Condensed Consolidated

Interim Financial Statements

Unaudited

Three months ended 31 March 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 31 March 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 31 March 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 31 March 2013 amounted to ISK 4,585 million, which corresponds to a 12.2% return on equity. Bank equity, according to the Consolidated Financial Position, amounted to ISK 152,101 million at 31 March 2013. The Bank's official capital ratio, calculated according to the Act on Financial Undertakings, was 25.8% and the Tier 1 ratio was 22.3%. The official capital ratio is based on audited retained earnings at 31 December 2012 since the accounts for 31 March 2013 are not audited. The Board of Directors refers to Note 56 for further understanding of the capital requirements of the Bank. The Bank's total assets amounted to ISK 828,971 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. Recent court rulings have affected the operations of the Bank and added to the uncertainty of how to value part of the loan portfolio. The Bank has made appropriate provisions to reflect the risk associated with those 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 37 for the principal risks and uncertainties currently faced by the Bank.

To the best of our knowledge, the Condensed Consolidated Interim Financial Statements provide a true and fair view of the Bank's operating profits and its financial position as at 31 March 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 31 March 2013 by means of their signatures.

Reykjavík, 29 May 2013

Board of Directors:

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

Chief Executive Officer:

Birna Einarsdóttir

Condensed Consolidated Income Statement for the three months ended 31 March 2013

	Notes	2013 1.1-31.3	2012 1.1-31.3
Interest income		15,573	16,060
Interest expense		(8,100)	(7,050)
Net interest income	7	7,473	9,010
Net valuation changes on loans and receivables	8	3,117	(1,544)
Provision for latent impairment	8,23	(124)	(121)
Net valuation changes		2,993	(1,665)
Net interest income after net valuation changes		10,466	7,345
Fee and commission income		3,855	3,308
Fee and commission expense		(1,403)	(1,206)
Net fee and commission income		2,452	2,102
Net financial income	9-10	881	914
Net foreign exchange (loss) gain	11	(1,563)	1,191
Other net operating income	12	412	295
Other net operating income		(270)	2,400
Total operating income		12,648	11,847
Administrative expenses	13-14	(6,303)	(6,429)
Contribution to the Depositors' and Investors' Guarantee Fund		(246)	(325)
Share of profit of associates net of tax		3	-
Profit before tax		6,102	5,093
Income tax	15	(1,448)	(1,452)
Profit for the period from continuing operations		4,654	3,641
(Loss) profit from discontinued operations, net of income tax		(69)	1,965
Profit for the period		4,585	5,606

The notes on pages 8 to 41 are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK million

Condensed Consolidated Statement of Comprehensive Income for the three months ended 31 March 2013

	Notes	2013 1.1-31.3	2012 1.1-31.3
Other comprehensive income			
Foreign currency translation differences for foreign operations		(144)	111
Other comprehensive income for the period		(144)	111
Total comprehensive income for the period		4,441	5,717
Attributable to:			
Equity holders of Íslandsbanki hf.		4,600	5,604
Non-controlling interests		(15)	2
Profit for the period		4,585	5,606
Basic earnings per share	16	0.46	0.56
Diluted earnings per share	16	0.46	0.56

The notes on pages 8 to 41 are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK million

Condensed Consolidated Statement of Financial Position as at 31 March 2013

	Notes	31.3.2013	31.12.2012
Assets			
Cash and balances with Central Bank	6,17	65,822	85,500
Derivatives	6,18	119	127
Bonds and debt instruments	6	71,796	64,035
Shares and equity instruments	6	9,730	10,445
Loans to credit institutions	6,19-20	57,633	54,043
Loans to customers	6,21-22	543,269	557,857
Investments in associates	24	505	503
Property and equipment		9,740	5,579
Intangible assets		277	261
Deferred tax assets		1,100	864
Non-current assets and disposal groups held for sale	27	46,929	39,046
Other assets	28	22,051	5,115
Total Assets		828,971	823,375
Liabilities			
Derivative instruments and short positions	6,18	12,141	18,435
Deposits from Central Bank	6,29	13	54
Deposits from credit institutions	6,29	26,300	38,218
Deposits from customers	6,30-31	465,735	471,156
Debt issued and other borrowed funds	6,32	68,227	66,571
Subordinated loans	6	22,014	23,450
Current tax liabilities		3,396	2,052
Deferred tax liabilities		29	20
Non-current liabilities and disposal groups held for sale	27	10,522	6,805
Other liabilities	33	68,493	48,954
Total Liabilities		676,870	675,715
Equity			
Share capital	34	10,000	10,000
Share premium	34	55,000	55,000
Other reserves		2,690	2,834
Retained earnings		83,171	78,571
Total equity attributable to the equity holders of Íslandsbanki hf.		150,861	146,405
Non-controlling interests		1,240	1,255
Total Equity		152,101	147,660
Total Liabilities and Equity		828,971	823,375

The notes on pages 8 to 41 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 three months ended 31 March 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			111		111		111
Net income recognised directly in equity	-	-	111	-	111	-	111
Profit for the period				5,604	5,604	2	5,606
Total comprehensive income for the period	-	-	111	5,604	5,715	2	5,717
Change in non-controlling interests					-		-
Equity at 31.3.2012	10,000	55,000	2,772	60,737	128,509	911	129,420
Equity at 1.1.2013	10,000	55,000	2,834	78,571	146,405	1,255	147,660
Translation differences for foreign operations			(144)		(144)		(144)
Net income recognised directly in equity	-	-	(144)		(144)	-	(144)
Profit for the period				4,600	4,600	(15)	4,585
Total comprehensive income for the period	-	-	(144)	4,600	4,456	(15)	4,441
Equity at 31.3.2013	10,000	55,000	2,690	83,171	150,861	1,240	152,101

The notes on pages 8 to 41 are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK million

Condensed Consolidated Statement of Cash Flows
for the three months ended 31 March 2013

	Notes	2013 1.1-31.3	2012 1.1-31.3
Cash flows from operating activities:			
Profit for the period		4,585	5,606
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		913	3,512
Changes in operating assets and liabilities		(24,903)	2,819
Income tax paid		(397)	(1,037)
Net cash (used in) provided by operating activities		(19,802)	10,900
Net cash (used in) investing activities		(323)	(358)
Net cash provided by financing activities		375	1,458
Changes in cash and cash equivalents		(19,750)	12,000
Effects of exchange rate changes on cash and cash equivalents		(66)	56
Cash and cash equivalents at the beginning of the period		112,810	78,571
Cash and cash equivalents at the end of the period		92,994	90,627
Reconciliation of cash and cash equivalents:			
Cash on hand	17	1,950	2,048
Cash balances with Central Bank and certificates of deposit	17	54,766	67,498
Bank accounts	19	36,278	21,081
Total cash and cash equivalents		92,994	90,627

Interest received from 1st of January to end of March 2013 amounted to ISK 11,419 million (2012: ISK 10,712 million) and interest paid in same period 2013 amounted to ISK 7,201 million (2012: ISK 8,656 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 41 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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Notes to the Condensed Consolidated Financial Statements

Accounting policies

General information

1. **The reporting entity**

Íslandsbanki hf. is a limited company incorporated and domiciled in Iceland. The unaudited Condensed Consolidated Interim Financial Statements for the three months ended 31 March 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 29 May 2013.

2. **Basis of preparation**

2.1 *Statement of compliance*

The unaudited Condensed Consolidated Interim Financial Statements for the three months ended 31 March 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 7, Net interest income, Note 9, Net financial income, and Note 11, Net foreign exchange gain, has been changed due to change in methodology. Note 7 from ISK -54 million to ISK 268 million for financial assets held for trading, Note 9 from ISK 224 million to ISK -185 million for net gain (loss) on financial instruments held for trading and Note 11 from ISK -635 million to ISK -548 million for financial assets held for trading.

Changes have been made in presentation of market risk notes. These are explained further under Note 52 and 53. 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.

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:

	Q1* 2013	Q4* 2012	Q3* 2012	Q2* 2012	Q1* 2012
Net interest income	7,473	8,560	7,785	7,585	9,010
Net valuation changes	3,117	3,704	713	3,613	(1,544)
Provision for latent impairment	(124)	(197)	(309)	(149)	(121)
Net fee and commission income	2,452	2,755	2,278	2,324	2,102
Net financial income	881	199	213	191	914
Net foreign exchange (loss) gain	(1,563)	1,507	491	(452)	1,191
Other net operating income	412	181	226	294	295
Administrative expenses	(6,303)	(6,928)	(5,495)	(6,595)	(6,429)
Impairment of goodwill	-	(425)	-	-	-
Contribution to the Depositors' and Investors' Guarantee Fund	(246)	(257)	(272)	(201)	(325)
Share of profit of associates	3	-	-	-	-
Profit before tax	6,102	9,099	5,630	6,610	5,093
Income tax	(1,448)	(1,790)	(1,465)	(1,546)	(1,452)
Profit for the period from continuing operations	4,654	7,309	4,165	5,064	3,641
(Loss) profit for the period from discontinued operations	(69)	(112)	432	954	1,965
Profit for the period	4,585	7,197	4,597	6,018	5,606

*The half year results were reviewed by the Bank's auditors, with an emphasis on the loan portfolio, but the splits between quarters were not audited.

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 31 March 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	17	-	-	65,822	-	65,822
Loans and receivables						
Loans to credit institutions	19-20	-	-	57,633	-	57,633
Loans to customers	21-22	-	-	543,269	-	543,269
Loans and receivables		-	-	666,724	-	666,724
Bonds and debt instruments						
Listed		37,328	31,647	-	-	68,975
Unlisted			2,821	-	-	2,821
Bonds and debt instruments		37,328	34,468	-	-	71,796
Shares and equity instruments						
Listed		2,370	3,681	-	-	6,051
Unlisted			3,679	-	-	3,679
Shares and equity instruments		2,370	7,360	-	-	9,730
Derivatives	18	119	-	-	-	119
Other financial assets		-	-	16,894	-	16,894
Total financial assets		39,817	41,828	683,618	-	765,263
Derivative instruments and short positions	18	12,141	-	-	-	12,141
Deposits from Central Bank	29	-	-	-	13	13
Deposits from credit institutions	29	-	-	-	26,300	26,300
Deposits from customers	30-31	-	-	-	465,735	465,735
Debt issued and other borrowed funds	32	-	-	-	68,227	68,227
Subordinated loans		-	-	-	22,014	22,014
Other financial liabilities		-	-	-	51,564	51,564
Total financial liabilities		12,141	-	-	633,853	645,994

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	17	-	-	85,500	-	85,500
Loans and receivables						
Loans to credit institutions	19-20	-	-	54,043	-	54,043
Loans to customers	21-22	-	-	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	18	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	18	18,435	-	-	-	18,435
Deposits from Central Bank	29	-	-	-	54	54
Deposits from credit institutions	29	-	-	-	38,218	38,218
Deposits from customers	30-31	-	-	-	471,156	471,156
Debt issued and other borrowed funds	32	-	-	-	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

Net interest income

7. Net interest income is specified as follows:

	2013 1.1-31.3	2012 1.1-31.3
Interest income:		
Cash and balances with Central Bank	954	560
Loans and receivables	14,067	14,831
Financial assets held for trading	40	268
Financial assets designated at fair value through profit or loss	511	368
Other assets	1	33
Total interest income	15,573	16,060
Interest expense:		
Deposits from credit institutions and Central Bank	(154)	(325)
Deposits from customers	(5,588)	(4,544)
Borrowings	(1,978)	(1,691)
Subordinated loans	(223)	(315)
Other financial liabilities	(112)	(113)
Other interest expense	(45)	(62)
Total interest expense	(8,100)	(7,050)
Net interest income	7,473	9,010

Net valuation changes on loans and receivables

8. Net valuation changes on loans and receivables:

	2013 1.1-31.3	2012 1.1-31.3
Impairment charged to the comprehensive income:		
Specific impairment losses on financial assets	(878)	(1,525)
Impairment of foreign exchange loss (gain)	384	(1,545)
Net specific impairment losses on financial assets	(494)	(3,070)
Provision for latent impairment losses	(124)	(121)
Total impairment charged to the income statement (see note 23)	(618)	(3,191)
Net valuation changes:		
Income (expense) due to revised estimated future cash flow from loans	3,995	(19)
Net specific impairment losses on financial assets	(494)	(3,070)
Foreign exchange (loss) gain (see note 11)	(384)	1,545
Net valuation changes on loans and receivables	3,117	(1,544)

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 11. 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.

Amounts are in ISK million

Net financial income

9. Net financial income is, specified as follows:

	2013 1.1-31.3	2012 1.1-31.3
Net gain (loss) on financial instruments held for trading	226	(185)
Net gain on financial instruments designated at fair value through P&L	655	1,099
Net financial income	881	914

10. Net gain on financial instruments designated at fair value through profit or loss are specified as follows:

Shares	806	1,138
Bonds	(151)	(39)
Net gain on financial instruments designated at fair value through P&L	655	1,099

Net foreign exchange (loss) gain

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

	2013 1.1-31.3	2012 1.1-31.3
Assets:		
Cash and balances with Central Bank	(66)	56
Financial assets held for trading	2,246	(548)
Loans to credit institutions	(3,401)	2,296
Loans to customers	(6,735)	6,320
Other assets	(74)	95
Total	(8,030)	8,219
Liabilities:		
Deposits from credit institutions	109	(320)
Deposits from customers	4,437	(3,725)
Subordinated loan	1,436	(1,366)
Other liabilities	101	(72)
Total	6,083	(5,483)
Unadjusted net foreign exchange (loss) gain	(1,947)	2,736
Foreign exchange reversal on loans to customers with ISK cash flow	384	(1,545)
Net foreign exchange (loss) gain	(1,563)	1,191

Other net operating income

12. Other net operating income is specified as follows:

	2013 1.1-31.3	2012 1.1-31.3
Agency fees and service level agreement fees	79	86
Legal cost and fees	24	20
Rental income	58	22
Rental income on foreclosed mortgages	63	114
Other net operating income	188	53
Other net operating income	412	295

Amounts are in ISK million

Administrative expenses

13. Administrative expenses are specified as follows:

	2013 1.1-31.3	2012 1.1-31.3
Salaries and related expenses	3,468	3,285
Other administrative expenses	2,523	2,717
Depreciation and amortisation	245	220
Bank tax	67	207
Administrative expenses	6,303	6,429

Salaries and related expenses

14. Salaries and related expenses are specified as follows:

	2013 1.1-31.3	2012 1.1-31.3
Salaries	2,645	2,542
Pension and similar expenses	361	347
Social security charges and financial activities tax	391	346
Other	71	50
Salaries and related expenses	3,468	3,285

Effective income tax rate

15. Income tax for the three month period to 31 March 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 23.7% for the three months ended 31 March 2013. The difference is specified as follows:

	2013 1.1-31.3		2012 1.1-31.3	
Profit before tax	6,102		5,093	
Income tax calculated on the profit for the period	1,220	20.0%	1,019	20.0%
Special financial activities tax	316	5.2%	102	2.0%
Effect of different tax rate in other countries	-	0.0%	(3)	(0.1%)
Non-deductable expenses	25	0.4%	60	1.2%
Income not subject to tax	(177)	(2.9%)	-	0.0%
Correction in accordance with ruling on prior years' taxable income	27	0.4%	10	0.2%
Other differences	37	0.6%	264	5.2%
Effective income tax	1,448	23.7%	1,452	28.5%

Earnings per share

16. Earnings per share are specified as follows:

	2013 1.1-31.3	2012 1.1-31.3
Net profit of the equity holders of the parent, according to the statement of comprehensive income	4,600	5,604
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	0.46	0.56
Diluted earnings per share	0.46	0.56

Amounts are in ISK million

Cash and balances with Central Bank

17. Specification of cash and balances with Central Bank:

	31.3.2013	31.12.2012
Cash on hand	1,950	2,008
Balances with Central Bank other than mandatory reserve deposits	6,712	16,221
Certificates of deposit	48,054	58,119
Included in cash and cash equivalents	56,716	76,348
Mandatory reserve deposits with Central Bank	9,106	9,152
Cash and balances with Central Bank	65,822	85,500

Mandatory reserve deposits are not available for use in the Bank's day-to-day operations.

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

18. Derivative instruments and short positions:

At 31 March 2013	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	3	1,000	1,532	20,400
Cross currency interest rate swaps	44	6,722	1,765	49,678
Equity forwards	3	8	118	34
Foreign exchange forwards	5	152	88	2,440
Foreign exchange swaps	23	1,745	2	125
Bond forwards	41	1,470	22	1,120
Bond options	-	-	83	25,000
Derivatives	119	11,097	3,610	98,797
Short positions in listed bonds			8,531	
Total	119	11,097	12,141	98,797

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

19. Loans to credit institutions:

	31.3.2013	31.12.2012
Money market loans	21,355	17,581
Bank accounts	36,278	36,462
Loans to credit institutions	57,633	54,043

20. Loans to credit institutions at amortised cost:

	31.3.2013	31.12.2012
Loans	57,633	54,043
Loans to credit institutions	57,633	54,043

21. Loans to customers:

	31.3.2013	31.12.2012
Loans to customers at amortised cost	543,269	557,857
Loans to customers	543,269	557,857

22. Loans to customers at amortised cost:

At 31 March 2013

	Gross amount	Individually assessed impairment allowance	Collectively assessed impairment allowance	Loans less impairment allowance
Loans to customers:				
Individuals	254,682	(7,917)	(1,700)	245,065
Commerce and services	76,018	(5,285)	(527)	70,206
Construction	18,505	(1,093)	(994)	16,418
Energy	5,286	-	(3)	5,283
Financial services	218	(23)	-	195
Industrial and transportation	45,513	(1,927)	(810)	42,776
Investment companies	19,331	(4,447)	-	14,884
Public sector and non-profit organisations	9,527	(305)	(53)	9,169
Real estate	74,213	(5,580)	(1,346)	67,287
Seafood	76,589	(2,713)	(28)	73,848
Loans to customers before latent impairment allowance				545,131
Latent impairment allowance				(1,862)
Loans to customers	579,882	(29,290)	(5,461)	543,269

Amounts are in ISK million

22. 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

23. 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	(8,974)	(1)	-	(8,975)
Recoveries of amounts previously written-off	187	-	-	187
Principal credit adjustment	(2,128)	(18)	-	(2,146)
Charged to the income statement	645	(151)	124	618
At 31 March 2013	29,290	5,461	1,862	36,613

	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 1.1-31.3	2012 1.1-31.3
Impairment losses charged to the income statement:		
Loans to customers	618	3,191
Impairment losses charged to the income statement	618	3,191

For the three months ended 31 March 2013 19 Amounts are in ISK million

Investment in associates

24. Changes in investments in associates:

	31.3.2013	31.12.2012
Investment in associates at the beginning of the period	503	1,070
Sales of shares in associates	-	(567)
Share of results	2	-
Investments in associates at the end of the period	505	503

Investment in subsidiaries

25. 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%
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%
EFF 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%
32 other subsidiaries (SME)		

Related party disclosures

26. 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:

	31.3.2013	31.12.2012
CEO and Managing Directors (including companies owned by them)	(28)	(82)
Members of the Board (including companies owned by them)	84	141
Associated companies and other related parties	(4,737)	2,813
Total	(4,681)	2,872
Guarantees	347	363
Loan commitments, overdraft and credit card commitments	3,115	3,195

Impairment allowances of ISK -11 million were recognised in the period against balances outstanding with associated companies (same period 2012: ISK 191 million).

No share option programmes were operated during the reporting period 1 January - 31 March 2013.

For the three months ended 31 March 2013 20 Amounts are in ISK million

Non-current assets and disposal groups held for sale

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

	31.3.2013	31.12.2012
Repossessed collateral	10,473	10,161
Assets of disposal groups classified as held for sale	36,456	28,885
Total	46,929	39,046

Repossessed collateral:

	31.3.2013	31.12.2012
Land and property	8,585	8,225
Industrial equipment and vehicles	73	94
Shares and equity instruments	1,702	1,702
Vehicles	113	140
Total	10,473	10,161

Assets of disposal groups classified as held for sale:	31.3.2013	31.12.2012
Cash	687	1,069
Equity instruments	922	1,037
Receivables	1,451	1,513
Tax assets	256	231
Properties	16,104	16,081
Assets classified as held for sale	13,174	4,937
Other assets	3,862	4,017
Total	36,456	28,885

Liabilities associated with assets classified as held for sale:	31.3.2013	31.12.2012
Payables	734	634
Deferred tax liabilities	618	676
Income Tax payable	48	-
Borrowings	3,424	3,588
Other liabilities	5,698	1,907
Total	10,522	6,805

Other assets

28. Other assets are specified as follows:

	31.3.2013	31.12.2012
Receivables	4,048	2,740
Unsettled securities transactions	16,894	1,259
Accruals	443	562
Prepaid expenses	373	271
Other assets	293	283
Other assets	22,051	5,115

Amounts are in ISK million

Deposits from Central Bank and credit institutions

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

	31.3.2013	31.12.2012
Repurchase agreements with Central Bank	13	54
Deposits from credit institutions	26,300	38,218
Deposits from Central Bank and credit institutions	26,313	38,272

Deposits from customers

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

	31.3.2013	31.12.2012
Demand deposits	373,069	379,257
Time deposits	92,666	91,899
Deposits from customers	465,735	471,156

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

	31.3.2013		31.12.2012	
	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	5,839	1%	4,963	1%
Municipalities	5,822	1%	5,671	1%
Companies	265,259	57%	276,168	59%
Individuals	188,815	41%	184,354	39%
Deposits from customers	465,735	100%	471,156	100%

Debt issued and other borrowed funds

32. Specification of debt issued and other borrowed funds:

	31.3.2013	31.12.2012
Non-listed issued bonds	50,527	51,335
Listed issued bonds	16,058	13,713
Loans from credit institutions	77	8
Other debt securities	1,565	1,515
Debt issued and other borrowed funds	68,227	66,571

Amounts are in ISK million

Other liabilities

33. Specification of other liabilities:

	31.3.2013	31.12.2012
Accruals	3,212	3,117
Liabilities to retailers for credit card provision	18,436	17,404
Provision for effects of court rulings*	12,812	14,736
Provision for estimated losses from guarantees**	505	868
Provision for reimbursement of interest***	-	2,493
Chargeable gain tax	790	1,896
Unsettled securities transactions	29,412	5,222
Deferred income	190	197
Sundry liabilities	3,136	3,021
Other liabilities	68,493	48,954

	Provision for effects of court rulings*	Provision for estimated losses from guarantees**	Provision for reimbursement of interest***	Total
At 1 January 2013	14,736	868	2,493	18,097
Provisions made during the year	-	-	-	-
Provision used during the year	(1,924)	-	(2,493)	(4,417)
Provisions reversed during the year	-	(363)	-	(363)
At 31 March 2013	12,812	505	-	13,317

Equity

34. Authorised share capital of the Bank is 10,000m ordinary shares of ISK 1 each. At 31.3.2013 paid up share capital totalled ISK 65,000m which is the total stated share capital of the Bank.

Total share capital:

	31.3.2013	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

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

	31.3.2013	31.12.2012
Financial guarantees	8,206	8,371
Undrawn loan commitments	14,303	12,798
Undrawn overdrafts	20,197	22,412
Credit card commitments	29,571	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

36. Balance of custody assets:

	31.3.2013	31.12.2012
Custody assets	708,286	762,568

Contingencies

37. **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, one against the Housing Financing Fund (HFF) and the other against 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 HFF case is based on the fund being noncompliance with the law on consumer loans. Thus the case will not address the legality of CPI indexation as such. The Landsbanki case is based on the argument that CPI indexation places a mortgage in line with a complex financial instrument as defined in the Act on Securities Transactions no. 108/2007 (MiFID Directive) and therefore unsuitable for retail/non-institutional investors. The case will probably be heard by the District Court this spring.

In addition, one customer challenged an auction procedure instigated by Islandsbanki on the grounds that indexation was unfair and in violation of the Icelandic Contract Law as amended by the EU Directive 93/13/EBE on Unfair Terms in Consumer Contracts. The judicial procedure involving such cases is a great deal shorter than the one necessary for regular cases and could be finalised in the Supreme Court before summer recess.

The possible effect on the Bank has not been estimated.

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.

Amounts are in ISK million

37. Cont'd

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 proposing a change to the Interest Law 38/2001. The legislation was passed as Amendment to the Interest Law 151/2010, 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.

The most recent Supreme Court ruling from 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.

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, with the exception of the loans deemed illegal by the January 2013 ruling. With regard to those loans, the Bank has estimated the effects of the ruling and recognised a provision of ISK 6.5 billion at year end 2012. The amount owed to customers with regards to paid-up loans is reflected in the Bank's provisions, see Note 33.

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 has begun, starting with car loans/contracs. 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.

Events after the end of the reporting period

38. The Annual General Meeting for the operating year 2012 held 18 April 2013 shareholders approved the Board´s proposal to pay dividend to shareholders for the financial year 2012 of ISK 0,3 per share. The dividend was paid on 30 April 2013. The dividend payment amounts to ISK 3,000 million.

Risk Management

39. 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. English version: www.islandsbanki.is/riskreport and Icelandic version: www.islandsbanki.is/ahaettuskyrsla

Credit risk

40. 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.

41. 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 employees 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.

42. Maximum credit exposure

The Bank's credit risk exposure comprises both on-balance sheet and off-balance sheet items. Maximum exposure to credit risk for on-balance sheet assets is the net carrying amount as reported in the statement of financial position before the latent impairment allowance is subtracted, see Note 22. 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

42. Cont'd

Maximum credit exposure 31.3.2013

	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	-	65,822	-	-	-	-	-	-	-	-	-	65,822
Derivatives	11	162	49	19	-	1,263	29	36	-	7	35	1,611
Bonds and debt instruments	-	64,822	338	-	-	4,686	-	1,017	446	487	-	71,796
Loans to credit institutions	-	-	-	-	-	57,633	-	-	-	-	-	57,633
Loans to customers:	245,066	-	70,205	16,418	5,283	195	42,776	14,884	9,169	67,287	73,848	545,131
Overdrafts	14,169	-	8,002	2,939	1	40	4,557	388	1,304	1,272	2,314	34,986
Credit cards	13,668	-	1,185	134	9	23	346	33	219	51	49	15,717
Mortgages	167,398	-	-	-	-	-	-	-	-	-	-	167,398
Leases	9,547	-	14,299	2,127	12	12	4,231	132	376	1,468	187	32,391
Other loans	40,284	-	46,719	11,218	5,261	120	33,642	14,331	7,270	64,496	71,298	294,639
Off-balance sheet items:												
Financial guarantees	1,324	-	2,394	1,899	4	1,001	823	30	47	155	529	8,206
Undrawn loan commitments	-	-	3,667	1,121	5,624	-	3,078	199	-	-	614	14,303
Undrawn overdraft	9,267	-	3,597	921	231	1,309	2,353	74	1,135	363	947	20,197
Credit card commitments	23,763	-	3,071	422	14	100	800	113	1,022	150	116	29,571
Total maximum credit exposure	279,431	130,806	83,321	20,800	11,156	66,187	49,859	16,353	11,819	68,449	76,089	814,270

Amounts are in ISK million

42. 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

43. 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 31 March 2013

	Real estate	Fishing vessels	Cash & securities	Vehicles & equipment	Other collateral	Total collateral
Derivatives	-	-	361	-	-	361
Loans and commitments to customers:	310,331	58,749	15,084	19,127	13,466	416,757
Individuals	198,770	91	2,709	8,035	-	209,605
Commerce and services	28,701	-	882	9,930	2,926	42,439
Construction	7,310	176	87	271	3,538	11,382
Energy	2,468	-	93	-	143	2,704
Financial services	67	-	13	12	-	92
Industrial and transportation	13,174	-	722	706	5,116	19,718
Investment companies	3,494	-	9,322	10	400	13,226
Public sector ad non-profit organisations	3,861	-	3	70	169	4,103
Real estate	47,987	134	387	51	-	48,559
Seafood	4,499	58,348	866	42	1,174	64,929
Total	310,331	58,749	15,445	19,127	13,466	417,118

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 ad 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	
Total	314,242	68,349	16,322	17,790	14,231	356,881

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

Amounts are in ISK million

44. Credit quality of financial assets

Loans are classified as impaired loans if contractual cash payments are not expected to be fulfilled and if financial restructuring of the obligor is expected to lead to a loss on that particular loan. In most cases, loss is avoided because of the difference between the claim value and the carrying amount resulting from the deep discount of the acquired loan portfolio. 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 31 March 2013

	Neither past due nor impaired	Past due but not impaired	Classified as impaired	Total carrying amount
Cash and balances with Central Bank	65,822	-	-	65,822
Derivatives	1,611	-	-	1,611
Bonds and debt instruments	71,796	-	-	71,796
Loans to credit institutions	57,633	-	-	57,633
Loans to customers:	462,438	44,960	37,733	545,131
Individuals	207,282	30,328	7,456	245,066
Commerce and services	55,932	4,390	9,883	70,205
Construction	13,638	2,139	641	16,418
Energy	5,282	-	1	5,283
Financial services	140	15	40	195
Industrial and transportation	38,526	1,837	2,413	42,776
Investment companies	11,309	810	2,765	14,884
Public sector and non-profit organisations	8,656	138	375	9,169
Real estate	54,447	4,667	8,173	67,287
Seafood	67,226	636	5,986	73,848
Total	659,300	44,960	37,733	741,993

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

Amounts are in ISK million

45. Neither past due nor impaired loans
The Bank uses internal rating models to assess the default probability of corporate and retail customers. The models assign each customer to one of ten risk classes. One risk class is for customers in default (risk class 10), and nine risk classes are for performing customers (risk classes 1-9). Risk classes are assigned on customer level and not facility level.

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

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

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

At 31 March 2013

	Risk class 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Total
Loans to customers						
Individuals	9,786	88,199	57,547	42,639	9,111	207,282
Commerce and services	5,722	19,069	19,314	9,051	2,776	55,932
Construction	2	2,692	8,298	1,801	845	13,638
Energy	7	5,225	23	27	-	5,282
Financial services	2	15	108	12	3	140
Industrial and transportation	10,901	17,477	6,147	3,490	511	38,526
Investment companies	665	6,940	1,027	1,705	972	11,309
Public sector ad non-profit organisations	241	5,311	2,517	554	33	8,656
Real estate	4,507	17,480	9,023	3,953	19,484	54,447
Seafood	28,871	29,936	5,226	525	2,668	67,226
Total	60,704	192,344	109,230	63,757	36,403	462,438

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 ad 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.

Amounts are in ISK million

46. Past due but not impaired loans

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

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

At 31 March 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	9,640	4,073	2,355	14,260	30,328
Commerce and services	2,023	536	363	1,468	4,390
Construction	459	339	120	1,221	2,139
Energy	-	-	-	-	-
Financial services	-	-	-	15	15
Industrial and transportation	673	148	237	779	1,837
Investment companies	340	49	4	417	810
Public sector and non-profit organisations	79	19	-	40	138
Real estate	2,338	529	126	1,674	4,667
Seafood	194	53	105	284	636
Total	15,746	5,746	3,310	20,158	44,960

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

47. 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 216/2007.

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 from the last reviewed financial statements at 31 December 2012 is used to define large exposures.

The Bank has one large exposure to a group of connected clients that amounts to 13% of the Bank's capital base. In particular, the Bank is below the aggregated 400% limit set by the law. No large exposure exceeds the maximum 25% set by the law.

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

		31.3.2013
Client groups	Gross	Net
Group 1	56%	0%
Group 2	13%	13%

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

For the three months ended 31 March 2013 33 Amounts are in ISK million

Liquidity Risk

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

Liquidity risk management

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

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

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

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

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

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

Maturity analysis 31 March 2013

Financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Short positions	8,531	-	-	-	-	-	8,531
Deposits from Central Bank	13	-	-	-	-	-	13
Deposits from credit institutions	23,135	2,371	820	-	-	-	26,326
Deposits from customers	329,488	49,255	40,055	28,657	22,440	-	469,895
Debt issued and other borrowed funds	77	2,408	7,629	44,299	23,041	1,016	78,470
Subordinated loans	-	239	505	6,175	26,519	-	33,438
Other financial liabilities	63,616	4,892	2,747	-	143	-	71,398
Total financial liabilities	424,860	59,165	51,756	79,131	72,143	1,016	688,071

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	8,206	-	-	-	-	-	8,206
Undrawn loan commitments	14,303	-	-	-	-	-	14,303
Undrawn overdrafts	20,197	-	-	-	-	-	20,197
Credit card commitments	29,571	-	-	-	-	-	29,571
Total	72,277	-	-	-	-	-	72,277
Total non-derivative financial liabilities and off balance sheet liabilities	497,137	59,165	51,756	79,131	72,143	1,016	760,348

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.

For the three months ended 31 March 2013 34 Amounts are in ISK million

48. 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	-	1,490	6,007	73,652	25,000	-	106,149
Outflow	-	(1,084)	(6,044)	(84,789)	(25,083)	-	(117,000)
Total	-	406	(37)	(11,137)	(83)	-	(10,851)
Net settled derivatives	-	(140)	-	-	-	-	(140)
Total	-	266	(37)	(11,137)	(83)	-	(10,991)

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	17,768	48,054	-	-	-	-	65,822
Bonds and debt instruments	10,036	27,312	-	-	31,134	3,314	71,796
Shares and equity instruments	-	-	6	338	-	9,386	9,730
Loans to credit institutions	34,704	22,776	153	-	-	-	57,633
Loans to customers	1,298	67,534	48,289	147,299	280,711	-	545,131
Other financial assets	17,075	4,778	96	1,462	-	3,618	27,029
Total financial assets	80,881	170,454	48,544	149,099	311,845	16,318	777,141

Derivative financial assets							
Gross settled derivatives							
Inflow	-	1,989	7,190	1,298	-	-	10,477
Outflow	-	(1,935)	(7,103)	(1,310)	-	-	(10,348)
Total	-	54	87	(12)	-	-	129
Net settled derivatives	-	47	-	-	-	-	47
Total	-	101	87	(12)	-	-	176

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

48. 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 March 2013 and end of 2012.

Composition and amount of liquidity back-up	31.3.2013	31.12.2012
Cash and balances with Central Bank	65,822	85,500
Domestic bonds eligible as collateral against borrowing at the Central Bank	20,436	12,704
Foreign government bonds	30,427	26,730
Short-term placements with credit institutions	53,997	49,264
Composition and amount of liquidity back-up	170,682	174,198

For the three months ended 31 March 2013 36 Amounts are in ISK million

Market risk

49. 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

50. 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.

51. 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	31.3.2013			31.12.2012		
	MV	Duration	BPV	MV	Duration	BPV
Indexed	3,460	9.27	(3.21)	1,589	11.01	(1.75)
Non-indexed	35,125	0.42	(1.46)	26,933	0.18	(0.50)
Total	38,585	1.21	(4.67)	28,522	0.79	(2.25)

Trading bonds and debt instruments, short positions	31.3.2013			31.12.2012		
	MV	Duration	BPV	MV	Duration	BPV
Indexed	-	-	-	521	10.65	0.55
Non-indexed	697	7.38	0.51	1,592	2.21	0.35
Total	697	7.38	0.51	2,113	4.29	0.90
Net position of trading bonds and debt instruments	37,888	1.10	(4.16)	26,409	0.50	(1.35)

For the three months ended 31 March 2013 37 Amounts are in ISK million

52. 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.

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 31 March 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	63,905	-	-	-	-	-	63,905
Bonds and debt instruments	31,326	828	338	1,365	552	59	34,468
Loans to credit institutions	57,479	154	-	-	-	-	57,633
Loans to customers	406,279	48,857	43,845	30,780	1,698	13,672	545,131
Total assets	558,989	49,839	44,183	32,145	2,250	13,731	701,137
Off balance sheet items..	47,950	27,435	-	-	113	-	75,498
Liabilities							
Short positions	3,248	352	588	859	-	-	5,047
Deposits from Central Bank	-	-	-	-	-	-	-
Deposits from credit institutions	25,882	418	-	-	-	-	26,300
Deposits from customers	453,115	3,031	1,602	1,172	6,815	-	465,735
Debt issued and other borrowed funds	8,426	-	548	49,133	4,471	5,780	68,358
Subordinated loans	-	22,014	-	-	-	-	22,014
Total liabilities	490,671	25,815	2,738	51,164	11,286	5,780	587,454
Off balance sheet items	49,642	8,836	10,287	8,839	-	-	77,604
Net interest gap on 31 March 2013	66,626	42,623	31,158	(27,858)	(8,923)	7,951	111,577

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

For the three months ended 31 March 2013 38 Amounts are in ISK million

Currency risk

53. 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 31 March 2013

Assets	EUR	USD	GBP	CHF	JPY	Other	Total
Cash and balances with Central Bank......................	256	144	72	30	21	239	762
Bonds and debt instruments.....................................	18,371	10,346	-	-	-	2,125	30,842
Shares and equity instruments.................................	425	248	13	-	-	2	688
Loans to credit institutions..	4,611	23,325	2,053	192	4,437	7,704	42,322
Loans to customers..	56,513	16,612	4,638	7,166	9,079	1,609	95,617
Investments in associates..	20	-	-	-	-	-	20
Other assets...	493	1,670	192	2	4	57	2,418
Total assets	80,689	52,345	6,968	7,390	13,541	11,736	172,669
Liabilities							
Deposits from credit institutions	36	5	-	-	-	-	41
Deposits from customers	33,056	24,950	4,162	373	711	5,333	68,585
Debt issued and other borrowed funds	6,456	-	-	-	-	86	6,542
Subordinated loans	23,954	-	-	-	-	-	23,954
Other liabilities..	-	4,146	977	4	17	282	5,426
Total liabilities	63,502	29,101	5,139	377	728	5,701	104,548
On balance sheet imbalance	17,187	23,244	1,829	7,013	12,813	6,035	68,121
Off balance sheet items							
Off balance sheet assets	4,464	8,824	94	-	58	146	13,586
Off balance sheet liabilities	17,473	25,808	32	6,923	11,959	399	62,594
Net off balance sheet items	(13,009)	(16,984)	62	(6,923)	(11,901)	(253)	(49,008)
Net currency imbalance on 31 March 2013..	4,178	6,260	1,891	90	912	5,782	19,113

For the three months ended 31 March 2013 39 Amounts are in ISK million

53. 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

54. 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

55. The Bank is exposed to inflation risk since the value of CPI-indexed assets exceeds CPI-indexed liabilities. The value of these assets and liabilities changes according to changes in the CPI at any given time and all changes in the CPI index affect profit and loss. On 31 March 2013 the CPI gap amounted to ISK 5.1 billion (31 December 2012: ISK 1.3 billion). Thus a 1% increase in the index would result in a profit of ISK 51 million and a 1% decrease would result in a corresponding loss, other risk factors held constant.

Amounts are in ISK million

Capital management

56. Risk exposure and capital base

The Bank's total official capital ratio, calculated according to the Act on Financial Undertakings, was 25.8% and the Tier 1 ratio was 22.3%. The official capital ratio is based on audited retained earnings at 31 December 2012 since the accounts for 31 March 2013 are not audited.

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 31 March 2013 and 31 December 2012. In addition, the table shows the official capital ratios based on audited retained earnings at 31 December 2012.

	31.3.2013	31.12.2012
Tier 1 capital		
Ordinary share capital	10,000	10,000
Share premium	55,000	55,000
Other reserves	2,690	2,834
Retained earnings	83,171	78,571
Non-controlling interests	1,240	1,255
Tax assets	(1,100)	(864)
Intangible assets	(277)	(261)
Other regulatory adjustments	(321)	(321)
Total Tier 1 capital	150,403	146,214
Tier 2 capital		
Other regulatory adjustments	(322)	(322)
Qualifying subordinated liabilities	22,014	23,450
Total regulatory capital	172,095	169,342
Risk weighted assets		
- due to credit risk	549,543	549,535
- due to market risk:	25,993	33,940
Market risk, trading book	6,834	6,006
Currency risk foreign exchange	19,159	27,934
- due to operational risk	81,214	81,214
Total risk weighted assets	656,750	664,689
Capital ratios		
Tier 1 ratio	22.9%	22.0%
Total capital ratio	26.2%	25.5%
Official Tier 1 ratio	22.3%	22.0%
Official capital ratio	25.8%	25.5%

For the three months ended 31 March 2013 41 Amounts are in ISK million