Condensed Consolidated

Interim Financial Statements

Six months ended 30 June 2012

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

Contents

Endorsement and Statement by the Board of Directors and the CEO

The Condensed Consolidated Interim Financial Statements of Íslandsbanki hf. for the period 1 January to 30 June 2012 comprise the Condensed Interim Financial Statements of Íslandsbanki hf. and its subsidiaries, together referred to as “the Bank”.

Accounting convention

The Condensed Consolidated Interim Financial Statements for the period 1 January to 30 June 2012 have been prepared on a going concern basis in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). The Financial Statements are presented in accordance with the International Accounting Standard (IAS) 34 Interim Financial Reporting.

Profit from the Bank's operations for the period 1 January to 30 June 2012 amounted to ISK 11,624 million, which corresponds to a 17.9% return on equity. Bank equity, according to the Consolidated Financial Position, amounted to ISK 135,481 million at 30 June 2012. The Bank's total capital ratio, calculated according to the Act on Financial Undertakings, was 23.5% and the Tier 1 ratio was 20.2%. Under Icelandic law the minimum capital requirement is 8.0%. However, as part of granting the Bank an operating licence as a financial undertaking, the Icelandic Financial Supervisory Authority (FME) requires the Bank to maintain a minimum Core Tier 1 ratio of 12% of risk weighted assets and a solvency ratio, allowing for subordinated Tier 2 debt, of 16%. The Bank’s total assets amounted to ISK 789,937 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. 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 38 for the principal risks and uncertainties currently faced by the Bank.

To the best of our knowledge, the Condensed Consolidated Interim Financial Statements provide a true and fair view of the Bank's operating profits and its financial position as at 30 June 2012.

The Board of Directors and the CEO of Íslandsbanki hf. hereby confirm the Bank's Condensed Consolidated Interim Financial Statements for the period 1 January to 30 June 2012 by means of their signatures.

Reykjavík, 29 August 2012

Board of Directors:

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

Chief Executive Officer:

Birna Einarsdóttir

Review Report on Interim Financial Information

To the Board of Directors and Shareholders of Íslandsbanki hf.

We have reviewed the accompanying Condensed Consolidated Statement of Financial Position of Íslandsbanki hf. (the "Bank") as of 30 June 2012 and the related Condensed Consolidated Statement of Comprehensive Income, Condensed Consolidated Statement of Changes in Equity and Condensed Consolidated Statement of Cash Flows for the six months then ended and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with International Financial Reporting Standards for Interim Financial Reporting, IAS 34, as adopted by the EU. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410, Review of Interim Financial Information Performed by the Independent Auditor of the Bank. This Standard requires that we plan and perform the review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information does not give a true and fair view of the financial position of the Bank as at 30 June 2012, and of its financial performance and its cash flows for the six month period then ended in accordance with International Financial Reporting Standards for Interim Financial Reporting, IAS 34, as adopted by the EU.

Emphasis of Matter

Without qualifying our opinion we draw your attention to:
Note 38 in the Condensed Consolidated Interim Financial Statements, which discuss the uncertainties relating to the interpretation of a recent Supreme Court ruling and describes the principal risks and uncertainties currently faced by the Bank.

Kópavogur, 29 August 2012

Deloitte ehf.

Pálína Árnadóttir

State Authorized Public Accountant

Páll Grétar Steingrímsson

State Authorized Public Accountant

Condensed Consolidated Statement of Comprehensive Income for the six months ended 30 June 2012

	Notes	2012*	2011*	2012	2011
		1.4-30.6	1.4-30.6	1.1-30.6	1.1-30.6
Interest income		14,822	15,158	30,560	27,555
Interest expense		(7,826)	(6,916)	(14,876)	(11,252)
Net interest income	8	6,996	8,242	15,684	16,303
Net valuation changes on loans and receivables	9	3,613	409	2,069	(255)
Provision for latent impairment	9,24	(149)	16	(270)	(155)
Net valuation changes		3,464	425	1,799	(410)
Net interest income after net valuation changes		10,460	8,667	17,483	15,893
Fee and commission income		3,561	1,805	6,869	4,402
Fee and commission expense		(1,237)	(507)	(2,443)	(1,389)
Net fee and commission income		2,324	1,298	4,426	3,013
Net financial income (expenses)	10-11	553	(330)	1,876	(468)
Net foreign exchange (loss) gain	12	(225)	134	879	336
Other net operating income	13	294	297	589	656
Other net operating income		622	101	3,344	524
Total operating income		13,406	10,066	25,253	19,430
Administrative expenses	14-15	(6,395)	(4,671)	(12,617)	(9,374)
Contribution to the Depositors' and Investors' Guarantee Fund		(201)	35	(526)	(432)
Profit before tax		6,810	5,430	12,110	9,624
Income tax	16	(1,546)	(1,202)	(2,998)	(2,067)
Bank tax		(200)	(289)	(407)	(344)
Profit for the period from continuing operations		5,064	3,939	8,705	7,213
Profit from discontinued operations, net of income tax		954	537	2,919	849
Profit for the period		6,018	4,476	11,624	8,062

* unaudited information

The notes on pages 10 to 43 are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK million

Condensed Consolidated Statement of Comprehensive Income for the six months ended 30 June 2012 (continued)

	Notes	2012* 1.4-30.6	2011* 1.4-30.6	2012 1.1-30.6	2011 1.1-30.6
Other comprehensive income					
Foreign currency translation differences for foreign operations		(8)	39	103	40
Other comprehensive income for the period		(8)	39	103	40
Total comprehensive income for the period		6,010	4,515	11,727	8,102
Attributable to:					
Equity holders of Íslandsbanki hf.		6,002	4,485	11,606	8,077
Non-controlling interests		16	(9)	18	(15)
Profit for the period		6,018	4,476	11,624	8,062
Basic earnings per share	17	0.60	0.45	1.16	0.81
Diluted earnings per share	17	0.60	0.45	1.16	0.81

* unaudited information

The notes on pages 10 to 43 are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK million

Condensed Consolidated Statement of Financial Position
as at 30 June 2012

	Notes	30.6.2012	31.12.2011
Assets			
Cash and balances with Central Bank	7,18	72,072	57,992
Derivatives	7,19	306	339
Bonds and debt instruments	7	50,386	58,662
Shares and equity instruments	7	9,870	11,107
Loans to credit institutions	7,20-21	50,218	43,655
Loans to customers	7,22-23	545,898	564,394
Investments in associates	25	912	1,070
Property and equipment		5,629	5,276
Intangible assets		608	544
Deferred tax assets		1,997	2,629
Non-current assets and disposal groups held for sale	28	39,149	42,690
Other assets	29	12,892	7,557
Total Assets		789,937	795,915
Liabilities			
Financial liabilities	7	11,154	9,346
Derivatives	7,19	5,377	4,027
Deposits from Central Bank	7,30	14	73
Deposits from credit institutions	7,30	41,900	62,772
Deposits from customers	7,31-32	457,887	462,943
Debt issued and other borrowed funds	7,33	66,513	63,221
Subordinated loans	7	21,853	21,937
Current tax liabilities		1,156	2,670
Deferred tax liabilities		238	17
Non-current liabilities and disposal groups held for sale	28	5,761	7,317
Other liabilities	34	42,603	37,889
Total Liabilities		654,456	672,212
Equity			
Share capital	35	10,000	10,000
Share premium	35	55,000	55,000
Other reserves		2,764	2,661
Retained earnings		66,739	55,133
Total equity attributable to the equity holders of Íslandsbanki hf.		134,503	122,794
Non-controlling interests		978	909
Total Equity		135,481	123,703
Total Liabilities and Equity		789,937	795,915

The notes on pages 10 to 43 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 six months ended 30 June 2012

	Attributable to equity holders of Íslandsbanki hf.					Non-controlling interests	Total equity
	Share capital	Share premium	Other reserves	Retained earnings	Total		
Equity at 1.1.2011	10,000	55,000	2,498	53,174	120,672	791	121,463
Translation differences for foreign operations			40		40		40
Net income recognised directly in equity	-	-	40	-	40	-	40
Profit for the period				8,077	8,077	(15)	8,062
Total comprehensive income for the period	-	-	40	8,077	8,117	(15)	8,102
Change in non-controlling interests					-	(785)	(785)
Equity at 30.6.2011	10,000	55,000	2,538	61,251	128,789	(9)	128,780
Equity at 1.1.2012	10,000	55,000	2,661	55,133	122,794	909	123,703
Translation differences for foreign operations			103		103		103
Net income recognised directly in equity	-	-	103		103	-	103
Profit for the period				11,606	11,606	18	11,624
Total comprehensive income for the period	-	-	103	11,606	11,709	18	11,727
Change in non-controlling interests					-	51	51
Equity at 30.6.2012	10,000	55,000	2,764	66,739	134,503	978	135,481

The notes on pages 10 to 43 are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK million

Condensed Consolidated Statement of Cash Flows for the six months ended 30 June 2012

	Notes	2012 1.1-30.6	2011 1.1-30.6
Cash flows from operating activities:			
Profit for the period		11,624	8,062
Adjustments to reconcile profit for the period to cash flows provident by operating activities:			
Non-cash items included in profit for the period and other adjustments		4,556	2,422
Changes in operating assets and liabilities		(1,875)	978
Income tax paid		(4,063)	(1,507)
Net cash provided by operating activities		10,242	9,955
Net cash (used in) by investing activities		(671)	(388)
Net cash provided by (used in) financing activities		1,247	(3,519)
Net increase in cash and cash equivalents		10,818	6,048
Effects of exchange rate changes on cash and cash equivalents		1	34
Cash and cash equivalents at the beginning of the period		78,571	37,152
Cash and cash equivalents at the end of the period		89,390	43,234
Reconciliation of cash and cash equivalents:			
Cash on hand	18	2,373	2,256
Cash balances with Central Bank and certificates of deposit	18	60,805	20,074
Bank accounts	20	26,212	20,904
Total cash and cash equivalents		89,390	43,234

Interest received in H1 2012 was ISK 20,706 million and interest paid in H1 2012 was ISK 15,025 million (H1 2011 not available). 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 10 to 43 are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK million

Notes to the Condensed Consolidated Financial Statements

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 Condensed Consolidated Interim Financial Statements for the six months ended 30 June 2012 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 August 2012.

2. **Basis of preparation**

2.1 *Statement of compliance*

The Condensed Consolidated Interim Financial Statements for the six months ended 30 June 2012 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 Book for the year ended 31 December 2011, available at the Bank's website www.islandsbanki.is.

2.2 *Basis of measurement*

The 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 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 notes 21 and 23 has been changed following a change in the categorisation by the FME of certain entities from a credit institution to a customer in 2011. This reduces impairment allowance for loans to credit institutions by ISK 555 with a corresponding increase in the impairment allowance of investment companies under loans to customers.

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 2011.

Business combination

4. **Changes within the group**

4.1 **Merger with Kreditkort hf.**

a) *Identification of the business*

At year end 2011, the Bank announced its intention to merge with its 100% owned subsidiary Kreditkort hf., a credit card company offering MasterCard and American Express in the Icelandic market. The merger was approved by the Financial Supervisory Authority (FME) on 30 March 2012 and the merger subsequently became effective from 1 April 2012. The two entities were combined under the Íslandsbanki hf. brand, but the Bank will continue to use the brand name Kreditkort for its credit card operations.

b) *Identification of the merged assets and liabilities*

The fair value of the net identifiable assets and liabilities in Kreditkort hf. at the date of the merger equals its carrying amount as follows:

	1.4.2012
Cash and balances with Central Bank	37
Loans to customers	5,273
Investment in associates	9
Property and equipment	121
Tax assets	121
Other assets	82
Assets	5,643
Borrowings	4,878
Other liabilities	147
Liabilities	5,025
Net identifiable assets and liabilities	618

The cost arising from the merger was immaterial and no goodwill arose from the transaction.

The total fair value of loans and receivables is ISK 5,273 million with a gross contractual amount of ISK 5,843 million, of which ISK 599 million is expexted to be uncollectible.

4.2 **Loss of control of a subsidiary**

On 14 January 2012 the Bank sold 82% of its shareholding in Jardboranir hf. The entity was classified as a non-current asset held for sale. The bank has derecognised the assets and liabilities, any non-controlling interests and other components related to the subsidiary. Any surplus or deficit arising on the loss of control is recognised in profit or loss under profit from discontinued operations, net of income tax. The retained 18% interest in the previous subsidiary was measured at fair value at the date that the control was lost and was subsequently accounted for as an equity-accounted investee.

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

On 3 May 2012, the Bank acquired 100% shareholding in the equity investments company Geysir Green Investment Fund slhf. and its 100% owned subsidiary Geysir General Partner ehf. The entities qualify as being held for sale in accordance with IFRS 5 and have therefore been classified as disposal groups held for sale.

Amounts are in ISK million

Business segments

5. A business segment is a distinguishable component of the Bank that is engaged in providing products or services that are subject to risks and rewards that may be different from those of other business segments. Transactions between the business segments are on normal commercial terms and conditions. No single customer generates 10% or more of the combined revenue of the Bank.

   The accounting policies for the reportable segments are in line with the Bank's accounting policies. The segment profit presented is the profit reported to the chief operating decision maker (CEO) and the Board for the purpose of resource allocation and assessment of segment performance. The Bank is organised into six main business segments based on products and services:

a) Retail banking operates branches and asset-based financing. The branches provide services to individuals and small and medium-sized enterprises from 22 branches in Iceland.

b) Corporate Banking offers lending and other credit services to medium and large corporates in Iceland. In addition, the Corporate Solutions unit manages and leads restructuring of the distressed large corporate portfolio.

c) Markets incorporates brokerage services in securities, foreign currencies and derivatives as well as providing money market lending and interbank services. The division further offers an extensive range of corporate finance services locally as well as to the international seafood sector.

d) Wealth Management offers a range of wealth and asset management products and services for individuals, corporations and institutional investors. The Wealth Management unit consists of VÍB which offers a broad range of asset management products and services and the fund management company Íslandssjódir. Net valuation changes in Wealth Management derive from a small loan book in a winding down process.

e) Midengi is an asset management company managing businesses which the Bank has acquired through repossessions following loan defaults, debt restructuring and bankruptcies of its customers. The aim is to divest the business at the earliest opportunity.

f) Treasury incorporates unallocated capital and is responsible for the Bank's funding and liquidity management as well as management of the Bank's shares and equity instruments.

Cost centres comprise Head Office, Human Resources, Risk Management & Credit Control, Legal, Finance, Operations & IT.

Capital is allocated to business segments based on the minimum Core Tier 1 ratio requirements set by the Financial Supervisory Authority (FME) of 12% of average risk weighted assets on which the segments receive risk free interest return. The remaining capital balance is reported under the Treasury unit.

Below is an overview showing the Bank's performance with a breakdown by business segments.

1 January to 30 June 2012

Operations	Retail Banking	Corporate Banking	Markets	Wealth Management	Midengi	Treasury	Cost centres & eliminations	Total
Net interest income	10,600	3,455	57	574	(171)	2,113	(944)	15,684
Net valuation changes	(455)	723	8	920	-	0	603	1,799
Net fee and commission income	2,588	35	847	725	(0)	(40)	271	4,426
Net other (expenses) income	(344)	185	392	63	131	660	2,257	3,344
Operating income	12,389	4,398	1,304	2,282	(40)	2,733	2,187	25,253
Administrative expenses	(4,395)	(270)	(524)	(455)	(158)	(144)	(6,671)	(12,617)
Insurance fund	(449)	(0)	(0)	(39)	-	(38)	-	(526)
Profit (loss) before tax	7,545	4,128	780	1,787	(198)	2,551	(4,483)	12,110
Net segment revenue from external customers	15,173	8,952	1,279	1,098	(40)	(3,589)	2,380	25,253
Net segment revenue from other segments	(2,784)	(4,554)	25	1,184	-	6,322	(193)	0

Amounts are in ISK million

Notes to the Condensed Consolidated Financial Statements

5. Cont'd

At 30 June 2012	Retail Banking	Corporate Banking	Markets	Wealth Management	Midengi	Treasury	Cost centres & eliminations	Total
Total segment assets	399,642	183,708	1,588	7,142	27,662	167,377	2,818	789,937
Total segment liabilities	387,245	71	1,016	49,156	22,413	216,601	(22,046)	654,456

At 31 December 2011	Retail Banking	Corporate Banking	Markets	Wealth Management	Midengi	Treasury	Cost centres & eliminations	Total
Total segment assets	380,905	183,908	1,099	7,175	26,820	193,311	2,697	795,915
Total segment liabilities	396,606	207	1,608	28,401	21,401	243,623	(19,634)	672,212

Amounts are in ISK million

Quarterly statements

6. Operations by quarters:

	Q2* 2012	Q1* 2012	Q4* 2011	Q3* 2011	Q2* 2011
Net interest income	6,996	8,688	7,074	7,848	8,242
Net valuation changes	3,613	(1,544)	(465)	(576)	409
Provision for latent impairment	(149)	(121)	64	167	16
Net fee and commission income	2,324	2,102	1,600	1,353	1,298
Net financial income (expenses)	553	1,323	2,986	131	(330)
Net foreign exchange (loss) gain	(225)	1,104	529	72	134
Other net operating income (expenses)	294	295	(74)	312	297
Administrative expenses	(6,395)	(6,222)	(6,118)	(4,378)	(4,671)
Impairment of goodwill	-	-	(17,873)	-	-
Contribution to the Depositors' and Investors' Guarantee Fund	(201)	(325)	(281)	(252)	35
Share of profit of associates	-	-	39	-	-
Profit (loss) before tax	6,810	5,300	(12,519)	4,677	5,430
Income tax	(1,546)	(1,452)	3,022	(1,030)	(1,202)
Bank tax	(200)	(207)	(173)	(165)	(289)
Profit (loss) for the period from continuing operations	5,064	3,641	(9,670)	3,482	3,939
Profit (loss) for the period from discontinued operation	954	1,965	190	(198)	537
Profit (loss) for the period	6,018	5,606	(9,480)	3,284	4,476

*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. The legislation for the Depositors' and investors' guarantee fund was changed in June 2011 which resulted in an amendment to charged amounts.

Amounts are in ISK million

Financial assets and liabilities

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

At 30 June 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	18	-	-	72,072	-	72,072
Loans and receivables						
Loans to credit institutions	20-21	-	-	50,218	-	50,218
Loans to customers	22-23	-	-	545,898	-	545,898
Loans and receivables		-	-	668,188	-	668,188
Bonds and debt instruments						
Listed		14,566	31,838	-	-	46,404
Unlisted		-	3,982	-	-	3,982
Bonds and debt instruments		14,566	35,820	-	-	50,386
Shares and equity instruments						
Listed		1,493	3,976	-	-	5,469
Unlisted		-	4,401	-	-	4,401
Shares and equity instruments		1,493	8,377	-	-	9,870
Derivatives	19	306	-	-	-	306
Total financial assets		16,365	44,197	668,188	-	728,750
Financial liabilities		11,154	-	-	-	11,154
Derivatives	19	5,377	-	-	-	5,377
Deposits from Central Bank	30	-	-	-	14	14
Deposits from credit institutions	30	-	-	-	41,900	41,900
Deposits from customers	31-32	-	-	-	457,887	457,887
Debt issued and other borrowed funds	33	-	-	-	66,513	66,513
Subordinated loans		-	-	-	21,853	21,853
Total financial liabilities		16,531	-	-	588,167	604,698

For the six months ended 30 June 2012 15 Amounts are in ISK million

7. Cont'd

At 31 December 2011	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	18	-	-	57,992	-	57,992
Loans and receivables						
Loans to credit institutions	20-21	-	-	43,655	-	43,655
Loans to customers	22-23	-	-	564,394	-	564,394
Loans and receivables		-	-	666,041	-	666,041
Bonds and debt instruments						
Listed		23,095	31,610	-	-	54,705
Unlisted		-	3,957	-	-	3,957
Bonds and debt instruments		23,095	35,567	-	-	58,662
Shares and equity instruments						
Listed		1,079	5,207	-	-	6,286
Unlisted		-	4,821	-	-	4,821
Shares and equity instruments		1,079	10,028	-	-	11,107
Derivatives	19	339	-	-	-	339
Total financial assets		24,513	45,595	666,041	-	736,149
Financial liabilities		9,346	-	-	-	9,346
Derivatives	19	4,027	-	-	-	4,027
Deposits from Central Bank	30	-	-	-	73	73
Deposits from credit institutions	30	-	-	-	62,772	62,772
Deposits from customers	31-32	-	-	-	462,943	462,943
Debt issued and other borrowed funds	33	-	-	-	63,221	63,221
Subordinated loans		-	-	-	21,937	21,937
Total financial liabilities		13,373	-	-	610,946	624,319

Amounts are in ISK million

Net interest income

8. Net interest income is specified as follows:

	2012* 1.4-30.6	2011* 1.4-30.6	2012 1.1-30.6	2011 1.1-30.6
Interest income:				
Cash and balances with Central Bank	846	212	1,406	494
Loans and receivables	13,736	14,464	28,567	26,045
Financial assets held for trading	(224)	164	(278)	322
Financial assets designated at fair value through profit or loss	445	311	813	641
Other assets	19	7	52	53
Total interest income	14,822	15,158	30,560	27,555
Interest expense:				
Deposits from credit institutions and Central Bank	(487)	(648)	(812)	(1,097)
Deposits from customers	(4,951)	(3,421)	(9,495)	(5,957)
Borrowings	(1,845)	(2,243)	(3,536)	(3,216)
Subordinated loans	(264)	(303)	(579)	(583)
Financial liabilities held for trading	(159)	(110)	(272)	(178)
Other interest expense	(120)	(191)	(182)	(221)
Total interest expense	(7,826)	(6,916)	(14,876)	(11,252)
Net interest income	6,996	8,242	15,684	16,303

* unaudited information

Net valuation changes

9. Net valuation changes:

	2012* 1.4-30.6	2011* 1.4-30.6	2012 1.1-30.6	2011 1.1-30.6
Impairment charged to the comprehensive income:				
Specific impairment losses on financial assets	(9,416)	(7,951)	(10,941)	(10,494)
Impairment of foreign exchange gain (loss)	1,062	(3,291)	(483)	(4,963)
Net specific impairment losses on financial assets	(8,354)	(11,242)	(11,424)	(15,457)
Provision for latent impairment losses	(149)	16	(270)	(155)
Total impairment charged to the comprehensive income (see note 24)	(8,503)	(11,226)	(11,694)	(15,612)
Net valuation changes:				
Income due to revised estimated future cash flow from loans	13,029	8,360	13,010	10,239
Net specific impairment losses on financial assets	(8,354)	(11,242)	(11,424)	(15,457)
Foreign exchange (loss) gain (see note 12)	(1,062)	3,291	483	4,963
Net valuation changes on loans and receivables	3,613	409	2,069	(255)

* unaudited information

Foreign exchange gain from customers with foreign exchange loans and cash flows in ISK is impaired and offset against total foreign exchange gain (loss) as per note 12. Foreign exchange loss is recognised after previously impaired gain has been reversed.

For the six months ended 30 June 2012 17 Amounts are in ISK million

Net financial income (expenses)

10. Net financial income (expenses) are specified as follows:

	2012* 1.4-30.6	2011* 1.4-30.6	2012 1.1-30.6	2011 1.1-30.6
Net gain (loss) on financial instruments held for trading	260	(272)	484	(413)
Net gain on financial instruments designated at fair value through P&L	293	-	1,392	3
Net loss on loss of control over subsidiary	-	(58)	-	(58)
Net financial income (expenses)	553	(330)	1,876	(468)

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

	2012* 1.4-30.6	2011* 1.4-30.6	2012 1.1-30.6	2011 1.1-30.6
Shares	137	-	1,275	3
Bonds	156	-	117	-
Net gain on financial instruments designated at fair value through P&L	293	-	1,392	3

* unaudited information

Net foreign exchange (loss) gain

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

	2012* 1.4-30.6	2011* 1.4-30.6	2012 1.1-30.6	2011 1.1-30.6
Assets:				
Cash and balances with Central Bank	(55)	8	1	34
Financial assets held for trading	1,218	(1,414)	583	(854)
Loans to credit institutions	(1,144)	808	1,152	1,548
Loans to customers	(5,133)	5,903	1,187	9,542
Other assets	(10)	3	85	12
Total	(5,124)	5,308	3,008	10,282
Liabilities:				
Deposits from credit institutions	167	(70)	(153)	(136)
Deposits from customers	2,181	(1,207)	(1,544)	(3,072)
Subordinated loan	1,450	(504)	84	(1,646)
Other liabilities	39	(102)	(33)	(129)
Total	3,837	(1,883)	(1,646)	(4,983)
Unadjusted net foreign exchange (loss) gain	(1,287)	3,425	1,362	5,299
Foreign exchange reversal on loans to customers with ISK cash flow	1,062	(3,291)	(483)	(4,963)
Net foreign exchange (loss) gain	(225)	134	879	336

* unaudited information

Other net operating income

13. Other net operating income is specified as follows:

	2012* 1.4-30.6	2011* 1.4-30.6	2012 1.1-30.6	2011 1.1-30.6
Agency fees and service level agreement fees	78	70	164	151
Legal cost and fees	22	22	42	45
Rental income	30	76	52	135
Rental income on foreclosed mortgages	100	72	214	145
Other net operating income	64	57	117	180
Other net operating income	294	297	589	656

* unaudited information

Amounts are in ISK million

Administrative expenses

14. Administrative expenses are specified as follows:

	2012* 1.4-30.6	2011* 1.4-30.6	2012 1.1-30.6	2011 1.1-30.6
Salaries and related expenses	3,335	2,477	6,620	4,969
Other administrative expenses	2,840	2,035	5,557	4,078
Depreciation and amortisation	220	159	440	327
Administrative expenses	6,395	4,671	12,617	9,374

* unaudited information

Salaries and related expenses

15. Salaries and related expenses are specified as follows:

	2012* 1.4-30.6	2011* 1.4-30.6	2012 1.1-30.6	2011 1.1-30.6
Salaries	2,573	2,004	5,115	4,014
Pension and similar expenses	345	273	692	542
Social security charges	359	193	705	371
Other	58	7	108	42
Salaries and related expenses	3,335	2,477	6,620	4,969

* unaudited information

Effective income tax rate

16. Taxes for the six month period to 30 June 2012 are 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 24.8% for the six months ended 30 June 2012. The difference is specified as follows:

	2012 1.1-30.6		2011 1.1-30.6	
Profit before tax	12,110		9,624	
Income tax calculated on the profit of the period	2,422	20.0%	1,925	20.0%
Special financial activities tax	425	3.5%	-	0.0%
Effect of different tax rate in other countries	(7)	(0.1%)	(22)	(0.2%)
Non-deductable expenses	42	0.3%	114	1.2%
Income not subject to tax	(316)	(2.6%)	(14)	(0.1%)
Correction in accordance with ruling on prior years' taxable income	19	0.2%	(43)	(0.4%)
Other differences	413	3.4%	107	1.0%
Income tax according to the statement of comprehensive income	2,998	24.8%	2,067	21.5%

Earnings per share

17. Earnings per share are specified as follows:

	2012 1.1-30.6	2011 1.1-30.6
Net profit of the equity holders of the parent, according to the statement of comprehensive income	11,606	8,077
Average outstanding shares:		
Weighted average number of outstanding shares for the period, million	10,000	10,000
Average outstanding shares, million	10,000	10,000
Basic earnings per share	1.16	0.81
Diluted earnings per share	1.16	0.81

For the six months ended 30 June 2012 19 Amounts are in ISK million

Cash and balances with Central Bank

18. Specification of cash and balances with Central Bank:

	30.6.2012	31.12.2011
Cash on hand	2,373	1,976
Balances with Central Bank other than mandatory reserve deposits	8,720	14,587
Certificates of deposit	52,085	35,059
Included in cash and cash equivalents	63,178	51,622
Mandatory reserve deposits with Central Bank	8,894	6,370
Cash and balances with Central Bank	72,072	57,992

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

Certificates of deposit (CDs) are short term instruments issued by the Central Bank at predetermined interest rates. CDs are issued solely to banks and other financial institutions and are not transferable except to other comparable institutions.

Derivative financial instruments

19. Derivatives held for trading:	Assets 30.6.2012	Notional values related to assets 30.6.2012	Liabilities 30.6.2012	Notional values related to liabilities 30.6.2012
Interest rate swap	28	1,300	959	19,100
Cross currency interest rate swaps	38	9,022	4,137	52,057
Equity forwards	3	220	53	829
Foreign exchange forwards	-	-	94	3,136
Foreign exchange swaps	195	3,876	28	2,139
Bond forwards	42	1,100	31	1,310
Bond options	-	-	75	25,000
Derivatives held for trading	306	15,518	5,377	103,571

Derivatives held for trading:	Assets 31.12.2011	Notional values related to assets 31.12.2011	Liabilities 31.12.2011	Notional values related to liabilities 31.12.2011
Interest rate swap	25	3,100	107	10,750
Cross currency interest rate swaps	186	11,239	3,690	51,600
Equity forwards	6	82	6	30
Foreign exchange forwards	45	15,566	98	2,449
Foreign exchange swaps	59	4,889	13	1,516
Bond forwards	18	955	39	400
Bond options	-	-	74	25,000
Derivatives held for trading	339	35,831	4,027	91,745

Amounts are in ISK million

Loans

20. Loans to credit institutions:

	30.6.2012	31.12.2011
Money market loans	24,006	16,706
Bank accounts	26,212	26,949
Loans to credit institutions	50,218	43,655

21. Loans to credit institutions at amortised cost:

	Gross amount	Impairment allowance	30.6.2012 Carrying amount	Gross amount	Impairment allowance	31.12.2011 Carrying amount
Loans	50,218	-	50,218	43,655	-	43,655
Loans to credit institutions	50,218	-	50,218	43,655	-	43,655

22. Loans to customers:

	30.6.2012	31.12.2011
Loans to customers at amortised cost	545,898	564,394
Loans to customers	545,898	564,394

23. Loans to customers at amortised cost:

	Gross amount	Impairment allowance	30.6.2012 Carrying amount	Gross amount	Impairment allowance	31.12.2011 Carrying amount
Loans to customers						
Individuals	246,923	(9,262)	237,661	235,088	(6,900)	228,188
Commerce and services	72,892	(4,891)	68,001	69,239	(5,284)	63,955
Construction	22,322	(3,638)	18,684	18,389	(3,690)	14,699
Energy	4,185	(135)	4,050	3,677	(172)	3,505
Financial services	1,205	(44)	1,161	1,406	(6)	1,400
Government secured customer loan	-	-	-	38,798	-	38,798
Industrial and transportation	40,376	(2,962)	37,414	37,429	(3,459)	33,970
Investment companies	24,069	(5,796)	18,273	29,225	(4,833)	24,392
Public sector and non-profit organisations	9,469	(113)	9,356	9,737	(198)	9,539
Real estate	95,361	(16,789)	78,572	90,524	(15,195)	75,329
Seafood	74,790	(2,064)	72,726	73,040	(2,421)	70,619
Loans to customers	591,592	(45,694)	545,898	606,552	(42,158)	564,394

Amounts are in ISK million

24. 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 2012	32,735	8,508	915	42,158
Amounts written-off	(6,181)	(33)	-	(6,214)
Period adjustments	1,878	(2,137)	47	(212)
Recoveries of amounts previously written-off	1,058	-	-	1,058
Principal credit adjustment	(2,119)	(671)	-	(2,790)
Charged to the comprehensive income	11,311	113	270	11,694
At 30 June 2012	38,682	5,780	1,232	45,694

	Individually assessed	Collectively assessed	Latent	Total
At 1 January 2011	45,623	15,687	991	62,301
Reclass transaction 1 January	1,220	-	-	1,220
Amounts written-off	(31,132)	(1,071)	-	(32,203)
Period adjustments	(1,242)	93	-	(1,149)
Recoveries of amounts previously written-off	1,291	-	-	1,291
Principal credit adjustment	(3,248)	(7,604)	-	(10,852)
Charged to the comprehensive income	20,223	1,403	(76)	21,550
At 31 December 2011	32,735	8,508	915	42,158

	2012 1.1-30.6	2011 1.1-30.6
Impairment losses charged to the comprehensive income:		
Loans to customers	11,694	15,635
Loans to credit institutions	-	(23)
Impairment losses charged to the comprehensive income	11,694	15,612

Investment in associates

25. Changes in investments in associates:

	30.6.2012	31.12.2011
Investment in associates at the beginning of the period	1,070	354
Acquisition of shares in associates	-	677
Sales of shares in associates	(153)	-
Revaluation	(5)	-
Share of results	-	39
Investments in associates at the end of the period	912	1,070

Amounts are in ISK million

Investment in subsidiaries

26. Significant subsidiaries:

	Location	Ownership
Borgun hf., Ármúla 30, 108 Reykjavík	Iceland	61.3%
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%
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%
Glacier Securities LLC, 7 Times Square, Suite 1605 New York	USA	100%
32 other subsidiaries (SME)		

Related party disclosures

27. 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. Transactions with state-controlled entities during the period were based on general business terms of the Bank.

Related party transactions

The Bank has a related party relationship with its associates, the Board of Directors of the parent company and the ulitmate controlling party, the executive vice presidents of the Bank, close family members of individuals referred to herein and entities with significant influence as the largest shareholders of the Bank.

All loans to employees are provided on general business terms of the Bank. Included in assets are loans to key management. The amounts are negative where deposits exceed loans to the related party.

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

	30.6.2012	31.12.2011
CEO and Managing Directors (including companies owned by them)	(117)	(163)
Members of the Board (including companies owned by them)	157	(82)
Associated companies and other related parties	9,100	6,884
Total	9,140	6,639
Guarantees	38	59
Loan commitments, overdraft and credit card commitments	784	145

Impairment allowances of ISK 73 m. were recognised in the period against balances outstanding with associated companies (H1 2011: ISK 3.2bn).

No share option programmes were operated during the reporting period 2012.

Amounts are in ISK million

Non-current assets and disposal groups held for sale

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

	30.6.2012	31.12.2011
Repossessed collateral	11,742	10,467
Assets of disposal groups classified as held for sale	27,407	32,223
Total	39,149	42,690

Repossessed collateral:

Residential property	9,454	7,683
Industrial property	68	95
Equipment	44	84
Shares and equity instruments	1,930	2,182
Other assets	246	423
Total	11,742	10,467

Assets of disposal groups classified as held for sale:	30.6.2012	31.12.2011
Cash	1,367	1,212
Investment properties	11,324	12,263
Properties	588	558
Equipment	-	2,299
Receivables	2,570	2,090
Tax assets	224	697
Inventory	1,292	2,056
Assets classified as held for sale	5,468	6,129
Other assets	4,574	4,919
Total	27,407	32,223

Liabilities associated with assets classified as held for sale:	30.6.2012	31.12.2011
Payables	464	1,237
Deferred tax liabilities	673	823
Borrowings	2,938	2,352
Other liabilities	1,686	2,905
Total	5,761	7,317

Amounts are in ISK million

Other assets

29. Other assets are specified as follows:

	30.6.2012	31.12.2011
Receivables	4,502	3,351
Unsettled securities transactions	6,373	2,199
Accruals	428	494
Prepaid expenses	404	311
Inventory (real estate)	538	534
Other assets	647	668
Other assets	12,892	7,557

Inventory comprises real estate valued at the lower of cost and net realisable value.

Deposits from Central Bank and credit institutions

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

	30.6.2012	31.12.2011
Repurchase agreements with Central Bank	14	73
Deposits from credit institutions	41,900	62,772
Deposits from Central Bank and credit institutions	41,914	62,845

Deposits from customers

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

	30.6.2012	31.12.2011
Demand deposits	272,964	259,994
Time deposits	184,923	202,949
Deposits from customers	457,887	462,943

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

	30.6.2012		31.12.2011	
	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	6,610	1%	14,362	3%
Municipalities	6,321	1%	7,054	2%
Companies	257,664	57%	257,842	55%
Individuals	187,292	41%	183,685	40%
Deposits from customers	457,887	100%	462,943	100%

Debt issued and other borrowed funds

33. Specification of debt issued and other borrowed funds:

	30.6.2012	31.12.2011
Non-listed issued bonds	54,183	55,742
Listed issued bonds	8,874	3,855
Loans from credit institutions	16	333
Other debt securities	3,440	3,291
Debt issued and other borrowed funds	66,513	63,221

Amounts are in ISK million

Other liabilities

34. Specification of other liabilities:

	30.6.2012	31.12.2011
Accruals	3,580	3,452
Liabilities to retailers for credit card provision	15,900	13,585
Provision for effects of court rulings	10,817	10,982
Guarantees	310	578
Chargeable gain tax	630	1,888
Unsettled securities transactions	7,374	3,047
Deferred income	157	215
Sundry liabilities	3,835	4,142
Other liabilities	42,603	37,889

Equity

35. Authorised share capital of the Bank is 10,000m ordinary shares of ISK 1 each. At 30.6.2012 paid up share capital totalled ISK 65,000m which is the total stated share capital of the Bank.

Total share capital

	30.6.2012	31.12.2011
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

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

	30.6.2012	31.12.2011
Financial guarantees	8,416	6,893
Undrawn loan commitments	12,027	12,592
Undrawn overdrafts	20,423	21,449
Credit card commitments	28,899	22,202
The Depositors and Investors Guarantee Fund (TIF) – declaration of guarantee	3,724	3,724

An amendment to Law 98/1999 on the Depositors' and Investors' Guarantee Fund was passed in Parliament in June. Following the amendment the annual premium will be 0.225% of all eligible deposits. In addition, there will be a variable premium based on Equity, Funding and a Loan Portfoly Analysis (LPA) ratio provided by the FME. The Bank has accordingly made an amendment to its charge to the profit and loss.

Balance of custody assets

37. Balance of custody assets:

	30.6.2012	31.12.2011
Custody assets	822,950	746,574

Amounts are in ISK million

Contingencies

38. **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 in any way. 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.

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 case has now been appealed to the Iceland Supreme Court. 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 and foreign currency loans

In order to address the uncertainty surrounding which foreign currency loans should be deemed to be illegally linked to foreign currency, 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 validity of the contract in question. The definition of a mortgage in the new 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 obliged to accept the offer. The interest rate on car loans going forward will, according to the law, be replaced by non-indexed CPI-rate. The same goes for mortgages for the first five years, in addition to a choice of indexed CPI rate. At the end of the five year term, mortgages will revert back to market rates.

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 Act 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. Significant uncertainty remains on how the ruling should be interpreted. The Bank made an assessment to the effect that the impact from this court ruling would be a loss of ISK 12.1 billion, however dependent on later rulings. The Bank recognised a provision at year end 2011 and the financial statements therefore reflect the impact of the court rulings at the time. The Bank still maintained a capital ratio above the minimum requirement of 16% set by the Icelandic Financial Supervisory Authority.

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 will affect, by precedent, approximately 4,100 similar contracts with a book value of approximately ISK 10.2 billion. Each affected contract will be recalculated as a result of the ruling.

The ruling on financial leasing contracts does not appear to set new precedent affecting other loan contracts, as the dismissal of the disputed contract's currency indexation is based on the Supreme Court's ruling from June 2010. It should also be noted that although the currency indexation has been deemed illegal, the customer's debt obligation in ISK at the signing of the contract is still valid. The effect of recalculation is minimal for contracts signed before 2004 – 2005.

38. Cont'd

The District Courts have ruled in favour of the Bank in a few cases regarding disputed foreign currency denominated loan contracts, thereby confirming that the disputed loans were indeed legitimate foreign currency loans. These rulings are somewhat offset by the June 2011 Supreme Court's ruling on a case regarding a disputed loan contract between Landsbankinn and its customer (Landsbankinn vs. MótorMax). Although the case did not involve Íslandsbanki, the disputed contract in the case must be regarded as typical of many foreign currency corporate loans granted by Íslandsbanki. In the ruling, the Supreme Court set new precedent by deciding that the disputed contract contained an illegal foreign currency indexation. Following the June 2011 ruling, the Bank has evaluated all corporate contract forms and assessed which forms are affected by the ruling and which are, by the Bank's estimation, 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.

Because of the widespread use of the box form and its predecessors, the impact of the decision is significant, mainly in three ways. Firstly, the 15 February 2012 ruling does not affect the bulk of the mortgage loans as far as further recalculation is concerned. Secondly, the Bank is not obliged to recalculate any similar loans not categorised as mortgage loans. Thirdly, no change is necessary to the method of recalculation in most of the offer loan category.
Furthermore, the Supreme Court decided in June that a loan contract similar to the one in the MótorMax case mentioned abowe was legal because the lender did actually receive payment in foreign currency.

Based on the Supreme Court's latest rulings, the Bank will estimate the financial effect of remaining lawsuits. In its estimates, the Bank will take into account that customers have already been offered principal adjustment of foreign currency debt, and that a ruling has been made by the Supreme Court on replacement interest rates. The Bank has divided all foreign currency loans into four categories, depending on the risk of the loans being deemed illegal. The Bank holds provisions for the expected financial effect for the highest risk category. Meanwhile, customers whose contracts are eligible for recalculation will have the option of fixed payments until the recalculations have been completed.

Formal investigation by the EFTA Surveillance Authority regarding alleged government aid granted by the Icelandic government to investment funds and associated fund management companies connected to the three failed Icelandic banks Glitnir, Kaupthing and Landsbanki

On 11 July 2012 the EFTA Surveillance Authority (the Authority) concluded that state aid was indeed provided in October 2008 when the three new Icelandic banks were established and acquired assets held by eight investment funds. With reference to the serious disturbance in the Icelandic economy at the time the Authority finds this state aid compatible with the EEA Agreement.

The Authority considers that the state aid is compatible with Article 61(3)(b) of the EEA Agreement that allows for aid to remedy a serious disturbance in the economy. In October 2008, the financial sector in Iceland had collapsed and the Government had to implement extraordinary measures in an attempt to stabilize the economy. The Authority considers that the measures at issue were necessary in order to try to restore faith in the financial sector. It was in that regard necessary and proportionate to protect the investors from even bigger losses on their savings.

Formal investigation by the EFTA Surveillance Authority into government aid granted in the restoration of certain operations of Glitnir and the establishment and capitalisation of Íslandsbanki

On 26 June 2012 the EFTA Surveillance Authority approved the state aid granted for the restructuring of Íslandsbanki.

With regard to the long-term viability of the Bank, the Authority emphasised in its decision that while challenges remain for the Bank and the Icelandic economy in general, the Bank has addressed the weaknesses of its predecessor. The Bank today has a strong capital ratio and has made good progress regarding the restructuring of loans to over-indebted customers. The Authority also took notice of numerous legislative amendments that Iceland has made since the collapse of the financial sector in 2008 which have strengthened the regulatory framework for financial institutions in Iceland.

The Bank and the Government have committed to a range of conditions that limit distortions of competition. During the restructuring period the Bank is not permitted to acquire other financial institutions without the Authority´s approval. Furthermore, the Bank will continue to divest businesses and shareholdings. The Bank will also provide information for customers on its website on the process and the documentation needed for switching banking services to another financial institution.

Risk Management

The Bank is exposed to various risks through its use of financial instruments. 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 2011.
English version: www.islandsbanki.is/riskreport
Icelandic version: www.islandsbanki.is/ahaettuskyrsla

Credit risk

39. 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.

The loan portfolio acquired from Glitnir is the largest part of the credit exposure of the Bank. Due to the extraordinary circumstances in the Icelandic economy and the fact that the loan portfolio was acquired at a deep discount, care must be taken when interpreting conventional measures of credit risk.

40. 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. 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

40. **Maximum credit exposure**

Maximum credit exposure 30.6.2012

	Individuals	Central Governments	Commerce and Services	Construction	Energy	Financial services	Government secured customer loan	Industrials and transporta-tion	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	72,072	-	-	-	-	-	-	-	-	-	-	72,072
Loans to credit institutions	-	-	-	-	-	50,218	-	-	-	-	-	-	50,218
Loans to customers:	237,661	-	68,001	18,683	4,050	1,161	-	37,414	18,273	9,357	78,572	72,726	545,898
Overdrafts	13,502	-	7,038	3,266	-	90	-	5,172	309	914	1,397	1,540	33,228
Credit cards	14,667	-	1,195	143	8	20	-	375	34	178	54	35	16,709
Mortgages	153,299	-	-	-	-	-	-	-	-	-	-	-	153,299
Leases	10,729	-	15,165	2,582	16	20	-	4,043	181	684	1,222	429	35,071
Other loans	45,464	-	44,603	12,692	4,026	1,031	-	27,824	17,749	7,581	75,899	70,722	307,591
Bonds and debt instruments	19	44,850	303	-	-	3,097	-	-	1,215	34	868	-	50,386
Derivatives	23	83	67	50	-	1,248	-	22	21	-	6	112	1,632
Financial guarantees	1,182	-	1,530	2,288	4	1,000	-	1,474	22	53	325	538	8,416
Undrawn loan commitments	-	-	881	84	6,891	-	-	3,142	9	-	-	1,020	12,027
Undrawn overdraft	9,094	-	4,152	991	202	2,112	-	1,593	72	1,021	319	867	20,423
Credit card commitments	23,257	-	2,956	407	15	99	-	739	140	1,032	140	114	28,899
Total maximum credit exposure	271,236	117,005	77,890	22,503	11,162	58,935	-	44,384	19,752	11,497	80,230	75,377	789,971

Amounts are in ISK million

40. Cont'd

Maximum exposure 31.12.2011

	Individuals	Central Governments	Commerce and Services	Construction	Energy	Financial services	Government secured customer loan	Industrials and transporta-tion	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	57,992	-	-	-	-	-	-	-	-	-	-	57,992
Loans to credit institutions	-	-	-	-	-	43,655	-	-	-	-	-	-	43,655
Loans to customers:	228,189	-	63,956	14,699	3,505	1,399	38,798	33,970	24,391	9,539	75,329	70,619	564,394
Overdrafts	14,506	-	6,636	3,522	28	1,185	-	3,557	488	1,287	1,073	1,200	33,482
Credit cards	15,769	-	1,566	129	5	17	8	194	22	117	39	29	17,895
Mortgages	140,517	-	-	-	-	-	-	-	-	-	-	-	140,517
Leases	11,177	-	8,906	2,744	16	7	-	3,703	193	772	1,188	551	29,257
Other loans	46,220	-	46,848	8,304	3,456	190	38,790	26,516	23,688	7,363	73,029	68,839	343,243
Bonds and debt instruments	-	52,217	282	-	-	4,077	-	-	1,137	89	849	11	58,662
Derivatives	10	58	71	54	2	1,161	-	13	41	-	1	70	1,481
Financial guarantees	1,058	-	1,443	1,577	4	1,012	-	1,055	12	73	339	320	6,893
Undrawn loan commitments	-	-	2,017	-	5,345	5,000	-	225	-	-	-	5	12,592
Undrawn overdraft	9,797	-	4,343	1,083	203	1,363	-	1,993	72	1,096	513	986	21,449
Credit card commitments	19,392	-	1,521	272	5	48	10	352	81	380	68	73	22,202
Total maximum credit exposure	258,446	110,267	73,633	17,685	9,064	57,715	38,808	37,608	25,734	11,177	77,099	72,084	789,320

Amounts are in ISK million

41. 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 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 overcollateralization. This means that if some loans have collateral values in excess of their claim value, then the excess is removed in order to reflect the Bank's actual maximum exposure to credit risk.

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

At 30 June 2012	Real estate	Fishing vessels	Cash & securities	Other collateral	Total collateral
Loans and commitments to credit institutions	-	-	-	-	-
Loans and commitments to customers:	310,732	58,695	12,668	16,749	398,844
Individuals	189,641	93	1,158	4	190,896
Commerce and Services	21,888	-	575	8,022	30,485
Construction	8,076	-	102	1,531	9,709
Energy	2,500	-	88	137	2,725
Financial services	59	-	28	-	87
Government secured customer loan	-	-	-	-	-
Industrial and transportation	12,366	-	186	5,479	18,031
Investment companies	4,127	-	9,589	395	14,111
Public sector ad non-profit organisations	3,924	-	12	237	4,173
Real estate	64,232	146	606	-	64,984
Seafood	3,919	58,456	324	944	63,643
Bonds and debt instruments	-	-	-	-	-
Derivatives	-	-	714	-	714
Total	310,732	58,695	13,382	16,749	399,558

At 31 December 2011	Real estate	Fishing vessels	Cash & securities	Other collateral	Total collateral
Loans and commitments to credit institutions	-	-	-	-	-
Loans and commitments to customers:	268,925	62,382	51,530	19,021	401,858
Individuals	170,491	71	1,148	3	171,713
Commerce and Services	15,728	-	725	10,504	26,957
Construction	7,757	-	457	1,270	9,484
Energy	2,517	-	83	149	2,749
Financial services	44	-	47	-	91
Government secured customer loan	-	-	38,799	-	38,799
Industrial and transportation	7,362	-	294	5,703	13,359
Investment companies	2,933	-	8,901	389	12,223
Public sector ad non-profit organisations	3,455	-	9	200	3,664
Real estate	54,679	154	675	-	55,508
Seafood	3,959	62,157	392	803	67,311
Bonds and debt instruments	-	-	-	-	-
Derivatives	-	-	600	-	600
Total	268,925	62,382	52,130	19,021	402,458

The Bank is still in the process of finalising the registration of necessary collateral information for this disclosure, in particular for loans recently acquired from Byr. Therefore, the table understates the value of the Bank's total collateral.

For the six months ended 30 June 2012 32 Amounts are in ISK million

42. 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.

	Neither past due nor impaired	Past due but not impaired	Classified as impaired	Total carrying amount
At 30 June 2012				
Cash and balances with Central Bank	72,072	-	-	72,072
Loans to credit institutions	50,218	-	-	50,218
Loans to customers:	421,923	64,111	59,864	545,898
Individuals	188,310	40,049	9,302	237,661
Commerce and Services	52,292	6,571	9,138	68,001
Construction	12,739	2,927	3,017	18,683
Energy	3,418	-	632	4,050
Financial services	1,105	45	11	1,161
Government secured customer loan	-	-	-	-
Industrial and transportationl	29,681	3,619	4,114	37,414
Investment companies	11,617	1,988	4,668	18,273
Public sector and non-profit organisations	8,604	458	295	9,357
Real estate	47,462	6,131	24,979	78,572
Seafood	66,695	2,323	3,708	72,726
Bonds and debt instruments	50,386	-	-	50,386
Derivatives	1,632	-	-	1,632
Total	596,231	64,111	59,864	720,206

	Neither past due nor impaired	Past due but not impaired	Classified as impaired loans	Total carrying amount
At 31 December 2011				
Cash and balances with Central Bank	57,992	-	-	57,992
Loans to credit institutions	43,655	-	-	43,655
Loans to customers:	408,462	70,963	84,969	564,394
Individuals	177,724	40,138	10,327	228,189
Commerce and Services	43,465	7,055	13,435	63,955
Construction	5,509	4,830	4,360	14,699
Energy	2,921	28	556	3,505
Financial services	164	177	1,059	1,400
Government secured customer loan	38,798	-	-	38,798
Industrial and transportation	24,688	2,779	6,502	33,969
Investment companies	8,453	3,431	12,508	24,392
Public sector and non-profit organisations	5,667	422	3,449	9,538
Real estate	36,343	9,235	29,751	75,329
Seafood	64,730	2,868	3,022	70,620
Bonds and debt instruments	58,662	-	-	58,662
Derivatives	1,481	-	-	1,481
Total	570,252	70,963	84,969	726,184

For the six months ended 30 June 2012 33 Amounts are in ISK million

43. 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. 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 or the assessment is that contractual payments will be fulfilled.

Amounts reported as past due refer to the total loan exposure and not only the payment or sum of payments that are past due. Past due but not impaired loans are as follows:

At 30 June 2012	Past due up to 30 days	Past due 31-60 days	Past due 61-90 days	Past due more than 90 days	Total past due loans
Loans to credit institutions	-	-	-	-	-
Loans to customers:					
Individuals	13,047	4,214	2,536	20,252	40,049
Commerce and Services	3,378	459	236	2,498	6,571
Construction	745	100	119	1,963	2,927
Energy	-	-	-	-	-
Financial services	12	3	2	28	45
Government secured customer loan	-	-	-	-	-
Industrial and transportation	2,065	177	88	1,289	3,619
Investment companies	529	59	55	1,345	1,988
Public sector ad non-profit organisations	181	29	79	169	458
Real estate	1,758	158	67	4,148	6,131
Seafood	1,247	28	25	1,023	2,323
Total	22,962	5,227	3,207	32,715	64,111

At 31 December 2011	Past due up to 30 days	Past due 31-60 days	Past due 61-90 days	Past due more than 90 days	Total past due loans
Loans to credit institutions	-	-	-	-	-
Loans to customers:					
Individuals	12,856	4,198	2,011	21,073	40,138
Commerce and Services	1,969	394	435	4,257	7,055
Construction	1,912	290	287	2,341	4,830
Energy	14	-	-	14	28
Financial services	55	-	-	122	177
Government secured customer loan	-	-	-	-	-
Industrial and transportation	675	377	110	1,617	2,779
Investment companies	380	41	5	3,005	3,431
Public sector ad non-profit organisations	289	24	11	98	422
Real estate	898	247	335	7,755	9,235
Seafood	118	29	66	2,655	2,868
Total	19,166	5,600	3,260	42,937	70,963

For the six months ended 30 June 2012 34 Amounts are in ISK million

44. Large exposure disclosure

When the Bank's total exposure to a group of connected clients exceeds 10% of the Bank's capital base 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. These criteria reflect the Bank's interpretation of Article (1)(a) in Law no. 161/2002 on Financial Undertakings, where groups of connected clients are defined.

The Bank has one large exposure to a group of connected clients that amounts to 16% of the Bank's capital base which is below the aggregated 400% limit set by the law. No large exposure exceeds the maximum 25% set by the law.

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

		30.6.2012
Client groups	Gross	Net
Group 1	63%	0%
Group 2	16%	16%

		31.12.2011
Client groups	Gross	Net
Group 1	56%	0%
Group 2	27%	0%
Group 3	15%	15%

For the six months ended 30 June 2012 35 Amounts are in ISK million

Liquidity Risk

45. 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.

Maturity analysis 30 June 2012

Financial Liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Short positions	11,154	-	-	-	-	-	11,154
Deposits from Central Bank	14	-	-	-	-	-	14
Deposits from credit institutions	28,294	8,171	5,541	-	-	-	42,006
Deposits from customers	333,420	35,487	44,907	36,409	22,572	-	472,795
Debt issued and other borrowed funds	16	315	6,993	49,043	26,350	2,717	85,434
Subordinated loans	-	253	502	5,965	38,846	-	45,566
Other financial liabilities	33,890	2,880	1,346	570	459	218	39,363
Total financial liabilities	406,788	47,106	59,289	91,987	88,227	2,935	696,332

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 gurantees	8,416	-	-	-	-	-	8,416
Undraw loan commitments	12,027	-	-	-	-	-	12,027
Undrawn overdraft	20,423	-	-	-	-	-	20,423
Credit card commitments	28,899	-	-	-	-	-	28,899
Total	69,765	-	-	-	-	-	69,765
Total non-derivative financial liabilities and off balance sheet liabilities	476,553	47,106	59,289	91,987	88,227	2,935	766,097

The table below shows the contractual cash flow of the Bank's derivative liabilities, i.e. derivatives that have a negative carrying amount at the date of reporting. Derivatives with a positive carrying amount are detailed separately. For derivatives settled on a gross basis, the cash flow for both legs of the derivative is shown, since netting cannot be applied upon settlement.

Amounts are in ISK million

45. 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	-	8,092	6,346	120,473	25,000	-	159,911
Outflow	-	(6,921)	(6,218)	(135,746)	(25,075)	-	(173,960)
Total	-	1,171	128	(15,273)	(75)	-	(14,049)
Net settled derivatives	-	(38)	-	-	-	-	(38)
Total	-	1,133	128	(15,273)	(75)	-	(14,087)

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	19,944	52,128	-	-	-	-	72,072
Bonds and debt instruments	3,122	12,221	-	-	31,062	3,981	50,386
Shares and equity instruments	-	196	334	46	-	9,294	9,870
Loans to credit institutions	21,076	29,125	-	-	17	-	50,218
Loans to customers	147	63,186	43,803	139,053	299,709	-	545,898
Other financial assets	6,382	769	1,251	7,719	-	461	16,582
Total financial assets	50,671	157,625	45,388	146,818	330,788	13,736	745,026

Derivative financial assets							
Gross settled derivatives							
Inflow	-	3,025	587	10,340	-	-	13,952
Outflow	-	(2,884)	(526)	(10,265)	-	-	(13,675)
Total	-	141	61	75	-	-	277
Net settled derivatives	-	41	-	-	-	-	41
Total	-	182	61	75	-	-	318

The tables below show the comparative amounts for financial assets and liabilities at the end of 2011.

Maturity analysis 31 December 2011

Financial Liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Short positions	9,346	-	-	-	-	-	9,346
Deposits from Central Bank	73	-	-	-	-	-	73
Deposits from credit institutions	49,527	12,209	1,077	-	-	-	62,813
Deposits from customers	351,478	53,730	28,670	25,411	12,907	-	472,196
Debt issued and other borrowed funds	333	2,226	7,108	43,423	27,381	2,145	82,616
Subordinated loans	-	298	559	6,124	38,288	-	45,269
Other financial liabilities	22,379	13,188	3,156	570	392	148	39,833
Total financial liabilities	433,136	81,651	40,570	75,528	78,968	2,293	712,146

Amounts are in ISK million

45. 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 gurantees	6,893	-	-	-	-	-	6,893
Undraw loan commitments	12,592	-	-	-	-	-	12,592
Undrawn overdraft	21,449	-	-	-	-	-	21,449
Credit card commitments	22,202	-	-	-	-	-	22,202
Total	63,136	-	-	-	-	-	63,136
Total non-derivative financial liabilities and off balance sheet liabilities	496,272	81,651	40,570	75,528	78,968	2,293	775,282

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	-	6,258	2,498	78,562	25,000	-	112,318
Outflow	-	(6,131)	(2,979)	(94,688)	(25,074)	-	(128,872)
Total	-	127	(481)	(16,126)	(74)	-	(16,554)
Net settled derivatives	-	(38)	-	-	-	-	(38)
Total	-	89	(481)	(16,126)	(74)	-	(16,592)

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	22,937	35,055	-	-	-	-	57,992
Bonds and debt instruments	6,617	16,494	82	152	31,361	3,956	58,662
Shares and equity instruments	-	-	525	48	-	10,534	11,107
Loans to credit institutions	22,027	21,556	-	-	72	-	43,655
Loans to customers	-	50,523	46,877	169,833	297,161	-	564,394
Other financial assets	-	2,567	237	2	-	380	3,186
Total financial assets	51,581	126,195	47,721	170,035	328,594	14,870	738,996

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	-	8,069	773	33,058	-	-	41,900
Outflow	-	(7,976)	(692)	(32,860)	-	-	(41,528)
Total	-	93	81	198	-	-	372
Net settled derivatives	-	21	-	-	-	-	21
Total	-	114	81	198	-	-	393

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 2011 and end of Q2 2012

Composition and amount of liquidity back-up	30.6.2012	31.12.2011
Cash and balances with Central Bank	72,072	57,992
Domestic bonds eligible as collateral against borrowing at the Central Bank	16,061	55,024
Foreign government bonds	12,221	16,323
Short-term placements with credit institutions	42,907	36,695
Government liquidity facility	25,000	25,000
Composition and amount of liquidity back-up	168,261	191,034

For the six months ended 30 June 2012 38 Amounts are in ISK million

Market risk

46. 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 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 originated from mismatches in assets and liabilities with respect to currencies, interest reset dates and inflation indexation and from shares and equity instruments acquired through restructuring. These mismatches are reported to management and are subject to regulatory and internal limits.

Interest rate risk

47. 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. The Bank holds a significant amount of highly liquid foreign government bills in its liquidity portfolio. The bills are held for cash management purposes and can be liquidated with a short notice.

Trading bonds and debt instruments, long positions		30.6.2012			31.12.2011	
	MV	Duration	BPV	MV	Duration	BPV
Indexed	435	9.01	(0.39)	379	9.22	(0.35)
Non-indexed	13,997	0.51	(0.72)	17,231	0.32	(0.55)
Total	14,432	0.77	(1.11)	17,610	0.51	(0.90)

Trading bonds and debt instruments, short positions		30.6.2012			31.12.2011	
	MV	Duration	BPV	MV	Duration	BPV
Indexed	-	-	-	962	7.89	0.76
Non-indexed	1,864	0.65	0.12	364	8.17	0.30
Total	1,864	0.65	0.12	1,326	7.97	1.06
Net position of trading bonds and debt instruments	12,568	0.79	(0.99)	16,284	(0.09)	0.16

For the six months ended 30 June 2012 39 Amounts are in ISK million

48. 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.

Banking book interest rate adjustment periods on 30 June 2012

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	69,698	-	-	-	-	-	69,698
Bonds and debt instruments	32,075	2,240	340	90	408	147	35,300
Loans to credit institutions	50,112	106	-	-	-	-	50,218
Loans to customers	386,140	33,694	39,863	69,657	1,443	15,101	545,898
Total assets	538,025	36,040	40,203	69,747	1,851	15,248	701,114
Off balance sheet items..	56,985	2,407	15,286	2,006	113	-	76,797
Liabilities							
Short positions	3,618	569	-	1,441	-	-	5,628
Deposits from Central Bank	14	-	-	-	-	-	14
Deposits from credit institutions	36,453	5,447	-	-	-	-	41,900
Deposits from customers	449,769	3,240	1,564	1,569	1,745	-	457,887
Debt issued and other borrowed funds	9,099	-	-	4,877	50,022	2,515	66,513
Subordinated loans	21,853	-	-	-	-	-	21,853
Total liabilities	520,806	9,256	1,564	7,887	51,767	2,515	593,795
Off balance sheet items	60,593	2,437	15,545	2,032	-	-	80,607
Net interest gap on 30 June 2012	13,611	26,754	38,380	61,834	(49,803)	12,733	103,509

Banking book interest rate adjustment periods 31 December 2011

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	56,016	-	-	-	-	-	56,016
Bonds and debt instruments	32,218	1,153	1,069	370	1,398	4,458	40,666
Loans to credit institutions	43,551	104	-	-	-	-	43,655
Loans to customers	420,171	27,158	35,739	63,895	1,914	15,517	564,394
Total assets	551,956	28,415	36,808	64,265	3,312	19,975	704,731
Off balance sheet items	59,201	-	10,007	3,115	113	-	72,436
Liabilities							
Short positions	-	3,567	1,815	477	-	-	5,859
Deposits from Central Bank	73	-	-	-	-	-	73
Deposits from credit institutions	61,711	1,061	-	-	-	-	62,772
Deposits from customers	456,329	3,383	759	807	1,665	-	462,943
Debt issued and other borrowed funds	7,221	-	-	6,679	49,133	188	63,221
Subordinated loans	21,937	-	-	-	-	-	21,937
Total liabilities	547,271	8,011	2,574	7,963	50,798	188	616,805
Off balance sheet items	62,484	-	9,862	3,070	-	-	75,416
Net interest gap on 31 December 2011	1,402	20,404	34,379	56,347	(47,373)	19,787	84,946

Amounts are in ISK million

Currency risk

49. Currency risk is the risk that earnings or capital may be negatively affected by the fluctuations of foreign exchange rates, due to transactions in foreign currencies or due to a mismatch in the currency composition of assets and liabilities.

Currency analysis 30 June 2012

Assets	EUR	USD	GBP	CHF	JPY	Other	Total
Cash and balances with Central Bank	413	248	97	31	12	257	1,058
Bonds and debt instruments	2,763	9,212	-	1	-	1,083	13,059
Shares and equity instruments	443	186	218	-	-	-	847
Loans to credit institutions	17,728	15,362	2,338	345	982	7,039	43,794
Loans to customers	62,006	17,435	3,866	17,928	19,690	1,816	122,741
Investments in associates	19	507	-	-	-	-	526
Other assets	160	689	94	-	-	248	1,191
Total assets	83,532	43,639	6,613	18,305	20,684	10,443	183,216
Liabilities							
Deposits from credit institutions	263	150	-	-	-	-	413
Deposits from customers	24,370	23,077	4,730	584	1,448	5,557	59,766
Debt issued and other borrowed funds	-	-	-	-	-	1	1
Subordinated loans	21,853	-	-	-	-	-	21,853
Other liabilities	1,294	2,052	478	1	1	277	4,103
Total liabilities	47,780	25,279	5,208	585	1,449	5,835	86,136
Non-adjusted foreign exchange on balance sheet imbalance	35,752	18,360	1,405	17,720	19,235	4,608	97,080
Adjustment of currency imbalance for FX/ISK loans	11,906	1,372	186	9,075	8,939	365	31,843
Adjusted imbalance	23,846	16,988	1,219	8,645	10,296	4,243	65,237
Off balance sheet items							
Off balance sheet assets	3,212	12,127	78	159	2,740	1,652	19,968
Off balance sheet liabilities	19,728	26,071	39	9,350	14,281	1,554	71,023
Net off balance sheet items	(16,516)	(13,944)	39	(9,191)	(11,541)	98	(51,055)
Net currency imbalance on 30 June 2012	7,330	3,044	1,258	(546)	(1,245)	4,341	14,182

Amounts are in ISK million

49. Cont'd

Currency analysis 31 December 2011

Assets	EUR	USD	GBP	CHF	JPY	Other	Total
Cash and balances with Central Bank	491	124	63	36	10	226	950
Bonds and debt instruments	5,919	5,890	-	-	-	5,238	17,047
Shares and equity instruments	630	122	213	-	-	-	965
Loans to credit institutions	18,866	10,355	1,492	1,236	382	5,220	37,551
Loans to customers	60,941	18,176	4,813	22,681	25,082	2,473	134,166
Investments in associates	20	433	-	-	-	-	453
Other assets	-	-	-	-	-	-	-
Total assets	86,867	35,100	6,581	23,953	25,474	13,157	191,132
Liabilities							
Deposits from credit institutions	2,511	380	135	11	2	95	3,134
Deposits from customers	21,307	19,451	4,557	725	536	8,547	55,123
Debt issued and other borrowed funds	-	-	-	-	-	14	14
Subordinated loans	21,937	-	-	-	-	-	21,937
Other liabilities	-	-	-	-	-	-	-
Total liabilities	45,755	19,831	4,692	736	538	8,656	80,208
Non-adjusted foreign exchange on balance sheet imbalance	41,112	15,269	1,889	23,217	24,936	4,501	110,924
Adjustment of currency imbalance for FX/ISK loans	16,007	3,075	806	12,638	13,210	912	46,648
Adjusted imbalance	25,105	12,194	1,083	10,579	11,726	3,589	64,276
Off balance sheet items							
Off balance sheet assets	4,265	17,238	38	239	2,459	76	24,315
Off balance sheet liabilities	21,176	25,427	294	11,106	15,011	1,891	74,905
Net off balance sheet items	(16,911)	(8,189)	(256)	(10,867)	(12,552)	(1,815)	(50,590)
Net currency imbalance on 31 December 2011...	8,194	4,005	827	(288)	(826)	1,774	13,686

Derivatives

50. 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 collateral for possible losses. Other derivatives in the Bank held for trading or for other purposes are insignificant.

Inflation risk

51. The Bank is exposed to inflation risk since the value of CPI-indexed assets exceeds CPI-indexed liabilities. The value of these assets and liabilities changes according to changes in the CPI at any given time and all changes in the CPI index affect profit and loss. On 30 June 2012 the CPI gap amounted to ISK 9.8 billion (31 December 2011: ISK 22.2 billion). Thus, a 1% increase in the index would have a positive impact on the profit and loss account to the amount of ISK 98 million in profit and a 1% decrease would result in a corresponding loss, other risk factors held constant.

Amounts are in ISK million

Capital management

52. Icelandic capital adequacy rules are based on the EU capital requirements directives (CRD). The capital adequacy rules require an absolute minimum capital level of 8% of risk weighted assets.

As part of the conditions for granting the Bank an operating license as a financial undertaking, the Icelandic Financial Supervisory Authority (FME) requires the Bank to maintain a minimum core Tier 1 ratio of 12% of risk weighted assets and a total capital ratio, allowing for subordinated Tier 2 debt, of 16%.

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. Market risk exposure for currency risk is based on the adjusted currency imbalance described in note 49.

The table below shows the total capital base, risk weighted assets and capital ratios of the Bank at 30 June 2012 and 31 December 2011.

	30.6.2012	31.12.2011
Tier 1 capital		
Ordinary share capital	10,000	10,000
Share premium	55,000	55,000
Other reserves	2,764	2,661
Retained earnings	66,739	55,133
Non-controlling interests	978	909
Tax assets	(1,997)	(2,629)
Intangible assets	(608)	(544)
Other regulatory adjustments	(436)	-
Total Tier 1 capital	132,440	120,530
Tier 2 capital		
Other regulatory adjustments	(436)	-
Qualifying subordinated liabilities	21,853	21,937
Total capital base	153,857	142,467
Risk weighted assets		
- due to credit risk	556,929	532,301
- due to market risk:	17,510	16,695
Market risk, trading book	1,533	1,895
Currency risk foreign exchange	15,977	14,800
- due to operational risk	80,423	80,423
Total risk weighted assets	654,862	629,419
Capital ratios		
Tier 1 ratio	20.2%	19.1%
Total capital ratio	23.5%	22.6%

For the six months ended 30 June 2012 43 Amounts are in ISK million