Condensed Consolidated

Interim Financial Statements

Unaudited

Nine months ended 30 September 2013

Íslandsbanki hf.
Kirkjusandur
155 Reykjavík
Reg. no. 491008-0160
Iceland

Contents

Endorsement and Statement by the Board of Directors and the CEO

The unaudited Condensed Consolidated Interim Financial Statements of Íslandsbanki hf. for the period 1 January to 30 September 2013 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 30 September 2013 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 30 September 2013 amounted to ISK 15,397 million, which corresponds to a 13.4% return on equity. Bank equity, according to the Consolidated Financial Position, amounted to ISK 159,664 million at 30 September 2013. The Bank's official capital ratio, calculated according to the Act on Financial Undertakings, was 26.6% and the Tier 1 ratio was 23.2%. The official capital ratio is based on reviewed own fund items at 30 June 2013 since the accounts for 30 September 2013 are not reviewed. The Board of Directors refers to Note 59 for further understanding of the capital requirements of the Bank. The Bank's total assets amounted to ISK 862,533 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 40 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 30 September 2013.

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 30 September 2013 by means of their signatures.

Reykjavík, 26 November 2013

Board of Directors:

Chief Executive Officer:

Birna Einarsdóttir

Condensed Consolidated Income Statement for the nine months ended 30 September 2013

	Notes	2013 1.7-30.9	2012 1.7-30.9	2013 1.1-30.9	2012 1.1-30.9
Interest income		13,399	12,100	41,514	43,571
Interest expense		(6,034)	(4,315)	(19,631)	(19,191)
Net interest income	10	7,365	7,785	21,883	24,380
Net valuation changes on loans and receivables	11	603	713	8,471	2,782
Provision for latent impairment	11,26	(48)	(309)	(66)	(579)
Net valuation changes		555	404	8,405	2,203
Net interest income after net valuation changes		7,920	8,189	30,288	26,583
Fee and commission income		4,241	3,744	12,162	10,613
Fee and commission expense		(1,779)	(1,466)	(4,578)	(3,909)
Net fee and commission income		2,462	2,278	7,584	6,704
Net financial income	12-13	315	213	1,865	1,318
Net foreign exchange gain (loss)	14	409	491	(1,306)	1,230
Other net operating income	15	314	226	1,442	815
Other net operating income		1,038	930	2,001	3,363
Total operating income		11,420	11,397	39,873	36,650
Administrative expenses	16-17	(5,284)	(5,495)	(17,831)	(18,519)
Contribution to the Depositors' and Investors' Guarantee Fund		(252)	(272)	(754)	(798)
Share of profit of associates net of tax		-	-	3	-
Profit before tax		5,884	5,630	21,291	17,333
Income tax	18	(1,570)	(1,465)	(5,365)	(4,463)
Profit for the period from continuing operations		4,314	4,165	15,926	12,870
(Loss) profit from discontinued operations, net of income tax		(125)	432	(529)	3,351
Profit for the period		4,189	4,597	15,397	16,221

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

Amounts are in ISK million

Condensed Consolidated Statement of Comprehensive Income for the nine months ended 30 September 2013

	Notes	2013 1.7-30.9	2012 1.7-30.9	2013 1.1-30.9	2012 1.1-30.9
Other comprehensive income					
Foreign currency translation differences for foreign operations		(62)	(33)	(231)	70
Other comprehensive income for the period		(62)	(33)	(231)	70
Total comprehensive income for the period		4,127	4,564	15,166	16,291
Attributable to:					
Equity holders of Íslandsbanki hf.		4,113	4,496	15,349	16,102
Non-controlling interests		76	101	48	119
Profit for the period		4,189	4,597	15,397	16,221
Basic earnings per share	19	0.41	0.45	1.53	1.61
Diluted earnings per share	19	0.41	0.45	1.53	1.61

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

Amounts are in ISK million

Condensed Consolidated Statement of Financial Position as at 30 September 2013

	Notes	30.9.2013	31.12.2012
Assets			
Cash and balances with Central Bank	6,20	92,980	85,500
Derivatives	6,21	289	127
Bonds and debt instruments	6	76,902	64,035
Shares and equity instruments	6	9,528	10,445
Loans to credit institutions	6,22-23	65,824	54,043
Loans to customers	6,24-25	548,537	557,857
Investments in associates	27	1,490	503
Property and equipment		9,085	5,579
Intangible assets		247	261
Deferred tax assets		1,059	864
Non-current assets and disposal groups held for sale	30	45,782	39,046
Other assets	31	10,810	5,115
Total Assets		862,533	823,375
Liabilities			
Derivative instruments and short positions	6,21	12,866	18,435
Deposits from Central Bank	6,32	44	54
Deposits from credit institutions	6,32	29,723	38,218
Deposits from customers	6,33-34	496,453	471,156
Debt issued and other borrowed funds	6,35	79,194	66,571
Subordinated loans	6	22,565	23,450
Current tax liabilities		6,051	2,052
Deferred tax liabilities		25	20
Non-current liabilities and disposal groups held for sale	30	9,778	6,805
Other liabilities	36	46,170	48,954
Total Liabilities		702,869	675,715
Equity			
Share capital	37	10,000	10,000
Share premium	37	55,000	55,000
Other reserves		2,603	2,834
Retained earnings		90,920	78,571
Total equity attributable to the equity holders of Íslandsbanki hf.		158,523	146,405
Non-controlling interests		1,141	1,255
Total Equity		159,664	147,660
Total Liabilities and Equity		862,533	823,375

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

Amounts are in ISK million

Condensed Consolidated Statement of Changes in Equity for the nine months ended 30 September 2013

	Attributable to equity holders of Íslandsbanki hf.					Non-controlling interests	Total equity
	Share capital	Share premium	Other reserves	Retained earnings	Total		
Equity at 1.1.2012	10,000	55,000	2,661	55,133	122,794	909	123,703
Translation differences for foreign operations			70		70		70
Net income recognised directly in equity	-	-	70	-	70	-	70
Profit for the period				16,102	16,102	119	16,221
Total comprehensive income for the period	-	-	70	16,102	16,172	119	16,291
Change in non-controlling interests					-	51	51
Equity at 30.9.2012	10,000	55,000	2,731	71,235	138,966	1,079	140,045
Equity at 1.1.2013	10,000	55,000	2,834	78,571	146,405	1,255	147,660
Translation differences for foreign operations			(231)		(231)		(231)
Net income recognised directly in equity	-	-	(231)		(231)	-	(231)
Profit for the period				15,349	15,349	48	15,397
Total comprehensive income for the period	-	-	(231)	15,349	15,118	48	15,166
Change in non-controlling interests					-	(162)	(162)
Dividends				(3,000)	(3,000)		(3,000)
Equity at 30.9.2013	10,000	55,000	2,603	90,920	158,523	1,141	159,664

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

Amounts are in ISK million

Condensed Consolidated Statement of Cash Flows for the nine months ended 30 September 2013

	Notes	2013 1.1-30.9	2012 1.1-30.9
Cash flows from operating activities:			
Profit for the period		15,397	16,221
Adjustments to reconcile profit for the period to cash flows by operating activities:			
Non-cash items included in profit for the period and other adjustments		(130)	4,989
Changes in operating assets and liabilities		977	31,009
Income tax paid		(1,764)	(6,311)
Net cash provided by operating activities		14,480	45,908
Net cash provided by (used in) investing activities		438	(807)
Net cash provided by (used in) financing activities		7,501	(162)
Changes in cash and cash equivalents		22,419	44,939
Effects of exchange rate changes on cash and cash equivalents		(92)	12
Cash and cash equivalents at the beginning of the period		112,810	78,571
Cash and cash equivalents at the end of the period		135,137	123,522
Reconciliation of cash and cash equivalents:			
Cash on hand	20	2,273	2,176
Cash balances with Central Bank and certificates of deposit	20	88,897	76,052
Bank accounts	22	43,967	45,294
Total cash and cash equivalents		135,137	123,522

Interest received from 1st of January to end of September 2013 amounted to ISK 34,938 million (2012: ISK 31,327 million) and interest paid in same period 2013 amounted to ISK 17,559 million (2012: ISK 21,088 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

Amounts are in ISK million

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 nine months ended 30 September 2013 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 26 November 2013.

2. **Basis of preparation**

2.1 *Statement of compliance*

The unaudited Condensed Consolidated Interim Financial Statements for the nine months ended 30 September 2013 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 2012, available at the Bank's website 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*

Comparable information in Note 10, Net interest income, Note 12, Net financial income, and Note 14, Net foreign exchange gain, has been changed due to change in methodology. Note 10 from ISK -36 million to ISK 1,059 million (Q3 2012: from ISK 242m to ISK 426m) for financial assets held for trading, Note 12 from ISK 598 million to ISK -183 million (Q3 2012: from ISK 114m to ISK 104m) for net gain (loss) on financial instruments held for trading and Note 14 from ISK 772 million to ISK 458 million (Q3 2012: from ISK 189m to ISK 15m) for financial assets held for trading.

2.5 Cont'd

Changes have been made in the presentation of market risk notes. These are explained further under Notes 55 and 56. Comparable information has been changed accordingly.

The Bank has changed its presentation in the Condensed Consolidated Income Statement where the Bank tax is not shown separately in the statement but has been added to administrative expenses. The 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 2012.

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

IFRS 13 Fair Value Measurement
The Bank has adopted IFRS 13 “Fair Value Measurement” which establishes a single source of guidance for fair value measurements under IFRS and introduces new and enhanced disclosure requirements. Disclosures of fair value measurement is provided in Note 7.

IFRS 7 Financial Instruments: Disclosures, Offsetting Financial Assets and Financial Liabilities
The Bank has adopted revision to IFRS 7 "Disclosures, Offsetting Financial Assets and Financial Liabilites“ requiring extended disclosures of new information in respect of an entity's use of enforcable netting arrangements. Disclosures of Offsetting are provided in Note 9.

Business combination

4. **Changes within the group**

4.1 **Aquisition of subsidiaries**

On 24 January 2013, the Bank acquired 100% shareholding in the real estate company EFF 1 ehf. and EFF 2 ehf.

4.2 **Aquisition of subsidiaries held exclusively with a view to disposal**

On 24 January 2013, the Bank acquired 100% shareholding in the real estate company EFF 4 ehf. The entity EFF 4 ehf. qualifies as being held for sale in accordance with IFRS 5 and has therefore been classified as disposal groups held for sale.

Quarterly statements

5. Operations by quarters:

	Q3* 2013	Q2* 2013	Q1* 2013	Q4* 2012	Q3* 2012
Net interest income	7,365	7,045	7,473	8,560	7,785
Net valuation changes	603	4,751	3,117	3,704	713
Provision for latent impairment	(48)	106	(124)	(197)	(309)
Net fee and commission income	2,462	2,670	2,452	2,755	2,278
Net financial income	315	669	881	199	213
Net foreign exchange gain (loss)	409	(152)	(1,563)	1,507	491
Other net operating income	314	716	412	181	226
Administrative expenses	(5,284)	(6,244)	(6,303)	(6,928)	(5,495)
Impairment of goodwill	-	-	-	(425)	-
Contribution to the Depositors' and Investors' Guarantee Fund	(252)	(256)	(246)	(257)	(272)
Share of profit of associates	-	-	3	-	-
Profit before tax	5,884	9,305	6,102	9,099	5,630
Income tax	(1,570)	(2,347)	(1,448)	(1,790)	(1,465)
Profit for the period from continuing operations	4,314	6,958	4,654	7,309	4,165
(Loss) profit for the period from discontinued operations	(125)	(335)	(69)	(112)	432
Profit for the period	4,189	6,623	4,585	7,197	4,597

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

For the nine months ended 30 September 2013 11 Amounts are in ISK million

Financial assets and liabilities

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

At 30 September 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	-	-	92,980	-	92,980
Loans and receivables						
Loans to credit institutions	22-23	-	-	65,824	-	65,824
Loans to customers	24-25	-	-	548,537	-	548,537
Loans and receivables		-	-	707,341	-	707,341
Bonds and debt instruments						
Listed		42,975	31,615	-	-	74,590
Unlisted		-	2,312	-	-	2,312
Bonds and debt instruments		42,975	33,927	-	-	76,902
Shares and equity instruments						
Listed		4,071	2,554	-	-	6,625
Unlisted		-	2,903	-	-	2,903
Shares and equity instruments		4,071	5,457	-	-	9,528
Derivatives	21	289	-	-	-	289
Other financial assets		-	-	6,814	-	6,814
Total financial assets		47,335	39,384	714,155	-	800,874
Derivative instruments and short positions	21	12,866	-	-	-	12,866
Deposits from Central Bank	32	-	-	-	44	44
Deposits from credit institutions	32	-	-	-	29,723	29,723
Deposits from customers	33-34	-	-	-	496,453	496,453
Debt issued and other borrowed funds	35	-	-	-	79,194	79,194
Subordinated loans		-	-	-	22,565	22,565
Other financial liabilities		-	-	-	29,050	29,050
Total financial liabilities		12,866	-	-	657,029	669,895

For the nine months ended 30 September 2013 12 Amounts are in ISK million

6. Cont'd

At 31 December 2012	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	-	-	85,500	-	85,500
Loans and receivables						
Loans to credit institutions	22-23	-	-	54,043	-	54,043
Loans to customers	24-25	-	-	557,857	-	557,857
Loans and receivables		-	-	697,400	-	697,400
Bonds and debt instruments						
Listed		28,400	31,661	-	-	60,061
Unlisted		-	3,974	-	-	3,974
Bonds and debt instruments		28,400	35,635	-	-	64,035
Shares and equity instruments						
Listed		2,835	3,681	-	-	6,516
Unlisted		-	3,929	-	-	3,929
Shares and equity instruments		2,835	7,610	-	-	10,445
Derivatives	21	127	-	-	-	127
Other financial assets		-	-	1,259	-	1,259
Total financial assets		31,362	43,245	698,659	-	773,266
Derivative instruments and short positions	21	18,435	-	-	-	18,435
Deposits from Central Bank	32	-	-	-	54	54
Deposits from credit institutions	32	-	-	-	38,218	38,218
Deposits from customers	33-34	-	-	-	471,156	471,156
Debt issued and other borrowed funds	35	-	-	-	66,571	66,571
Subordinated loans		-	-	-	23,450	23,450
Other financial liabilities		-	-	-	23,494	23,494
Total financial liabilities		18,435	-	-	622,943	641,378

Amounts are in ISK million

Fair value information for financial instruments

7. Financial instruments at amortised cost

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

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 valued specifically on a quarterly basis 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.
b) Fixed rate loans: The interest rate level used as a base for pricing fixed rate loans may have shifted.

The Bank takes these effects into account for each loan by discounting the resulting interest rate difference from 30 September 2013 to that loan's next interest reset. At this time positive credit migrations balance out negative migrations. Furthermore, while nominal fixed rates have increased, a decrease in real rates counter-balances that effect. Thus the assessment is that the carrying amount of loans on the Bank's balance sheet fully represents their fair value.

On the liabilities side most deposits carry floating interest rates and 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 estimated rate that a similar product would carry today. For "Debt issued and other borrowed funds" the Bank uses an observed market value where it is available while other debt is valued in the same manner as deposits.

For "Cash and balances with Central Bank" the carrying value is very well approximated by the carrying amount since they are very short term in nature. The liabilities in Subordinated loans carry floating interest rates and the Bank believes that in the current market environment it is very difficult to assess the funding rates of these instruments. There is no clear evidence that the funding premium has changed from the time of issuance of these loans. Therefore, their fair value equals their carrying amount.

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

	Carrying amount 30.9.2013	Fair value 30.9.2013	Carrying amount 31.12.2012	Fair value 31.12.2012
Financial assets:				
Cash and balances with Central banks	92,980	92,980	85,500	85,500
Loans to credit institutions	65,824	65,824	54,043	54,043
Loans to customers	548,537	548,537	557,857	557,857
Total financial assets	707,341	707,341	697,400	697,400
Financial liabilities:				
Deposits from Central Bank	44	44	54	54
Deposits from credit institutions	29,723	29,724	38,218	38,218
Deposits from customers	496,453	496,760	471,156	471,402
Debt issued and other borrowed funds	79,194	80,027	66,571	67,100
Subordinated loans	22,565	22,565	23,450	23,450
Total financial liabilities	627,979	629,120	599,449	600,224

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8. Fair value hierarchy

The table below categorises financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

Level 1: Quoted market prices (unadjusted) in active markets for identical assets or liabilities

Level 2: Inputs other than quoted market 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)

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities carried at fair value in the consolidated balance sheet are categorised as at 30 September 2013:

At 30 September 2013

Financial assets:	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	74,589	1,072	1,241	76,902
Shares and equity instruments	6,677	-	2,851	9,528
Derivative instruments	-	289	-	289
Total financial assets	81,266	1,361	4,092	86,719

Financial liabilities:	Level 1	Level 2	Level 3	Total
Short positions	9,965	209	-	10,174
Derivative instruments	-	2,607	85	2,692
Total financial liabilities	9,965	2,816	85	12,866

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities carried at fair value in the consolidated balance sheet are categorised as at 31 December 2012:

At 31 December 2012

Financial assets:	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	59,542	795	3,698	64,035
Shares and equity instruments	6,516	-	3,929	10,445
Derivative instruments	-	107	20	127
Total financial assets	66,058	902	7,647	74,607

Financial liabilities:	Level 1	Level 2	Level 3	Total
Short positions	11,991	-	-	11,991
Derivative instruments	-	1,270	5,174	6,444
Total financial liabilities	11,991	1,270	5,174	18,435

Amounts are in ISK million

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Reconciliation of financial instruments in level 3

January-September 2013	Bonds and debt instruments	Shares and equity instruments	Derivatives
Recorded value at 1 January 2013	3,698	3,929	(5,099)
Additions/purchases	-	1,240	-
Sales	-	(1,048)	-
Recategorised as affiliate	-	(959)	-
Settled	(759)	-	-
Net gains on financial instruments	(475)	(122)	4,326
Transfers to level 1 or 2	(1,223)	-	(75)
Other *	-	(189)	-
Recorded value at 30 September 2013	1,241	2,851	(848)

The responsibility for the valuation at fair value of financial instruments lies within the relevant busines units. Risk Management is then responsible for categorising the valuation methods and assessing the extent of market data used. Level 3 contains primarily unlisted and illiquid equities and bonds. ISK 75 million of derivatives were transferred from level 3 to level 2 in 2013. ISK 1,223 million of bonds were transferred from level 3 to level 1 because the underlying bonds, previously unlisted, were listed on the domestic market in Q1 2013.

For the nine months ended 30 September 2013 16 Amounts are in ISK million

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 enforcable 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					
At 30 September 2013	Gross recognised financial assets before balance sheet netting	Balance sheet netting with gross recog-nised financial liabilities	Financial assets recognis-ed 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
Derivatives	1,579	(1,290)	289	(136)	(47)	(106)	-	-	289
Total assets	1,579	(1,290)	289	(136)	(47)	(106)	-	-	289
At 31 December 2012									
Derivatives	127	-	127	(97)	(30)	-	-	-	127
Total assets	127	-	127	(97)	(30)	-	-	-	127

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					
At 30 September 2013	Gross recognised financial liabilities before balance sheet netting	Balance sheet netting with gross recog-nised financial assets	Financial liabilities recognis-ed 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
Derivative instruments and short position	3,982	(1,290)	2,692	(136)	(32)	(763)	1,761	10,174	12,866
Total liabilities	3,982	(1,290)	2,692	(136)	(32)	(763)	1,761	10,174	12,866
At 31 December 2012									
Derivative instruments and short position	6,444	-	6,444	(97)	(33)	(5,044)	1,270	11,991	18,435
Total liabilities	6,444	-	6,444	(97)	(33)	(5,044)	1,270	11,991	18,435

Amounts are in ISK million

Net interest income

10. Net interest income is specified as follows:

	2013 1.7-30.9	2012 1.7-30.9	2013 1.1-30.9	2012 1.1-30.9
Interest income:				
Cash and balances with Central Bank	1,317	996	3,354	2,402
Loans and receivables	11,313	10,214	36,007	38,781
Financial assets held for trading	308	426	709	1,059
Financial assets designated at fair value through profit or loss	417	452	1,371	1,265
Other assets	44	12	73	64
Total interest income	13,399	12,100	41,514	43,571
Interest expense:				
Deposits from credit institutions and Central Bank	(130)	(166)	(418)	(978)
Deposits from customers	(4,273)	(3,198)	(13,814)	(12,693)
Borrowings	(1,268)	(535)	(4,307)	(4,071)
Subordinated loans	(247)	(260)	(715)	(839)
Other financial liabilities	(78)	(95)	(257)	(406)
Other interest expense	(38)	(61)	(120)	(204)
Total interest expense	(6,034)	(4,315)	(19,631)	(19,191)
Net interest income	7,365	7,785	21,883	24,380

Net valuation changes on loans and receivables

11. Net valuation changes on loans and receivables:

	2013 1.7-30.9	2012 1.7-30.9	2013 1.1-30.9	2012 1.1-30.9
Impairment charged to the comprehensive income:				
Specific impairment losses on financial assets	(1,142)	(545)	(8,579)	(11,486)
Impairment of foreign exchange (gain) loss	(22)	(226)	462	(709)
Net specific impairment losses on financial assets	(1,164)	(771)	(8,117)	(12,195)
Provision for latent impairment losses	(48)	(309)	(66)	(579)
Total impairment charged to the income statement (see note 26)	(1,212)	(1,080)	(8,183)	(12,774)
Net valuation changes:				
Income due to revised estimated future cash flow from loans	1,745	1,258	17,050	14,268
Net specific impairment losses on financial assets	(1,164)	(771)	(8,117)	(12,195)
Foreign exchange gain (loss) (see note 14)	22	226	(462)	709
Net valuation changes on loans and receivables	603	713	8,471	2,782

Foreign exchange gain from customers with foreign exchange loans and cash flows in ISK is impaired and offset against total foreign exchange gain as per Note 14. Foreign exchange loss is recognised after previously impaired gain has been reversed.

The impairment which is offset against total foreign exchange gain is mainly to account for currency changes in loans that are on the verge of being converted to ISK.

For the nine months ended 30 September 2013 18 Amounts are in ISK million

Net financial income

12. Net financial income is specified as follows:

	2013 1.7-30.9	2012 1.7-30.9	2013 1.1-30.9	2012 1.1-30.9
Net gain (loss) on financial instruments held for trading	223	104	622	(183)
Net gain on financial instruments designated at fair value through P&L	92	109	1,243	1,501
Net financial income	315	213	1,865	1,318

13. Net gain (loss) on financial instruments designated at fair value through profit or loss is specified as follows:

Shares	66	181	1,358	1,456
Bonds	26	(72)	(115)	45
Net gain on financial instruments designated at fair value through P&L	92	109	1,243	1,501

Net foreign exchange gain (loss)

14. Net foreign exchange gain (loss) is specified as follows:

	2013 1.7-30.9	2012 1.7-30.9	2013 1.1-30.9	2012 1.1-30.9
Assets:				
Cash and balances with Central Bank	(15)	11	(92)	12
Financial assets held for trading	174	15	2,919	458
Loans to credit institutions	(268)	741	(4,388)	1,893
Loans to customers	905	1,126	(6,040)	2,313
Other assets	81	63	95	148
Total	877	1,956	(7,506)	4,824
Liabilities:				
Deposits from credit institutions	88	108	222	(45)
Deposits from customers	(168)	(1,063)	4,598	(2,607)
Subordinated loan	(316)	(240)	901	(156)
Other liabilities	(50)	(44)	17	(77)
Total	(446)	(1,239)	5,738	(2,885)
Unadjusted net foreign exchange (loss) gain	431	717	(1,768)	1,939
Foreign exchange reversal on loans to customers with ISK cash flow	(22)	(226)	462	(709)
Net foreign exchange gain (loss)	409	491	(1,306)	1,230

Other net operating income

15. Other net operating income is specified as follows:

	2013 1.7-30.9	2012 1.7-30.9	2013 1.1-30.9	2012 1.1-30.9
Agency fees and service level agreement fees	93	75	261	239
Legal cost and fees	46	27	137	69
Rental income	24	24	109	76
Gain from sale of buildings	-	-	549	-
Rental income on foreclosed mortgages	110	64	238	278
Other net operating income	41	36	148	153
Other net operating income	314	226	1,442	815

Amounts are in ISK million

Administrative expenses

16. Administrative expenses are specified as follows:

	2013 1.7-30.9	2012 1.7-30.9	2013 1.1-30.9	2012 1.1-30.9
Salaries and related expenses	2,851	2,809	9,871	9,429
Other administrative expenses	2,148	2,236	7,068	7,793
Depreciation and amortisation	209	226	684	666
Bank tax	76	224	208	631
Administrative expenses	5,284	5,495	17,831	18,519

Salaries and related expenses

17. Salaries and related expenses are specified as follows:

	2013 1.7-30.9	2012 1.7-30.9	2013 1.1-30.9	2012 1.1-30.9
Salaries	2,178	2,182	7,531	7,297
Pension and similar expenses	300	292	1,030	984
Social security charges and financial activities tax	350	318	1,168	1,023
Other	23	17	142	125
Salaries and related expenses	2,851	2,809	9,871	9,429

Effective income tax rate

18. Income tax for the nine month period ended 30 September 2013 is calculated at 20%. New tax, 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 25.2% for the nine months ended 30 September 2013. The difference is specified as follows:

	2013 1.1-30.9		2012 1.1-30.9	
Profit before tax	21,291		17,333	
Income tax calculated on the profit for the period	4,258	20.0%	3,467	20.0%
Special financial activities tax	1,164	5.5%	631	3.6%
Effect of different tax rate in other countries	-	0.0%	(11)	(0.1%)
Non-deductable expenses	59	0.3%	178	1.0%
Income not subject to tax	(337)	(1.6%)	(333)	(1.9%)
Correction in accordance with ruling on prior years' taxable income	27	0.1%	29	0.2%
Other differences	194	0.9%	502	2.9%
Effective income tax	5,365	25.2%	4,463	25.7%

Earnings per share

19. Earnings per share are specified as follows:

	2013 1.1-30.9	2012 1.1-30.9
Net profit of the equity holders of the parent, according to the statement of comprehensive income	15,349	16,102
Average outstanding shares:		
Weighted average number of outstanding shares for the period, million	10,000	10,000
Average outstanding shares, million	10,000	10,000
Basic earnings per share	1.53	1.61
Diluted earnings per share	1.53	1.61

Amounts are in ISK million

Cash and balances with Central Bank

20. Specification of cash and balances with Central Bank:

	30.9.2013	31.12.2012
Cash on hand	2,273	2,008
Balances with Central Bank other than mandatory reserve deposits	7,737	16,221
Certificates of deposit	81,160	58,119
Included in cash and cash equivalents	91,170	76,348
Mandatory reserve deposits with Central Bank	1,810	9,152
Cash and balances with Central Bank	92,980	85,500

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 9,648 million for September 2013 (December 2012: ISK 9,152 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 30 September 2013

	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	23	2,000	1,562	19,500
Cross currency interest rate swaps	50	3,000	851	57,435
Equity forwards	70	10	161	109
Foreign exchange forwards	106	4,376	16	1,401
Foreign exchange swaps	16	158	-	-
Bond forwards	24	1,400	17	210
Bond options	-	-	85	25,000
Derivatives held for trading	289	10,944	2,692	103,655
Short positions in listed bonds	-	-	10,174	-
Total	289	10,944	12,866	103,655

At 31 December 2012

	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	5	500	1,142	19,900
Cross currency interest rate swaps	20	7,199	5,094	55,351
Equity forwards	-	-	89	95
Foreign exchange forwards	8	1,503	8	219
Foreign exchange swaps	33	1,154	9	2,492
Bond forwards	61	2,250	22	1,325
Bond options	-	-	80	25,000
Derivatives held for trading	127	12,606	6,444	104,382
Short positions in listed bonds	-	-	11,991	-
Total	127	12,606	18,435	104,382

Amounts are in ISK million

Loans

22. Loans to credit institutions:

	30.9.2013	31.12.2012
Money market loans	21,857	17,581
Bank accounts	43,967	36,462
Loans to credit institutions	65,824	54,043

23. Loans to credit institutions at amortised cost:

	30.9.2013	31.12.2012
Loans	65,824	54,043
Loans to credit institutions	65,824	54,043

24. Loans to customers:

	30.9.2013	31.12.2012
Loans to customers at amortised cost	548,537	557,857
Loans to customers	548,537	557,857

25. Loans to customers at amortised cost:

At 30 September 2013

	Gross amount	Individually assessed impairment allowance	Collectively assessed impairment allowance	Loans less impairment allowance
Loans to customers:				
Individuals	258,018	(9,037)	(1,602)	247,379
Commerce and services	87,904	(5,335)	(505)	82,064
Construction	18,629	(1,261)	(894)	16,474
Energy	3,561	-	(4)	3,557
Financial services	39	-	-	39
Industrial and transportation	46,501	(2,347)	(651)	43,503
Investment companies	14,696	(3,698)	(3)	10,995
Public sector and non-profit organisations	6,789	(26)	(53)	6,710
Real estate	75,208	(5,075)	(1,184)	68,949
Seafood	72,686	(2,015)	0	70,671
Loans to customers before latent impairment allowance				550,341
Latent impairment allowance				(1,804)
Loans to customers	584,031	(28,794)	(4,896)	548,537

Amounts are in ISK million

25. Cont'd

At 31 December 2012

	Gross amount	Individually assessed impairment allowance	Collectively assessed impairment allowance	Loans less impairment allowance
Loans to customers:				
Individuals	254,461	(7,896)	(2,139)	244,426
Commerce and services	75,130	(5,761)	(564)	68,805
Construction	18,954	(1,576)	(913)	16,465
Energy	4,945	-	(3)	4,942
Financial services	282	(27)	(1)	254
Industrial and transportation	46,773	(2,406)	(707)	43,660
Investment companies	21,943	(5,920)	-	16,023
Public sector and non-profit organisations	11,307	(329)	(44)	10,934
Real estate	86,849	(12,686)	(1,222)	72,941
Seafood	84,142	(2,959)	(38)	81,145
Loans to customers before latent impairment allowance				559,595
Latent impairment allowance				(1,738)
Loans to customers	604,786	(39,560)	(5,631)	557,857

26. Financial assets - impairments

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

	Individually assessed	Collectively assessed	Latent	Total
At 1 January 2013	39,560	5,631	1,738	46,929
Amounts written-off	(14,251)	(38)	-	(14,289)
Recoveries of amounts previously written-off	850	-	-	850
Principal credit adjustment	(6,142)	(37)	-	(6,179)
Charged to the income statement	8,777	(660)	66	8,183
At 30 September 2013	28,794	4,896	1,804	35,494

	Individually assessed	Collectively assessed	Latent	Total
At 1 January 2012	32,735	8,508	915	42,158
Merger with Kreditkort,	205	(252)	47	-
Amounts written-off	(12,643)	(46)	-	(12,689)
Recoveries of amounts previously written-off	2,136	-	-	2,136
Principal credit adjustment	(3,998)	(751)	-	(4,749)
Charged to the income statement	21,125	(1,828)	776	20,073
At 31 December 2012	39,560	5,631	1,738	46,929

	2013 1.1-30.9	2012 1.1-30.9
Impairment losses charged to the income statement:		
Loans to customers	8,183	12,774
Impairment losses charged to the income statement (see Note 11)	8,183	12,774

For the nine months ended 30 September 2013 23 Amounts are in ISK million

Investment in associates

27. Changes in investments in associates:

	30.9.2013	31.12.2012
Investment in associates at the beginning of the year	503	1,070
Additions during the period	24	-
Sales of shares in associates	-	(567)
Transfers	960	-
Share of results	3	-
Investments in associates at the end of the period	1,490	503

Investment in subsidiaries

28. Significant subsidiaries:

	Location	Ownership
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%
HTO ehf. formerly Höfdatorg ehf., Skúlagötu 63, 105 Reykjavík	Iceland	72.5%
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%
EFF 2 ehf., Kirkjusandi 2, 105 Reykjavík	Iceland	100%
EFF 4 ehf., Kirkjusandi 2, 105 Reykjavík	Iceland	100%
Geysir Green Investment Fund slhf., Hafnargötu 90, Reykjanesbæ	Iceland	100%
Island Fund S.A., 5 Allée Scheffer L-2520 Luxembourg	Luxembourg	100%
Glacier Geothermal and Seafood Corporation, 7 Times Square, Suite 1605 New York	USA	100%
29 other subsidiaries (SME)		

Related party disclosures

29. 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 ulitmate 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. The amounts are negative where deposits exceed loans to the related party.

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

	30.9.2013	31.12.2012
CEO and Managing Directors (including companies owned by them)	(78)	(82)
Members of the Board (including companies owned by them)	(661)	141
Associated companies and other related parties	3,093	2,813
Total	2,354	2,872
Guarantees	35	363
Loan commitments, overdraft and credit card commitments	3,089	3,195

Impairment allowances of ISK 27 million were recognised in the period against balances outstanding with associated companies (same period 2012: ISK 210 million).

No share option programmes were operated during the reporting period 1 January - 30 September 2013.

For the nine months ended 30 September 2013 24 Amounts are in ISK million

Non-current assets and disposal groups held for sale

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

	30.9.2013	31.12.2012
Repossessed collateral	12,816	10,161
Assets of disposal groups classified as held for sale	32,966	28,885
Total	45,782	39,046

Repossessed collateral:

Land and property	11,170	8,225
Industrial equipment and vehicles	77	94
Shares and equity instruments	1,508	1,702
Vehicles	61	140
Total	12,816	10,161

Assets of disposal groups classified as held for sale:	30.9.2013	31.12.2012
Cash	321	1,069
Equity instruments	856	1,037
Receivables	360	1,513
Tax assets	124	231
Properties	14,346	16,081
Assets classified as held for sale	12,964	4,937
Other assets	3,995	4,017
Total	32,966	28,885

Liabilities associated with assets classified as held for sale:	30.9.2013	31.12.2012
Payables	835	634
Deferred tax liabilities	636	676
Income tax payable	48	-
Borrowings	7,626	3,588
Other liabilities	633	1,907
Total	9,778	6,805

Other assets

31. Other assets are specified as follows:

	30.9.2013	31.12.2012
Receivables	2,600	2,740
Unsettled securities transactions	6,814	1,259
Accruals	722	562
Prepaid expenses	392	271
Other assets	282	283
Other assets	10,810	5,115

Amounts are in ISK million

Deposits from Central Bank and credit institutions

32. Deposits from Central Bank and credit institutions are specified as follows:

	30.9.2013	31.12.2012
Repurchase agreements with Central Bank	44	54
Deposits from credit institutions	29,723	38,218
Deposits from Central Bank and credit institutions	29,767	38,272

Deposits from customers

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

	30.9.2013	31.12.2012
Demand deposits	407,783	379,257
Time deposits	88,670	91,899
Deposits from customers	496,453	471,156

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

	30.9.2013		31.12.2012	
	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	5,577	1%	4,963	1%
Municipalities	5,421	1%	5,671	1%
Companies	297,964	60%	276,168	59%
Individuals	187,491	38%	184,354	39%
Deposits from customers	496,453	100%	471,156	100%

Debt issued and other borrowed funds

35. Specification of debt issued and other borrowed funds:

	30.9.2013	31.12.2012
Non-listed issued bonds	47,536	51,335
Listed issued bonds	30,201	13,713
Loans from credit institutions	56	8
Other debt securities	1,401	1,515
Debt issued and other borrowed funds	79,194	66,571

For the nine months ended 30 September 2013 26 Amounts are in ISK million

Other liabilities

36. Specification of other liabilities:

	30.9.2013	31.12.2012
Accruals	2,969	3,117
Liabilities to retailers for credit card provision	19,685	17,404
Provision for effects of court rulings*	9,934	14,736
Provision for estimated losses from guarantees**	264	868
Provision for reimbursement of interest***	-	2,493
Chargeable gain tax	670	1,896
Unsettled securities transactions	9,101	5,222
Deferred income	185	197
Sundry liabilities	3,362	3,021
Other liabilities	46,170	48,954

	Provision for effects of court rulings*	Provision for estimated losses from guarantees**	Provision for reimbursem. of interest***	Total
At 1 January 2013	14,736	868	2,493	18,097
Provision change during the period	(4,802)	(604)	(2,493)	(7,899)
At 30 September 2013	9,934	264	-	10,198

Equity

37. Authorised share capital of the Bank is 10,000m ordinary shares of ISK 1 each. At 30.9.2013 paid up share capital totalled ISK 65,000m which is the total stated share capital of the Bank.

Total share capital:

	30.9.2013	31.12.2012
Ordinary share capital	10,000	10,000
Share premium account	55,000	55,000
Total share capital	65,000	65,000

Off balance sheet items

Obligations

38. The Bank has granted its customers guarantees, overdraft facilities and loan commitments. These items are specified as follows:

	30.9.2013	31.12.2012
Financial guarantees	9,581	8,371
Undrawn loan commitments	23,122	12,798
Undrawn overdrafts	22,528	22,412
Credit card commitments	27,892	27,710

The Depositors' and Investors' Guarantee Fund

Under the previous legislation, the Bank was required to grant the fund a declaration of guarantee in case the fund's assets did not meet the required minimum amount. Accordingly, in 2010, 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 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.

Amounts are in ISK million

Balance of custody assets

39. Balance of custody assets:

	30.9.2013	31.12.2012
Custody assets	750,292	762,568

Contingencies

40. **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 priority claims on the liquidated assets of Glitnir and the netting exercise is therefore 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 Islandsbanki 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.

The Islandsbanki case is based on the indexation being in violation of the EU directive 93/13/EU on unfair terms in consumer loan contracts. 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. The directive was not adopted by Iceland in its entirety. The existing contract law was amended instead by adding 4 articles. Because of this discrepancy, 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 local law. The opinion is expected in the first months of next year. Icelandic courts are not obliged to accept an opinion of the EFTA court.

The possible effect on the Bank has not been estimated, but clearly, any downgrading of the indexation would seriously affect the already suffering government backed Icelandic Housing Fund (ILS) and consequently the pension funds as holders of most of the ILS bonds.

The Landsbanki case is 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 district court of Reykjavík has very 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/EBE) 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 original argument has more or less been put aside, making the case very similar to the one Islandsbanki is defending.

For the nine months ended 30 September 2013 28 Amounts are in ISK million

40. Cont'd

Foreign currency loans

Several rulings of the Supreme Court of Iceland during the years 2010 to 2013 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 a principal of loans in ISK being linked to foreign currencies. Consequently, such loans could not carry Libor interest rates.

In order to address the uncertainty surrounding which foreign currency loans should be deemed to be illegally linked to foreign currency exchange rates, the Parliament introduced in 2010 a new legislation, taking effect on 28 December 2010. Based on the context of this new law, the Bank treated all foreign currency dominated mortgages and car loans according to the method previously set forth in a September 2010 ruling of the Supreme Court concerning car loans/leasing contracts. All customers with foreign currency mortgages were presented with an offer of having their mortgage recalculated according to a similar formula, regardless of the legality of the contract in question. The definition of a mortgage in the legislation refers to tax law. The recalculation had to be offered if the debtor was eligible for a refund in part of paid interest (interest subsidy) of the loan. The Bank decided to expand this definition to cover all residential loans to individuals, although the debtors were not required to accept the offer. The interest rate on car loans going forward was, according to the law, replaced by the lowest non-indexed Central Bank rate. The same goes for mortgages for the first five years, in addition to a choice of an indexed CPI rate. At the end of the five year term, mortgages will revert back to market rates.

Several court rulings have found additional loan contract types illegally indexed to foreign currency exchange rates. In April 2011, the District Court of Reykjavík ruled on a dispute regarding the nature of a financial leasing contract between the Bank and a customer. The court ruled that although the contract had the form of a lease, it was by nature a loan contract, thereby subject to the Interest Law 38/2001. The contract was denominated in foreign currency, and the court further ruled that the contract had an illegal foreign currency indexation, citing the precedent set by the Supreme Court in June 2010. In October 2011, the District Court ruling was confirmed by the Supreme Court. The ruling affected, by precedent, approximately 4,100 similar contracts. The Supreme Court set a new precedent in June 2011 by deciding that a Landsbankinn loan contract contained an illegal foreign currency indexation (MótorMax case).

In other cases, the courts have ruled that disputed contracts are indeed legal foreign currency loan contracts. On 3 November 2011, the Supreme Court ruled on an appeal of a District Court's decision to dismiss a case involving a disputed foreign currency bond (the box form). The Supreme Court ruled that because the disputed bond was by its nature not affected by the Supreme Court's previous rulings (including the June 2010 and 2011 rulings) the District Court should hear the case and pass a ruling of its own. The Supreme Court specifically mentions in the ruling that the bond's principal is stated in foreign currencies, and reiterates that a correctly written foreign currency debt agreement is not prohibited according to the Interest Law 38/2001. Consequently, the District Court ruled on the case as presented and found in favour of the Bank. In June 2012, the Supreme Court in effect confirmed this decision by ruling 7-0 on an identical loan contract. Furthermore, the Supreme Court decided in June 2012 that a loan contract similar to the one in the MótorMax case mentioned above was legal because the lender did actually receive payment in foreign currency.

On 15 February 2012, the Supreme Court in Iceland passed a ruling (no. 600/2011) that affects the recalculation of loans that are illegally linked to the value of foreign currencies. The ruling states that Law 151/2010, which the Icelandic Parliament passed in December 2010 and instructed banks on how to recalculate foreign currency linked mortgages, violates the provisions of the Icelandic constitution that protects the freedom to hold private property, as the legislator cannot pass a law that retroactively deprives a person of an asset without adequate compensation. More specifically, the Court ruled that the recalculation in the disputed case, which had been carried out as prescribed by Law 151/2012, was not appropriate. The Supreme Court passed on 18 October 2012 a new ruling on a similar case. The ruling gave to a certain extent instructions on how the disputed loans shall be recalculated. In both cases the amount of an outstanding loan was in dispute and the court found that borrowers that had made payments in line with instructions from the lender should not suffer a higher interest charge for payments already made. Internal and external legal counsel are unanimously of the opinion that the rulings affect loans to various types of borrowers, including individuals, corporate and municipalities and both long and short term loans.

A Supreme Court ruling issued on 17 January 2013 on a currency loan involved an Íslandsbanki loan contract. The loan amount was denominated in ISK and the loan was disbursed to the customer in ISK, with the exception of one document/annex named “loan application” in which the loan amount was presented in foreign currencies. The court found that this document could not change or offset the illegal nature of the contract, mainly because the contract itself did not refer to any such document (technically, every such contract has an annex named “disbursement notice”, but this was scarcely used as the opinion was that the loan application did serve more or less the same purpose). The ruling affected at least 300 loan contracts, some of which had previously been recalculated according to the offers made by the Bank. However, despite being relatively few in number, these type of contracts generally carry the greatest loan amounts.

As stated before, the Supreme Court previously found that one of the most common loan contracts in Islandsbanki (June 2012) was legal. However, the wording of most housing loans deviates slightly from that of the common contract. This deviation has been tested before the district court and found to be of no importance. The Supreme court will rule on the decision late this year. Being great in numbers, a reversal of the verdict on the housing loans would have significant impact.

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 36.

40. Cont'd

These court rulings have gradually reduced the uncertainty regarding which foreign currency loans are illegal. The Bank has made an announcement to the effect that it will recalculate illegally foreign currency-linked and outstanding as well as paid-up loans in line with the instructions given in the most recent ruling. This process in well on its way, for instance most car loans/contracts have been recalculated. However, finding that the ruling is based on the Bank being the dominant and expert party in the contractual relationship, the ruling does 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.

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. During the last 18 months, the Byr loan portfolio has been thoroughly assessed in order to quantify such a refund claim. A claim was filed with the Committee in June 2013 amounting to ISK 6,943 million plus interest. The Committee rejected the claim with a letter dated September 30th. Settlement negotiations have not been scheduled at this point and the claim will be filed with the District Court of Reykjavík in early December. 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). A formal claim amounting to ISK 911 million plus interest was filed with the Ministry on September 24th. The Ministry has not responded as of this date. Any possible revenues relating to this claim have as yet not been incorporated into the Bank’s current financial statements.

Events after the end of the reporting period

41. The Bank has agreed in September 2013 to sell its 72.5% stake in HTO ehf. The sale is subject to documentation and approval from the competition authorities.

Risk Management

42. 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 2012. The English and Icelandic versions are available at the Bank’s homepage under investor relations: www.islandsbanki.is/ir.

Credit risk

43. 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.

44. Restructuring and forbearance

Restructuring of customers’ debt has been one of the Bank’s main tasks since October 2008. This has been a challenging task as such a large part of the customers needed forbearance measures. Legal issues, political environment and the general economy have contributed in ways of uncertainty and complications. Íslandsbanki 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, interest discount, write offs and tailor made solutions in complicated cases where general solutions do not suffice. In some cases, often prior to formal restructuring, customers undergo less formal forbearance measures such as temporary payment holidays, extension of loans terms and capitalisation of arrears.

This has been done without a significant loss to the Bank because the loan portfolio was acquired at a deep discount. The Bank has furthermore offset any foreign exchange gain or loss due to currency movements relating to loans to customers with ISK cash flow.

45. 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 latent impairment allowance is subtracted, see Note 25. 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:

Credit risk exposure

45. Cont'd

Maximum credit exposure 30.9.2013

	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrials and transporta-tion	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	92,980	-	-	-	-	-	-	-	-	-	92,980
Derivatives	51	171	16	-	311	1,037	46	43	-	29	107	1,811
Bonds and debt instruments	-	72,072	-	-	58	3,205	-	968	151	448	-	76,902
Loans to credit institutions	-	-	-	-	-	65,824	-	-	-	-	-	65,824
Loans to customers:	247,379	-	82,064	16,474	3,557	39	43,503	10,995	6,710	68,949	70,671	550,341
Overdrafts	14,951	-	7,873	3,523	1	20	3,693	494	1,353	1,376	2,369	35,653
Credit cards	14,684	-	1,309	157	6	19	383	33	179	47	53	16,870
Mortgages	172,476	-	-	-	-	-	-	-	-	-	-	172,476
Leases	9,314	-	14,530	1,768	11	0	5,079	151	313	1,401	215	32,782
Other loans	35,954	-	58,352	11,026	3,539	0	34,348	10,317	4,865	66,125	68,034	292,560
Off-balance sheet items:												
Financial guarantees	1,270	-	2,526	2,575	-	1,483	1,045	27	11	133	511	9,581
Undrawn loan commitments	-	-	3,892	967	7,427	-	4,435	4,913	0	-	1,488	23,122
Undrawn overdraft	9,504	-	5,225	1,185	216	1,147	2,310	153	1,156	603	1,029	22,528
Credit card commitments	22,215	-	3,148	396	13	74	770	117	858	164	137	27,892
Total maximum credit exposure	280,419	165,223	96,871	21,597	11,582	72,809	52,109	17,216	8,886	70,326	73,943	870,981

Amounts are in ISK million

45. Cont'd

Maximum exposure 31.12.2012

	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrials and transporta-tion	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	85,500	-	-	-	-	-	-	-	-	-	85,500
Derivatives	8	132	51	30	-	1,292	12	70	-	8	36	1,639
Bonds and debt instruments	-	58,141	316	-	-	2,174	-	2,162	19	1,223	-	64,035
Loans to credit institutions	-	-	-	-	-	54,043	-	-	-	-	-	54,043
Loans to customers:	244,426	-	68,805	16,465	4,942	254	43,660	16,023	10,934	72,941	81,145	559,595
Overdrafts	14,871	-	6,487	2,705	3	94	3,508	418	1,756	1,616	1,898	33,356
Credit cards	15,825	-	1,243	138	2	26	333	34	182	45	41	17,869
Mortgages	164,416	-	-	-	-	-	-	-	-	-	-	164,416
Leases	9,763	-	14,187	2,266	14	13	4,181	176	408	1,492	413	32,913
Other loans	39,551	-	46,888	11,356	4,923	121	35,638	15,395	8,588	69,788	78,793	311,041
Off-balance sheet items:												
Financial guarantees	1,307	-	2,242	1,858	4	1,001	873	360	55	152	519	8,371
Undrawn loan commitments	-	-	3,308	422	5,436	-	2,798	1	-	-	833	12,798
Undrawn overdraft	9,502	-	4,330	1,141	229	1,318	3,117	279	1,146	471	879	22,412
Credit card commitments	21,893	10	2,990	426	17	93	796	123	1,096	154	112	27,710
Total maximum credit exposure	277,136	143,783	82,042	20,342	10,628	60,175	51,256	19,018	13,250	74,949	83,524	836,103

Amounts are in ISK million

46. 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.

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

At 30 September 2013

	Real estate	Fishing vessels	Cash & securities	Vehicles & equipment	Other collateral	Total collateral
Derivatives	-	-	629	-	-	629
Loans and commitments to customers:	322,257	65,992	8,448	19,323	15,201	431,221
Individuals	201,144	15	1,936	7,609	-	210,704
Commerce and services	29,272	0	879	10,733	4,769	45,653
Construction	7,561	-	69	271	3,284	11,185
Energy	2,609	-	92	-	122	2,823
Financial services	-	-	-	-	-	-
Industrial and transportation	17,129	-	110	556	4,406	22,201
Investment companies	3,852	-	3,990	12	257	8,111
Public sector and non-profit organisations	1,431	-	11	24	-	1,466
Real estate	53,851	27	460	78	-	54,416
Seafood	5,408	65,950	901	40	2,363	74,662
Total	322,257	65,992	9,077	19,323	15,201	431,850

At 31 December 2012

	Real estate	Fishing vessels	Cash & securities	Vehicles & equipment	Other collateral	Total collateral
Derivatives	-	-	640	-	-	640
Loans and commitments to customers:	314,242	68,349	15,682	17,790	14,231	430,294
Individuals	197,187	89	2,918	8,145	-	208,339
Commerce and services	27,477	-	913	8,471	3,083	39,944
Construction	7,622	186	121	287	3,662	11,878
Energy	2,601	-	6	3	146	2,756
Financial services	69	-	8	11	-	88
Industrial and transportation	13,036	-	724	674	5,793	20,227
Investment companies	3,493	-	10,150	17	397	14,057
Public sector and non-profit organisations	3,645	-	10	59	194	3,908
Real estate	54,596	139	233	76	-	55,044
Seafood	4,516	67,935	599	47	956	74,053
Total	314,242	68,349	16,322	17,790	14,231	430,934

The Bank is still in the process of finalising the registration of necessary collateral information for this disclosure.

Amounts are in ISK million

47. 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. Loans are also classified as impaired if the Bank has made impairments to offset currency movements. This impairment does not signal a loss from the deep discount.

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

At 30 September 2013

	Neither past due nor impaired	Past due but not impaired	Classified as impaired	Total carrying amount
Cash and balances with Central Bank	92,980	-	-	92,980
Derivatives	1,811	-	-	1,811
Bonds and debt instruments	76,902	-	-	76,902
Loans to credit institutions	65,824	-	-	65,824
Loans to customers:	479,267	38,117	32,957	550,341
Individuals	213,624	25,325	8,430	247,379
Commerce and services	70,510	3,668	7,886	82,064
Construction	14,159	1,311	1,004	16,474
Energy	3,553	3	1	3,557
Financial services	39	0	-	39
Industrial and transportation	39,766	1,812	1,925	43,503
Investment companies	9,644	399	952	10,995
Public sector and non-profit organisations	6,576	120	14	6,710
Real estate	57,796	3,241	7,912	68,949
Seafood	63,600	2,238	4,833	70,671
Total	716,784	38,117	32,957	787,858

At 31 December 2012

	Neither past due nor impaired	Past due but not impaired	Classified as impaired	Total carrying amount
Cash and balances with Central Bank	85,500	-	-	85,500
Derivatives	1,639	-	-	1,639
Bonds and debt instruments	64,035	-	-	64,035
Loans to credit institutions	54,043	-	-	54,043
Loans to customers:	469,435	42,205	47,955	559,595
Individuals	206,255	29,714	8,457	244,426
Commerce and services	55,908	3,330	9,567	68,805
Construction	13,411	1,717	1,337	16,465
Energy	4,941	-	1	4,942
Financial services	197	16	41	254
Industrial and transportation	39,531	1,454	2,675	43,660
Investment companies	11,736	631	3,656	16,023
Public sector and non-profit organisations	10,425	101	408	10,934
Real estate	51,351	4,598	16,992	72,941
Seafood	75,680	644	4,821	81,145
Total	674,652	42,205	47,955	764,812

For the nine months ended 30 September 2013 35 Amounts are in ISK million

48. 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.

At 30 September 2013

	Risk class 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Total
Loans to customers						
Individuals	8,006	72,112	81,921	42,507	9,078	213,624
Commerce and services	12,700	23,177	25,895	6,437	2,301	70,510
Construction	-	1,943	9,624	1,826	766	14,159
Energy	2,158	1,368	25	2	-	3,553
Financial services	10	11	15	3	-	39
Industrial and transportation	11,786	18,126	6,305	3,210	339	39,766
Investment companies	842	2,889	2,220	2,320	1,373	9,644
Public sector and non-profit organisations	421	4,248	1,597	282	28	6,576
Real estate	129	30,327	9,538	9,644	8,158	57,796
Seafood	23,376	30,387	6,975	1,684	1,178	63,600
Total	59,428	184,588	144,115	67,915	23,221	479,267

At 31 December 2012

	Risk class 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Total
Loans to customers						
Individuals	8,215	71,069	66,147	49,650	11,174	206,255
Commerce and services	3,737	14,624	21,225	10,326	5,996	55,908
Construction	-	1,511	9,062	2,117	721	13,411
Energy	2	2,882	24	2,033	-	4,941
Financial services	5	16	99	77	-	197
Industrial and transportation	10,494	18,062	7,432	2,937	606	39,531
Investment companies	661	7,092	1,358	1,812	813	11,736
Public sector and non-profit organisations	639	4,994	2,000	2,774	18	10,425
Real estate	4,443	15,369	10,643	4,553	16,343	51,351
Seafood	31,949	34,605	5,638	705	2,783	75,680
Total	60,145	170,224	123,628	76,984	38,454	469,435

Note that the same customer can have loans that are more than 90 days past 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 tables above.

For the nine months ended 30 September 2013 36 Amounts are in ISK million

49. 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 30 September 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	9,127	3,604	761	11,833	25,325
Commerce and services	1,786	647	130	1,105	3,668
Construction	388	193	77	653	1,311
Energy	-	-	-	3	3
Financial services	-	-	-	-	-
Industrial and transportation	606	429	34	743	1,812
Investment companies	133	11	15	240	399
Public sector and non-profit organisations	102	12	1	5	120
Real estate	1,591	401	174	1,075	3,241
Seafood	705	529	63	941	2,238
Total	14,438	5,826	1,255	16,598	38,117

At 31 December 2012

	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	8,567	4,652	1,107	15,388	29,714
Commerce and services	1,023	502	101	1,704	3,330
Construction	323	82	97	1,215	1,717
Energy	-	-	-	-	-
Financial services	1	1	1	13	16
Industrial and transportation	299	269	72	814	1,454
Investment companies	73	30	38	490	631
Public sector and non-profit organisations	42	19	-	40	101
Real estate	580	1,528	133	2,357	4,598
Seafood	45	30	34	535	644
Total	10,953	7,113	1,583	22,556	42,205

Amounts are in ISK million

50. Large exposure disclosure

When the Bank's total exposure to a group of connected clients is 10% of the Bank's capital base or higher it is considered a large exposure. The exposure is evaluated net of credit risk mitigating effects eligible according to FME rules 625/2013.

When assessing the exposure, both on-balance sheet and off-balance sheet items from all types of financial instruments are included as defined by the FME rules. The Bank has internal criteria that define connections between clients. This 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 used to define large exposures includes reviewed own fund items at 30 June 2013.

The Bank has currently no large exposure. In particular, the Bank is both below the aggregated 400% limit and 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.

		30.9.2013
Client groups	Gross	Net
Group 1	73%	0%

		31.12.2012
Client groups	Gross	Net
Group 1	53%	0%
Group 2	15%	15%

For the nine months ended 30 September 2013 38 Amounts are in ISK million

Liquidity Risk

51. 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 30 September 2013

Financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Short positions	10,174	-	-	-	-	-	10,174
Deposits from Central Bank	44	-	-	-	-	-	44
Deposits from credit institutions	25,465	3,760	444	-	-	-	29,669
Deposits from customers	353,325	53,912	45,164	30,110	22,255	-	504,766
Debt issued and other borrowed funds	2	6,932	12,209	42,818	28,946	1,040	91,947
Subordinated loans	-	261	810	7,302	26,312	-	34,685
Other financial liabilities	44,584	1,678	5,704	-	74	-	52,040
Total financial liabilities	433,594	66,543	64,331	80,230	77,587	1,040	723,325

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.

Off-balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees	9,581	-	-	-	-	-	9,581
Undrawn loan commitments	23,122	-	-	-	-	-	23,122
Undrawn overdrafts	22,528	-	-	-	-	-	22,528
Credit card commitments	27,892	-	-	-	-	-	27,892
Total	83,123	-	-	-	-	-	83,123
Total non-derivative financial liabilities and off-balance sheet liabilities	516,717	66,543	64,331	80,230	77,587	1,040	806,448

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.

Amounts are in ISK million

51. Cont'd

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	10,329	45,458	54,399	25,000	-	135,186
Outflow	-	(9,613)	(51,082)	(59,294)	(25,085)	-	(145,074)
Total	-	716	(5,624)	(4,895)	(85)	-	(9,888)
Net settled derivatives	-	(178)	-	-	-	-	(178)
Total	-	538	(5,624)	(4,895)	(85)	-	(10,066)

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.

Financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Cash and balances with Central Bank	11,820	81,160	-	-	-	-	92,980
Bonds and debt instruments	3,497	39,598	-	-	31,179	2,628	76,902
Shares and equity instruments	-	-	10	313	-	9,205	9,528
Loans to credit institutions	43,987	21,679	158	-	-	-	65,824
Loans to customers	862	73,911	40,791	151,027	283,702	-	550,293
Other financial assets	6,762	-	31	2,817	-	2,343	11,953
Total financial assets	66,928	216,348	40,990	154,157	314,881	14,176	807,480
Derivative financial assets							
Gross settled derivatives							
Inflow	-	1,103	7,120	2,278	5,959	-	16,460
Outflow	-	(1,011)	(6,908)	(2,443)	(5,912)	-	(16,274)
Total	-	92	212	(165)	47	-	186
Net settled derivatives	-	94	-	-	-	-	94
Total	-	186	212	(165)	47	-	280

The tables below show the comparative amounts for financial assets and liabilities at the end of 2012.

Maturity analysis 31 December 2012

Financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Short positions	11,991	-	-	-	-	-	11,991
Deposits from Central Bank	54	-	-	-	-	-	54
Deposits from credit institutions	29,726	8,119	401	-	-	-	38,246
Deposits from customers	338,464	46,390	41,059	27,590	23,969	-	477,472
Debt issued and other borrowed funds	8	2,449	7,304	44,288	23,085	983	78,117
Subordinated loans	-	236	523	6,337	28,919	-	36,015
Other financial liabilities	42,190	5,957	2,154	-	291	-	50,592
Total financial liabilities	422,433	63,151	51,441	78,215	76,264	983	692,487

Amounts are in ISK million

51. Cont'd

Off-balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees	8,371	-	-	-	-	-	8,371
Undrawn loan commitments	12,798	-	-	-	-	-	12,798
Undrawn overdrafts	22,412	-	-	-	-	-	22,412
Credit card commitments	27,710	-	-	-	-	-	27,710
Total	71,291	-	-	-	-	-	71,291
Total non-derivative financial liabilities and off-balance sheet liabilities	493,724	63,151	51,441	78,215	76,264	983	763,778

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	6,074	1,872	75,987	25,000	-	108,933
Outflow	-	(5,849)	(1,944)	(93,004)	(25,080)	-	(125,877)
Total	-	225	(72)	(17,017)	(80)	-	(16,944)
Net settled derivatives	-	(115)	-	-	-	-	(115)
Total	-	110	(72)	(17,017)	(80)	-	(17,059)

Financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Cash and balances with Central bank	27,380	58,120	-	-	-	-	85,500
Bonds and debt instruments	1,281	26,730	-	-	31,120	4,904	64,035
Shares and equity instruments	-	-	13	326	-	10,106	10,445
Loans to credit institutions	34,665	19,227	151	-	-	-	54,043
Loans to customers	578	70,346	50,267	149,005	289,399	-	559,595
Other financial assets	1,640	1,007	209	1,201	-	1,998	6,055
Total financial assets	65,544	175,430	50,640	150,532	320,519	17,008	779,673

Derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	1,805	909	8,284	-	-	10,998
Outflow	-	(1,755)	(860)	(8,189)	-	-	(10,804)
Total	-	50	49	95	-	-	194
Net settled derivatives	-	61	-	-	-	-	61
Total	-	111	49	95	-	-	255

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 September 2013 and end of 2012.

Composition and amount of liquidity back-up	30.9.2013	31.12.2012
Cash and balances with Central Bank	92,980	85,500
Domestic bonds eligible as collateral against borrowing at Central Bank	18,378	12,704
Foreign government bonds	39,598	26,730
Short-term placements with credit institutions	63,834	49,264
Composition and amount of liquidity back-up	214,790	174,198

For the nine months ended 30 September 2013 41 Amounts are in ISK million

Market risk

52. 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

53. 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% upward parallel shift in the yield curve on the fair value of these exposures.

54. 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 netting of long and short positions in specific securities between different portfolios.

Trading bonds and debt instruments, long positions	30.9.2013			31.12.2012		
	MV	Duration	BPV	MV	Duration	BPV
Indexed	2,495	8.01	(2.00)	1,589	11.01	(1.75)
Non-indexed	43,216	0.46	(2.00)	26,933	0.18	(0.50)
Total	45,711	0.87	(4.00)	28,522	0.79	(2.25)

Trading bonds and debt instruments, short positions	30.9.2013			31.12.2012		
	MV	Duration	BPV	MV	Duration	BPV
Indexed	94	9.41	(0.09)	521	10.65	0.55
Non-indexed	96	6.60	(0.06)	1,592	2.21	0.35
Total	190	8.00	(0.15)	2,113	4.29	0.90
Net position of trading bonds and debt instruments	45,521	0.91	(4.15)	26,409	0.50	(1.35)

Amounts are in ISK million

55. 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 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 the 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 restrucuring. The end-of-year figures for 2012 have been updated accordingly and thus differ from those previously reported in the Annual Report 2012.

Banking book interest rate adjustment periods on 30 September 2013

Assets	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Cash and balances with Central Bank	92,980	-	-	-	-	-	92,980
Bonds and debt instruments	30,905	754	20	1,218	288	379	33,564
Loans to credit institutions	65,666	158	-	-	-	-	65,824
Loans to customers	432,323	14,339	65,324	21,959	1,324	13,269	548,538
Total assets	621,874	15,251	65,344	23,177	1,612	13,648	740,906
Off-balance sheet items..	47,949	27,642	-	4,831	113	-	80,535
Liabilities							
Short positions	2,653	2,809	-	885	-	-	6,347
Deposits from Central Bank	44	-	-	-	-	-	44
Deposits from credit institutions	29,294	429	-	-	-	-	29,723
Deposits from customers	484,677	932	1,641	2,218	6,985	-	496,453
Debt issued and other borrowed funds	10,639	4,393	361	48,607	6,396	8,798	79,194
Subordinated loans	-	22,565	-	-	-	-	22,565
Total liabilities	527,307	31,128	2,002	51,710	13,381	8,798	634,326
Off-balance sheet items	48,845	20,466	5,318	8,180	-	-	82,809
Net interest gap on 30 September 2013	93,671	(8,701)	58,024	(31,882)	(11,656)	4,850	104,306

Amounts are in ISK million

55. Cont'd

Banking book interest rate adjustment periods 31 December 2012

Assets	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	83,493	-	-	-	-	-	83,493
Bonds and debt instruments	33,424	795	403	382	575	58	35,637
Loans to credit institutions	53,891	151	-	-	-	-	54,042
Loans to customers	422,980	48,961	27,250	46,197	1,314	12,893	559,595
Total assets	593,788	49,907	27,653	46,579	1,889	12,951	732,767
Off-balance sheet items	47,981	29,259	-	-	113	-	77,353
Liabilities							
Short positions	-	3,226	1,140	850	-	-	5,216
Deposits from Central Bank	54	-	-	-	-	-	54
Deposits from credit institutions	37,837	381	-	-	-	-	38,218
Deposits from customers	459,233	1,657	888	2,743	6,635	-	471,156
Debt issued and other borrowed funds	7,420	-	-	6,018	48,193	4,940	66,571
Subordinated loans	23,450	-	-	-	-	-	23,450
Total liabilities	527,994	5,264	2,028	9,611	54,828	4,940	604,665
Off-balance sheet items	52,896	9,479	10,552	9,754	-	-	82,681
Net interest gap on 31 December 2012	60,879	64,423	15,073	27,214	(52,826)	8,011	122,774

Amounts are in ISK million

Currency risk

56. 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 mismatch in the currency composition of assets or liabilities.

The adjustment of previous reports for FX/ISK loans, i.e. loans with a non-ISK contractual currency to customers with ISK income, is no longer included. Such loans have been or are on the verge of being converted to ISK and as such are excluded from the figures or are believed to remain as FX loans and are in such cases included in the figures.

Currency analysis 30 September 2013

Assets	EUR	USD	GBP	CHF	JPY	Other	Total
Cash and balances with Central Bank......................	357	189	100	35	14	266	961
Bonds and debt instruments....................................	17,196	16,708	-	-	-	6,099	40,003
Shares and equity instruments................................	302	300	14	1	-	2	619
Loans to credit institutions.......................................	14,628	26,331	3,245	2,749	6,552	7,852	61,357
Loans to customers...	57,850	11,300	4,595	7,187	7,179	2,473	90,584
Other assets..	5,263	1,447	140	-	27	55	6,932
Total assets	95,596	56,275	8,094	9,972	13,772	16,747	200,456
Liabilities							
Deposits from credit institutions	232	19	-	-	15	-	266
Deposits from customers	40,733	32,227	5,697	3,236	969	6,301	89,163
Debt issued and other borrowed funds	-	-	-	-	-	60	60
Subordinated loans	22,565	-	-	-	-	-	22,565
Other liabilities...	6,848	4,656	-	3	39	216	11,762
Total liabilities	70,378	36,902	5,697	3,239	1,023	6,577	123,816
On-balance sheet imbalance	25,218	19,373	2,397	6,733	12,749	10,170	76,640
Off balance sheet items							
Off-balance sheet assets	10,933	8,698	235	155	585	77	20,683
Off-balance sheet liabilities	27,953	24,835	186	6,953	11,361	3,579	74,867
Net off-balance sheet items	(17,020)	(16,137)	49	(6,798)	(10,776)	(3,502)	(54,184)
Net currency imbalance on 30 September 2013..	8,198	3,236	2,446	(65)	1,973	6,668	22,456

Amounts are in ISK million

56. Cont'd

Currency analysis 31 December 2012

Assets	EUR	USD	GBP	CHF	JPY	Other	Total
Cash and balances with Central Bank	355	187	101	30	11	248	932
Bonds and debt instruments	15,283	10,686	-	-	-	1,149	27,118
Shares and equity instruments	491	255	16	2	-	-	764
Loans to credit institutions	13,721	17,758	683	2,166	2,836	9,235	46,399
Loans to customers	60,309	17,674	5,314	8,590	10,808	1,729	104,424
Investments in associates	21	348	-	-	-	-	369
Other assets	358	1,096	138	-	4	30	1,626
Total assets	90,538	48,004	6,252	10,788	13,659	12,391	181,632
Liabilities							
Deposits from credit institutions	44	5	-	-	-	-	49
Deposits from customers	28,752	26,484	3,960	1,025	720	5,937	66,878
Debt issued and other borrowed funds	-	-	-	-	-	128	128
Subordinated loans	23,450	-	-	-	-	-	23,450
Other liabilities	1,521	4,088	669	1	16	166	6,461
Total liabilities	53,767	30,577	4,629	1,026	736	6,231	96,966
On-balance sheet imbalance	36,771	17,427	1,623	9,762	12,923	6,160	84,666
Off-balance sheet items							
Off-balance sheet assets	3,862	12,786	445	-	1,800	464	19,357
Off-balance sheet liabilities	24,610	26,826	722	9,818	13,394	795	76,165
Net off-balance sheet items	(20,748)	(14,040)	(277)	(9,818)	(11,594)	(331)	(56,808)
Net currency imbalance on 31 December 2012...	16,023	3,387	1,346	(56)	1,329	5,829	27,858

Derivatives

57. 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

58. 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 30 September 2013 the CPI gap amounted to ISK -1.1 billion (31 December 2012: ISK 1.3 billion). Thus, a 1% decrease in the index would have a positive impact on the profit and loss account to the amount of ISK 11 million and a 1% increase would result in a corresponding loss, other risk factors held constant.

Amounts are in ISK million

Capital management

59. Risk exposure and capital base

The Bank's total official capital ratio, calculated according to the Act on Financial Undertakings, was 26.6% and the Tier 1 ratio was 23.2%. The official capital ratio is based on reviewed own fund items at 30 June 2013.

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.

The table below shows the capital base, risk weighted assets and capital ratios of the Bank at 30 September 2013 and 31 December 2012. In addition, the table shows the official capital ratios based on reviewed own fund items at 30 June 2013.

	30.9.2013	31.12.2012
Tier 1 capital		
Ordinary share capital	10,000	10,000
Share premium	55,000	55,000
Other reserves	2,603	2,834
Retained earnings	90,920	78,571
Non-controlling interests	1,141	1,255
Tax assets	(1,059)	(864)
Intangible assets	(247)	(261)
Other regulatory adjustments	(225)	(321)
Total Tier 1 capital	158,133	146,214
Tier 2 capital		
Other regulatory adjustments	(225)	(322)
Qualifying subordinated liabilities	22,565	23,450
Total regulatory capital	180,473	169,342
Risk weighted assets		
- due to credit risk	553,364	549,535
- due to market risk:	28,327	33,940
Market risk, trading book	5,801	6,006
Currency risk foreign exchange	22,526	27,934
- due to operational risk	81,214	81,214
Total risk weighted assets	662,905	664,689
Capital ratios		
Tier 1 ratio	23.9%	22.0%
Total capital ratio	27.2%	25.5%
Official Tier 1 ratio	23.2%	22.0%
Official capital ratio	26.6%	25.5%

Amounts are in ISK million