Íslandsbanki

CONSOLIDATED UNAUDITED INTERIM FINANCIAL STATEMENTS **1Q17**

1Q 2017 HIGHLIGHTS:

- Earnings from regular operations was ISK 3.5bn, which is at comparable levels to1Q16.
- Return on equity from regular operations on 15% CET1 was 10.6% in 1Q17 compared to 9.4% in 1Q16.
- Profit after tax was ISK 3.0bn in 1Q17, compared to ISK 3.5bn in 1Q16. The profit in 1Q17 was driven by strong core income. Return on equity was 7.0% in 1Q17, compared to 6.9% in 1Q16.
- Net interest income amounted to ISK 7.4bn in 1Q17 (1Q16 ISK 7.5bn) down 2% over the year. The net interest margin was 2.9% in 1Q17 (1Q16: 2.9%).
- Net fee and commission income was ISK 3.3bn in 1Q17 compared to 3.1bn in 1Q16, up 4% over the year.
- Administrative costs totalled ISK 6.4bn in 1Q17, down 1.5% from 1Q16.
- Cost to income ratio was 60.1% in 1Q17 (1Q16: 59.0%), the cost to income ratio excludes the bank tax and one-off cost items.
- Total assets amounted to ISK 1,029bn (Dec16: ISK 1,048bn), whereby loans to customers and liquidity portfolio account for 96% of the balance sheet.
- Loans to customers grew by 2.3% (ISK 15.7bn) in 1Q17 to ISK 703bn. Total new lending was ISK 46bn across various lending divisions.
- Asset quality continues to improve whereby the ratio of loans more than 90 days past due and impaired continues to improve and was 1.6% (Dec16: 1.8%).
- Deposits from customers contracted by 4.5% (ISK 27bn) in 1Q17 to ISK 567bn.
- Total capital ratio was 23.1% and CET1 ratio was 22.8% at period end, compared to 25.2% and 24.9% respectively at year-end 2016.
- The liquidity position is strong and exceeds internal and external requirements. At period end the Bank's liquidity coverage ratio (LCR) was 181% (Dec16: 187%) and the total net stable funding ratio (NSFR) was 121% (Dec16: 123%).
- Leverage ratio was 15.5% at Mar17 compared to 16.0% at Dec16, indicating a moderate leverage.
- Íslandsbanki is the only Icelandic bank to have two international credit ratings. In January 2017, Fitch upgraded the Bank to BBB/F3, with a stable outlook, and in October 2016, S&P upgraded the Bank to BBB/A-2, with a positive outlook.

Birna Einarsdóttir, Chief Executive Officer at Íslandsbanki:
"Our core operations continued to produce stable core income, whereby net interest income and net fee and commission income contribute 97% of the Bank's total income. Return on equity from regular operations on 15% CET1 was 10.6%, compared to 9.4% in 1Q16. In March, the AGM approved a dividend payment of ISK 10bn to the Bank's shareholders for 2016 profits. All liquidity and capital measures remain solid and leverage remains modest at 15.5%

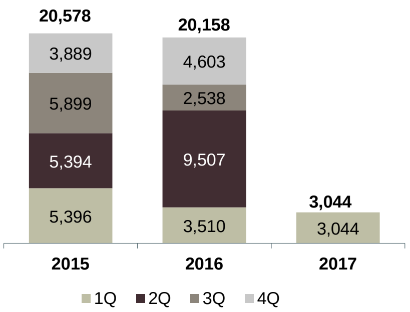
The full capital account liberalisation introduced in March marks a significant milestone for the Icelandic economy. As a result, upgrades were granted to the Iceland sovereign ratings. Íslandsbanki also received an upgrade and now has a BBB rating from both Fitch and S&P.

This step towards a more normalised operating environment in Iceland is a gratifying one for Íslandsbanki. Over the quarter, ISK 46bn was granted in new lending which was well spread across all business segments. Net fee and commission income was up 4% over the year. Corporate finance has been very active and closed several mandates. We also note a rise in demand for interest rate and FX risk related products from both domestic and international customers.

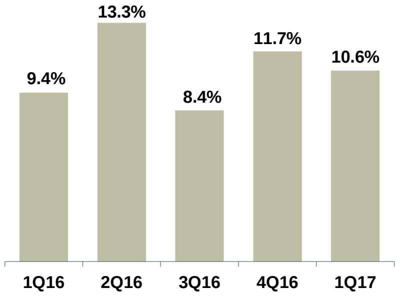
Individuals and companies are now allowed to invest in international securities without limitations. VÍB, Íslandsbanki's wealth management arm, has a broad range of funds available to clients that only invest in international markets. Customers can now also buy foreign currency in the online bank and process payments to overseas accounts as per usual.

In April, the branches in Kirkjusandur and Suðurlandsbraut were merged to form Laugardalur, the Bank's largest branch for individuals and SMEs. As a result, Íslandsbanki continues to operate the most efficient branch network in Iceland, with 14 branches nationwide. Simultaneously, we are making great strides in digitalisation and customer satisfaction continues to rise. For four years in a row, Íslandsbanki has been named Iceland's #1 bank in the Icelandic Customer Satisfaction Survey."

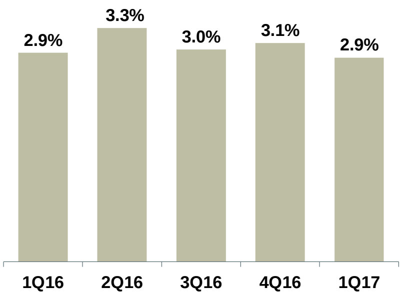
NET PROFIT
ISK m



ROE (Regular operations CET1 15%)
%



NET INTEREST MARGIN
%



Income Statement (ISK m)	1Q17	1Q16	Δ	4Q16	Δ	2016
Net interest income	**7,397**	7,539	(142)	8,149	(751)	31,802
Net fee and commission income	**3,270**	3,144	126	3,831	(562)	13,723
Net financial income	**12**	604	(592)	37	(25)	6,096
Net foreign exchange gain (loss)	**201**	12	188	77	123	443
Other operating income	**160**	151	9	(17)	177	652
Total operating income	**11,040**	11,450	(410)	12,077	(1,037)	52,716
Administrative expenses	**(6,418)**	(6,517)	98	(7,392)	974	(27,121)
Depositors'and Investors' Guarantee Fund	**(253)**	(261)	8	(252)	(0)	(1,063)
Bank Tax	**(720)**	(691)	(29)	(691)	(29)	(2,843)
Total operating expenses	**(7,391)**	(7,469)	77	(8,335)	944	(31,027)
Profit before net loan impairment	**3,649**	3,981	(332)	3,742	(94)	21,689
Net loan impairment	**240**	(320)	560	484	(244)	735
Profit before tax	**3,889**	3,661	228	4,226	(337)	22,424
Income tax expense	**(1,130)**	(866)	(264)	(1,353)	223	(5,205)
Profit for the period from continuing operations	**2,759**	2,795	(36)	2,874	(115)	17,219
Profit from discontinued ops. net of income tax	**285**	715	(430)	1,730	(1,445)	2,939
Profit for the period	**3,044**	3,510	(466)	4,603	(1,559)	20,158
ROE 15% CET1 (regular operations)	**10.6%**	9.4%		11.7%		10.7%
Return on assets	**1.2%**	1.4%		1.7%		1.9%
Net interest margin (of total assets), %	**2.9%**	2.9%		3.1%		3.1%
Cost to income ratio, %	**60.1%**	59.0%		59.8%		56.9%

INCOME STATEMENT

Stable and strong recurring revenues

Total income amounted to ISK 11.0bn in 1Q17, a decrease of 6% from 1Q16, the decrease is manily attributable to a lower interest rate environment. Net interest income totalled ISK 7.4bn, a decrease of 2% from the previous year. The net interest margin was 2.9%, at comparable levels to 1Q16. The net interest margin is expected to be slightly below 3.0% in the near to medium term.

Net fee and commission income rose 4%, to ISK 3.3bn in 1Q17. Net fee income benefited from increased customer activity within the parent company and its fee-generating subsidiaries.

Core income (net interest income and net fee and commission income) contributed 97% of total operating income and is at a similar position to 1Q16, which is in line with the Bank’s focus on core earnings and its objective of generating stable cash flows over the long term.

Net financial loss amounted to ISK 12m in 1Q17, compared to a gain of ISK 0.6bn in 1Q16, due to movements in fair value gains in equity holdings and bond and equity trading. The Bank also realised a net foreign exchange gain of ISK 0.2bn in 1Q17, compared with a gain of ISK 12m in 1Q16.

Other operating income, rental income, service level agreement fees, and a share in the profit or loss of associates, totalled ISK 0.2bn in 1Q17 (1Q16: ISK 0.2bn).

Continued focus on cost control

Administrative expenses (excluding one-off extraordinary expenses) decreased by ISK 0.1bn year-on-year in 1Q17. Total salaries and related expenses were ISK 3.7bn in 1Q17, a 7% decrease between years. The Bank's operations, which were spread across 4 locations, will be fully consolidated in the new headquarters at Nordurturn in Kópavogur later in 2017. Branches in Kirkjusandur and Sudurlandsbraut merged into a new branch in Laugardalur in February 2017, reducing the total number of branches to 14, and reaffirming Íslandsbanki as the most efficient branch network in Iceland. These changes added on front-end costs but are expected to be offset by future savings.

The average number of full time equivalent positions (FTE) was 896 for the parent company (923 in 1Q16) and 1,067 (1,081 in 1Q16) on a consolidated basis, excluding entities held for sale.

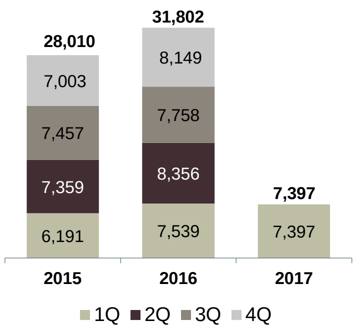
The cost-to-income ratio for the period was 60.1%, compared with 59.0% in 1Q16, which is above the Bank’s long-term target of 55%. The cost-to-income ratio excludes the bank tax and other one-off cost items.

The after-tax profit from discontinued operations was ISK 0.3bn in 1Q17 compared with ISK 0.7bn in 1Q16. The profit derives from the sale of non-core subsidiaries and income from foreclosed assets. The Bank has successfully divested all non-core business-related assets.

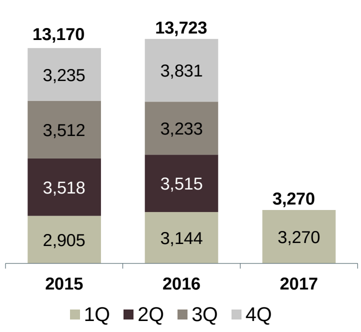
Net loan impairment gains

Net loan impairment generated a gain of ISK 0.2bn in 1Q17, compared to a loss of ISK 0.3bn in 1Q16. Because the Bank now has a fully restructured balance sheet, a large proportion of the revised estimated future cash flows have been realised and will have less impact on profitability in the future. The total gain of ISK 0.24bn is composed of ISK 0.4bn gain for specific and collective impairments, ISK 0.06bn gain from impairment reversal due to revision of estimated future cash flows from loans and negative ISK 0.22bn charge due to a court ruling.

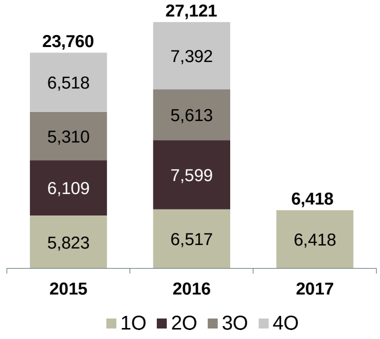
NET INTEREST INCOME
ISK m



NET FEE AND COMMISSION INCOME
ISK m



ADMINISTRATIVE EXPENSES
ISK m



Taxes and levies continue to affect profitability

The tax on the profit for the quarter amounted to ISK 1.1bn, compared to ISK 0.9bn in 1Q16. The effective tax rate was 29.1%, compared to 23.7% in 1Q16. The bank tax accounted for ISK 0.7bn in 1Q17 (1Q16: ISK 0.7bn).The bank tax increased significantly in 2013 as a temporary measure, but it is now unclear how the tax rate will develop in coming years. If the bank tax is continued, the Bank will need to try to find ways to offset it through pricing or further efficiency gains.

The Bank is subject to the special financial tax of 6% on taxable profits in excess of ISK 1bn, as well as contributions to the Debtors' and Investors' Guarantee Fund, the Financial Supervisory Authority, and the Office of the Debtors' Ombudsman. The contribution to the Depositors' and Investors' Guarantee Fund, at ISK 0.3bn, was comparable to that in the previous year.

Total taxes and levies amounted to ISK 2.4bn in 1Q17, as opposed to ISK 2.1bn in 1Q16.

BALANCE SHEET

Assets – balanced growth in loans to customers despite stiffening competition

The balance sheet contracted, by 1.8% in the first quarter, to ISK 1,029bn. This was primarily a result of lower liquidity levels with the Central Bank.

Loans to customers grew 2.3%, or ISK 15.6bn during 1Q17. Demand for new credit stemmed prodominately from corporations and to a lesser extent individuals, with mortgage loans rising by ISK 4bn since year-end 2016. New lending amounted to ISK 46bn, as opposed to ISK 39bn in 4Q16, an increase of 19%. There has been a notable increase in car lending to both individuals and companies.

Credit quality continues to improve, as can be seen in the Bank's declining non-performing loan ratios. The share of loans that are either impaired or 90 days in arrears was 1.6% at March 2017, down from 1.8% at year-end 2016.

The Bank's asset encumbrance ratio was 14.2% at period end March, compared to 15.4% in 2016.

Asset (ISK m)	**31.03.2017**	31.12.2016	Δ
Cash and balances with CB	**210,437**	275,453	-65,016
Bonds and debt instruments	**35,678**	31,256	4,423
Shares and equity instruments	**12,128**	10,626	1,502
Derivatives	**2,322**	1,953	369
Loans to credit institutions	**35,142**	17,645	17,497
Loans to customers	**703,447**	687,840	15,607
Investment in associates	**705**	450	255
Property and equipment	**6,376**	6,211	165
Intangible assets	**3,024**	2,672	352
Other assets	**14,298**	7,064	7,234
Non-current assets held for sale	**5,251**	6,384	-1,133
Total assets	**1,028,808**	1,047,554	-18,746
Risk weighted assets	**730,120**	704,177	25,943
Non performing loans, %	**1.6%**	1.8%	

Liabilities – deposits still the main source of funding

Total liabilities amount to ISK 858bn, a decrease of 1.2% since year end 2016.

The Bank maintained a strong liquidity position, with all regulatory and internal metrics well above the set limits. At March 2017, the Bank's liquidity coverage ratio (LCR) was 181%, and the net stable funding ratio (NFSR) in foreign currency was 142% at the group level. The total NFSR was 121% at group level.

Total deposits contracted by 3.4% in the first quarter to ISK 578.7bn. Deposits are still the Bank's main source of funding, and concentration levels are monitored closely. The decrease was due mainly to transfers of funds related to foreign financial institutions deposits that were trapped in Iceland under the capital controls. As a result, the ratio of customer deposits to customer loans declined to 80.7% at Mar17, compared to 86.4% at the end of 2016. The deposit-to-loan ratio is expected to remain high but decrease gradually in coming years as the effects of capital control lifting comes through fully.

Liabilities and Equity (ISK m)	**31.03.2017**	31.12.2016	Δ
Deposits from CB and credit inst.	**11,253**	4,922	6,331
Deposits from customers	**567,486**	594,187	-26,701
Derivatives and short positions	**5,041**	4,798	243
Debt issued and other borrowings	**223,327**	212,468	10,859
Tax liabilities	**10,062**	8,473	1,589
Other liabilities	**40,606**	43,456	-2,851
Non-current liabilities held for sale	**268**	325	-56
Total liabilities	**858,043**	868,629	-10,586
Total equity	**170,765**	178,925	-8,160
Total liabilities and equity	**1,028,808**	1,047,554	-18,746
CET1 ratio, %	**22.8%**	24.9%	
Total capital adequacy ratio, %	**23.1%**	25.2%	
LCR ratio, %	**181.0%**	187.0%	
NFSR ratio, %	**121.0%**	123.0%	
Total deposits to total loans ratio, %	**78.4%**	84.9%	
Leverage ratio, %	**15.5%**	16.0%	

The Bank's debt issuance increased in the first quarter through issuance of covered bonds and commerical paper continuing the strategy of mitigating risk through diversification of funding. The Bank issued ISK 8.1bn in covered bonds in the first quarter in line with the Bank's issuance plan. It also issued short-term unsecured bonds (1-12 month maturity) in the first quarter, with an outstanding March balance of about ISK 6.7bn.

Due to the Bank´s strong liquidity position and low demand for FX loans, there was no issuance in foreign currencies in the first quarter. That said, secondary spreads have continued to tighten over the quarter.

Due to the Bank's strong liquidity position both in ISK and foreign currencies, its successful foreign-denominated transactions, and favourable developments in the spread on outstanding foreign-denominated transactions, the Bank may explore buybacks and/or refinancing or exchanges of outstanding transactions in 2017.

Equity

Total equity amounted to ISK 170.8bn at March 2017, compared to ISK 178.9bn at the end of 2016. Of that total, ISK 3.0bn is attributable to non-controlling interests. The nominal value of the Bank's authorised share capital was ISK 10bn at the end of the first quarter, and share capital amounted to ISK 65bn.

At March 2017 the Bank's total capital ratio was 23.1%, compared to 25.2% at year-end 2016, above its short-term target of 23%. The Bank's Tier 1 ratio was 22.8% at March 2017, compared to 24.9% at year-end 2016. The Icelandic Financial Supervisory Authority (FME) sets the minimum requirement for total capital at 19.2%. For the first time in 4Q16, the Bank introduced a new long-term capital target, which is based on its internal capital adequacy assessment (ICAAP) and the supervisory review and evaluation process (SREP). The target assumes that the Bank will maintain a management buffer of 0.5%-1.5% in excess of the SREP results to ensure that short-term fluctuations do not bring the ratio below regulatory minimum. The capital target supports the Bank's business strategy and takes into account changes or uncertainties in the operating environment. It can change over time, reflecting changes in the Bank's risk profile, business strategy, and external environment. Based on last year's SREP results, this translates to a long-term target total capital ratio of around 20% and a minimum CET1 ratio of above 15%.

Íslandsbanki uses the standardised method to calculate its risk-weighted assets (RWA), which amounted to ISK 730.1bn at March 2017, or 71% of total assets, a marginal increase from year-end 2016 as a result of increased lending. The period end leverage ratio was 15.5%, compared to 16.0% at the end of 2016, indicating moderate leverage. The marginal decrease in the first quarter is due mainly to the dividend paid in March.

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

The upgrade of the Bank's credit ratings from Standard & Poor's (in October 2016) and Fitch Ratings (in January 2017) will facilitate issuance across the capital spectrum in 2017 and beyond. The Bank is considering issuing Tier 2 and, eventually, additional Tier 1 capital instruments in order to enhance its capital efficiency.

Imbalances

The Bank is exposed to inflation risk because CPI-linked assets exceed CPI-linked liabilities. At March 2017, the Bank's consolidated net inflation (CPI) imbalance amounted to ISK 63.0bn (37.4% of the total capital base), compared to ISK 60.9bn at year end 2016 (34.3% of the total capital base). The imbalance is managed via CPI-linked swaps, issuance of CPI-linked covered bonds and long term CPI-linked deposit programmes.

The currency imbalance was ISK -0.2bn (0.1% of the total capital base) at March 2017, compared to ISK -0.4bn (0.2% of the total capital base) at year end 2016. The Bank's imbalances are strictly monitored and are within regulatory limits.

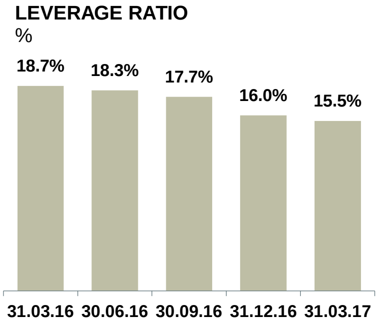
Ratings

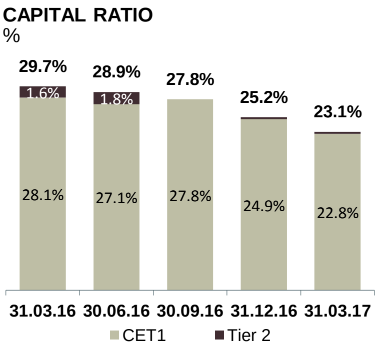
Íslandsbanki is the only bank in Iceland that is rated by two international rating agencies, Fitch and Standard & Poor's (S&P).

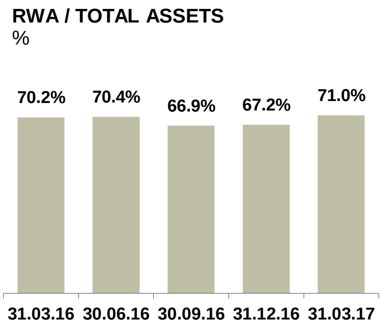
In March 2017 S&P raised Republic of Iceland Ratings to 'A/A-1' on lifting of capital controls with a stable outlook. The stable outlook reflects the potential for improvement in Iceland's public finances, balanced by the risk of the domestic economy overheating over the next two years.

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

In October 2016, S&P upgraded the Bank to BBB/A-2, with a positive outlook. The upgrade reflected improving operating conditions for Iceland's banking sector, with falling private sector leverage and improved access to foreign debt capital markets. The continued positive outlook reflects positive trends in the Icelandic economy and the banking sector and assumes that the Bank's capital ratios will remain strong while it prepares for a potential change of ownership.







INVESTOR RELATIONS

Investor call in English

On Thursday 11 May 2017 at 1pm Icelandic time (Central European Time 3pm), the Bank will host an investor call in English to present the results. The call will start with a short macro update on the Icelandic economy, followed by a review of the financial results and Q&A.

Please register by replying to ir@islandsbanki.is. Dial-in details and presentation will be sent out two hours prior to the call.

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

Financial Calendar

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

- 2Q2017 - 17 August 2017
- 3Q2017 - 9 November 2017

Please note that the dates are subject to change.

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