Íslandsbanki

CONSOLIDATED UNAUDITED INTERIM FINANCIAL STATEMENTS **9M17**

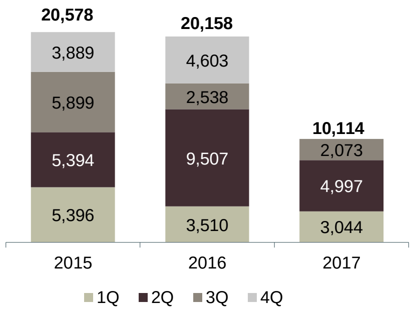
9M17 HIGHLIGHTS:

- Profit after tax was ISK 10.1bn in 9M17, compared to ISK 15.6bn in 9M16 which was considerably higher due to one-off income from the sale of shares in Visa Europe. Return on equity was 7.7% in 9M17, compared to 10.3% in 9M16.
- Earnings from regular operations was ISK 10.2bn, compared to 11.3bn in 9M16.
- Return on equity from regular operations on 15% CET1 was 10.1% in 9M17 compared to 10.4% in 9M16.
- Net interest income amounted to ISK 22.7bn in 9M17 (9M16 ISK 23.7bn) down 4% in the period. The net interest margin was 2.9% in 9M17 (9M16: 3.0%).
- Net fee and commission income was ISK10.1bn in 9M17 compared to 9.9bn in 9M16, up 2% in the period.
- Administrative costs totalled ISK 19.3bn in 9M17, down 2% from 9M16. When adjusted for one-off costs, there is a 2.7% rise in costs, or a 1.0% rise in real terms when adjusted for inflation.
- Cost to income ratio was 60.2% in 9M17 (9M16: 55.9%), the cost to income ratio excludes the bank tax and one-off cost items.
- Total assets amounted to ISK 1,078bn (Jun17: ISK 1,047bn), whereby loans to customers and the Bank´s liquidity portfolio account for 96% of the balance sheet.
- Loans to customers grew by 7.8% (ISK 53.5bn) in 9M17 to ISK 741bn. Total new lending was ISK 152bn across various lending divisions.
- Asset quality continues to improve whereby the ratio of loans more than 90 days past due was 1.1% (Jun17: 1.2%, Mar17: 1.6% and Dec16: 1.8%).
- Deposits from customers contracted in line with expectations by 1.2% (ISK 7.3bn) in 9M17 to ISK 587bn.
- Total capital ratio was 22.7% and CET1 ratio was 22.5% at period end, compared to 23.5% and 23.3% respectively at June 2017.
- The liquidity position is strong and exceeds internal and external requirements. At period end, the Bank's liquidity coverage ratio (LCR) was 183% (Jun17: 171%) and the total net stable funding ratio (NSFR) was 115% (Jun17: 119%).
- Leverage ratio was 15.3% at Sep17 compared to 15.7% at Jun17, indicating a moderate leverage in both domestic and international comparison.
- Íslandsbanki is the only Icelandic bank to have two international credit ratings. In January 2017, Fitch upgraded the Bank to BBB/F3, with a stable outlook, and in October 2017, S&P upgraded the Bank to BBB+/A-2, with a stable outlook.

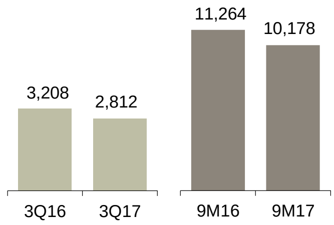
3Q17 HIGHLIGHTS:

- Profit after tax was ISK 2.1bn in 3Q17 (3Q16: ISK 2.5bn).Return on equity was 4.7% in 3Q17, compared to 5.1% in 3Q16.
- Return on regular operations normalised on 15% CET1 was 8.1% in the quarter (3Q16: 8.4%).
- Net interest income amount to ISK 7.5bn in 3Q17 (3Q16: ISK 7.8bn) and the net interest margin was 2.8% (3Q16: 3.0%).
- Net fee and commission income was ISK 3.3bn in 3Q17 (3Q16: ISK 3.2bn).

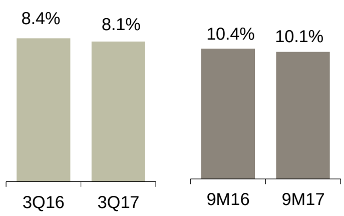
NET PROFIT
ISK m



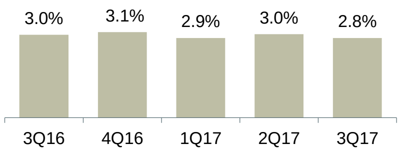
REGULAR EARNINGS
ISK m



ROE OF REGULAR EARNINGS
%, normalised for CET1 15%



NET INTEREST MARGIN
%



Birna Einarsdóttir, Chief Executive Officer at Íslandsbanki:

"Credit growth measures 7.8% year-to-date, owing mainly to an increase in corporate lending. It is gratifying to have the opportunity to participate in a wide variety of investments undertaken by Icelandic businesses. Securities brokerage activity was brisk in Q3 and the Bank had the largest share in fixed income brokerage.

The Bank's operating profit for the first nine months totalled ISK 10.1bn, and returns on core operations measured 10.1%, which is in line with the Bank's target. Positive loan value adjustments have strongly affected returns, and the quality of the loan portfolio continues to improve.

Íslandsbanki's credit rating was recently upgraded by S&P Global Ratings, supporting the positive developments in the Icelandic economy as a whole. The terms offered to the Bank in foreign capital markets have been improving and we are now on a much better competitive footing vis-à-vis foreign competitors. We welcome this trend and look forward to continued collaboration with our customers in the future.

Our relocation to our new headquarters in Norðurturn is now complete, and the advantages of increased cooperation and integration are already visible. Our activity based seating is proving successful and dozens of Icelandic firms have already visited us to learn about this progressive work environment.

Major changes lie ahead in the global financial market, with new regulations that will open the market even further for consumers. We are in the final stages of changes to our core systems which will make us even better able to embrace the exciting challenges ahead."

Income Statement (ISK m)	9M17	9M16	Δ	3Q17	3Q16	Δ
Net interest income	**22,661**	23,653	(992)	**7,450**	7,758	(307)
Net fee and commission income	**10,118**	9,892	226	**3,305**	3,233	71
Net financial income (loss)	**(975)**	6,059	(7,034)	**(1,084)**	(607)	(477)
Net foreign exchange gain (loss)	**446**	366	80	**76**	49	27
Other operating income	**506**	669	(163)	**291**	45	246
Total operating income	**32,756**	40,639	(7,883)	**10,038**	10,478	(440)
Administrative expenses	**(19,313)**	(19,729)	416	**(6,047)**	(5,613)	(434)
Depositors'and Investors' Guarantee Fund	**(795)**	(811)	16	**(280)**	(283)	2
Bank Tax	**(2,278)**	(2,152)	(127)	**(806)**	(745)	(60)
Total operating expenses	**(22,386)**	(22,692)	306	**(7,133)**	(6,641)	(492)
Profit before net loan impairment	**10,370**	17,947	(7,576)	**2,905**	3,837	(931)
Net loan impairment	**587**	251	336	**147**	(118)	265
Profit before tax	**10,957**	18,198	(7,241)	**3,052**	3,719	(666)
Income tax expense	**(3,335)**	(3,852)	517	**(1,072)**	(1,266)	194
Profit for the period from continuing operations	**7,622**	14,346	(6,724)	**1,980**	2,452	(472)
Profit from discontinued ops. net of income tax	**2,492**	1,209	1,283	**93**	85	8
Profit for the period	**10,114**	15,555	(5,442)	**2,073**	2,538	(464)
ROE 15% CET1 (regular operations)	**10.1%**	10.4%		**8.1%**	8.4%	
Return on assets	**1.3%**	2.0%		**0.8%**	1.0%	
Net interest margin (of total assets), %	**2.9%**	2.9%		**2.8%**	3.0%	
Cost to income ratio, %	**60.2%**	55.9%		**62.7%**	56.1%	

INCOME STATEMENT

Stable and strong recurring revenues

Total income amounted to ISK 32.8bn in 9M17 (3Q17: ISK 10.0bn), a decrease of 19% from 9M16. The decrease is mainly attributable to a lower interest rate environment and one-off income from Borgun's sale of shares in Visa Europe which resulted in a 6.2bn gain in 1H16.

Net interest income totalled ISK 22.7bn (3Q17: ISK 7.5bn), a decrease of 4% from the previous year due to the lower interest rate environment. The net interest margin (NIM) was 2.9%, and is expected to be slightly below 3.0% in the near to medium term.

Net fee and commission income rose 2%, to ISK 10.1bn in 9M17 (3Q17: ISK 3.3bn). Net fee income benefited from increased customer activity within the parent company. Combined, net interest income and net fee and commission income, contributed 100% of total operating income, which is in line with the Bank’s focus on core earnings and its objective of generating stable cash flows over the long term.

Net financial loss amounted to ISK 975m in 9M17 (3Q17: ISK -1.1bn), due to fair value changes in derivatives and bond and equity trading losses, compared to a gain of ISK 6.1bn in 9M16 (3Q16: ISK -0.6bn). The variance is a result of the abovementioned sale of shares in Visa Europe by the Bank's subsidiary Borgun. The Bank also realised a net foreign exchange gain of ISK 0.45bn in 9M17, compared with a gain of ISK 0.4bn in 9M16.

Other operating income which consists of rental income, service level agreement fees, and a share in the profit or loss of associates, totalled ISK 0.5bn in 9M17 (9M16: ISK 0.7bn).

Continued focus on cost control

Administrative expenses (excluding one-off extraordinary expenses) increased by ISK 0.5bn year-on-year in 9M17. Total salaries and related expenses were ISK 10.9bn in 9M17, a 2% increase between years. The Bank´s head office operations, which were spread across 4 locations, has been fully consolidated in the new headquarters at Nordurturn in Kópavogur. Branches in Kirkjusandur and Suðurlandsbraut merged into a new branch in Laugardalur in February 2017, reducing the total number of branches to 14, and reaffirming Íslandsbanki as the Bank with the most efficient branch network in Iceland. These changes added on front-end costs but are expected to be offset by future savings.

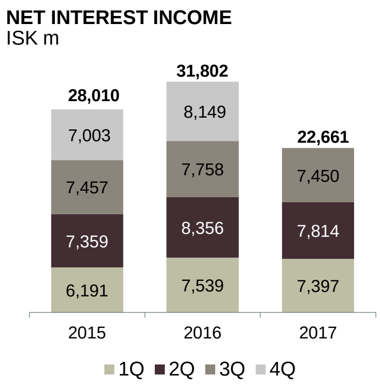
The average number of full time equivalent positions (FTE) was 919 for the parent company (968 in 9M16) and 1,102 (1,131 in 9M16) on a consolidated basis, excluding entities held for sale. Excluding summer employees the average number of full time equivalent positions (FTE) within the parent company was 881 (922 in 9M16). The number of FTEs for the parent company at period end was 871 when adjusted for summer employees.

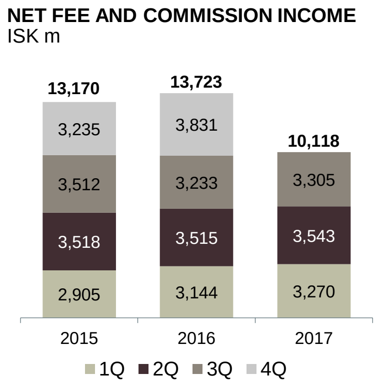
The cost-to-income ratio for the period was 60.2%, compared with 55.9% in 9M16, which is above the Bank’s long-term target of 55%. The cost-to-income ratio excludes the bank tax and other one-off cost items.

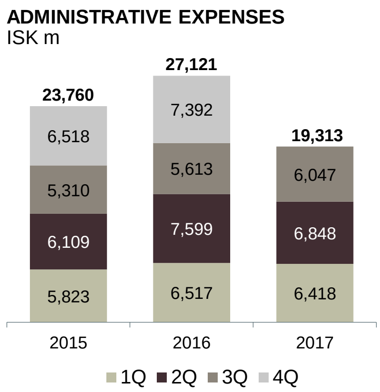
The after-tax profit from discontinued operations was ISK 2.5bn in 9M17 (3Q17: ISK 93m) compared with ISK 1.2bn in 9M16 (3Q16: ISK 85m). The profit derives from the sale or liquidation of subsidiaries and income from foreclosed assets. The Bank has successfully divested all non-core business-related assets.

Net loan impairment gains

Net loan impairment generated a gain of ISK 0.6bn in 9M17 (3Q17: ISK 0.15bn), compared to a gain of ISK 0.3bn in 9M16 (3Q16: ISK -0.12bn). Because the Bank has now a fully restructured balance sheet, a large proportion of the revised estimated future cash flow has been realised and will have less of an impact on profitability in the future. The total gain is composed of specific and collective impairments, loss from impairment charges due to court rulings and from revision of estimated future cash flows from loans.







The tax on the profit in 9M17 amounted to ISK 3.3bn, compared to ISK 3.9bn in 9M16. The effective tax rate was 30.4%, compared to 21.2% in 9M16, with the difference mainly due to how the profit from the Borgun sale in Visa Europe was taxed. The bank tax accounted for ISK 2.3bn in 9M17 (9M16: ISK 2.2bn).The bank tax increased significantly in 2013 as a temporary measure, but it is unclear how the tax rate will develop in coming years. If the bank tax is continued, the Bank will need to try to find ways to offset it through pricing or further efficiency gains.

The Bank is subject to the special financial tax of 6% on taxable profits in excess of ISK 1bn, as well as contributions to the Debtors' and Investors' Guarantee Fund, the Financial Supervisory Authority, and the Office of the Debtors' Ombudsman. The contribution to the Depositors' and Investors' Guarantee Fund, ISK 0.8bn, was comparable to that in the previous year.

Total taxes and levies amounted to ISK 7.0bn in 9M17, as opposed to ISK 7.6bn in 9M16.

Profit for the period

Profit after tax was ISK 10.1bn in 9M17 (3Q17: ISK 2.1bn) compared to ISK 15.6bn in 9M16 (3Q16: ISK 2.5bn), rendering a ROE of 7.7%.

Earnings from regular operations was ISK 10.2bn (3Q17: ISK 2.8bn), compared to ISK 11.3bn in 9M16 (3Q16: ISK 3.2bn). Return on equity from regular operations normalised for 15% CET1 was 10.1% in 9M17, compared to 10.4% in 9M16.

Regular earnings decrease by 1.1bn, as a result of lower net interest income due to dividend payments and lower interest rate environment, losses in financial income as a result of swap positions and trading losses and regular costs increasing when excluding one-off costs.

BALANCE SHEET

Assets – balanced growth in loans to customers despite stiff competition

The total size of the balance sheet was ISK 1,078bn, which is 3% or 30bn above that at year-end 2016. The majority of the increase coming in the third quarter primarily as a result of greater bond and debt instruments and increased customer lending.

Cash and balances with CB, Bonds and debt instruments, and Loans to credit institutions, amount to about ISK 295bn, whereby ISK 269bn are considered to be liquid assets.

Loans to customers grew 7.8%, or ISK 53.5bn during 9M17 (9M16: 2.8% or ISK 18.5bn). Demand for new credit stemmed predominantly from corporations within the real estate and commerce and services sectors and to a lesser extent individuals. New lending amounted to ISK 152bn (3Q17: 44.2bn), as opposed to ISK 124bn in 9M16 (3Q16: 33.2bn) an increase of 22%.

Loans to customers predominately consist of lending to individuals, with a strong presence from seafood, real estate and tourism sectors.

Credit quality continues to improve, as can be seen in the Bank's declining non-performing loan ratios. The share of loans that are either impaired or 90 days in arrears was 1.1% at September 2017, down from 1.2% at June 2017 and 1.8% at year-end 2016.

Asset (ISK m)	30.09.2017	30.06.2017	31.12.2016
Cash and balances with CB	**214,254**	227,189	275,453
Bonds and debt instruments	**42,871**	33,301	31,256
Shares and equity instruments	**11,420**	11,936	10,626
Derivatives	**3,266**	3,942	1,953
Loans to credit institutions	**37,874**	23,983	17,645
Loans to customers	**741,380**	721,820	687,840
Investment in associates	**669**	705	450
Property and equipment	**7,189**	6,663	6,211
Intangible assets	**4,077**	3,644	2,672
Other assets	**11,201**	10,103	7,064
Non-current assets held for sale	**3,422**	3,935	6,384
Total assets	**1,077,623**	1,047,221	1,047,554
Risk exposure amount (REA)	**767,536**	736,310	704,177
Non performing loans, %	**1.1%**	1.2%	1.8%

Real estate remains Íslandsbanki´s most important type of collateral. The weighted average loan-to-value (LTV) ratio for the residential mortgage portfolio was 62% at September 2017, compared to 61% at June 2017. The average LTV has decreased since year end 2016, mainly due to the newly published tax valuation that increased housing valuations on average by 15.5% from its last publication.

Non-current assets held for sale contracted by ISK 3.0bn since year-end 2016; with the divestment of assets within the parent company (ISK 1.5bn) and assets in held for sale entities

The Bank's asset encumbrance ratio was 13.99% at end of September, compared to 13.4% at June 2017.

Liabilities – deposits still the main source of funding

Total liabilities amount to ISK 900bn, an increase of 3.3% since June 2017.

The Bank maintained a strong liquidity position, with all regulatory and internal metrics well above the set limits. At September 2017, the Bank's liquidity coverage ratio (LCR) was 183%, and the net stable funding ratio (NSFR) in foreign currency was 119% at the group level. The total NSFR was 115% at group level.

Total deposits from customers grew by 3% in the third quarter to ISK 600bn to comparable levels to year-end 2016 position. Deposits are still the Bank's main source of funding, and concentration levels are monitored closely. The ratio of deposits to loans declined to 76.9% at Sep17, compared to 78.0% at June17.

Liabilities and Equity (ISK m)	30.09.2017	30.06.2017	31.12.2016
Deposits from CB and credit inst.	**12,684**	9,362	4,922
Deposits from customers	**586,922**	572,407	594,187
Derivatives and short positions	**5,167**	7,344	4,798
Subordinated loans	**0**	0	0
Tax liabilities	**13,143**	11,581	8,473
Other liabilities	**41,513**	43,209	43,456
Non-current liabilities held for sale	**116**	116	325
Total liabilities	**899,804**	871,293	868,629
Total equity	**177,819**	175,928	178,925
Total liabilities and equity	**1,077,623**	1,047,221	1,047,554
CET1 ratio, %	**22.5%**	23.3%	24.9%
Total capital adequacy ratio, %	**22.7%**	23.5%	25.2%
LCR ratio, %	**183%**	171%	187%
NFSR ratio, %	**115%**	119%	123%
Total deposits to total loans ratio, %	**76.9%**	78.0%	84.9%
Leverage ratio, %	**15.3%**	15.7%	16.0%

Funding - the largest issuer of covered bonds in Iceland

The Bank increased its debt issuance with covered bonds and commercial paper continuing the strategy of mitigating risk through diversification of funding. Íslandsbanki is the largest issuer of covered bonds in Iceland in 2017; the Bank issued ISK 7.2bn in covered bonds in the third quarter. The Bank also issued short-term unsecured bonds (1-12 month maturity) in 9M17, with an outstanding September balance of about ISK 6.7bn.

Due to the Bank´s strong liquidity position and low demand for FX loans, there was no issuance in foreign currencies in the third quarter. The third quarter of 2017 saw continued tightening of Íslandsbanki´s secondary bond spreads in strongly-performing credit markets. For example, the bank´s EUR-denominated bond maturing in 2020 experienced a spread contraction by 19 basis points, from 83 bps over mid swaps to approximately 64bps.

As market conditions continue to improve and the Bank´s liquidity position remains strong, the Bank may consider debt buybacks and/or refinancing or exchanges of outstanding issues in 2017.

Equity - focus on optimising the capital structure

Total equity amounted to ISK 177.8bn at September 2017, compared to ISK 175.9bn at June 2017. Of that total, ISK 2.5bn is attributable to non-controlling interests. The nominal value of the Bank's authorised share capital was ISK 10bn at the end of the third quarter, and share capital amounted to ISK 65bn.

At end of September 2017 the Bank's total capital ratio was 22.7%. The Bank's CET1 ratio was 22.5% at September 2017, compared to 23.3% at June 2017. Based on the SREP 2017 results the overall capital requirement for Íslandsbanki is 19.8% of risk exposure amount (REA) an increase from 19.2% since SREP 2016. The increase is due to increased capital buffer requirement from 8.0% to 8.6% of REA.

For the first time in 4Q16, the Bank introduced a new long-term capital target, which is based on its internal capital adequacy assessment (ICAAP) and the supervisory review and evaluation process (SREP). The target assumes that the Bank will maintain a management buffer of 0.5%-1.5% in excess of the SREP results to ensure that short-term fluctuations do not bring the ratio below regulatory minimum.

The capital target supports the Bank's business strategy and takes into account changes or uncertainties in the operating environment. It can change over time, reflecting changes in the Bank's risk profile, business strategy, and external environment. Based on last year's SREP results, this translates to a long-term target total capital ratio of around 20.3-21.3% and a minimum CET1 ratio of 15.4-16.4% .

The Bank will disclose the impact of the implementation of IFRS9 in the full year accounts and the impact will leave the Bank well above regulatory capital requirements. in addition the Bank is assessing the impact of a recent ruling regarding the Bank´s ability to reset interest rates on a certain part of its CPI linked mortgage book. While the ruling can have an impact on the capital requirements for interest rate risk, the Bank´s capital will remain well above regulatory requirements.

Íslandsbanki uses the standardised method to calculate its risk exposure amount (REA), which amounted to ISK 767.5bn at end of September 2017, or 71.2% of total assets, a marginal increase from June 2017 as a result of increased lending. The period end leverage ratio was 15.3%, compared to 15.7% at June 2017, indicating moderate leverage.

In the first quarter, ISK 10bn in dividends were paid out based on net 2016 income, which was in line with the Bank's dividend payment policy. The Board was also authorised to call an extraordinary shareholders' meeting later in the year because of the possibility that a proposal for an extraordinary dividend on previous operational years could be presented.

The upgrade of the Bank's credit ratings from Standard & Poor's (October 2017) and Fitch Ratings (January 2017) will facilitate issuance across the capital spectrum in 2017 and beyond. The Bank is considering issuing Tier 2 and, eventually, additional Tier 1 capital instruments in order to enhance its capital efficiency.

Imbalances

The Bank is exposed to inflation risk because CPI-linked assets exceed CPI-linked liabilities. At September 2017, the Bank's consolidated net inflation (CPI) imbalance amounted to ISK 41.4bn (23.8% of the total capital base), compared to ISK 49.8bn at June 2017 (28.8% 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 currency imbalance was ISK 0.2bn (0.1% of the total capital base) at September 2017, at comparable levels to June 2017. The Bank's imbalances are strictly monitored and are within regulatory limits.

Ratings

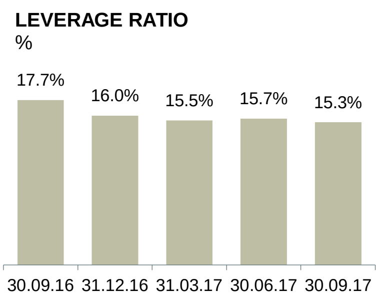
Íslandsbanki is the only bank in Iceland that is rated by two international rating agencies, Fitch and Standard & Poor's (S&P).

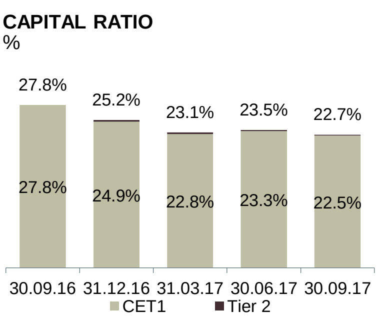
In October 2017, S&P Global Ratings (S&P) upgraded Íslandsbanki's credit ratings from BBB/A-2 to BBB+/A-2 , with a stable outlook.

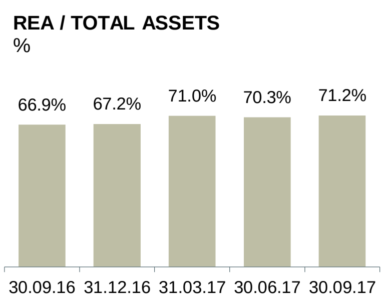
The upgrade was largely based on an improving operating environment for the Icelandic banking system following the liberalisation of capital controls and declining private sector debt. Because of this, S&P is of the view that the Icelandic banking system has strengthened and Íslandsbanki's long-term risk-adjusted capital position has improved. The stable outlook on the Bank's ratings reflect S&P's expectation that the Icelandic economy will remain resilient and that the Bank will maintain a strong capital position in coming years, even while it continues to optimise its capital structure.

In July 2017, Fitch raised the Republic of Iceland Rating to A- with a positive outlook on the back of robust economic growth and reduced external vulnerability. In June 2017, S&P raised Republic of Iceland Ratings to 'A/A-1' on lifting of capital controls with a stable outlook. The stable outlook reflects the potential for improvement in Iceland's public finances, balanced by the risk of the domestic economy overheating over the next two years.

In January 2017, Fitch upgraded the Bank to BBB/F3, with a stable outlook, citing continuous strengthening of the Icelandic operating environment as reflected in an extended record of robust economic growth, combined with an improved external position.







INVESTOR RELATIONS

Investor call in English

The Bank will host an investor call in English to present the results at 1 pm Icelandic time today 9th November 2017. 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 annual and interim financial statements according to the below financial calendar:

- 4Q2017 - 14 February 2018
- 1Q2018 - 9 May 2018

Please note that the dates are subject to change.

For information on Íslandsbanki's financial calendar and silent periods please refer to: http://www.islandsbanki.is/english/investor-relations/calendar/.