source of funding

- Total liabilities amounted to ISK 815.1bn at March 2016, a decrease of 3.4% from year-end 2015.
- Deposits from customers contracted by 8.2% from year-end 2015, to ISK 544.4bn. Customer deposits are still Íslandsbanki´s main source of funding, and concentration levels are monitored closely. This decrease was partly a result of the expected reduction in deposits from Glitnir. As a result, the ratio of customer deposits to customer loans declined to 80% at March 2016, compared to 89% at the end of 2015.
- Íslandsbanki maintained a strong liquidity position into 2016, and all regulatory and internal metrics were well above the set limits. At March 2016 its liquidity coverage ratio (LCR) was 154% (Dec15: 143%) at the group level, and the FX net stable funding ratio (NSFR) and total NSFR were 157% (Dec15: 141%) and 118% (Dec15: 120%) respectively at group level.
- Íslandsbanki´s debt issuance has continued into 2016, primarily reflecting issuance under its Global Medium Term Note Programme (GMTN) and covered bond programme, aimed at mitigating risk through diversification of funding. The Bank issued ISK 5.7bn in covered bonds in the first quarter, bringing the total outstanding balance to 61.85bn. The Bank also issues commercial paper, with an outstanding balance of just over ISK 11bn at March 2016. In January the Bank issued a USD 35m one-year floating-rate note paying 3 month USD LIBOR +170 bps .
- The Bank has issued a Tier 2 euro denominated subordinated loan currently totalling ISK 19.4bn which is set to mature in 2019. Only 75% of the amount eligible as regulatory capital.

Equity

- Total equity amounted to ISK 205.6bn at the end of March 2016, compared with ISK 202.2bn at year-end 2015. Of that total, ISK 4.0bn is attributable to minority interests. The nominal value of Íslandsbanki´s authorised share capital was ISK 10bn at March 2016, and paid-up share capital amounted to ISK 65bn.
- At March 2016, the capital ratio was 29.7%, compared to 30.1% at year-end 2015, well above the short to medium-term target of >23%. The Tier 1 capital ratio was 28.1% at March 2016, marginally down from 28.3% at year-end 2015. Íslandsbanki uses the standardised method to calculate its risk-weighted assets (RWA), which amounted to ISK 716.6bn at the end of the period, or 70% of total assets, a marginal increase from year-end. The leverage ratio was 18.7%, compared to 18.1% in 2015, indicating moderate leverage.
- Due to increased capital requirements, medium to long-term CET1 targets are expected to rise. The target ratio will be determined within the next 12-18 months in line with more clarity on the lifting of capital controls and regulatory capital requirements. As a guidance however, the medium to long-term CET1 target will likely be in the range of 14-16%.

Equity (cont.)

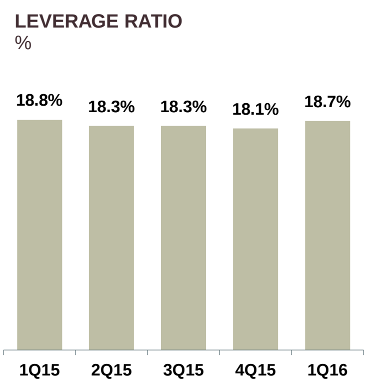
- The total capital reference for Íslandsbanki is 19.9%, assuming full implementation of the capital buffers. Based on the current risk profile, the composition of the 19.9% is subject to some restrictions, see details in the Pillar 3 Report.
- At the 19 April AGM, it was decided that ISK 10bn (just under 50% of net profit in 2015) would be paid in dividends to shareholders, but otherwise the profit would be added to the Bank's equity (the dividend pay-out date was 27th April 2016). In addition it was agreed that the Board may convene a special shareholder meeting later in the year where a proposal regarding payment of dividends of profit for the previous fiscal years could be discussed.

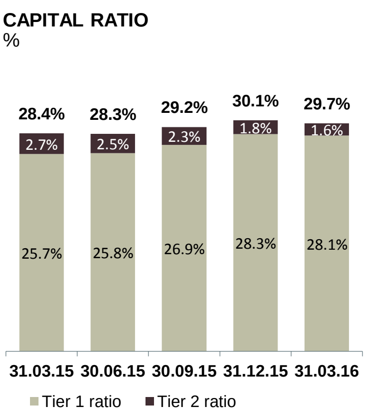
Imbalances

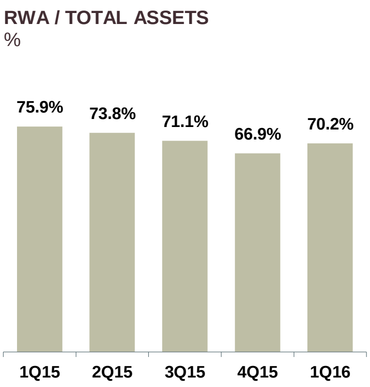
- Íslandsbanki is exposed to inflation risk as CPI-linked assets exceed CPI-linked liabilities. At March 2016, the net inflation (CPI) imbalance amounted to ISK 43.8bn (20.5% of the total capital base), compared to ISK 46.8bn at year-end 2015 (22.2% of the total capital base). The imbalance is managed via CPI-linked swaps, issuance of CPI-linked covered bonds, and long-term CPI-linked deposit programmes.
- The consolidated foreign exchange balance at the end of March 2016 was ISK 9.0bn (4.2% of the total capital base), compared to 4.3bn at year-end 2015 (2.0% of the total capital base). The Bank's imbalances are strictly monitored and are within the regulatory limits.

Ratings

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







INVESTOR RELATIONS

Investor call in English

The Bank will host an investor call in English to present its financial results at 1 pm Icelandic time on 11 May 2016. The call will start with a short macro update on the Icelandic economy, followed by a review of the financial results and Q&A. Please register by replying to ir@islandsbanki.is. Dial-in details and presentation will be sent out two hours prior to the call.

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

Financial Calendar

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

2Q16 – 22 August 2016

3Q16 – 8 November 2016

4Q16 – 21 February 2017

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