Risk and Capital Management 2015

Pillar III risk report of Landsbankinn hf.
31.12.2015

Landsbankinn hf. in brief

Landsbankinn hf. was founded on 7 October 2008 by the Ministry of Finance on behalf of the Icelandic State Treasury. The Bank is a limited liability company incorporated and domiciled in Iceland. The Bank is licensed as a commercial bank and operates in accordance with Act No. 161/2002 on Financial Undertakings. Landsbankinn is subject to supervision by the Financial Supervisory Authority of Iceland (FME) in accordance with Act No. 87/1998 on Official Supervision of Financial Activities.

Landsbankinn hf. is a leading Icelandic financial institution. The Group offers a full range of financial services and is the market leader in the Icelandic financial service sector with the largest branch network. Focused on commercial banking, Landsbankinn provides retail and corporate banking services, capital markets services and asset and wealth management for private banking clients.

The National Treasury of Iceland holds 98.2% of shares in the Bank, Landsbankinn hf. holds 0.91% and over 1,800 other shareholders hold the remaining 0.89%.

Content

The disclosures have been put together to explain the basis of preparation and disclosure of certain capital requirements and provide information about the management of certain risks and for no other purposes. They do not constitute any form of audited financial statement and have been produced solely for the purpose of Pillar III. They should not be relied upon in making judgements about the Group. The disclosures will only be subject to external verification to the extent that they are equivalent to those made under accounting requirements.

This publication, Risk and Capital Management 2015, has not been audited by external auditors. However, it has been appropriately verified internally and includes information from the audited Consolidated Financial Statements 2015. There may be some discrepancy between financial information in the Consolidated Financial Statement 2015 and information in the Risk and Capital Management 2015 as the report has been prepared in accordance with the Capital Requirements Directive and the Basel II capital framework, rather than in accordance with IFRS.

1 Highlights of 2015

Economic conditions and developments were in many respects very good in 2015. Unemployment levels continued to contract and are now close to record low levels, real wages grew significantly and household debt decreased. The Icelandic króna (ISK) has appreciated and inflation remained below, but close to the CBI inflation target for the second year in a row. The low level of inflation has been supported by declining import prices, mainly petroleum, while imputed rent for housing has been the main driver of inflation due to rising housing prices.

In real terms, the gross domestic product (GDP) for the first nine months of 2015 increased by 4.5% compared with the same period 2014, in line with Landsbankinn Economic Research's most recent Macroeconomic Forecast (November 2015) for the whole year. The GDP growth reflects increased growth in domestic demand as domestic final expenditure increased by 6.2%. While the balance of trade in goods and services improved in nominal terms, the contribution to economic growth of foreign trade was negative as in real terms, imports grew faster than exports. The post-crisis slack in output is thought to have been fully absorbed 2015 and a positive output gap has opened up.

In early June the government announced a plan for liberalisation of the capital controls and the Winding-up Boards of the former banks soon after submitted composition proposals. The CBI delivered a report at the end of October, confirming that the proposals, together with anticipated mitigating measures, should neither result in instability in exchange rate and monetary affairs nor upset financial stability. The District Court of Reykjavík has since confirmed the composition proposals and the CBI has granted final exemption from capital controls to all the failed bank's estates. The planned currency auction for holders of offshore ISK has however not yet been held.

Following the strong economic recovery, monetary policy was tightened significantly during 2015. The Central Banks of Iceland's Monetary Policy Committee increased the banks interest rates 1.25 percentage points 2015. The banks key interest rate, seven-day term deposit rate, was at end of year 2015 5.75%.

Due to significant increases in the number of foreign tourists' arrivals, improved terms of trade, and net investment inflows by non-residents, there was a significant increase in net inflow of foreign currency in 2015. The CBI net foreign currency purchases in the interbank market 2015 totalled ISK 272 bn. The CBI's foreign exchange reserves, net of CBI and Treasury foreign currency denominated debt, was at year end ISK 313 bn compared with ISK 57 bn. end of year 2014. Despite the interventions of the CBI in the currency market the króna appreciated by roughly 7% in 2015.

Improved credit quality despite robust lending growth

The Bank's loan portfolio grew by ISK 93 billion in 2015, most significantly in the construction and real estate market and the retail housing market. Nonetheless the exposure-weighted average probability of default for corporates and households decreased in 2015 in line with the risk appetite of the Bank.

Loans 90 days past due also decreased in 2015 by 0.5 percentage points to 1.8%. Most notable decrease is in the private individuals part of the Banks' portfolio where the 90 days past due ratio was 4.1% in 2014 but is now 2.7%. In addition there has been a large inflow of new high quality loans which contributes to lower probability of default

Internal measurements of Loss Given Default continued to decrease in 2015, largely due to value increases in underlying collateral and better collateralization of the portfolio.

The Bank continues to improve and strengthen internal models and measurements of credit risk as the application for F-IRB is still ongoing. Developments in external regulatory environment, most notably in reducing the possibility of using internal models to reduce capital requirements as well as new technical standards, will most likely impact the application process. It is the firm belief of the Bank that internal models capture risk in a more concise manner and the usage of internally developed credit risk measures enhance risk management as a whole. Furthermore, internal credit risk models are a large part of the implementation of new accounting policies, IFRS 9, which will be implemented in 2018. Therefor the Bank encourages Icelandic regulators to implement regulatory changes with regards to internal models and uses in line with Europe.

Market and liquidity risk in line with risk appetite

Market risk of the Bank was stable and within risk appetite in 2015. The Bank continued to reduce holdings in non-core unlisted equity holdings as in previous years while growing financial market operations.

The Bank's liquidity position remains above regulatory requirements where the ratio of LCR is 113% in total and 360% in foreign currencies, both above regulatory requirements made by the Central Bank of Iceland.

A longer term funding measurement, the NSFR ratio remains well above regulatory requirements at 136% at year end.

Strong external rating and increased foreign funding

In July 2015 the rating firm Standard and Poor's upgraded the Banks' credit rating from BB+ to BBB-/A-3 with a positive outlook. The main contributing factors for the upgrade were S&P's opinion that the operating environment of the Icelandic banking system has improved, risk has decreased and that lower credit losses can be expected going forward. Furthermore, S&P's announcement stated that stability is expected to improve in coming years.

The upgrade allowed for positive developments in the foreign funding base of the Bank and in Q4 2015 the Bank issued debt in EUR, NOK and SEK. The Bank also increased issuance under the covered bond programme to ISK 22 billion in 2015 from 7.5 billion at year end 2014.

Robust equity position

The Bank's equity position strengthened in 2015 and was 30.4% at year end, despite a dividend payment of ISK 23.7 billion in March. Thereof 0.1% is Tier 2 capital which the Bank received after mergers with savings banks in the year.

Internal estimate for Economic Capital decreased during the year in line with increased credit quality, enhanced measures of interest rate risk and reduced uncertainty in legal matters. These factors decrease the internal estimate by 1 percentage point to 13.0% at year end. The Bank aims at holding capital to meet the requirements of the FSA at all times.

Economic outlook for 2016

Landsbankinn Economic Research (LER) expects GDP growth will remain relatively strong throughout 2018. LER anticipates 4.5% GDP growth in 2016, driven mainly by increasing private consumption and investment. A number of key factors that influence the development of private consumption are currently favourable. The employment situation is good, wages and disposable income have increased and the asset and debt balance of households improved. Growth in gross capital formation is expected to be driven mostly by strong growth in business investment although residential investment is expected to contribute significantly with double digit growth over the next three years.

Most signs indicate that housing prices will continue to increase. Supply of new housing does not appear to be keeping up with demand. There is increased competition in the housing mortgage market and supply of credit has become more plentiful. Purchasing power looks set to continue to increase, household debt has improved considerably and rising real estate prices have provided increased scope for mortgage. These factors will all contribute to rising real estate prices in the near future.

Total export growth is expected to be driven by service exports, primarily a continuing double digit growth in the tourism sector. Foreign travellers to Iceland increased by 30% 2015 and are expected to increase by more than 20% in 2016. LER forecasts continued trade surplus throughout 2018 and the current account is expected to remain positive throughout the forecast period.

Signs of the economy over heating

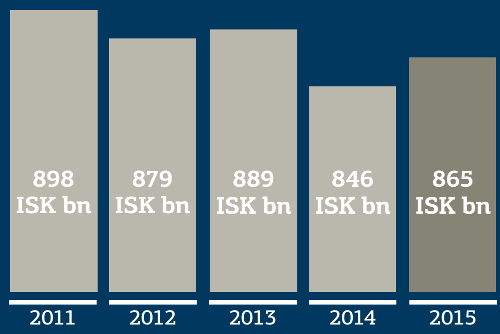
Inflation at the end of 2015 was 2.0%, below the CBI's 2.5% target. Inflation first fell below the target in February 2014 and has remained below target for a continuous period of almost 2 years. Global price developments and a stronger króna have helped to keep inflation in line, with a significant deflationary contribution of petrol and other imported goods. The inflation outlook for the first half of 2016 is fairly good as the annual rate of inflation is expected to remain close to the 2.5% inflation target, helped in part by base-effects and changes in import duties. Wages are however expected to increase significantly in excess of expected productivity growth and the inflation target rate over the next three years. This will inevitably lead to increased price pressures assuming that the drop in import prices will level off in the near future. LER therefore expects inflation to pick up during the second half of the year and peak at close to 5% (quarterly average) in the first half of 2017. It is expected to drop again below the upper tolerance limit of the CBI's inflation target by the end of the forecast period but remain well over the 2.5% target. The Central Bank of Iceland's Monetary Policy Committee has also repeatedly voiced concerns over growing inflation pressures due to fast growing unit labour costs and has signalled that a tighter monetary stance will probably be needed to counteract this development.

The Bank has set the risk appetite and overall risk limits for 2016. While current market conditions appear favourable there are signs of increased external risk in the Banks' operating environment. Most notably are the macro economic conditions along with lifting of capital controls expected in the first half of 2016.

In 2015 competition increased in the lending market with the entrance of pension funds and foreign banks. This is beneficial for borrowers which has in turn reduced debt servicing cost and increased other consumption. However, this increased pressure on pricing can distort the pricing of credit risk and will likely increase debt burden. From 2010 there has been a marked reduction of indebtedness for households and companies from the unsustainable levels before 2008. To reduce the risk of over indebtedness and adequate pricing of risk, regulators need to ensure an equal operating environment for all market participants.

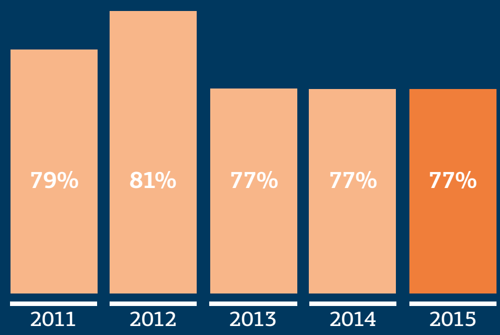
Risk in review

Risk weighted assets



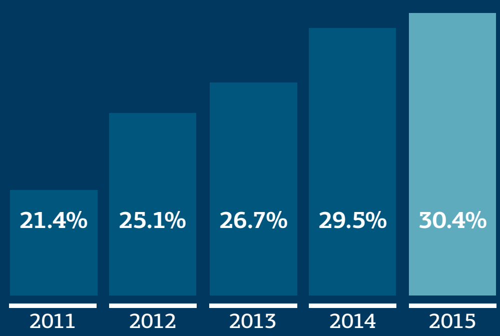
865 ISK bn

RWA to total assets



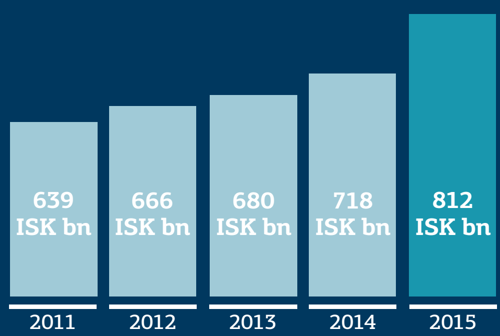
77%

Capital adequacy ratio



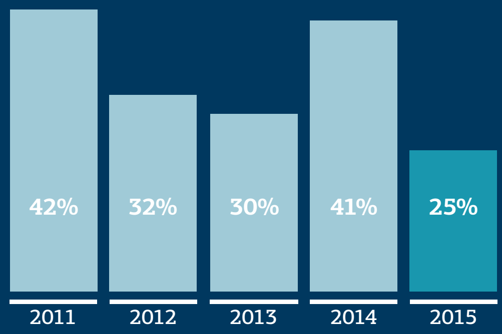
30.4%

Loans and advances to customers



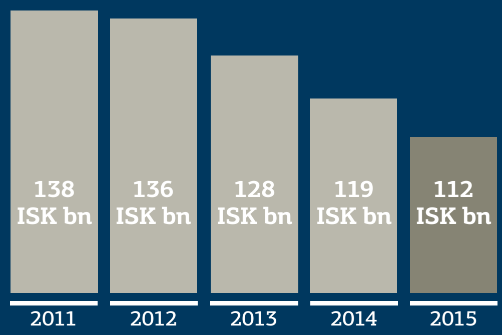
812 ISK bn

Large exposures to capital base



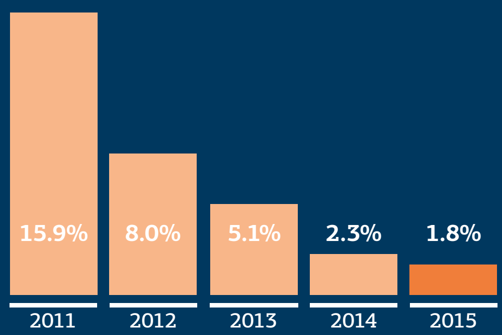
25%

Economic Capital



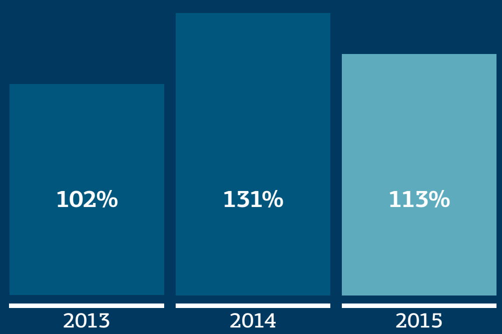
112 ISK bn

90 days past due loans



1.8%

Liquidity coverage ratio total



113%

Reynivellir

2 Risk Management

Risk Management

Risk is inherent in the Group's activities and is managed through a process of on-going identification, measurement, management and monitoring, subject to risk limits and other controls. Risk identification involves finding the origins and structures of possible risk factors in the Group's operations and undertakings. Risk measurement entails measuring the identified risks for management and monitoring purposes. Finally, risk controls and limits ensure compliance with rules and procedures, as well as adherence with the Group's risk appetite.

The objective of the Group's risk policies and procedures is to ensure that the risks in its operations are detected, measured, monitored and effectively managed. Exposure to risk is managed to ensure that it will remain within limits and the risk appetite adopted by the Group will comply with regulatory requirements. In order to ensure that fluctuations which might affect the Group's equity as well as performance are kept limited and manageable, the Group has adopted several policies regarding the risk structure of its asset portfolio which are covered in more detail under each risk type.

Risk policy is implemented through the risk appetite, goal setting, business strategy, internal policies and limits that comply with the regulatory framework of the financial markets.

2.1 Risk appetite

The Group's risk appetite is defined as the level and nature of risk that the Bank is willing to take in order to pursue its articulated strategy, and is defined by constraints reflecting the views of the Board of Directors, the CEO and Executive Board.

The Group's risk appetite has been reviewed, revised and implemented for 2016. The Group's risk policy is as follows:

The Group provides universal financial services to customers. For this purpose, the Bank has set objectives regarding financial position, asset quality, exposures and a sustainable long-term profitability. In the pursuit of its goals, the Bank only takes on risks that it understands, is able to measure and manage. The Bank aims to be comparable with leading banks in the Nordic countries in similar fields.

The Bank seeks to maintain solid business relationships, having regard for its own position as well as that of customers at each time and with due regard for any internal connections between customers. The Bank pursues long-term business relationships and aims to avoid being linked to transactions that might damage its reputation.

The Bank seeks to ensure diversified and sound financing and a sustainable risk profile in the balance sheet. The Bank has set internal limits that provide for a strong capital and liquidity position which, along with active risk management, ensure long-term profitability and strong standing. In this manner, the Bank aims to minimise fluctuation in its operations and is well positioned to withstand stress scenarios.

The Bank's corporate culture is characterised by professionalism and processes that support a high level of risk management. Managers are responsible for monitoring and managing risk within their units. Decisions are based on a thorough and professional discussion of major advantages having the long-term interests of the Bank and its customers in mind. Efficient follow-up on decisions and risk monitoring are integral to the Bank's operations.

2.2 Risk identification

The Group is exposed to the following material risks which arise from financial instruments:

- Credit risk
- Market risk
  - Currency risk
  - Interest rate risk
  - Other market risk
- Liquidity risk
- Operational risk

The the table at the top of page 13 provides a link between the Group's business units and the principal risks that they are exposed to. The significance of risk is assessed within the context of the Group as a whole and is

Principal risk	Personal Banking	Corporate Banking	Markets	Treasury
Credit risk	High	High	Low	Low
Operational risk	Medium	Medium	High	Medium
Market risk	Low	Low	Medium	High
Liquidity risk	n/a	n/a	n/a	High

measured based on allocation of Economic Capital within the Group.

The Group also manages other relevant risks, such as concentration, business, legal and compliance risk.

2.3 Risk management structure

The Group aims to meet best practice international standards and recommendations for banks' risk management in order to support its business model. The Group devotes substantial resources to developing and maintaining procedures and tools to fulfil this ambition.

The Group's risk management is based on guidelines, policies and instructions determined by the Board of Directors. The Group has prepared specific instructions on risk management for individual business units based on the general policies set by the Board of Directors. At the unit level, these instructions are used, among other things, as the basis for business and control procedures.

2.3.1 Risk committees

The Group's risk management governance structure at year-end 2015 is as follows:

Board of Directors

Supervision by the Board of Directors and its sub-committees
Risk Committee
Audit Committee
Remuneration Committee
Strategic Development Committee

Key risk management bodies and committees

Committee	Chair	Other members
Executive Board	CEO	Managing Directors
Risk & Finance Committee	CEO	CFO, CRO, Head of Legal Department
Credit Committee	CEO	CRO, MD of Corporate Banking, MD of Personal Banking
Operational Risk Committee	CRO	MD of Personal Banking, MD of Operation & IT, Head of Compliance, Head of Operational risk

Proper organisation of the Board's work is a prerequisite for the smooth operation of the Group and the Directors' work. The establishment of sub-committees can improve treatment of issues for the Board's attention and can boost the efficacy work.

The Board assesses the need to establish sub-committees at the Board level according to legal requirements and the size and scope of the Group at each time, as well as the composition of the Board. The Group's corporate governance statement is required to provide information on the establishment and appointment of sub-committees. There are four sub-committees of the Board of Directors and their role is to prepare discussion for the Board of specific areas of operation and investigate in more detail matters related to them.

The Audit Committee shall endeavour to ensure the quality of the Group's financial statements and other financial information, as well as the independence of its auditors. The Committee's function is, among other things, to supervise accounting procedures. The Committee also monitors the organisation and function of internal auditing. Moreover, the Committee supervises auditing of the Group's financial and consolidated statements and assesses the independence of the Group's external auditors. It also supervises other tasks performed by external auditors and submits proposals to the Board of Directors for the selection of external auditors.

The Risk Committee monitors the organisation and effectiveness of the Bank's risk management structure and compliance. The Committee monitors the management of credit, market, operating and other types of risks as and where applicable.

The Remuneration Committee is comprised of three Board members. The Committee guides the Board of Directors and the CEO on the terms of employment with respect to the salaries of key management and remuneration policy. The Committee ensures that the remuneration of key management is within the remuneration policy's framework and reports accordingly to the Board of Directors annually. According to the Act on the Senior Civil Servant's Board No. 47/2006 the Senior Civil Servant's Salary Board determines the remuneration of the Bank's CEO. For further details on the Group's remuneration policy, see Section 9.1 of Landsbankinn's 2015 Remuneration Report.

The Strategic Development Committee prepares the Board of Directors for discussion and decisions on the future vision and strategy of the Group. The Strategic Development Committee monitors changes in the Group's operating environment and deliberates on the Group's position and business plan w.r.t. strategic development. The Committee is also tasked with prioritising objectives in relation to the Group's strategy.

The Board of Directors of the Group has overall responsibility for the establishment and oversight of the Group's risk management framework and risk appetite setting. The CEO is responsible for the effective implementation of the framework and risk appetite through the corporate governance structure and committees. The CEO has established and is a member of the Executive Board, the Risk & Finance Committee and the Credit Committee.

The Credit Committee deals with credit risk – individual credit decisions, credit limits on customers and credit risk policy – while the Risk & Finance Committee covers primarily market risk, liquidity risk and legal risk. The Risk & Finance Committee monitors the overall Group's risk position, is responsible for enforcing the Group's risk appetite and risk limits, and reviews and approves changes to risk models before presented to the Board of Directors. The Executive Board serves as a forum for consultation and communication between the CEO and the managing directors, addressing the main current issues in each division and takes decisions on operating matters not being considered in other standing committees. The Operational Risk Committee is a forum for discussions and decisions on operational risk issues and review of the effective implementation of the operational risk framework.

Governance pertaining to specific risks can be found in the relevant chapters.

2.3.2 Risk Management Division

The Group's Risk Management Division is responsible for the Bank's risk management framework. Subsidiaries of the Bank have their own risk management functions and the Risk Management Division receives information on exposures from the subsidiaries and collates them into Group exposures. The Risk Management Division is also responsible for comprehensive risk reporting on risk positions to various internal departments and committees and supervisory authorities.

The Risk Management Division is comprised of five departments.

- The Credit Management Department reviews credit decisions made by the Bank's business units when credit applications exceed the business units limits. The department has confirmation and veto rights on those credit applications. Confirmation by Credit Management increases the limits of business units but decisions exceeding the confirmation limits of the Risk Management Division are referred to the Bank's Credit Committee.

- The Credit Risk & Economic Capital Department is responsible for providing the Bank with internal models on credit risk and credit monitoring systems as well as related processes to measure and monitor credit risk and economic capital. The Department also supports the implementation of such models and processes within the Bank. In addition, the Department is responsible for credit risk, economic capital and impairment analysis and reporting within the Bank;

- The Market Risk Department is responsible for measuring and monitoring market risk, liquidity risk and interest rate risk in the Group's banking book which includes model development. Market Risk is also responsible for monitoring all derivatives trading the Group enters into, both for hedging and trading purposes. Market risk monitoring also includes FX balance monitoring for the Group as well as limit monitoring for pension funds under management by the Bank;

- The Operational Risk Department is responsible for ensuring that the Group's operational risks are monitored and that the Bank implements and maintains an effective operational risk management framework. The Department assists the Bank's managers with operational risk assessment incidents related to normal operations and operational loss incidents analysis, and oversees business continuity plans. The Department is partly responsible for the security system of the online bank. The Operational Risk Department leads the work on the Group's certification under the ISO 27001 standard for information security;

- Restructuring is responsible for corporate and individual debt restructuring – both for over indebted individuals as of those who are unable to service their loans due to illness or humanitarian reasons – and appropriated assets. This includes selling and renting out real estate assets which the Bank has acquired through enforcement or as a part of debt restructuring. In addition the Department sells cars, equipment and other items that the Bank has acquired through appropriation.

2.3.3 Compliance

The Bank's Compliance Department ensures that the Group adheres to its own rules on securities trading and insider trading and that the Group's operations comply with Act No. 108/2007, on Securities Transactions, Act No. 67/2006, on Actions to Combat Money Laundering and Terrorist Financing, and other relevant legislation and regulations. Compliance also concentrates on Group adherence to codes of ethics and on limiting market abuse, minimising conflicts of interest and ensuring best practice.

Compliance is one of the Group's support functions and is integral to its corporate culture.

2.3.4 Internal Audit

Group Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve the Group's operations. The Board has oversight of Group Internal Audit and appoints the Chief Internal Auditor. It helps the Group to evaluate and improve the effectiveness of its risk management, controls, and governance processes. Group Internal Audit determines whether the risk management framework, control, and governance processes as designed and represented by management are adequate and functioning, and thus supports the Group accomplish its objectives.

2.4 Risk measurement

The Group regularly monitors and assesses its current risk profile in the most important business areas and for the most important risk types. It also constantly seeks to improve the process for its risk appetite in order to supplement the risk management framework and to support the business model.

The risk appetite framework considers key risks relevant to the Group's business activities by setting risk appetite targets and limits. On an aggregate level, the risk appetite is represented in terms of credit risk, market risk, liquidity risk and funding risk. Each statement varies in detail, as well as which metrics are used, depending on their properties and are suited to enable the Group to manage risk in an efficient manner. In addition the Group measures and monitors other key risk indicators which address operational risk and process risk as well as additional credit, market, liquidity and funding risk measurements.

Economic Capital (EC) is a key element to the management of the Group's risk and capital structure, as well as in the day-to-day financial management. EC is the estimated capital required to cover the Group's unexpected loss one year into the future. One of the benefits of EC is that it presents an aggregate figure for all risk types, products and business units. It thus produces unified risk measurement expressed in a single unit of value, and the capital will at any time reflect the Group's risk the next year. Further details on EC are provided in section 3.5.

Overview of the main risk appetite measures

Risk	Metric
Credit risk	Probability of default
	Past due ratio
	Industry concentration
	Single name concentration
Market risk	Equities
	Fixed income
	Currency
	Interest rate risk in the banking book
Liquidity risk	Liquidity Coverage ratio - Total
	Liquidity Coverage ratio - FX
Funding risk	Net stable funding ratio
	Capital ratio

2.5 Risk monitoring

The Group allocates considerable resources for ensuring on-going adherence with the approved risk limits and for risk monitoring. It has set guidelines for reporting to relevant management bodies, including the Board of Directors, the Risk Committee, the Risk & Finance Committee and the Executive Board on developments in risk measures and risk appetite of the balance sheet.

The Board of Directors receives thorough risk reports six times a year for different risk types as well as a monthly risk overview. Risk-related material is also reported through an integrated monthly management report to the Board of Directors. The Risk & Finance Committee and the Executive Board receive a monthly risk report or more frequently if required. Furthermore, the Group has implemented an internal on-line risk dashboard for executive managers where up-to-date risk material is available. Once a year, an expanded ICAAP report is submitted to the Board for approval, which is then subject to the FME's Supervisory Review and Evaluation Process (SREP). Finally, a detailed EC report is submitted to the Board of Directors once a year.

Principal reporting to the Board of Directors

Annual	
Risk and Capital Management report	Pillar III disclosures
ICAAP report	Evaluation of the risk profile and the solvency need. The report contains conclusions drawn from stress testing, including the effect of various scenarios on expected losses and capital needs
Economic Capital report	Thorough analysis of EC developments and EC breakdown by risk types and business units as well as RWA and other related aspects
Bi-annual	
Credit risk report	Thorough risk report summarising the Group's credit risk exposures and any concerns regarding credit risk
Market & Liquidity risk report	Thorough risk report summarising the Group's liquidity risk and market risk exposures and any concerns regarding liquidity and/or market risk
Operational risk report	Thorough risk report providing analysis of operational risk aspects
Monthly	
Risk report	An aggregate report containing information on the Group's risk appetite and material from the credit, market, liquidity and operational risk reports. The report is interactive and available electronically
Executive Board report	An aggregated report containing risk related material such as risk appetite, EC and RAROC

3 Capital Management

Höfn í Hornafirði

Capital Management

3.1 Capital management structure

The Group's capital management governance structure for year-end 2015 is described in the table below.

3.2 Capital management framework

The purpose of the Group's capital management is to support the Group's strategy and ensure that it has sufficient capital to cover its risks at all times.

The capital management framework of the Bank comprises of four interdependent activities: Capital assessment, risk appetite/capital target, capital planning, and reporting/monitoring.

The Group uses standardised approaches in measuring the regulatory capital requirement (CR) for Pillar I risks and Economic Capital (EC) for capital management purposes.

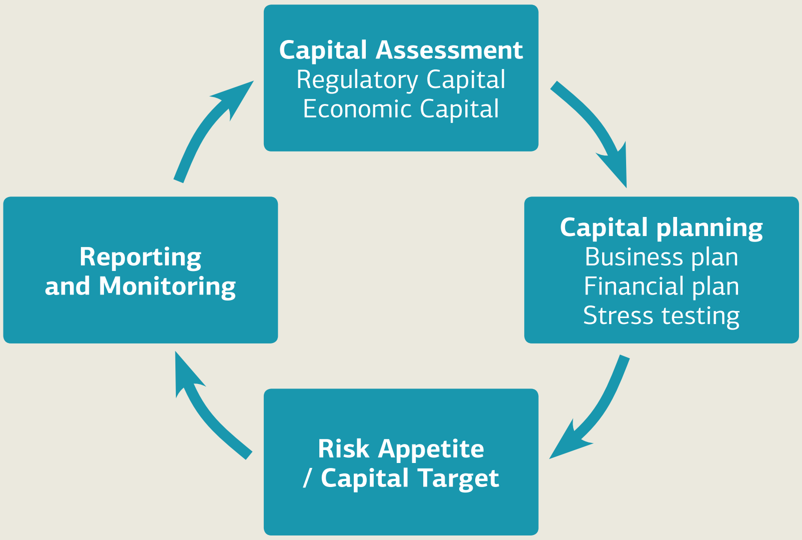
Capital management structure

Responsible party	Role
Board of Directors	The Board of Landsbankinn is responsible for determining the Group's capital policy. The Board shall ensure that management establishes and maintains frameworks for assessing risks, relating risk to capital, as well as capital management. The Board approves the ICAAP reports.
CEO	The CEO decides on the overall capital management framework. The CEO shall ensure, on an on-going basis, that the capital management framework is according to the Group's risk profile and business plan and functions properly. The CEO shall provide the Board of Directors with annual ICAAP and monthly management reports on capital ratios and the capital base. The CEO shall notify the Board of material changes or exceptions from established policies that will significantly impact the operations of the capital management framework.
Finance	The Managing Director of Finance is responsible for capital management, including the capital base, capital adequacy reporting, capital planning activities and the ICAAP. Furthermore the MD of Finance shall monitor the development of capital requirements and the capital base. Finance shall review on an annual basis the capital management policy and make proposals to the Board on capital targets. Finance reports to the CEO and Board regarding capital management. Finance is responsible for liquidity management and funding as well as the stress testing framework, including definition of scenarios.
Risk Management	The Managing Director of Risk Management is responsible for the risk management framework, as well as the Economic Capital framework for relating capital to risk.
Internal Audit	Internal Audit shall at least annually review the capital management framework and its operations to ensure that they remain comprehensive and proportionate to the nature, scale and complexity of the Group's activities .

The total capital ratio target is set annually as part of the Bank's risk appetite. When setting the target, EC, Pillar I and II capital requirements, regulatory capital buffers, internal capital buffers, risk appetite, and strategic objectives are considered.

The Internal Capital Adequacy Assessment Process (ICAAP) under Pillar II is the Group's own assessment of its capital need (as a percentage of RWA) and is based on EC calculations, stress tests and results of the Supervisory Review and Evaluation Process (SREP). ICAAP is the foundation of the capital planning process which includes the business plan, financial plan and stress testing.

Capital management framework



The Bank's target for the Group's minimum total capital ratio is to be comfortably above the fully phased-in FME capital requirements plus capital buffers. The Bank also aims to be in the highest category for risk-adjusted capital ratio, as determined and measured by the relevant credit rating agencies.

As a result and as at the reporting date, the Bank's target for the Group's minimum total capital ratio is 21.8% of RWA.

The Group's most recent capital requirements, as determined by the FME, are as follows (as a percentage of RWA):

	SREP based on data from 31.12.2014	SREP based on data from 31.12.2013
Pillar I	8.0%	8.0%
Pillar II	6.3%	7.8%
Total capital requirement	14.3%	15.8%
Systemic risk buffer	3.0%	3.0%
Capital buffer for systematically important institutions	2.0%	2.0%
Countercyclical capital buffer	0.0%	0.0%
Capital conservation buffer	2.5%	2.5%
Total capital buffers	**7.5%**	**7.5%**
Total capital requirement plus capital buffers	**21.8%**	**23.3%**

All amounts are in ISK million 21

3.3 The capital base

The Group's equity at 31 December 2015 amounted to ISK 265 billion (2014: ISK 251 billion) and the capital adequacy ratio, calculated in accordance with Article 84 of Act No. 161/2002, on Financial Undertakings, was 30.4% at 31 December 2015 (2014: 29.5%). Under the Act the minimum requirement for this ratio is 8%.

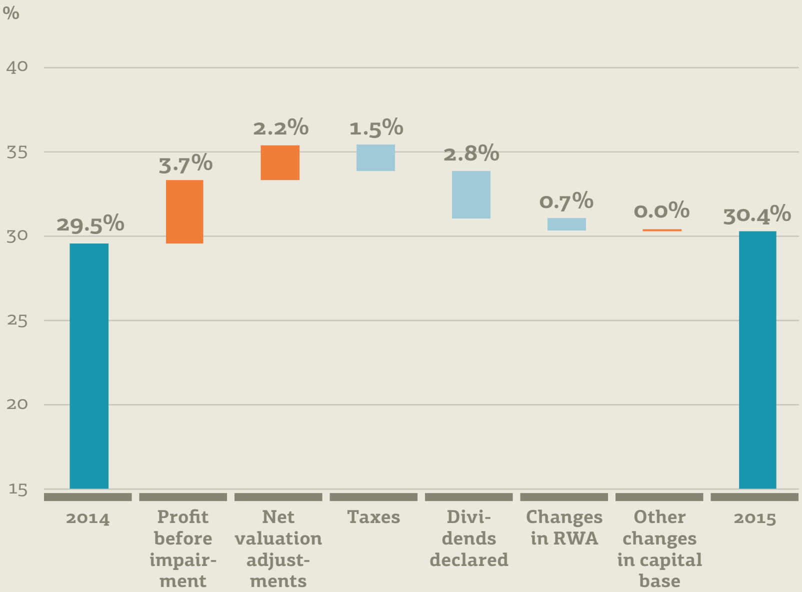
The Group's capital adequacy ratio rose by 0.9% in 2015. A dividend payment of ISK 1.0 pr. share or ISK 23.7 billion was made, approximately 80% of the previous year's earnings after tax.

3.3.1 Tier 1 capital and statutory deductions

Tier 1 capital consists of core Tier 1 capital less statutory deductions according to requirements of the FME based on Articles 54 and 55 of Act No. 113/1996.[1] The Group makes deductions in order to determine its core Tier 1 capital where applicable:

- Carrying amounts of intangible assets
- Deferred tax assets
- Capital holdings in other credit and financial institutions amounting to more than 10% of their capital

Change in capital ratio



3.4 Capital requirement

The regulatory minimum capital requirement under Pillar I of the Directive is 8% of risk-weighted assets for credit risk, market risk and operational risk. The Group uses the standardized approach[2] in measuring Pillar I capital requirements for credit risk and market risk. For operational risk it uses the basic indicator approach[3] in calculating capital requirement.

Risk-weighted assets (RWA) for credit risk, the single largest risk type, amounted to 85% of total RWA.

Total amount of risk-weighted assets increased by 5% in 2015.

1 Article 55, see http://www.althingi.is/lagas/127b/1996113.html
2 See Staðalaðferð http://www.stjornartidindi.is/Advert.aspx?ID=f051707c-8c23-4e99-a305-68dcb6f97a29
3 Capital requirements for operational risk are calculated by aggregating the operating revenues for the last three years and obtaining the arithmetic mean. If the aggregate operating revenues for any given year are negative, it is excluded in the calculations. The capital requirement for operational risk is equal to 15% of this mean.

The capital base consists of Tier 1 and Tier 2 capital and the breakdown is as follows:

The capital base

Capital base	31/12/15	31/12/14
Share capital	23,782	23,687
Share premium	122,105	121,275
Reserve	6,000	6,000
Retained earnings	112,614	99,841
Non-controlling interests	30	
Intangible assets	-2,012	-1,225
Deferred tax assets	0	-83
Tier 1 capital	**262,519**	**249,495**
Subordinated liabilities	639	0
Regulatory amortisation	-157	0
Tier 2 capital	**482**	**0**
Deduction from original and additional own funds	0	0
Capital base	**263,001**	**249,495**

Risk-weighted assets		
Credit risk*	737,720	665,167
Market risk*	31,919	83,601
Operational risk	95,843	96,836
Total risk-weighted assets	**865,482**	**845,604**

Tier 1 capital ratio	**30.3%**	**29.5%**
Capital adequacy ratio	**30.4%**	**29.5%**

*Classification of equity, bond and debt instrument exposures in the trading book has been revised as of 1 January 2015. Accordingly, risk-weighted assets in equity bond and debt instruments in the banking book are classified as credit risk instead of market risk.

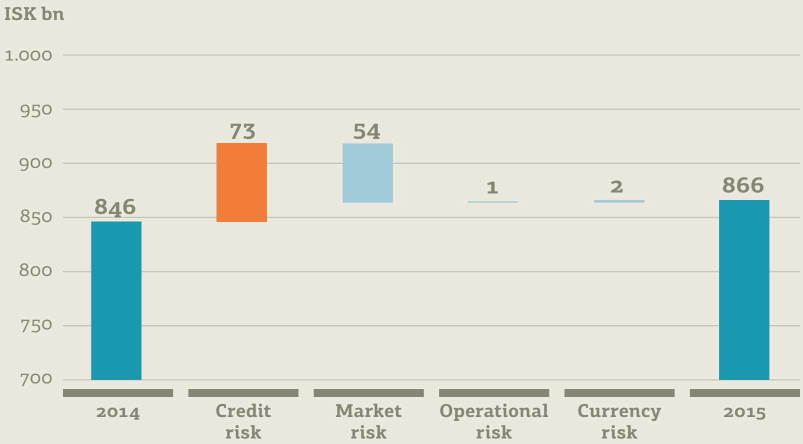
Landsbankinn 2015 All amounts are in ISK million 23

Capital requirement

Capital requirement and risk-weighted assets	31/12/15		31/12/14	
Credit risk breakdown	**Capital requirement**	**RWA**	**Capital requirement**	**RWA**
Central governments or central banks	532	6,650	512	6,402
Regional governments or local authorities	143	1,792	180	2,245
Institutions	642	8,024	1,521	19,017
Corporations	35,760	447,006	30,555	381,941
Retail	7,139	89,242	6,797	84,960
Secured by real estate property	9,931	124,136	8,763	109,534
Past due items	1,250	15,623	1,227	15,333
Items belonging to regulatory high-risk categories	0	0	0	0
Short-term claims on institutions and corporate	0	0	0	0
Other items	3,620	45,247	3,659	45,736
Credit risk	**59,018**	**737,720**	**53,213**	**665,167**
Market risk breakdown				
Traded debt instruments	158	1,973	1,767	22,090
Equities	487	6,090	3,211	40,132
Market risk	**645**	**8,063**	**4,978**	**62,222**
Currency risk	1,908	23,856	1,710	21,379
Operational risk	7,667	95,843	7,747	96,836
Total capital requirement and RWA	**69,239**	**865,482**	**67,648**	**845,604**

Risk-weighted assets increased by ISK 20 billion from the previous year. Market risk was reduced by ISK 54 billion, mostly due to of reclassification of assets as not held for trading and thereby classified as Credit risk instead of Market risk. Changes in currency risk and operational risk are negligible between years.

Change in Risk Weighted Assets



24 All amounts are in ISK million Landsbankinn 2015

3.5 Economic Capital

Economic Capital (EC) is a risk measure which is applied to all material risks. It captures unexpected losses and reduction in value or income for which the Group needs to hold capital to avoid insolvency. It arises from the unexpected nature of losses as distinct from expected losses. EC is defined as the difference between unexpected losses and expected losses, where unexpected loss is defined as the 99.9% Value-at-Risk (VaR), with a one-year time horizon.

The table below summarizes how the Group calculates its Economic EC for the risks included in the framework.

The purpose of the EC framework is to enable the Group to assess the amount of capital it requires to cover the economic

Economic capital

Risk	Calculation method
Credit risk	The credit risk EC model is the asymptotic single risk factor (ASRF) model from the Basel II internal rating based (IRB) approach's risk weight formula, i.e. the EC equals the capital requirements of the IRB approach in the capital requirements directive. The main input to the model are the risk parameters probability of default (PD), loss given default (LGD) and exposure at default (EAD).
Market risk	Market risk EC includes EC for interest rate risk in the trading book and EC for equity price risk. Market risk EC for interest rate risk in the trading book is calculated using the Stressed Value at Risk method according to the Basel II market risk framework, i.e. the EC equals the capital requirements for interest rate risk in the trading book of the internal models approach in the capital requirements directive. The model inputs for Stressed VaR are calibrated to historical data from the previous 5 years. Market risk EC for equity risk is calculated using the following risk weights: • 290% for exchange traded equity exposures; • 370% for all other equity exposures, i.e. the EC for equity price risk equals the capital requirements using the risk weights above.
Currency risk	EC for foreign exchange risk is calculated according to a modified Stressed Value at Risk model where the model inputs are calibrated to historical data from a period of significant stress relevant to the Groups' net FX position. The time horizon is one year.
Concentration risk	EC for single name concentration is calculated by adjusting for the granularity and non-homogeneity in the portfolio. This is necessary as the credit risk EC model assumes that the portfolio is infinitely large and homogenous, hence the single name concentration EC is given as an add-on. An internal model is used to measure the additional EC for credit risk related to industry concentrations in the loan portfolio, i.e. a concentration add-on. EC is given by the increase in credit risk EC when a correlation adjusted for the concentration in the portfolio is used.
Interest rate risk and inflation risk in the banking book	EC for interest rate risk and inflation risk in the banking book is equal to the loss in economic value corresponding to the 99.9th percentile of interest rate and inflation risk factor changes estimated by a Monte Carlo simulation model.
Operational risk	EC for Operational risk is calculated using the basic indicator approach, which means that it equals the Group's capital requirement.
Business risk	Economic Capital for Business risk is calculated using an internal model, which is based on the volatility of the Bank's income, before profit or loss due to any other material risk.
Legal and regulatory risk	Economic Capital for legal and regulatory risk is calculated by adding the potential loss of on-going disputes weighted by their status within the legal system.

Economic Capital ISK million	As at 31 December 2015	As at 31 December 2014
Credit risk - Loans to customers and credit institutions	64,239	60,401
Credit risk - Other assets	7,719	3,659
Market risk	1,531	9,403
Currency risk	3,933	1,946
Operational risk	7,667	7,747
Single name concentration risk	6,109	7,093
Industry concentration risk	4,665	4,067
Inflation risk	-	5,139
Interest rate risk in the banking book	-	9,345
Interest rate risk and inflation risk in the banking book*	10,575	-
Business risk	3,834	3,873
Legal and regulatory risk	1,862	6,697
Total	**112,134**	**119,369**
EC/RWA	**13.0%**	**14.1%**

*See note in text below.

effects of risk-taking activities, as well as to compare different risk types using a common “risk currency”.

The objective of the EC framework is to measure unexpected losses as well as to decompose EC on various levels to enable capital allocation, limit setting, pricing of products, risk adjusted performance measurement and value based management.

The framework covers the following risk types: credit risk, market risk, currency risk, operational risk, concentration risk, interest rate risk in the non-trading book, inflation risk, legal risk and business risk.

The Group made several key changes to its’ economic capital framework in 2015. The Group’s trading book/banking book boundary was redefined and an economic capital model for interest rate risk in the trading book was introduced. As a result, EC for market risk was significantly reduced since EC for banking book exposures, previously a part of market risk EC (equities and bonds in the banking book), is now a part of credit risk. The Group also introduced an economic capital model for interest rate risk and inflation risk in the banking book. The EC models for interest rate risk in the banking book and inflation risk respectively are now repealed. As a result, the collective EC for interest rate risk in the banking book and inflation risk in the banking book is significantly reduced due to observed diversification effects. Finally, the Group revised its’ EC model for FX risk which explains the increase in economic capital for currency risk in line with last year’s SREP. The Group intends to further develop its’ VaR models in 2016 with emphasis on accounting for the domestic operating environment.

Credit risk at 31 December 2015	PD	LGD*	EAD	EC
Financial institutions	0.1%	45.0%	22,229	644
Public entities	0.2%	45.0%	171,062	1,804
Individuals	3.6%	29.8%	309,227	11,795
Corporations	4.4%	41.4%	586,344	49,996
Total	**3.4%**	**38.7%**	**1,088,862**	**64,239**

Credit risk as at 31 December 2014	PD	LGD*	EAD	EC
Financial institutions	0.1%	45.0%	50,060	828
Public entities	0.5%	44.4%	17,661	474
Individuals	4.1%	31.1%	263,099	10,039
Corporates	5.8%	42.7%	556,742	49,059
Total	**4.8%**	**39.3%**	**887,562**	**60,401**

*Foundation LGD is used for EC calculations and risk management. The Group has also implemented an internal LGD model for impairment use (see section 4.1.2).

Although EC for banking book exposures are now part of credit risk, as well as the Group experienced lending growth during 2015, the increase in EC for credit risk is reasonably modest due to decreased probability of default and overall improved quality of the loan portfolio.

Above is a further breakdown for credit risk, probability of default by asset class as well as loss given default, exposure at default and EC.

3.6 Risk-Adjusted Return on Capital

To analyse the Group's risk adjusted profit and profitability, i.e. including the cost of risk, the measures risk adjusted profit (RAP) and Risk-Adjusted Return on Capital (RAROC), are reported monthly to the senior management. The objective of the measures is to measure shareholder-value creation and profitability in relation to the equity capital needed to cover the risks taken on, i.e. the economic capital. The measures enable risk-based pricing, increases incentives to measure and manage risk appropriately, focus on long term profit, as well as support the assessment of the Bank's optimal capital structure.

The measures have been enforced throughout the Group. By enforcing this measure, the Group can ensure that each of its departments are considering the cost of risk in the same way, and deciding how to structure and accept transactions within the same risk appetite guidelines.

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3.7 Stress testing

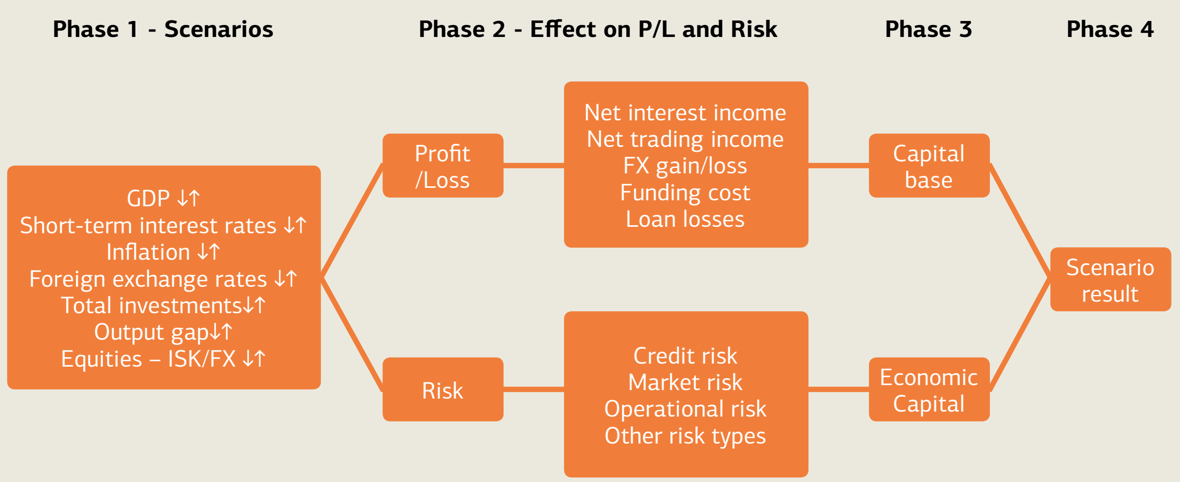
As a part of ICAAP and the capital planning process, internal stress tests are used as an important risk management tool in order to determine how severe, unlikely but plausible, changes in the business and macro environment affect the capital need. Stress tests reveal how the capital need varies during a stress scenario, where impact on financial statements, regulatory capital requirements and capital ratios occur. The stress testing process is divided into the following steps:

- Scenario development and approval
- Scenario translation
  - Translation model to determine loan loss
  - Translation method to determine the effect on financial statements
  - Translation model to determine EC
- Calculation
- Management actions
- Analysis and reporting

In 2015, the Group developed 4 scenarios, including a baseline scenario. These scenarios forecast developments of key macro indicators over a given period. Scenarios demonstrate an alternative development of key economic variables induced by various shocks compared to the baseline macroeconomic and inflation forecast of Landsbankinn's Economic Research department.

When scenarios have been developed and approved by the Board, a scenario translation is applied. The Group uses both statistical models as well as expert judgement in the translation.

The Group uses a loan loss model which incorporates macroeconomic variables and produces probability of default (PD), default



rates as well as loss given default (LGD) which can then be translated into loan losses.

The effect on financial statements is then translated and calculated with a resulting impact on the capital base. The effect on other material risks is also translated and calculated, resulting in changes to EC, i.e. the capital need.

One of the scenarios reflects a mild recession. The purpose of the scenario is to analyse how much additional capital is needed to ensure that the Group will not have to intervene with management actions, other than not paying dividends, in the case of a mild recession. Mild recession is also important to the Group's assessment of the appropriateness of the risk appetite related to capital as well as the assessment the size of the minimum internal buffer.[4]

In addition to these two main scenarios, a baseline and mild recession, the Group applies various specialised scenarios to provide management with a better understanding of how the Group will be affected by specific events which might require management action.

3.8 Leverage ratio

Capital Requirements Regulation (CRR) as part of Basel III framework requires banks to measure,

Leverage ratio

	2015	2014
Tier 1 capital	262,519	250,803
Leverage exposure		
- Loans and advances and other assets	1,118,371	1,098,292
- Derivatives market value	287	78
- Potential future exposure on derivatives	714	295
- Off balance sheet commitments	103,456	95,897
- Regulatory adjustments included in Tier 1 capital	-2,012	-1,142
Total leverage exposure	**1,220,817**	**1,193,420**
Leverage ratio	21.5%	21.0%

4 The internal capital buffer is a countercyclical buffer which equals the amount of capital that is needed to ensure that the Bank stays above the minimum capital requirement during normal fluctuations of the business environment, e.g. a mild recession, and inherent risks in the Group's operations.

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report and monitor their leverage ratios. The ratio is defined as Tier 1 capital as a percentate of total leveraged exposure (see table on page 29) and acts as a credible supplementary measure to the risk-based capital requirements.

A credible leverage ratio is one that ensures broad and adequate capture of both the on- and off-balance sheet sources of banks' leverage, aimed at revealing hidden leverage on banks' balance sheets. The ratio reinforces the risk-based requirements with a simple, non-risk based "back-stop" measure and is intended to

Pillar 1 risks	RWA 2015	RWA 2014	CR 2015	CR 2014	EC 2015	EC 2014
Credit risk	737,720	665,167	59,018	53,213	71,958	64,060
Market risk	31,919	83,601	2,554	6,688	5,464	11,349
Operational risk	95,843	96,836	7,667	7,747	7,667	7,747
Total Pillar 1 risks	**865,482**	**845,604**	**69,239**	**67,648**	**85,089**	**83,156**

Pillar 2 risks		
Concentration risk	10,774	11,160
Inflation risk	-	5,139
Interest rate risk in the banking book	-	9,345
Business risk	3,834	3,873
Interest rate risk and inflation risk in the banking book	10,575	-
Legal- & Government risk	1,862	6,697
Total Pillar 2 risks	**27,045**	**36,214**
Total capital requirements	112,134	119,370
Total own funds (Capital base)	263,001	249,495
EC/RWA	13.0%	14.1%

30 All amounts are in ISK million Landsbankinn 2015

restrict the build-up of leverage in the banking sector. The leverage ratio minimum requirement is 3%.

At 31.12.2015 the Group's leverage ratio was 21.4%, significantly above the 3% mimimum requirement.

3.9 Summary of Capital Requirement and Economic Capital

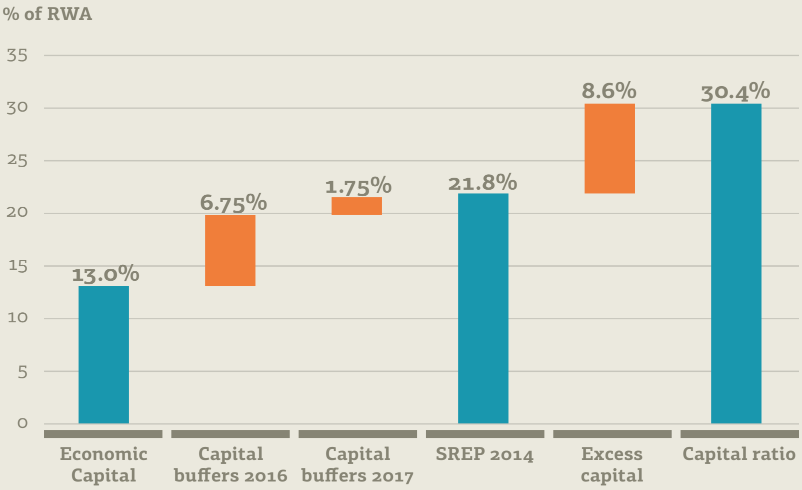
At 31.12.2015 the Group estimated its EC at ISK 112 billion (13% of RWA) and the capital requirement to be ISK 69 billion under Pillar I.

The add-on for Pillar I risks is ISK 13 billion on credit risk and ISK 13 billion on market risk. Pillar II risks require ISK 27 billion of capital, the largest risks being concentration risk and interest rate and inflation risk.

The Group's strategy is to maintain a total capital ratio above the aggregate of the current SREP at each time which include the new capital buffers under CRD IV.

Landsbankinn Capital position as of 31.12.2015

Economic Capital vs. Capital ratio



Main subsidiaries held directly or indirectly as at 31.12.2015 are as follows:

Company	Ownership interest	Activity
Eignarhaldsfélag Landsbankans ehf. (Iceland)	100%	Holding company
Landsbréf hf. (Iceland)	100%	Management company for mutual funds
Hömlur ehf. (Iceland)	100%	Holding company

Investments in associates as at 31.12.2015 are as follows:

Associates	Ownership interest	Carrying amount 31.12.2015	Carrying amount 31.12.2014
Reiknistofa bankanna	39%	630	552
Auðkenni hf.	22%	104	56
Greiðslumiðlun Íslands ehf.	48%	175	167
Other		0	2
Total		**909**	**777**

3.10 Consolidation methods

Risk and Capital Management 2015 is based on the definition of the Landsbankinn Group used in the 2015 Annual Report and complies with IFRS. Subsidiaries are entities over which the Group has the power to govern financial and operating policies so as to obtain benefits from their activities, generally accompanied by a shareholding of over half of the voting rights. Subsidiaries are fully consolidated in the financial statements according to the acquisition method. In capital requirement calculations and EC the Group consolidates its subsidiaries with a full look-through approach; that is, the Group looks through the subsidiary and down at each individual asset.

Associates are those entities in which the Group has significant influence, but not control, over financial and operating policies. Significant influence is presumed to exist when the Group holds, directly or indirectly, between 20-50% of the voting power of another entity. The Group accounts for investments in associates in the financial statement using the equity method. In capital requirement calculations and EC the Group classifies the share in each associate with an applicable risk weight.

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3.11 New regulations

On 1 January 2014, a new framework for prudential requirements for banking entered into force in the EU. The framework, referred to as CRD IV, consists of two parts, an updated Directive (CRD IV, Capital Requirements Directive) and a Regulation (CRR, Capital Requirements Regulation).

The new framework is being implemented into Icelandic law. The phasing in of capital buffers is expected to be completed in the first quarter of 2017 for the three large Icelandic banks, including Landsbankinn. In the case of smaller financial firms, the phasing in is expected to be completed in January 2019. The framework is not expected to be applied to the Housing Financing Fund (HFF).

The capital buffers are:

1. Systemic Risk Buffer
2. Other Systemically Important Institution Buffer (O-SII Buffer)
3. Countercyclical Buffer
4. Capital Conservation Buffer

The capital buffers will be determined as a percentage of Risk Weighted Assets (RWA) and shall solely consist of Tier1 capital. The requirement is additional to the minimum Capital Requirements. If banks fail to hold sufficient capital buffers they will be restricted to pay out dividends, variable remuneration or other payments which would lead to Tier1 ratio lower than minimum requirements taking capital buffers into account.

Landsbankinn is currently in a discussion with the FME on how these capital buffers will interact with each other and how they are likely to evolve according to changes in the internal and external environment.

The Icelandic Financial Stability Council has recommended[5] to the FME to impose the capital buffers according to the following timeline:

	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017
Systemic Risk Buffer	0.00%	3.00%	3.00%	3.00%	3.00%
O-SII Buffer	0.00%	2.00%	2.00%	2.00%	2.00%
Countercyclical Buffer	0.00%	0.00%	0.00%	0.00%	1.00%
Capital Conservation Buffer	1.00%	1.00%	1.75%	1.75%	2.50%

5 https://www.ministryoffinance.is/news/first-meeting-of-the-financial-stability-council-in-2016

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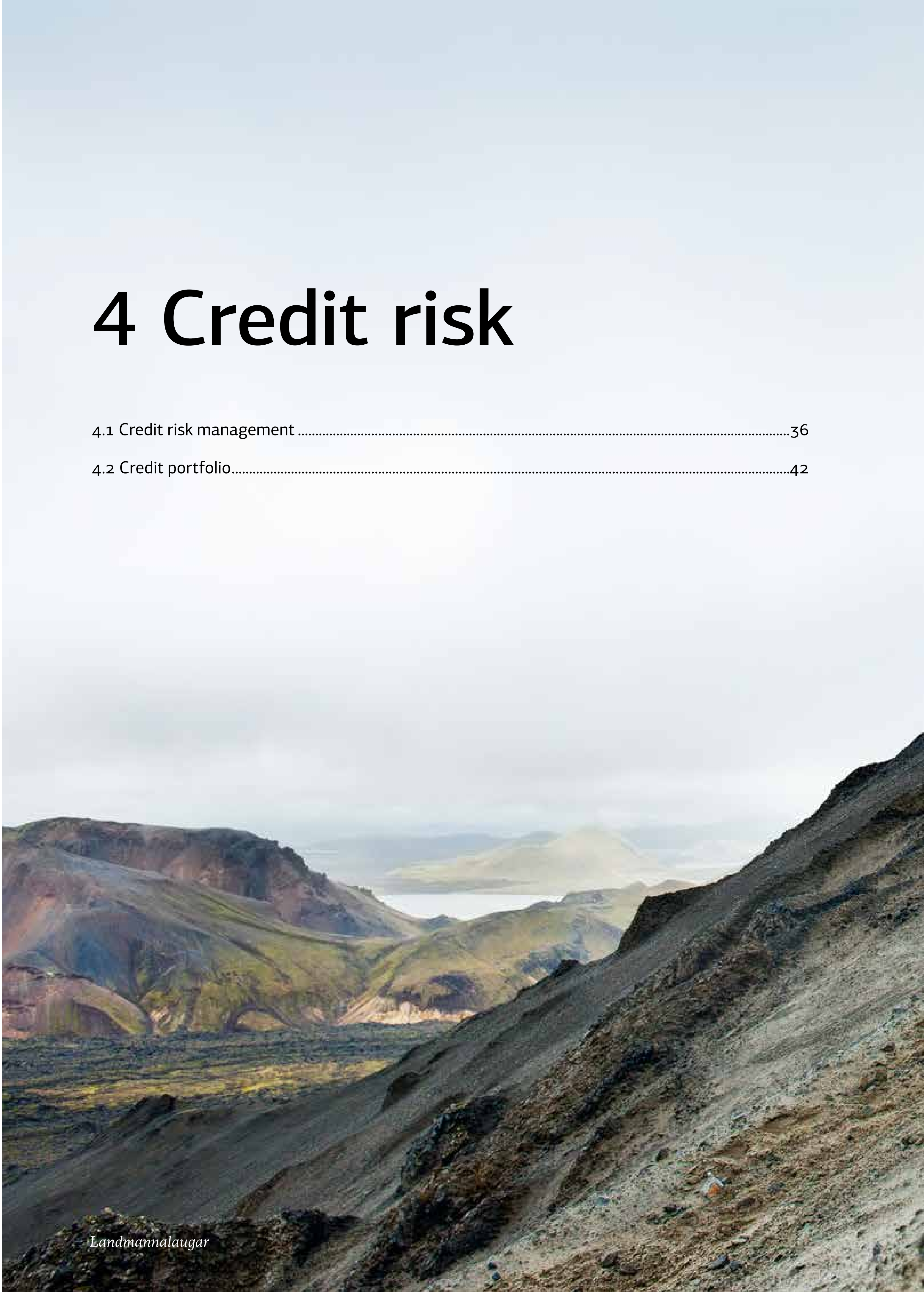

4 Credit risk

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Credit risk

Landsbankinn offers loans, credits, guarantees and other credit related products as part of its business model and thus undertakes credit risk.

At the end of 2015, 85% of the Group's risk-weighted assets were due to credit risk. On the same date, total loans and advances to customers amounted to ISK 832,340 million (2014: ISK 768,144 million), with ISK 811,549 million coming from lending activities (2014: ISK 718,355 million) and ISK 20,791 million from loans and advances to financial institutions (2014: ISK 49,789 million).

4.1 Credit risk management

Credit risk is mainly managed through the credit process and the Group's credit risk models which include PD, LGD and EAD modelling. The models are used for various purposes, e.g. in the credit process in provisioning and management reporting.

4.1.1 Identification

Credit risk is defined as the risk of loss if customers fail to fulfil their agreed obligations and the estimated value of pledged collateral does not cover existing claims.

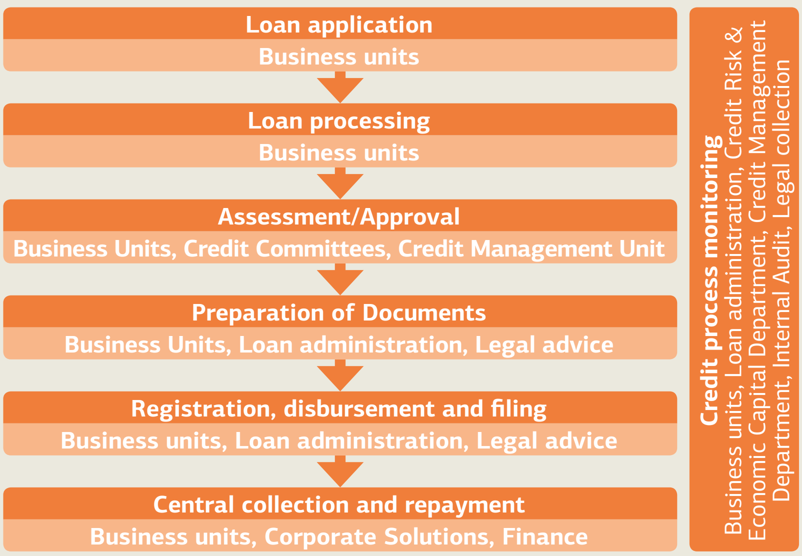
The Group's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of an entity to honour its obligations to deliver cash, securities or other assets as contractually agreed.

Credit risk is the greatest single risk faced by the Group and arises principally from loans and advances to customers and from investments in debt securities, but also from commitments, guarantees and documentary credits, counterparty credit risk in derivatives contracts, and aforementioned settlement risk.

4.1.2 Assessment

Credit risk is measured in three main dimensions: probability of default (PD), loss given default (LGD) and exposure at default (EAD). For the purpose of measuring PD, the Group has developed an internal rating system, including a number of internally developed rating models. The objectives of the rating system are to provide: a meaningful assessment of obligor characteristics; a meaningful differentiation of credit quality; and accurate and consistent quantitative estimates of default risk, i.e. probabilities of default (PD). Internal ratings and associated PD are essential in the risk management and decision-making process, and in the credit approval and corporate governance functions.

The rating system has an obligor rating scale which reflects exclusively quantification of the risk of obligor default, or credit quality. The obligor rating scale has 10 rating grades for non-defaulted obligors from '1' to '10', '10' indicating the highest credit quality, and the grade '0' for defaulted obligors. The rating assignment is supported by rating models, which take information such as industry classification, financial



accounts and payment behaviour into account.

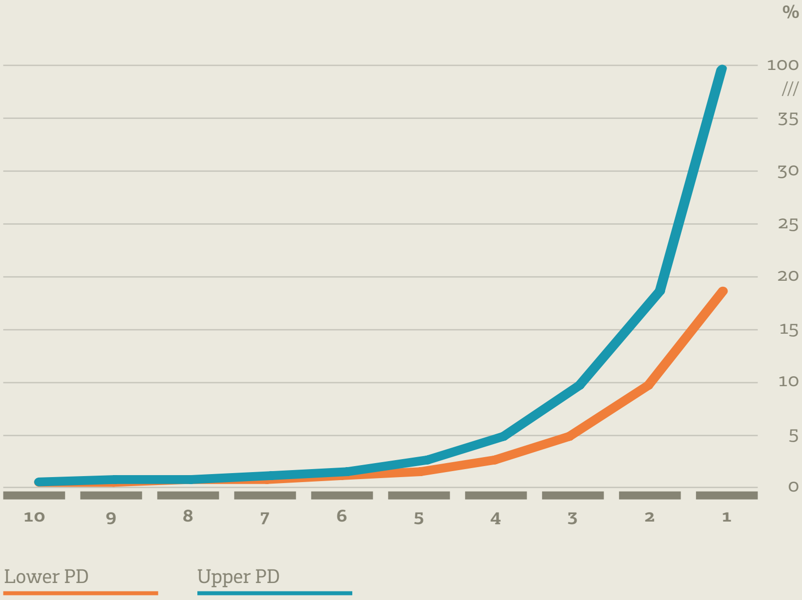
The rating assignment and approval is an integrated part of the credit approval process and assignment shall be updated at least annually or when material information on the obligor or exposure becomes available, whichever is earlier.

The credit rating models' discriminatory power significantly exceeds the Basel II requirement of 0.5. Furthermore, the models are well calibrated, i.e. the weighted probability of default for each rating grade is equal to the actual default rate with respect to reasonable error limits.

LGD is measured using the foundation LGD models defined in the Basel framework for the purpose of EC calculations. In addition, the Group has implemented in the business processes an internal LGD model, which takes into account more types of collateral and is more sensitive to the collateralisation level than the aforementioned Basel model.

Exposure at default is an estimate of the amount outstanding (drawn amounts plus likely future drawdowns of yet undrawn lines) in case the borrower defaults.

Rating category and PD band



Internal mapping from internal rating grade to S&P rating grades

Internal rating grade	S&P	Lower PD	Upper PD
10	AAA/AA+/AA/AA-	0.00%	0.04%
9	A+/A/A-	0.04%	0.10%
8	BBB+	0.10%	0.21%
7	BBB/BBB-	0.21%	0.46%
6	BB+/BB	0.46%	0.99%
5	BB-	0.99%	2.13%
4	B+	2.13%	4.54%
3	B	4.54%	9.39%
2	B-	9.39%	18.42%
1	CCC/C	18.42%	100.00%

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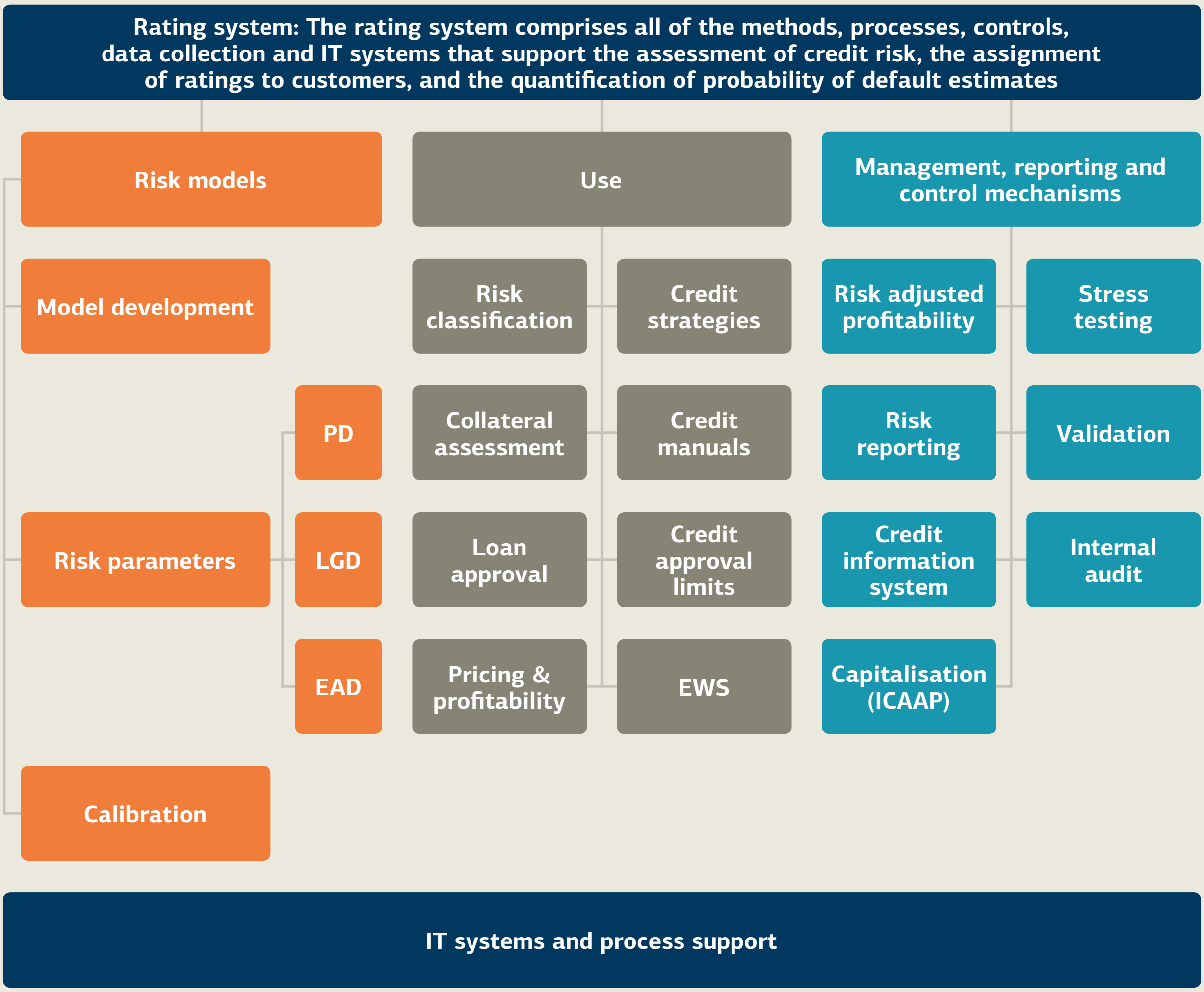


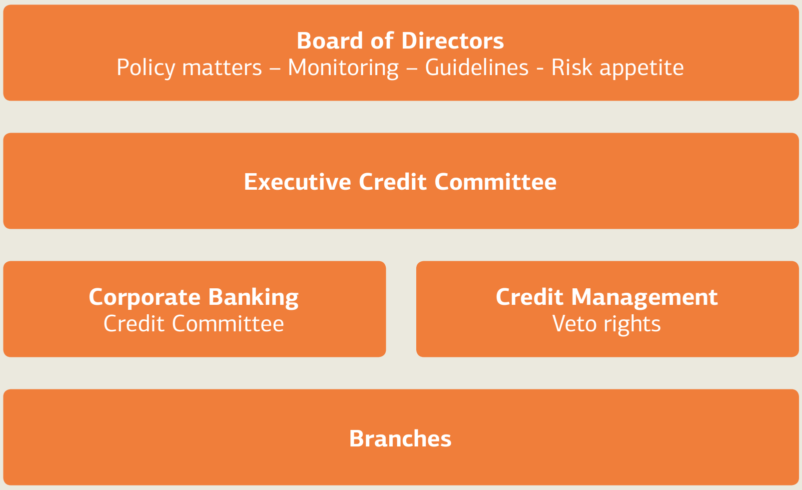
4.1.3 Management and policy

The Group's credit risk management is based on active monitoring by the Board of Directors, the CEO, the Risk & Finance Committee, the Credit Committee, the credit departments within the Risk Management Division and the business units. The Group manages credit risk according to the risk appetite statement and credit policy approved by the Board of Directors as well as detailed lending rules approved by the CEO. The risk appetite and credit policy include limits on large exposures to individual borrowers or groups of borrowers, concentration of risk and exposures to certain industries. The CEO ensures that the risk policy is reflected in the Group's internal framework of regulations and guidelines. The Bank's executives are responsible for the Bank's business units to execute the risk policy appropriately as the CEO is responsible for the oversight of the process as a whole.

Incremental credit authorisation levels are defined based on size of units, types of customers and lending experience of credit officers. The Group has also implemented industry policies to the credit decision process. Credit decisions exceeding authorization levels of business units are subject to confirmation by Credit Management, a department within Risk Management. Credit decisions exceeding the limits of Credit Management are subject to approval by the Group's Credit Committee. Credit decisions exceeding the limits of the Credit Committee are subject to approval by the Board of Directors which holds the highest credit authorisation within the Bank.

4.1.4 Mitigation

Mitigating risks in the credit portfolio is a key element of the Group's credit policy as well as being an inherent part of the credit decision process. Securing loans with collateral is the main method of mitigating credit risk whereas for some loan products, collateral is required by legislation, as in the mortgage finance market, or is standard market practice.



The most majority types of collateral are real estate, vessels and financial assets (shares or bonds).

The amount and type of collateral required depends on an assessment of the credit risk associated with the counterparty. Valuation parameters and the acceptability of different types of collateral are defined in the Group's credit policy. Credit extended by the Group may be secured on residential or commercial properties, land, securities, transport vessels, fishing vessels together with their non-transferable fishing quotas, etc. The Group also secures its loans by means of receivables, inventory and operating assets, such as machinery and equipment. Residential mortgages involve the underlying residential property. Less stringent requirements are set for securing short-term personal loans, such as overdrafts and credit card borrowings.

The Group regularly assesses the market value of collateral received. The Group has developed models to estimate the value of the most frequent types of collateral. For collateral for which no valuation model exists, the Group estimates the value as the market value less a haircut. The haircut represents a conservative estimate of the costs to sell in a forced sale. Costs to sell include maintenance costs in the period over which the asset is up for sale, fees for external advisory services and any loss in value. For listed securities, haircuts are calculated with an internal model based on variables, such as price volatility and marketability.

The Group monitors the market value of mark-to-market collateral and may require additional collateral in accordance with the underlying loan agreements.

In order to limit further the credit risk arising from financial instruments, the Group enters into netting agreements, under which the Group is able to set off all contracts covered by the netting agreement against the debt in cases of default. The arrangements generally include all market transactions between the Group and the client.

Generally, collateral is not held over loans and advances to financial institutions, nor is it usually held against bonds and debt instruments.

The Group includes all collateral to which a value is assigned in accordance with its internal procedures. Guarantees are included if they imply lower risk weights than the original exposure. In addition, collateral is volatility-adjusted (by means of a haircut) in order to take into account price volatility and the expected costs of repossession and sale of the pledge.

4.1.4.1 Derivative financial instruments

In order to mitigate credit risk arising from derivatives, the Group chooses the counterparties for derivatives trading based on stringent rules, according to which clients must meet certain conditions set by the Group. The Group also enters into standard International Swaps and Derivatives Association (ISDA) master netting agreements and similar general netting agreements with financial counterparties.

Commensurate collateral and margin requirements are in place for all derivative contracts the Group enters into. Collateral management and monitoring is performed daily and derivative contracts with clients are usually fully hedged.

The Group's supervision system monitors both derivatives exposure and collateral value and calculates a credit equivalent value for each derivative intraday. It also issues margin calls and manages netting agreements.

Amounts due to and from the Group are offset when the Group has a legally enforceable right to set off a recognised amount and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. External ratings are used where applicable to assist in managing the credit risk exposure of bonds. Otherwise the Group uses fair value estimates based on available information and the Group's own estimates.

4.1.5 Control and monitoring

The Group monitors exposures to identify signs of weakness in customer earnings and liquidity as soon as possible. To monitor customers, the Group uses – supplemental to ratings – an Early Warning System which classifies credit exposures to four credit risk groups (green, yellow, orange and red). The colour classification is the following:

- Green customers are considered as performing without signs of repayment problems;
- Yellow customers are on watch list 1. They have temporary difficulties and may need some instalments postponed or modification of terms or loan covenants;
- Orange customers are on watch list 2. They are still under the supervision of the relevant business unit but are likely to go through debt restructuring or postponement of instalments;
- Red customers are under supervision by Restructuring and need restructuring, or are in legal collection. Restructuring options may include deferred payments, interest and/or debt forgiveness, collateral or guarantees being collected or that the management of the customer‘s operations possibly being taken over by the Group and subsequently sold.

The Credit Risk & Economic Capital Department within Risk Management is together with the business units responsible for the colour classification of customers and the transfer of customers from business units to Restructuring if necessary.

4.1.6 Impairment process

Group policy requires that individual financial assets above materiality thresholds are reviewed at least quarterly, and more frequently when circumstances require. Impairment allowances on individually assessed accounts are determined on a case-by-case basis by evaluating incurred losses at the reporting date. Collectively assessed impairment allowances are permitted in the following cases: (i) portfolios of homogenous loans that are individually below materiality thresholds, and (ii) losses that have been incurred but not yet identified, using the available historical experience together with experienced judgement and statistical techniques.

Should the expected cash flows be re-examined and the present value of the cash flows (calculated using the effective interest rate) be revised, the difference is then recognised in profit or loss (as either impairment or net adjustments to loans and advances). Impairment is calculated using the effective interest rate, before any revision of the expected cash flows. Any adjustments to the carrying amount which result from revising the expected cash flows are recognised in profit or loss. The impact of financial restructuring of the Group's customers is reflected in loan impairment, or net adjustments to loans and advances, as the expected cash flow of customers has changed.

4.2 Credit portfolio

4.2.1 Credit exposure

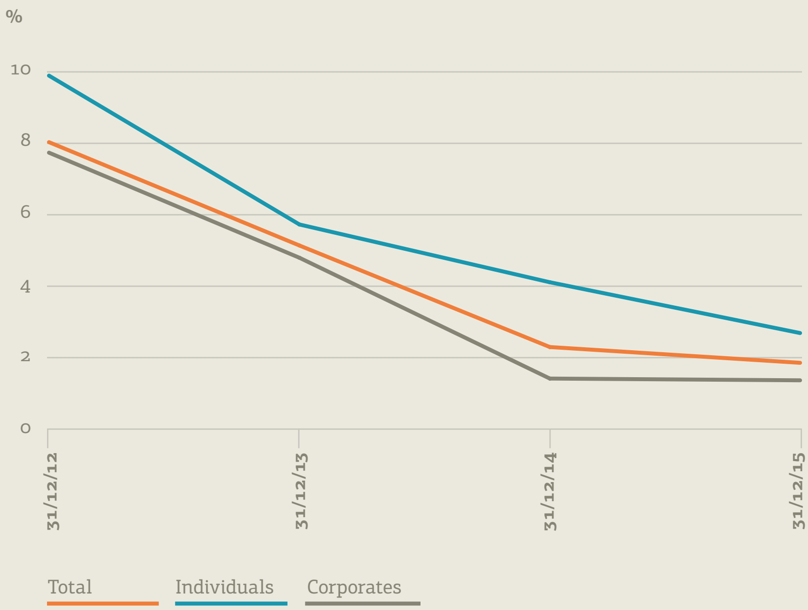
The Group's credit exposure shown in the table on page 43 is defined as balance sheet items and off-balance sheet items that carry credit risk, and the exposure is calculated net of accumulated loan impairment charges. Most of the exposure derives from lending activities in the form of loans with and without collateral.

At the end of 2015, the total carrying amount was ISK 1,099 billion. Some ISK 812 billion are derived from lending activities, ISK 204 billion from bonds and debt instruments, and ISK 0.3 billion is derived from the carrying amount of derivatives.

4.2.1.1 Credit exposure from lending activities

At the end of 2015, the Group's total credit exposure from lending activities amounted to ISK 811,549 million, against ISK 718,355 million at the end of 2014. This represents an increase of 13%. In 2015, the Group experienced increased credit demand in the corporate area, mainly in the construction and real estate sector, which resulted in a significant increase in credit exposure. Credit exposure to individuals also grew substantially, mainly due to an increase in household mortgage lending. In addition the Group merged with two savings banks which slightly increased the Group's credit exposure.

90 days past due ratio



90 days past due ratio decreased further during the year, but at a slower pace than in the previous years.

Together with increased lending activities the Group continued its focus on services to existing customers and refinancing of their loans as well as restructuring clients in financial distress. Since the beginning of 2015 credit exposure in over 90 days past due decreased from ISK 17 billion to ISK 15 billion resulting in 1.8% 90 days past due ratio. The decrease is mainly due to improved market conditions and the fact that corporate loans were restructured, returned to performing standing or written off in part or whole. In part, this is also due to the Group's continued emphasis on reacting before default occurs. Customers in default represented 4% of the portfolio in year end 2015.

At the same time, the portfolio quality has improved during the year, resulting in an exposure weighted average probability of default of 3.4% (discussed further in section 5.2.3).

The following table shows the classification of the Group's financial assets.

Classification of the Group's financial asset

As at 31 December 2015

Financial assets	Loans and receivables	Held for trading	Designated as at fair value	Liabilities at amortised cost	Other liabilities at fair value	Total carrying amount
Cash and balances with Central Bank	25,164	-	-	-	-	25,164
Bonds and debt instruments	125,211	69,279	9,194	-	-	203,684
Equities and equity instruments	-	11,385	17,807	-	-	29,192
Derivatives instruments	-	287	-	-	-	287
Loans and advances to financial institutions	20,791	-	-	-	-	20,791
Loans and advances to customers	811,549	-	-	-	-	811,549
Other financial assets	6,918	-	-	-	-	6,918
Total	**989,633**	**80,951**	**27,001**	**-**	**-**	**1,097,585**

As at 31 December 2014

Financial assets	Loans and receivables	Held for trading	Designated as at fair value	Liabilities at amortised cost	Other liabilities at fair value	Total carrying amount
Cash and balances with Central Bank	10,160	-	-	-	-	10,160
Bonds and debt instruments	113,074	106,788	23,727	-	-	243,589
Equities and equity instruments	-	5,871	23,562	-	-	29,433
Derivatives instruments	-	78	-	-	-	78
Loans and advances to financial institutions	49,789	-	-	-	-	49,789
Loans and advances to customers	718,355	-	-	-	-	718,355
Other financial assets	19,733	-	-	-	-	19,733
Total	**911,111**	**112,737**	**47,289**	**-**	**-**	**1,071,137**

Landsbankinn 2015 All amounts are in ISK million 43

Past due loans by industry

As at December 2015	Loans and advances to customers	Past due loans	Loans and advances to customers past due more than 90 days
Public entities	8,738	3.4%	0.2%
Individuals	290,961	7.1%	2.7%
Corporates	511,849	2.7%	1.4%
Construction and Real estate companies	155,334	3.1%	1.9%
Holding companies	47,612	1.1%	0.4%
Fisheries	159,514	1.2%	0.9%
Manufacturing	27,205	2.2%	0.9%
Agriculture	10,118	7.5%	1.6%
Information, technology and communication	15,502	1.3%	1.0%
Retail	36,021	3.7%	1.9%
Services	60,469	6.2%	2.0%
Other	75	0.3%	0.0%
Total loans	**811,549**	**4.3%**	**1.8%**
Financial institutions	20,791	0.0%	0.0%
Total loans including financial institutions	**832,340**	**4.2%**	**1.8%**

As at December 2014	Loans and advances to customers	Past due loans	Loans and advances to customers past due more than 90 days
Public entities	13,708	0.8%	0.2%
Individuals	238,932	10.7%	4.1%
Corporates	465,715	3.8%	1.5%
Construction and Real estate companies	112,880	4.4%	1.8%
Holding companies	42,861	1.7%	0.7%
Fisheries	156,023	1.6%	9.0%
Manufacturing	28,760	8.9%	2.2%
Agriculture	8,751	10.6%	1.6%
Information, technology and communication	19,798	0.8%	0.5%
Retail	39,118	5.1%	2.0%
Services	56,387	7.2%	2.6%
Other	1,137	0.0%	0.0%
Total loans	**718,355**	**6.0%**	**2.3%**
Financial institutions	49,789	0.0%	0.0%
Total loans including financial institutions	**768,144**	**5.7%**	**2.2%**

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The following table show the collateral value less a haircut held to mitigate credit risk.

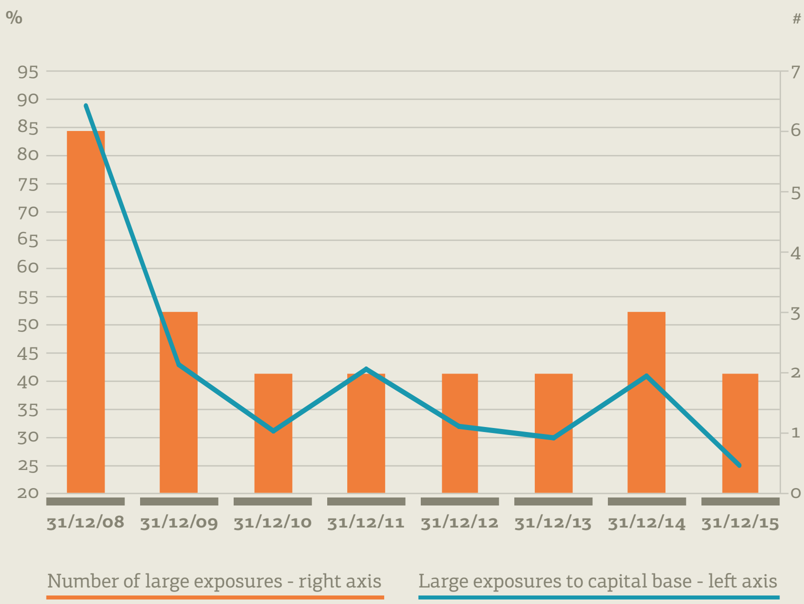
As at 31 December 2015			Collateral types			
Collateral value after haircut	**Real estate**	**Vessels**	**Deposits**	**Securities**	**Other**	**Total**
Financial institutions	-	-	-	-	-	-
Public entities	1,996	-	62	-	108	2,166
Individuals	334,641	563	247	3,149	17,025	355,626
Corporates	212,653	170,104	2,134	66,853	81,163	532,907
Construction and real estate companies	125,830	47	349	585	3,631	130,443
Holding companies	5,282	15	35	39,519	701	45,552
Fisheries	13,012	169,341	106	17,852	28,692	229,003
Manufacturing	9,214	18	341	6,630	9,733	25,937
Agriculture	9,522	17	6	-	1,902	11,446
Information, technology & communication	732	2	398	993	4,879	7,003
Retail	13,586	14	324	826	18,246	32,996
Services	35,384	650	575	448	13,379	50,435
Other	91	-	-	-	-	91
Total	**549,290**	**170,667**	**2,443**	**70,002**	**98,296**	**890,699**

As at 31 December 2014			Collateral types			
Collaterals after haircut	**Real estate**	**Vessels**	**Deposits**	**Securities**	**Other**	**Total**
Financial institutions	-	-	-	-	-	-
Public entities	1,935	-	35	-	43	2,013
Individuals	260,452	472	408	2,449	15,730	279,511
Corporates	178,130	156,904	2,215	54,720	74,776	466,745
Construction and real estate companies	97,317	18	647	393	2,655	101,030
Holding companies	8,168	-	52	29,975	482	38,677
Fisheries	11,123	155,421	36	14,623	23,911	205,114
Manufacturing	9,080	382	415	6,075	8,874	24,826
Agriculture	8,116	17	7	-	1,850	9,990
Information, technology & communication	578	2	140	1,002	5,784	7,506
Retail	13,557	456	192	662	18,968	33,835
Services	30,174	608	726	1,940	11,360	44,808
Other	17	-	-	50	892	959
Total	**440,517**	**157,376**	**2,658**	**57,169**	**90,549**	**748,269**

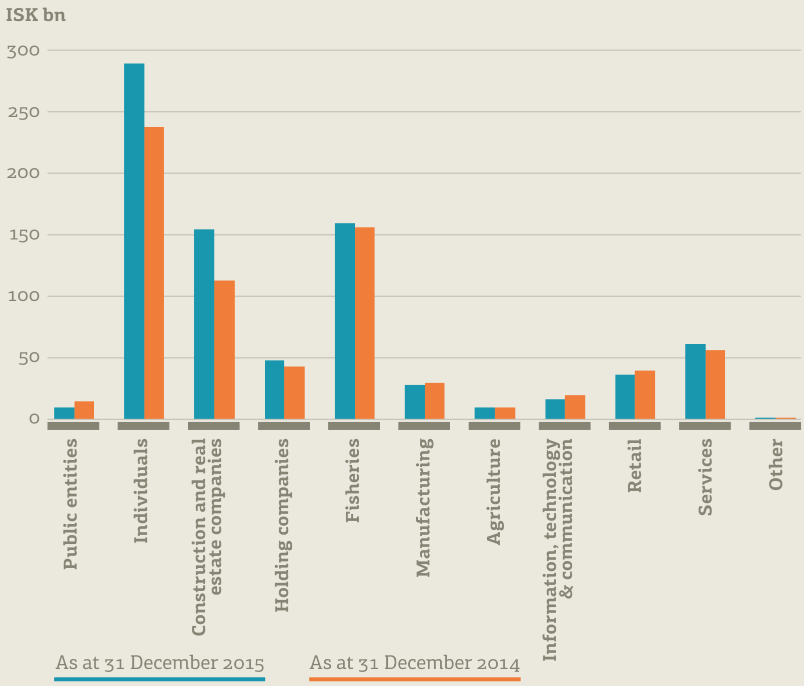
Note: The item Other includes such collateral as financial claims, invoices, liquid assets, vehicles, machines, aircraft and inventories.

Landsbankinn 2015 All amounts are in ISK million 45

Large exposures between 10% and 20% of the Group's capital base



Industry segmentation of credit exposure



4.2.2 Risk concentration

Concentration risk includes (i) single name concentrations of large (connected) individual counterparties[6] and (ii) significant exposures to groups of counterparties whose likelihood of default is driven by common underlying factors, e.g. sector, economy, geographical location, instrument type or other.

Limit management for single name and segment concentrations is set, monitored and managed through the Group's risk appetite and its limit management structure. The Group's risk profile for concentration risks is reported monthly to the Risk & Finance Committee and the Board of Directors according to internal guidelines.

The Group uses the identification of risk concentrations in the credit portfolio as a credit risk management parameter. Risk concentrations arise in the credit portfolio as an inevitable consequence of the Group's business strategy. Concentration risk is

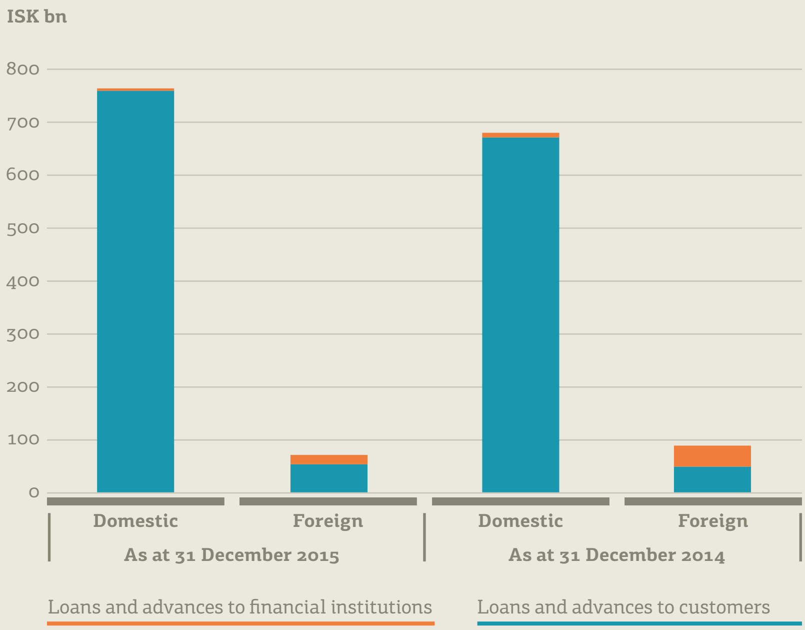
6 Single name exposures are calculated according to the FME rules on large exposures (216/2007).

credit risk related to the degree of diversification in the credit portfolio and includes both single name concentration risk and segment concentration risk.

According to the FME rules on large exposures (216/2007), exposures to a single customer or a group of related customers – after the deduction of particularly secure claims – may not exceed 25% of the capital base.

The Group's risk profile for large exposures is reported monthly to management and Board of Directors according to internal guidelines. Since the end of 2008, both the number and the sum of exposures that exceed 10% of the capital base have been substantially reduced.

Loans and advances by geographical area



As for single name concentration the Group's Board of Directors has introduced portfolio limits for the year 2016 for segment concentration in the Group's risk appetite.

It is a logical consequence of the Group's business model that credit exposure from lending activities is concentrated to some industries. At the end of 2015, lending to personal customers represented 36% of the Group's total credit exposure (year-end 2014: 33%). Most of the demand from personal customers is for property financing and the Group's lending to retail customers is therefore mostly secured on real estate.

The Group's credit exposures are primarily to Icelandic corporate customers. Fisheries and construction & real estate companies represent the largest exposure to single industry sectors.

Customers domiciled in Iceland accounted for 93% of the Group's total credit exposure (2014: 93%). Exposure to foreign counterparties relates mainly to the management of the Group's foreign liquidity reserves.

4.2.3 Migration analysis

Migration analysis in this section is based on the Group's rating scale and PD estimates. At the end of 2015, the average exposure-weighted PD was 3.4% (2014: 4.8%). Excluding loans to financial institutions, which as mentioned above relates to the management of the Group's foreign liquidity reserves, the exposure-weighted PD was 4.0% (2014: 5.1%).

The overall credit quality of the loan portfolio improved further in 2015, experiencing positive migration within all industry sectors. Reasons for improvement include improved borrower operating performance as was

Probability of default (PD)

(%)		As at 31 December 2015	As at 31 December 2014
Financial institutions		0.1%	0.1%
Public entities		0.2%	0.5%
Individuals		3.6%	4.1%
Corporates		4.4%	5.8%
	Construction and real estate companies	5.6%	6.9%
	Holding companies	4.3%	4.7%
	Fisheries	3.3%	5.7%
	Manufacturing	2.7%	5.0%
	Agriculture	4.4%	6.5%
	Information, technology & communication	1.6%	4.3%
	Retail	3.3%	4.3%
	Services	6.0%	6.4%
	Other	7.3%	3.6%
Total		**3.4%**	**4.8%**

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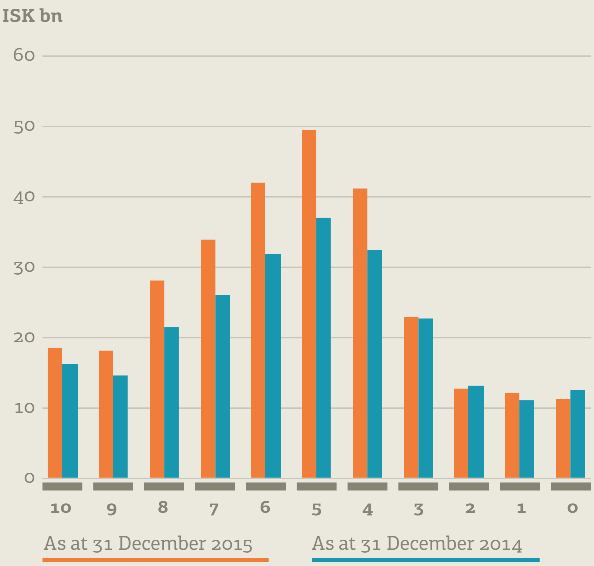
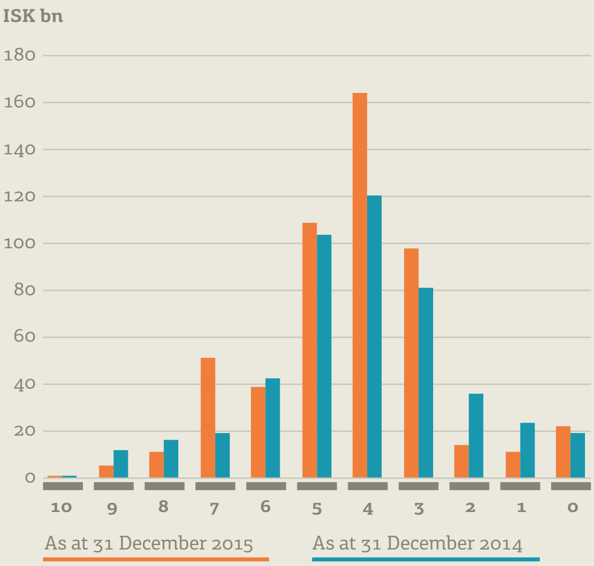
seen in the Fisheries industry which is the largest sector in the portfolio, debt restructurings and customers with poor credit rating leaving the Group. Furthermore, new exposures to highly rated customers and improving market conditions in the construction and real estate sector, have a positive impact on the credit quality of the corporate portfolio. Improved credit quality in the individuals portfolio contributes as well to lower probability of default in the loan portfolio.

The following charts show the rating grade distribution of the loan portfolio broken down by individuals and corporates.

Rating grade distribution - Individuals



Rating grade distribution - Corporates



The figures on pages 50 and 51 show the rating grade migration for corporates and individuals during 2015, based on existing customers at year-end 2014 and 2015. Migration is shown both in terms of number of customers and exposure.

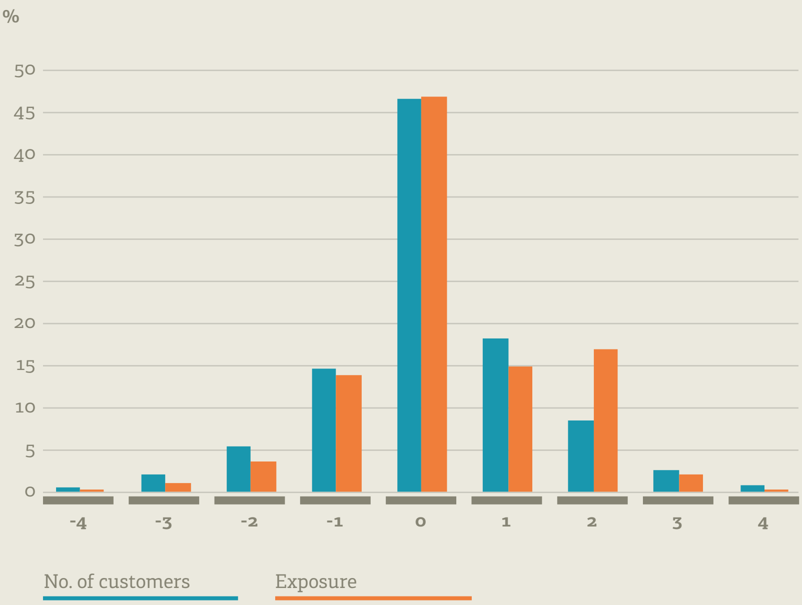
Migration analysis does not cover customers in default, i.e., customers in rating category 0.

Out of the total exposure in the corporate portfolio, approximately 53% migrated up or down during 2015. This corresponds also to 53% of counterparties. Upward migration was significantly higher than downward migration during 2015.

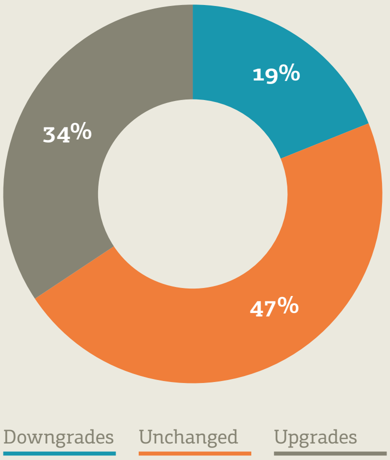
In the individuals portfolio, approximately 68% migrated either up or down in 2015 with respect to exposure and 57% in terms of customer numbers.

On an overall level, migration had a positive impact on credit risk EC during 2015 and reduced IRB credit risk EC for corporations by approximately 3%. This calculation does not take into account the changes in exposure

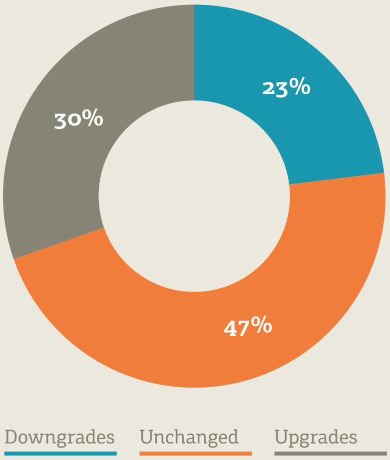
Rating migration of corporates in 2015



Rating migration of corporates in 2015 Carrying amount



Rating migration of corporates in 2015 No. of customers

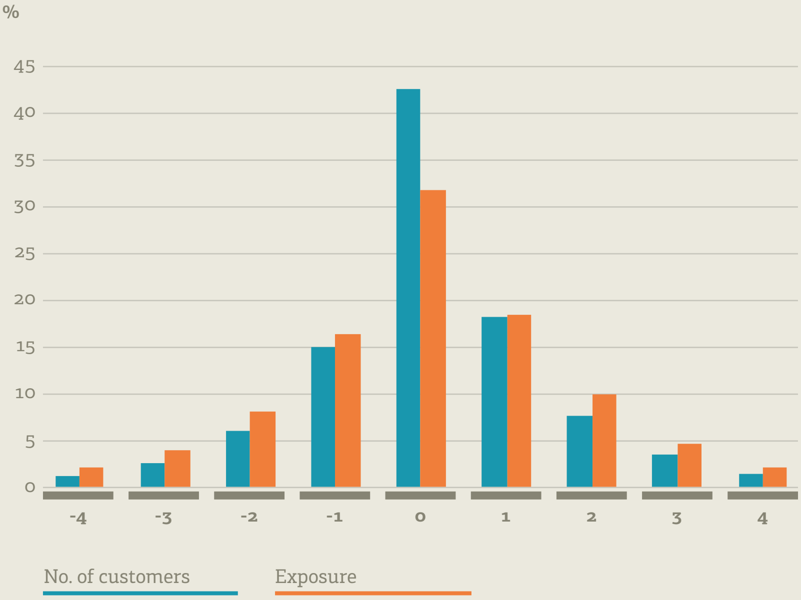


distribution nor rating distribution of lost and new customers or customers who defaulted during the year.

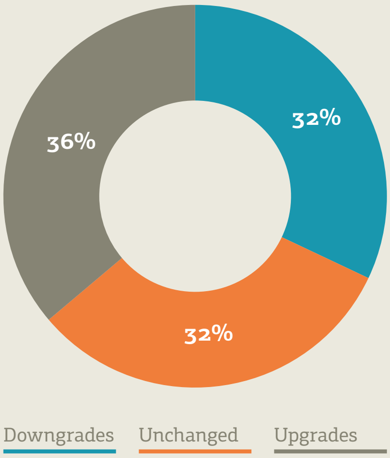
The rating and risk grade distribution changes mainly due to three factors: Changes in rating grade for existing customers, or pure migration; different rating grade distribution of new customers and customers leaving the Group, compared to the rating grade distribution of existing customers during the comparison period; and, increased or decreased exposure per rating grade to existing customers.

Altogether, the percentage of upgrades was higher than the percentage of downgrades both in the corporate and individual segment. At the end of 2015, the average exposure-weighted PD for corporate customers was 4.4% (2014: 5.8%). For individuals, the average exposure-weighted PD was 3.6% (2014: 4.1%). As mentioned before positive developments in the fisheries, construction and real estate and individual sectors have the largest impact of decrease to the measurement value.

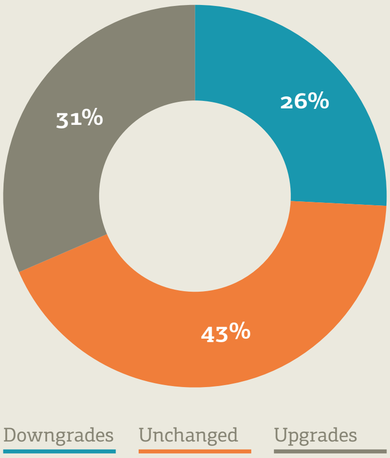
Rating migration of individuals in 2015



Rating migration of individuals in 2014 Carrying amount



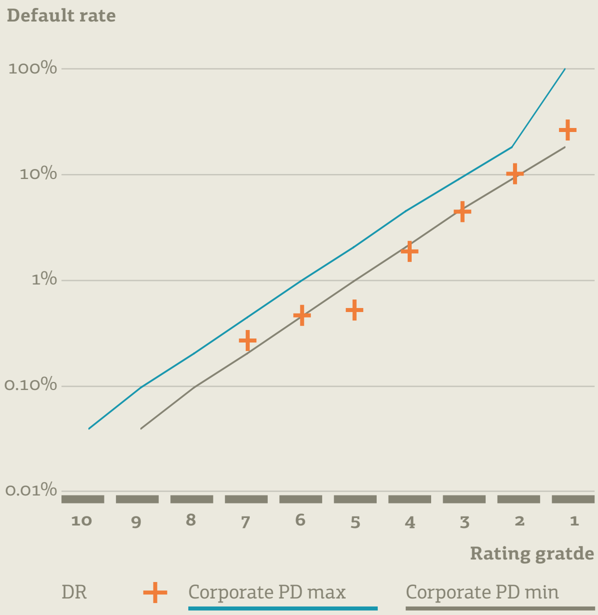
Rating migration of individuals in 2014 No. of customers



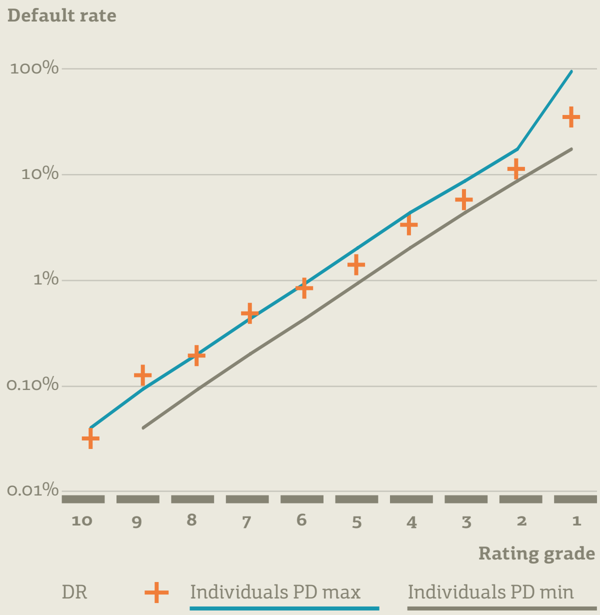
The default rate, which is measured by number of customers and not exposure weighted, for corporate customers for 2015 was 4.6% as compared to the predicted 6.0%. There were no defaults in grades 8, 9 and 10. For individual rating grades, the default rate was mainly in coherence with what expected, except for grade 9, though not significant.

The default rate for individuals for 2015 was 2.5% as compared to the predicted 2.5%.

12 month default rate vs. probability of default band - Corporates 2015



12 month default rate vs. probability of default band - Individuals 2015



4.2.4 Loan impairment

Allowance for impairment totalled ISK 34 billion in 2015, as compared to ISK 41 billion in 2014. Allowances decreased in all industry sectors during 2015 while the overall carrying amount increased. The decrease in allowances is mainly due to written-off loans, lower probability of default, improved collaterals and lower past due rate.

At the end of 2015, 91% of the portfolio consisted of claims that were neither past due nor impaired. The accumulated impairment amounted to ISK 5 billion.

Loan impairment

	Individual allowance	Collective allowance	Total
Open 1.1.2015	-33,731	-7,716	-41,447
New provisions	-10,645	0	-10,645
New provisions due to merger	-2,863	-491	-3,354
Reversals	12,821	2,565	15,386
Provisions used to cover write-offs	6,570	0	6,570
Translation difference	-351	185	-166
Closing 31.12.2015	-28,200	-5,457	-33,657

	Individual allowance	Collective allowance	Total
Open 1.1.2014	-41,278	-9,666	-50,944
New provisions	-19,209	0	-19,209
Reversals	16,852	1,827	18,679
Provisions used to cover write-offs	9,917	0	9,917
Translation difference	-13	123	110
Closing 31.12.2014	-33,731	-7,716	-41,447

Landsbankinn 2015 All amounts are in ISK million 53

	1.1.-31.12.2015		
Impairment loss	Customers	Financials	Total
New provisions	-10,645	-645	-11,290
Write-offs	-7,602	0	-7,602
Provisions used to cover write-offs	6,570	0	6,570
Reversals	15,386	0	15,386
Recoveries	2,146	0	2,146
Translation difference	-166	0	-166
Impairment loss for the period	5,689	-645	5,044
Impairment of claims reversed	0	0	0
Net impairment loss for the period	5,689	-645	5,044

	1.1.-31.12.2014		
Impairment loss	Customers	Financials	Total
New provisions	-19,209	0	-19,209
Write-offs	-14,905	0	-14,905
Provisions used to cover write-offs	9,917	0	9,917
Reversals	18,679	0	18,679
Recoveries	3,242	0	3,242
Translation difference	110	0	110
Impairment loss for the period	-2,166	0	-2,166
Impairment of claims reversed	0	128	128
Net impairment loss for the period	-2,166	128	-2,038

Impaired loans gross decreased by 26% during the year to reach ISK 57 billion. This corresponds to 6.7% of total loans excluding financial institutions. The decrease in impaired loans was mainly related to the improved conditions in the fisheris industry, which saw a decrease of ISK 7 billion and decreases of ISK 13 billion were seen in the holding company industry as well, partially due to reclassification. Impaired loans gross in the household sector also decreased by ISK 6 billion.

Impaired loans net, after allowances for individually assessed impaired loans, decreased to ISK 29 billion, corresponding to 3.4% of total loans. Allowances for individually assessed loans decreased by ISK 6 billion, to ISK 28 billion, and collectively assessed loans reduced to ISK 5 billion. The ratio of individual allowances for impaired loans increased to 50% (2014: 44%) and total allowances in relation to impaired loans increased as well to 59% (2014: 54%).

The table on page 55 shows impaired loans split by industry sectors. The positive development of the Icelandic economy is still expected to continue slightly, although the economy is still fragile and uncertainty is still high. Private consumption and the housing market remain the key drivers for a sustainable and significant improvement and consumers have become more optimistic. The housing market has developed positively with prices increasing, although primarily in the capital region.

54 All amounts are in ISK million Landsbankinn 2015

Impaired loans by industry sectors

As at 31 December 2015	Gross carrying amount	Carrying amount	Impaired loans before allowances	Impaired loans in % of loans	Collective allowance	Individual allowance	Total provision-ing ratio
Financial institutions	20,791	20,791	-	0.0%	-	-	-
Public entities	8,969	8,738	462	5.1%	-8	-222	49.9%
Individuals	303,349	290,962	19,714	6.5%	-1,967	-10,420	62.8%
Corporates	532,888	511,849	36,624	6.9%	-3,482	-17,556	57.4%
Construction and Real estate companies	162,090	155,334	11,382	7.0%	-1,431	-5,326	59.4%
Holding companies	48,649	47,612	978	2.0%	-343	-695	106.1%
Fisheries	162,160	159,515	4,615	2.8%	-224	-2,420	57.3%
Manufacturing	29,384	27,205	7,333	25.0%	-231	-1,950	29.7%
Agriculture	10,440	10,118	808	7.7%	-71	-251	39.8%
Information, technology and communication	15,787	15,502	261	1.7%	-137	-148	109.3%
Retail	38,069	36,021	2,871	7.5%	-325	-1,723	71.4%
Services	66,233	60,469	8,376	12.6%	-719	-5,045	68.8%
Other	76	75	-	0.0%	-1	-	-
Total	**865,997**	**832,340**	**56,800**	**6.6%**	**-5,457**	**-28,200**	**59.3%**

As at 31 December 2014	Gross carrying amount	Carrying amount	Impaired loans before al-lowances	Impaired loans in % of loans	Collective allowance	Individual allowance	Total pro-visioning ratio
Financial institutions	49,789	49,789	-	0.0%	-	-	-
Public entities	13,831	13,708	115	0.8%	-25	-99	107.5%
Individuals	254,955	238,932	26,003	10.2%	-2,240	-13,783	61.6%
Corporates	491,015	465,715	51,105	10.4%	-5,452	-19,849	49.5%
Construction and Real estate companies	119,926	112,880	10,652	8.9%	-1,552	-5,494	66.1%
Holding companies	45,451	42,861	14,201	31.2%	-603	-1,986	18.2%
Fisheries	162,507	156,023	11,548	7.1%	-637	-5,847	56.1%
Manufacturing	30,837	28,760	6,514	21.1%	-433	-1,644	31.9%
Agriculture	9,269	8,751	484	5.2%	-104	-415	107.2%
Information, technology and communication	20,454	19,798	235	1.2%	-486	-170	278.9%
Retail	42,198	39,118	4,410	10.4%	-491	-2,589	69.9%
Services	59,228	56,387	3,061	5.2%	-1,137	-1,704	92.8%
Other	1,145	1,137	-	0.0%	-8	-	-
Total	**809,590**	**768,144**	**77,223**	**9.5%**	**-7,716**	**-33,730**	**53.7%**

Landsbankinn 2015 All amounts are in ISK million 55

4.2.5 Credit risk analysis by industry sectors

This section describes developments in credit quality in selected segments of the Group's lending portfolio in the year 2015.

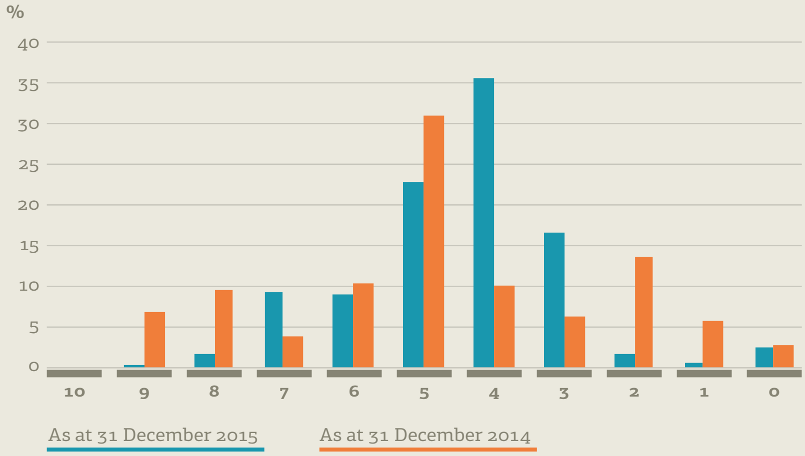
4.2.5.1 Fisheries

Icelandic fisheries are currently sailing in calmer waters after the storms of the banking system collapse and exchange rate plunge (which actually improved the industry's operating environment). While debt grew considerably with the currency depreciation, the ability of the industry to service its debt increased even more strongly. The ratio of EBITDA and EBIT, on the one hand, to liabilities, on the other hand, has not been this favourable in years. At year-end 2013 the debts of the Icelandic fisheries sector were 5.3 times EBITDA; the summary prepared by Statistics Iceland of the performance of fishing and processing in 2014 was not yet available at the time of writing. This ratio averaged 10.9 in the years 2004 to 2009. According to the forecast by Landsbankinn's Economic Research for EBITDA in fishing excluding fishing fees for 2014, it is expected to be slightly higher than in 2013, primarily due to product price increases YoY.

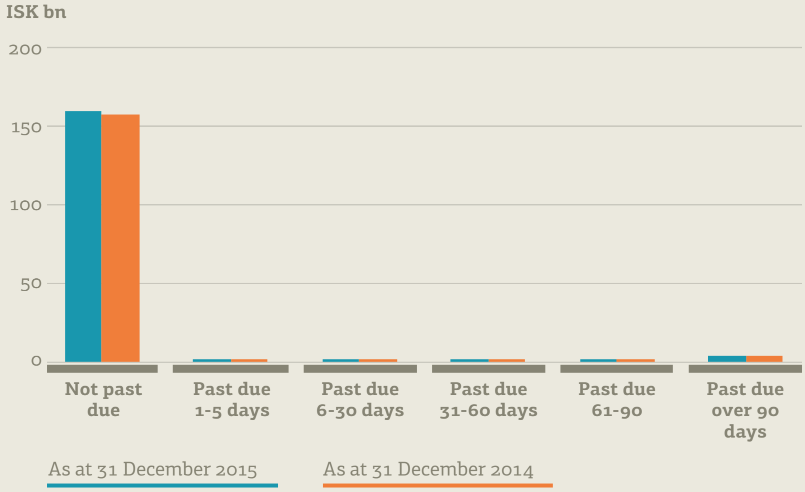
The marine products price index in foreign currency developed favourably last year and has not been higher during the entire period from 2006. Most of the upward trend has resulted from increases in groundfish prices, while pelagic prices have weakened slightly. This groundfish price trend has to be seen as a very positive sign, not least in consideration of the fact that world market prices for meat, as measured by the UN Food and Agriculture Organisation (FAO), have declined somewhat in recent quarters. Historically speaking, prices for Icelandic groundfish have generally followed changes in world market meat prices with a lag of several months. In recent months, however, these effects have not been detected, although it is not improbable that some impact may be felt in the coming months.

According to the outlook, this year's capelin season will not match the strong season last year; catches this year are likely to be similar to those of 2014, which was a relatively poor season in an historical context. Trade sanctions against Russia have had a substantial impact on Icelandic fisheries, although the effects have most likely been overestimated if consideration is given to the major weakening of the Russian rouble last year due to falling global oil prices. Europe is the largest market for Icelandic marine products, importing around 80% of production. The outlook for growth in the continent is good, with 2015 growth in the EU estimated at 1.9%. Forecasts suggest that growth will be around this level right up until 2020.

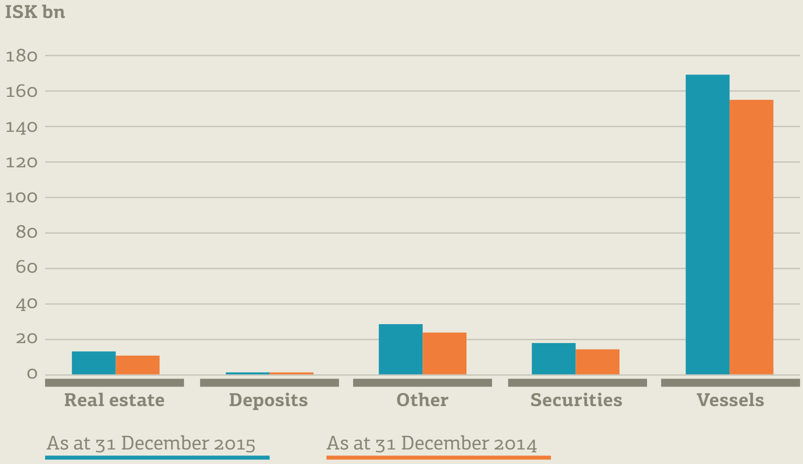
Loans and advances to fishery customers per rating grade



Fisheries - Gross carrying amount - Past due



Fisheries - Collateral types



Loans and advances to customers in the fisheries industry amounted to ISK 160 billion as at 31 December 2015 (2014: ISK 156 billion). Credit exposure to the sector represented 20% of the Group's loan portfolio.

The lower chart on page 56 shows the gross carrying amount of loans and advances to customers in the fisheries industry that have failed to make payments which had become contractually overdue by one or more days.

Impaired exposure in the sector amounts to ISK 5 billion and the amount of not individually impaired loans is ISK 158 billion. The collective allowance is ISK 0.2 billion.

At the end of 2015, the loans and advances to fisheries customers in rating grades 4 and higher represented 79% of the total compared to 72% in 2014.

The sector's average exposure-weighted PD was 3.3% as at 31 December 2015 and decreased significantly during the year. The decrease is to some extent due to few customers which were, although performing, with low rating grades in the year 2014 but managed to resolve their difficulties during 2015. Credit extended by the Group to the fisheries industry is mainly secured by transport and fishing vessels together with their non-transferable fishing quotas, or 74% of the total sector's collateral.

4.2.5.2 Construction and real estate companies

In 2015 construction and real estate companies witnessed favourable developments in respective market conditions, both in terms of housing prices and hotel operations.

Real estate prices in the capital region increased by 8.5% between 2013 and 2014. The trend continued in a similar manner this past year and at year-end the 12 month increase in housing prices was 9.4%.

The rate of increase is high for both single-unit and multi-unit dwellings. Multi-unit dwellings have risen in price fairly steadily since 2011, while the price increase for single family dwellings has been lower and more erratic. A glance at developments in recent years shows that the 12M price increase for multi-unit dwellings has been over 8%. It is also evident that the rise in price of single-unit dwellings has been considerably more 2015 than in 2012-2014.

Most signs indicate that housing prices will continue to increase. It appears evident, for example, that the supply of housing does not satisfy demand and such market conditions drive prices up. There have also been signs of increased competition in the housing mortgage market. Pension funds are making their presence felt in this market. They have lowered their mortgage rates in line with bond market yields and offer rates lower than the commercial banks, and non-indexed mortgages as

Fisheries	As at 31 December 2015	As at 31 December 2014
Gross carrying amount	162,160	162,507
Performing - Individual allowance	-901	-4,497
Non-performing - Individual allowance	-1519	-1,350
Collective allowance	-224	-637
Carrying amount	159,517	156,023

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well. Pension funds have raised their LTV ratios and lowered up-front fees for new mortgages. Some response has already been seen from the commercial banks, suggesting possible increased mortgage market competition. All of which facilitates access to financing, which in turn encourages price rises. In addition to this factors such as lower funding costs and lower taxes on financial undertakings could increase the banks' scope for lowering housing mortgage rates.

Following major wage increases recently the development of purchasing power is still favourable. Household finances have greatly improved recently, debt has decreased, their equity position has improved and mortgage ratios are lower. This means households should be capable of increasing their debts in a conceivably unchanged or more favourable future conditions. All of these factors point in the direction of continuing increases in real estate prices. Other factors could be mentioned in this connection, e.g. the need for increased import of labour in coming quarters, which will require additional housing, and if the increase in foreign travellers continues at the same pace, the renting of accommodations to tourists will reduce the supply of housing still further.

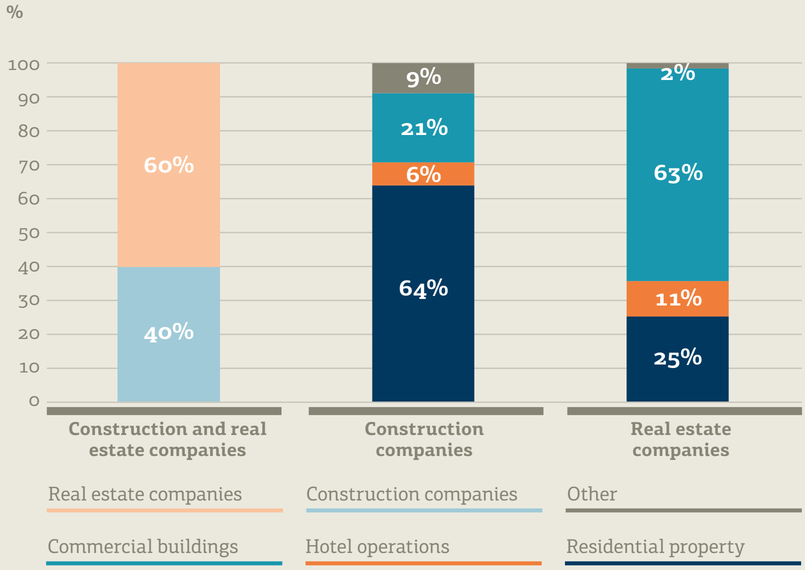
In May 2015 the government issued a declaration on housing affairs in consultation with the social partners and local authorities. The declaration is aimed at the construction of 2,300 social housing rental units over the next four years, i.e. from 2016 to 2019, however, at a maximum rate of 600 units per year. This is a high volume if compared, for example, with the number of units purchased by enterprises from individuals for rental and also compared with construction activity in recent years. It appears evident that these plans will be delayed somewhat, e.g. the construction of all the units planned for the next two years in the declaration will hardly be completed.

Substantial investment in hotel operations is in the pipeline, and the Group has been involved to some extent in its funding. In the capital region, which is by far the largest market, the Bank has a 23% market share of long-term funding of hotels (percentage of hotel rooms). The decrease in the market share of long-term hotel funding is due to the strong growth of special real estate companies and real estate funds of securities firms.

The Group provides project financing for around 13% of the total number of hotel rooms under construction or in preparation.

Loans and advances to construction and real estate companies amounted to ISK 155 billion as at 31 December 2015 (2014: ISK

Construction & real estate companies split by operations



Construction and real estate companies	At 31 December 2015	At 31 December 2014
Gross carrying amount	162,090	119,926
Performing - Individual allowance	-2,618	-2,850
Non-performing - Individual allowance	-2,708	-2,644
Collective allowance	-1,431	-1,552
Carrying amount	155,333	112,880

58 All amounts are in ISK million Landsbankinn 2015

113 billion). Credit exposure to the sector represented 19% of the Group's loan portfolio. 9% of total credit exposure to construction and real estate companies is to hotel operations, 72% of which is to real estate companies and 28% to construction companies. 41% of the total loans to the sector is due to residential property, 63% of which is to construction companies. Loans due to commercial buildings, other than for hotel operations, represent 46% of credit exposure to the sector, 82% of which is to real estate companies.

The chart shows the gross carrying amount of loans and advances to construction and real estate companies that have failed to make payments which had become contractually overdue by one or more days.

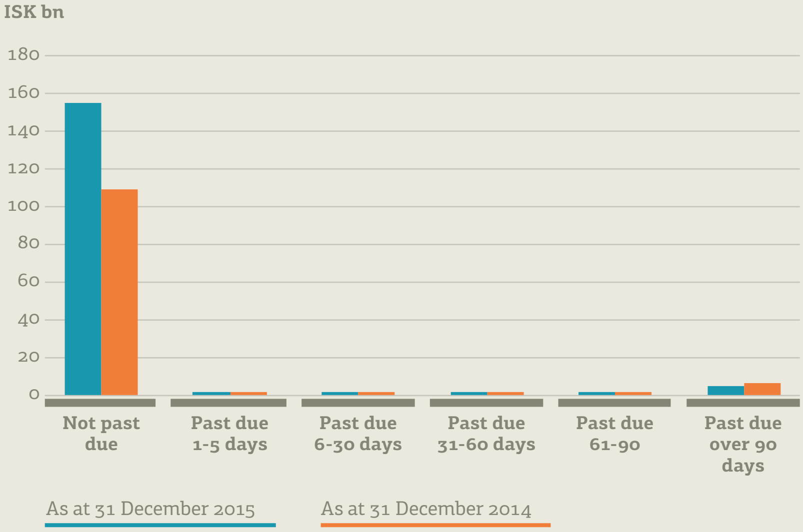
Impaired exposure in the sector amounts to ISK 11 billion and the amount of not individually impaired loans is ISK 151 billion. The collective allowance is ISK 1.4 billion.

Positive developments and improvement in the sector's credit quality can both be seen in a significant migration from the lowest rating grades, 1 and 2, to higher ones as well as increased exposure in rating grades 5 and higher.

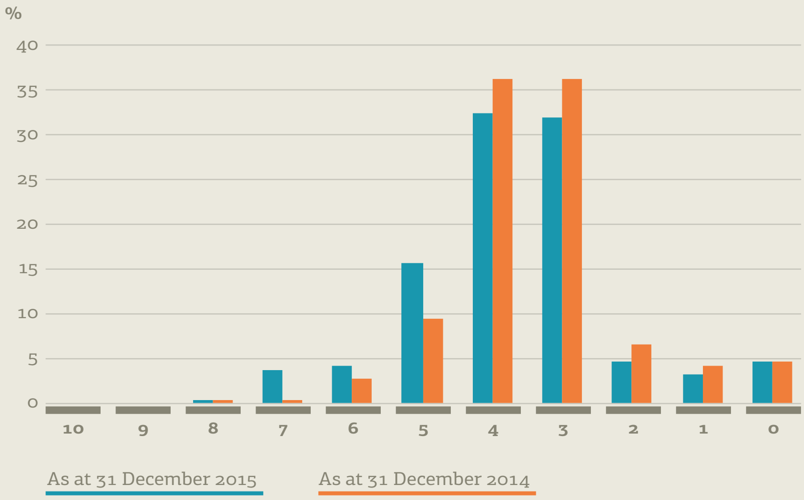
The sector's average exposure-weighted PD was 5.6% as at 31 December 2015 and improved during the year.

Credit extended by the Group to construction and real estate companies is well secured, mainly on real estate, 62% of which is fully built commercial buildings, 31% fully built residential property and 7% real estate under construction.

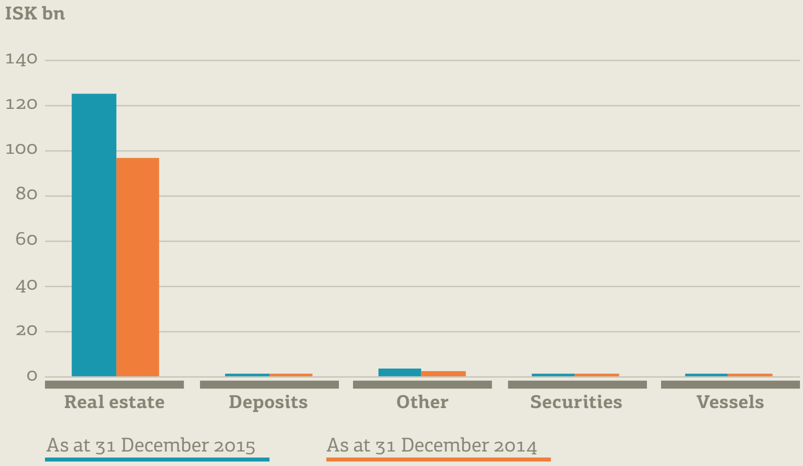
Construction and real estate companies Gross carrying amount - Past due



Loans and advances to Construction and real estate customers per rating grade



Construction and real estate companies - Collateral types



Svínafellsjökull

5 Market risk

Market risk

Market risk is the risk that changes in market prices will adversely impact the fair value or future cash flows of financial instruments. Market risk arises from open positions in currency, equities and interest rate products, all of which are exposed to general and specific market movements and changing volatility levels in market rates and prices, for instance in interest rates, inflation, foreign exchange rates and equity prices.

The majority of the Group's products and exposures that entail market risk consist of equities and equity derivatives, bonds and fixed income products and open currency positions.

5.1 Market risk management and policy

The Board of Directors is responsible for determining the Group's market risk appetite and the Risk & Finance Committee is responsible for developing detailed market risk management policies and setting market risk limits. Market risk is managed centrally by Treasury as well as within trading units. The objective of market risk management is to identify, locate and monitor market risk exposures and analyse and report them to appropriate parties. Together, the risk appetite of the Bank and the market risk policies set the overall limits that govern market risk management within the Bank.

The Group separates its exposure to market risk into trading and non-trading portfolios, managing each separately. Trading portfolios include positions arising from market-making, hedges for derivative sales and proprietary position-taking. Non-trading portfolios include positions arising from the Group's retail and commercial banking operations, proprietary position-taking as part of asset and liability management and funding transactions, managed by Treasury. Treasury is also responsible for day-to-day liquidity management.

Market risk mitigation is reflected in the Group's overall risk appetite by identifying the target level and strategy of market risk factors. Other market risk mitigation plans are made on a case-by-case basis involving hedging strategies and risk reduction through diversification.

In 2015 the Group has further strengthened controls and processes involving market risk management, for example by revising the trading book/banking book boundary and implementing policies to ensure compliance within the Group. Furthermore, the Group has revised and updated some of its' market risk models and introduced new models to further enhance market risk measurements.

5.2 Control and monitoring

The aim of the market risk management process is to quickly detect and correct deficiencies in compliance to policies, processes and procedures. The Group monitors early indicators that can provide warning of an increased risk of future losses. Market risk indicators need to be concise, reported in a timely manner, give clear signals and highlight portfolio risk concentrations and reflect current risk positions. The risk reports show the Group's total risk in addition to summarizing risk concentration in different business units and asset classes as well as across other attributes, as appropriate, pursuant to the Group's activities.

Market risk arising from trading and non-trading activities is measured, monitored and reported on a daily, weekly and monthly basis. The market risk limits set by the Risk & Finance Committee are monitored by Market Risk and all exceptions and breaches of limits are reported on a regular basis to the Risk & Finance Committee and other relevant parties as necessary. Furthermore, summarized reports highlighting market risk, risk appetite measurements and any concerns regarding market risk are sent to the Board of Directors on a regular basis.

Total exposure subject to market risk

	Net position at year-end	
	2015	2014
Equities and equity instruments in the trading book	2,144	1,886
Bonds and debt instruments in the trading book	34,997	33,649
Net FX position	23,795	20,320

5.3 Market risk exposure

The table above summarizes the Group's exposure to market risk at year-end 2015.

The Group also faces counterparty credit risk arising from derivative contracts with customers and financial institutions. Counterparty credit risk is, however, very low compared to other credit risk and is mitigated through strict collateral requirements and limits. The Group does not have any exposure to securitisation positions.

5.3.1 Banking book exposures

The banking book exposures of the Group pertaining to market risk are exposures in equities and bonds. The majority of the equities are unlisted and are, for the most part, legacy positions obtained through corporate restructuring or were acquired when the Bank was established in 2008. The bond holdings in the banking book are comprised of strategic investments and liquidity management instruments. Capital reserved against these exposures is classified as credit risk.

5.4 Measuring market risk

The Bank uses risk-weighted assets (RWA) and economic capital (EC) as a common denominator for measuring risk across different asset classes, including those assets subject to market risk. Risk-weighted assets are determined by applying specific risk weights to the Group's assets, following capital requirement regulations. Several other indicators are used as measures of market risk as well, including Value-at-Risk (VaR), daily profits and losses, delta positions and net positions across different attributes such as the currency and issuer.

Total market risk (RWA measure) at year-end

	2015		2014	
	RWA	Ratio to RWA	RWA	Ratio to RWA
Equity price risk in the trading book	6,090	0.7%	3,772	0.4%
Interest rate risk in the trading book	1,973	0.2%	678	0.1%
Foreign exchange risk	23,856	2.8%	21,379	2.5%
Total	**31,919**	**3.7%**	**25,829**	**3.1%**

All amounts are in ISK million 63

Total market risk, measured as ratio of risk-weighted assets to total RWA, is considered modest, amounting to 3.7% at year-end 2015 (compared to 3.1% at year-end 2014), well within the Group's market risk appetite.

5.4.1 Equity price risk in the trading book

Equity price risk is the risk of equity value fluctuations due to open positions in equity-based instruments. The Group's equity trading portfolio is comprised of proprietary trading positions and exposures due to market making, including equity derivatives and hedging positions. All equity-based derivative contracts are usually fully hedged with regards to market risk and are subject to various limit requirements.

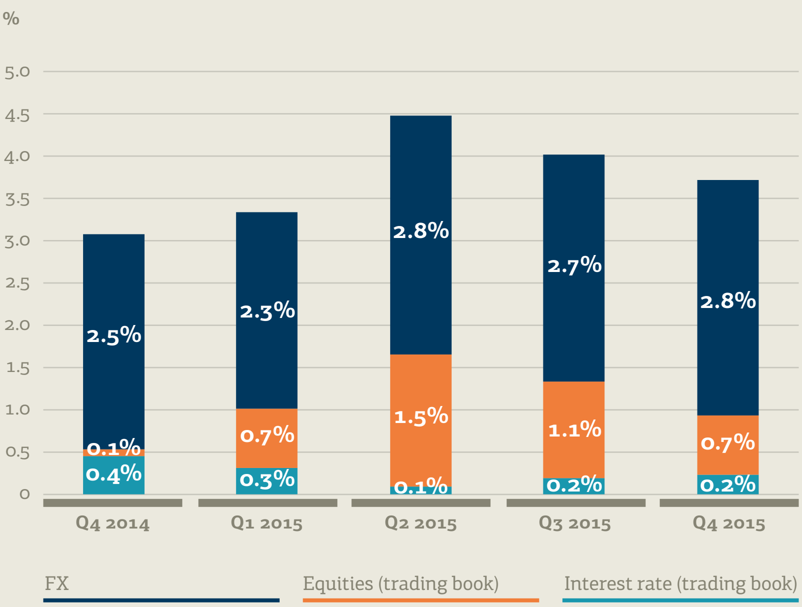
5.4.2 Interest rate risk in the trading book

Interest rate risk is the risk of loss arising from the impact of adverse changes in market interest rates. The Group's trading portfolios contain exposures due to market making and proprietary trading, highly concentrated on government-guaranteed bills/bonds as well as covered bonds and fixed income derivatives. As with equity-based derivatives, all fixed income derivative contracts are usually fully hedged with regards to market risk and are subject to strict limit requirements.

5.4.3 Interest rate risk in the banking book

Interest rate risk in the banking book is the current or prospective risk to earnings and capital arising from adverse movements in interest rates. Changes in interest rates on the Group's assets and liabilities impact its interest rate margin and/or the value of its shareholders' equity. This risk is primarily the result of duration mismatch of assets and liabilities. Net positions of assets and liabilities in the banking book by interest rate fixing period, at year-end 2015 and 2014, are shown in the table on page 65.

Total market risk (Ratio to total RWA)



Assets and liabilities in the banking book by interest rate fixing period

	Net position at year-end 2015				
	Up to 3 M	**3-12 M**	**1-5 Y**	**Over 5 Y**	**Total**
Total assets	802,657	114,138	100,448	51,150	1,068,393
Total liabilities	-737,825	-24,400	-60,427	-11,880	-834,532
Net on-balance sheet position	64,832	89,738	40,021	39,270	233,861
Net off-balance sheet position	359	-176	-183	0	0
Total interest repricing gap	**65,191**	**89,562**	**39,838**	**39,270**	**233,861**

	Net position at year-end 2014				
	Up to 3 M	**3-12 M**	**1-5 Y**	**Over 5 Y**	**Total**
Total assets	809,129	106,944	71,092	54,539	1,041,704
Total liabilities	-790,447	-23,924	-9,159	-1,678	-825,208
Net on-balance sheet position	18,682	83,020	61,933	52,861	216,495
Net off-balance sheet position	430	-140	-290	0	0
Total interest repricing gap	**19,112**	**82,880**	**61,643**	**52,861**	**216,495**

The Group employs a monthly stress test of the interest rate risk in the banking book by measuring the impact of shifting the relevant interest rates for every currency on the fair value of all interest-rate sensitive assets and liabilities in the banking book. The table on page 66 summarizes the sensitivity of the Group's banking book fair value resulting from a flat 100 bp upward shift of all yield curves at year-end.

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Interest rate risk (fair value sensitivity) in the banking book at year-end

	Shift (bps)	2015	2014
ISK non-indexed	100	-282	-183
ISK indexed	100	-6,040	-6,936
EUR	100	851	-339
USD	100	-433	-40
GBP	100	-3	13
JPY	100	-5	-3
CHF	100	-6	-5
Other	100	-16	-9
Total		**-5,934**	**-7,503**

5.4.4 Foreign exchange risk

Foreign exchange risk (FX risk) is the risk of losses due to exchange rate fluctuations. Foreign exchange risk within the Bank may arise from holding assets in one currency and liabilities in another, or from a spot or forward foreign exchange trade, currency swaps or other currency contracts which are not matched with an offsetting contract. The net FX balance at year-end 2015 can be seen in the table to the right:

5.4.5 Other market risk

Other market risk within the Group is comprised only of inflation risk. Inflation risk is the risk that the fair value or future cash flows of CPI-indexed financial instruments may fluctuate due to changes in the Icelandic CPI index. Mismatch between CPI-linked assets and liabilities exposes the Group to inflation risk.

The Group's total CPI indexation balance at year-end amounted to ISK 169 billion as compared to ISK 158 billion at year-end 2014.

In a scenario of ongoing high (low) inflation, floating unindexed interest rates are likely to remain higher (lower) than would be the case in the reverse scenario, thus counterbalancing the positive (negative) income effects for the Group in the longer term.

5.5 Market risk VaR

Landsbankinn uses value-at-risk (VaR) as a common ground for measuring market risk in different products. An internal VaR model is in place for the quantifi-

Net FX balance

	Net position at year-end	
	2015	2014
CHF	657	-418
EUR	11,869	17,276
GBP	1.884	578
JPY	401	233
USD	4,628	786
Other	4,356	-248
Total	**23,795**	**20,320**

66 All amounts are in ISK million Landsbankinn 2015

cation of market risk and estimation of economic capital for FX risk and interest rate risk in the trading book.

The Group calculates VaR at the 99% confidence interval with a time horizon of one day using one year of historical data. Both parametric and historical daily VaR for the Group's trading books in equity, fixed income and FX are calculated and reported to relevant parties.

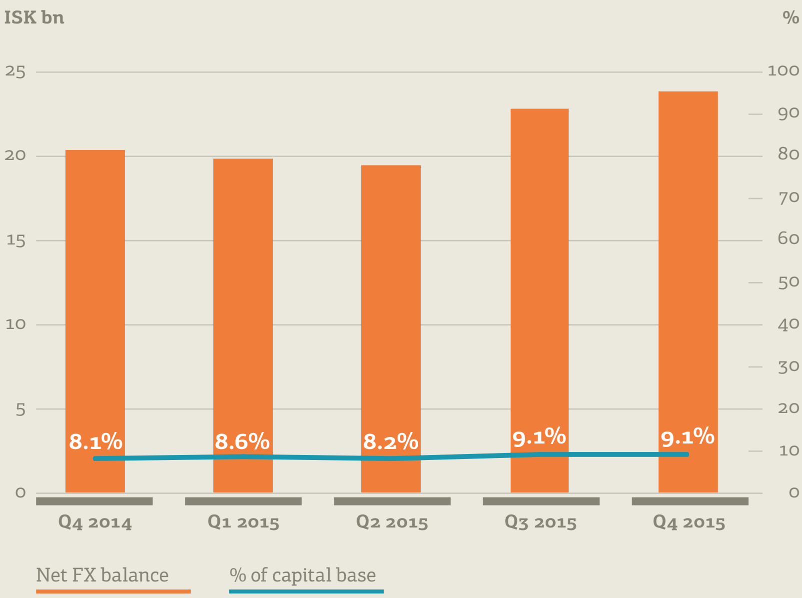
Back-testing is used to evaluate the quality and accuracy of the Group's VaR model. Back-testing is done according to the Basel II market risk framework comparing the output of the model (i.e. VaR numbers) to actual and hypothetical P&L values ("hypothetical" means using changes in portfolio value that would occur were end-of-day positions to remain unchanged). A period of one year is applied as a general reference.

Back-testing shows that the model works well, having less than four outliers on an annual basis, which is equal to the expected number of outliers given the confidence level.

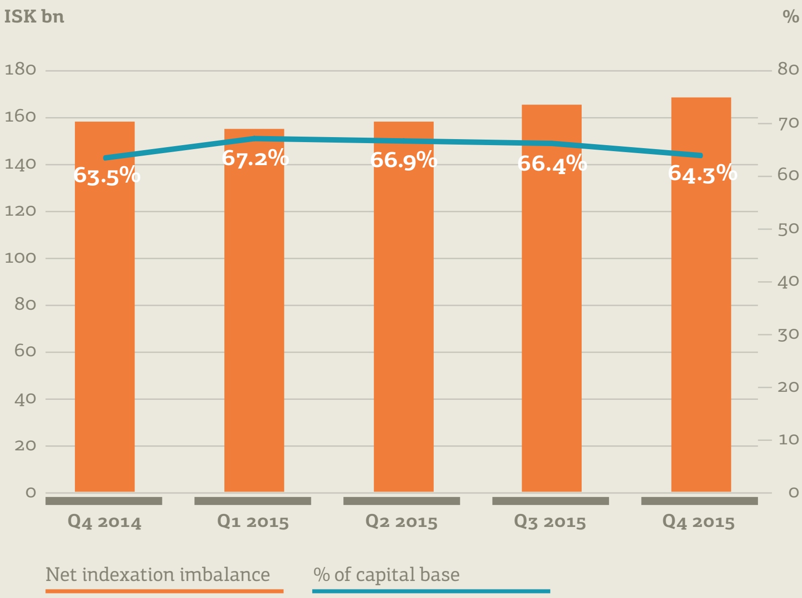
5.5.1 Stress test / sensitivity analysis

The Group conducts quarterly sensitivity analysis of its trading and non-trading portfolios with regards to equity and interest rate risk as well as a quarterly sensitivity analysis of its net FX balance, measuring sensitivity to currency risk.

Net FX balance



Indexation imbalance



6 Liquidity risk

Vestmannaeyjar

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting its obligations associated with financial liabilities that are settled by delivering cash or another financial asset, or of having to do so at excessive cost. This risk arises from earlier maturities of financial liabilities than financial assets.

Liquidity risk is identified as one of the Group's key risks. Accordingly, the Bank places great emphasis on liquidity risk management, reflected in both its risk appetite as well as in internal liquidity management policies and rules. In light of the changing regulatory environment as well as changes in the Bank's balance sheet and operating environment, even greater focus has been put on securing and maintaining a strong liquidity position, which is reflected in the Bank's business plan where moderate lending growth and increased debt issuance is assumed. As steps were taken towards the easing of capital controls with composition agreements and stability contributions by the estates of the fallen banks, there was an outflow of deposits from the Bank in December. This was in line with expectations and the Bank was well prepared to meet the outflow.

The Bank's liquidity position is strong at year-end and the Bank is well prepared for future changes in its operating environment, such as further steps towards lifting capital controls.

6.1 Identification

The Board has set a liquidity risk management policy for the Group. Liquidity risk management refers to the internal policies and procedures containing quantitative and qualitative objectives, limits and reporting put in place. The policy describes the manner in which the Group identifies, evaluates, measures, monitors, manages and reports its liquidity. The policy clearly outlines the structure, responsibilities and controls for managing liquidity risk within the Group and includes a contingency liquidity plan, along with a communication strategy. The contingency plan provides a framework for detecting an upcoming liquidity event with predefined early warnings and actions for preventing temporary or longer term liquidity disruptions.

6.2 Management

The objective of the liquidity management policy is to ensure that sufficient liquid assets and funding capacity are available to meet financial obligations and sustain withdrawals of confidence sensitive deposits in a timely manner and at a reason-

Short-term liquidity risk

» Intra-day
» 30 days (LCR)
» Stress testing

Longer-term liquidity risk

» Medium to long-term (NSFR)
» Cash flow projections
» Stress testing

Structural issues

» Balance sheet mismatches and maturity profiling
» Concentration of liquidity
» Contingency planning

LCR and NSFR regulatory implementation schedule

	2013	2014	2015	2016	2017
FX	100%	100%	100%	100%	100%
Total	60%	70%	80%	90%	100%

NSFR

	2013	2014*	2015	2016	2017
FX	N/A	80%	80%	90%	100%

* From December 1st

able cost, even under stressed conditions.

The policy aims to ensure that the Group maintains an adequate level of unencumbered, high-quality liquid assets that can readily be converted into cash. The Group has also implemented stress tests that have a realistic basis in the Group's operating environment to further measure the Group's ability to withstand different and adverse scenarios of stressed operating environments.

The Group's liquidity risk is managed centrally by Treasury and is monitored by Market Risk. This allows management to monitor and manage liquidity risk throughout the Group. The Risk & Finance Committee monitors the Group's liquidity risk, while the Bank's Internal Audit function assesses whether the liquidity management process is designed properly and operating effectively.

The Group's liquidity management process entails procedures, measurements, monitoring and reporting of both short-term and longer-term liquidity risk as well as structural issues in the balance sheet.

The liquidity management policy is largely built on the liquidity risk measurement framework defined in Basel III, as well as taking the Bank's current operating environment into account.

6.3 Assessment

The Group measures two key indicators, LCR and NSFR, to monitor and manage short-term liquidity risk and medium to long-term liquidity risk respectively.

The Group complies with the liquidity and funding rules set by the Central Bank of Iceland No. 1031/2014 and No. 1032/2014. The Central Bank Rules are based on the standards defined in Basel III but are adapted to Icelandic conditions e.g. including special requirements on foreign currency funding and treatment of risk related to the winding-up of estates of the fallen banks. The implementation schedule presented above shows the requirements of the LCR and NSFR set forth by the regulators.

Landsbankinn 2015 All amounts are in ISK million 71

In addition to measuring and monitoring the LCR and NSFR, the Bank follows FME guidelines No. 2/2010 on best practices for managing liquidity in banking organisations. The guidelines further promote sound management and supervision of liquidity within the Bank which is reflected in the Group's risk appetite and internal processes and policies.

The Group submits regularly reports on its liquidity position to the Central Bank and the FME.

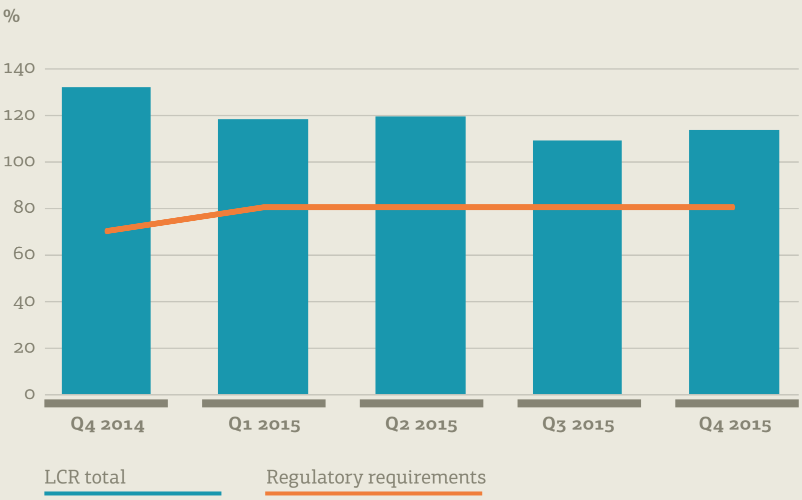
6.3.1 Liquidity Coverage Ratio (LCR)

The Group measures the Liquidity Coverage Ratio (LCR) as a key indicator for short-term liquidity. The objective of the ratio is to promote short-term resilience by ensuring that the Group has sufficient high-quality liquid assets to survive a significant stress scenario lasting 30 calendar days. The calculations for the ratio at year-end 2015 and 2014 are shown in the table on page 73.

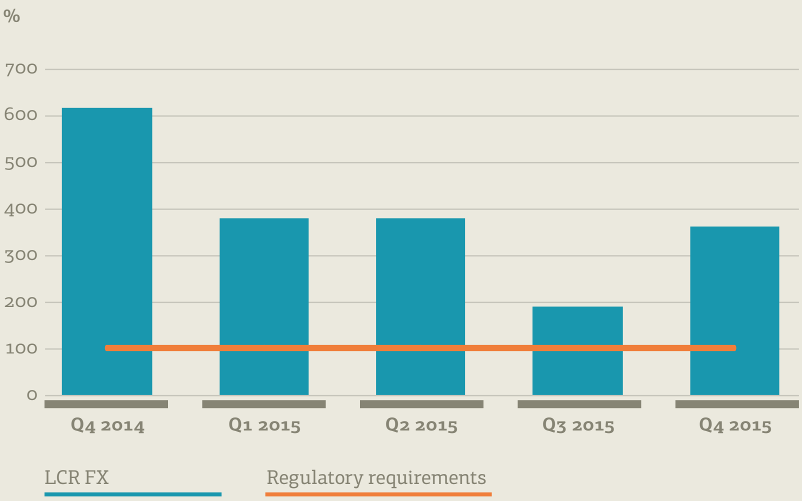
Estimated inflow and outflow weights, according to liquidity rules No. 1031/2014, are applied to the total balance amount for each group, reflecting the next 30 calendar days. Run off rates for deposits are shown in the table on page 74.

As can be seen the LCR FX decreased in the year 2015 due to changes in FX funding (see section 6.5).

Liquidity Coverage Ratio (total)



Liquidity Coverage Ratio (FX)



Liquidity Coverage Ratio

	Total		Foreign currencies	
As at 31 December 2015	**Unweighted**	**Weighted**	**Unweighted**	**Weighted**
Level 1 liquid assets	192,467	192,467	42,722	42,722
Level 2 liquid assets and information items	16,631	0	42	0
A. Total liquid assets	**209,098**	**192,467**	**42,764**	**42,722**
Deposits	408,785	148,337	61,340	27,645
Borrowing	1,014	1,014	1,014	1,014
Other outflows	185,594	54,110	30,721	3,557
B. Total outflows (0-30 days)	**595,393**	**203,461**	**93,075**	**32,216**
Loans and advances to financial institutions	17,581	16,376	17,581	16,376
Other inflows	48,369	17,440	8,155	3,963
Limit on inflows	0	0	0	0
C. Total inflows (0-30 days)	**65,950**	**33,816**	**25,736**	**20,339**
Liquidity Coverage Ratio: A/(B-C)		**113%**		**360%**

	Total		Foreign currencies	
As at 31 December 2014	**Unweighted**	**Weighted**	**Unweighted**	**Weighted**
Level 1 liquid assets	206,017	206,017	68,314	68,314
Level 2 liquid assets and information items	9,387	0	0	0
A. Total liquid assets	**215,404**	**206,017**	**68,314**	**68,314**
Deposits	411,670	174,587	73,287	41,845
Borrowing	620	620	620	620
Other outflows	169,506	46,501	31,500	2,028
B. Total outflows (0-30 days)	**581,796**	**221,708**	**105,407**	**44,493**
Loans and advances to financial institutions	37,933	32,978	37,933	32,978
Other inflows	74,493	31,173	22,148	10,654
Limit on inflows	0	0	0	-10,262
C. Total inflows (0-30 days)	**112,426**	**64,151**	**60,081**	**33,370**
Liquidity Coverage Ratio: A/(B-C)		**131%**		**614%**

Landsbankinn 2015 All amounts are in ISK million 73

Total deposits* by groups

As at 31 December 2015 — **0-30 days deposits balance by groups**

Groups	Less stable deposits	Applied run-off rate	Stable deposits	Applied run-off rate	Term deposits
1. Individuals	89,491	10%	70,745	5%	86,602
2. Small and medium size corporates	46,315	10%	10,187	5%	4,609
3. Operational deposits	7,069	25%	169	5%	229
3. Large corporates	61,185	40%	367	20%	25,645
4. Government, municipalities and Central Bank	29,124	40%	-	20%	642
5. Financial institutions in resolution process	19,273	100%	-	-	48,321
6. Financial institutions	63,417	100%	-	-	38,566
7. Other foreign counterparties	9,581	100%	1,862	25%	2,384
Total deposits	**325,455**		**83,330**		**206,998**

*Deposits and other liabilities due to financial institutions and Central Bank

As at 31 December 2014 — **0-30 days deposits balance by groups**

Groups	Less stable deposits	Applied run-off rate	Stable deposits	Applied run-off rate	Term deposits
1. Individuals	77,510	10%	64,060	5%	82,793
2. Small and medium size corporates	42,719	10%	9,630	5%	3,835
3. Operational deposits	6,574	25%	161	5%	286
3. Large corporates	58,949	40%	303	20%	18,317
4. Government, municipalities and Central Bank	28,233	40%	-	20%	857
5. Financial institutions in resolution process	49,018	100%	-	-	58,561
6. Financial institutions	40,241	100%	-	-	26,080
7. Other foreign counterparties	32,623	100%	1,650	25%	2,863
Total deposits	**335,867**		**75,804**		**193,592**

*Deposits and other liabilities due to financial institutions and Central Bank

6.3.2 Net Stable Funding Ratio (NSFR)

The Net Stable Funding Ratio has a longer time horizon and its objective is to capture structural issues in the balance sheet with the aim to provide a sustainable maturity structure of assets and liabilities. The aim of NSFR is to promote more medium and long term funding. It establishes a minimum acceptable amount of stable funding based on the Group's liquidity risk profile and limits over-reliance on short-term wholesale funding when markets are liquid.

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NSFR is defined as the ratio between the amount of available stable funding to the amount of required stable funding:

$$\text{NSFR} = \frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}}$$

Available stable funding is defined as the portion of capital and liabilities expected to be reliable over the time horizon considered by the NSFR. The amount of such stable funding required of the Bank is a function of the liquidity characteristics and residual maturities of the various assets held by that institution as well as those of its off-balance sheet exposures. The Group's NSFR in foreign currencies as of 31 December 2015 was 136%.

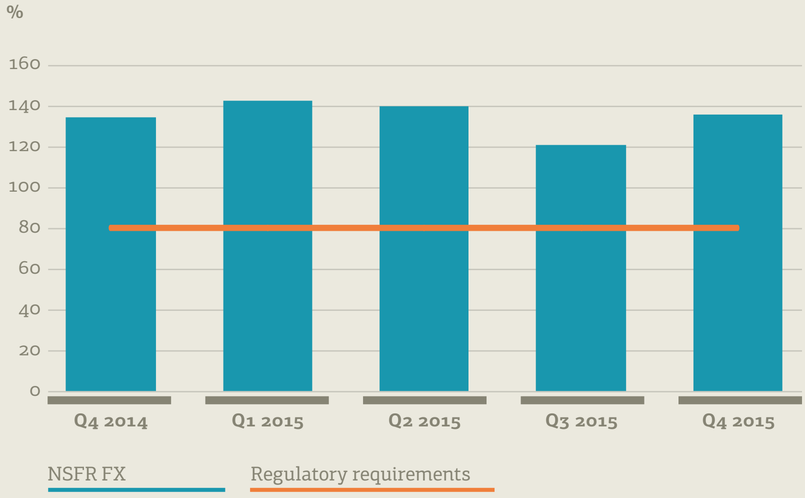
6.4 Control and monitoring

The Bank's Treasury Department is responsible for day-to-day liquidity management which entails closely monitoring current trends and potential market developments that may present significant and complex challenges for the Bank's liquidity strategy.

Liquidity risk is primarily controlled through limits set in the Group's risk appetite. Limit management is supplemented by regular monitoring and reporting of liquidity position under normal and stressed business conditions.

The Risk Management Division of the Bank regularly evaluates the Group's liquidity position and monitors internal and external events and factors that may affect the liquidity position.

Net Stable Funding Ratio (FX)



6.4.1 Liquidity Contingency Plan

The Bank has in place a contingency plan which is set to provide a framework for detecting an upcoming liquidity event with predefined early warning indicators and actions for preventing temporary or longer term liquidity disruptions.

The Liquidity Contingency Plan stipulates the actions which shall be taken to monitor the likelihood or imminence of the occurrence of a liquidity event or a confidence crisis. It also includes a detailed action plan and procedures for the managing of a liquidity event. The Contingency Plan includes the following items:

- A list of potential confidence crisis scenarios and their likely effects on the Bank's liquidity position;
- A list of potential liquidity events and their effects on the Bank's liquidity management.

The contingency plan is supplemented by monitoring of the early warning indicators along with their defined warning and trigger levels.

6.4.2 Stress test / sensitivity analysis

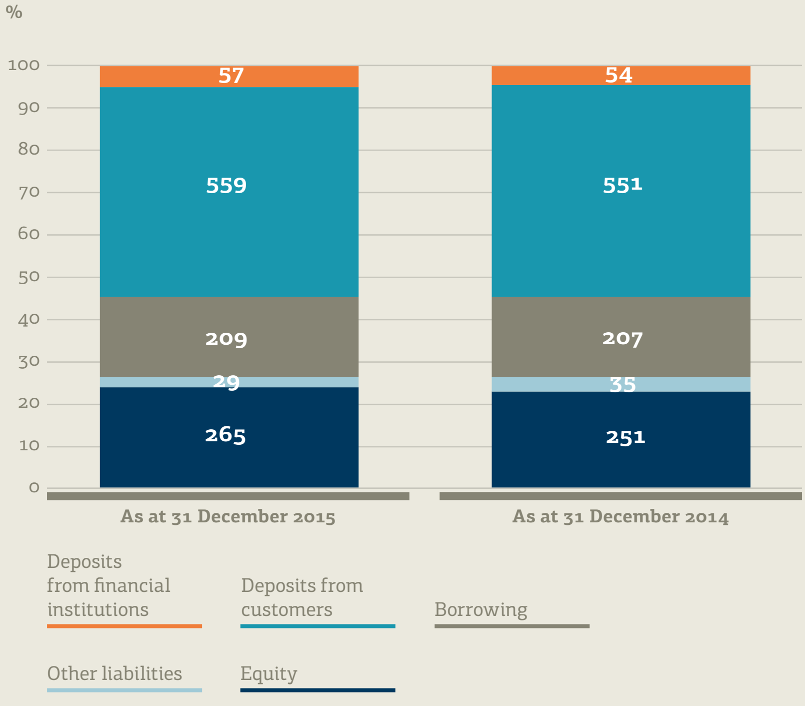
Various stress tests have been constructed to try to efficiently model how different scenarios affect the Group's liquidity position and liquidity risk. The stress tests are conducted weekly and measure the Group's ability to withstand deposit withdrawals under various levels of adverse conditions. These stress tests are set up to measure the Group's ability to operate in its current environment in Iceland, e.g. measure the effect of an easing of capital controls, as well as more general stress tests, e.g. loss of confidence in the Bank or a deposit competition/pricing scenario and other severe stress tests. The Group also performs other internal stress tests which may vary from time to time.

6.5 Funding and financing

Significant progress was achieved over the year 2015 in diversifying the Bank's funding profile, in particular in foreign currency. The Bank completed it's inaugural bond issuance under the Bank's EMTN programme in October 2015 with a EUR 300 million issuance and used the proceeds to repay maturities on secured bonds issued to LBI hf. The Bank was also an active issuer on the domestic bond market with issuance of covered bonds as well as with issuance of bills.

The Bank has a credit rating from Standard and Poor's and the Bank's credit rating is BBB- / A-3 with a positive outlook. The last rating action taken by S&P was in July 2015 when the Bank received an upgrade from BB+.

Funding profile



6.5.1 Funding

The Bank's funding is primarily divided into four parts. Deposits from customers are the Bank's primary funding source but the Bank also funds itself through borrowing in the form of bond issuance, both in the international markets in foreign currencies as well as in the domestic market in Icelandic kronur. Deposits from financial institutions are a source of funding for the Bank primarily in Icelandic kronur but have been decreasing in significance and will most likely continue to do so with the continued easing of capital controls. Last but not least the Bank finances itself with contributions from owners in the form of equity. The chart above shows the Bank's funding structure as of year-end 2015 and 2014.

EMTN Programme

As at 31 December 2015	Currency	Final maturity	Remaining principal	Contractual interest rate
Senior unsecured	EUR	19/10/18	300	3.00% fixed rate
Senior unsecured	NOK	08/06/19	250	NIBOR + 2.60%
Senior unsecured	SEK	08/06/19	250	STIBOR + 2.60%

6.5.2 Borrowing

6.5.2.1 EMTN Programme

The Bank has set up an EMTN programme to the amount of EUR 1 billion and the Bank completed its first bond issuance under the EMTN programme in October last year with a EUR 300 million issuance. The Bank followed that transaction with a NOK 250 million issuance and a SEK 250 million issuance, primarily sold to Nordic investors, in December 2015.

6.5.2.2 Secured bonds

The Bank issued foreign currency denominated bonds to LBI hf. in December 2009 as part of settlement when assets and liabilities of LBI hf. were transferred to the Bank. An amendment to the bonds was agreed upon and came into force in December 2014. The outstanding amount will be paid in bonds denominated in EUR and USD and maturing every second year. Interest rates will

Secured bonds

As at 31 December 2015	Currency	Final maturity	Remaining principal	Contractual interest rate (Base rate + initial margin / Step-up margin)
Bond D	USD	09/10/20	271	LIBOR + 2.90% / 3.50%
Bond E	EUR	09/10/22	192	LIBOR + 2.90% / 3.65%
Bond F	USD	09/10/24	271	LIBOR + 2.90% / 3.95%
Bond G	EUR	09/10/26	192	LIBOR + 2.90% / 4.05%

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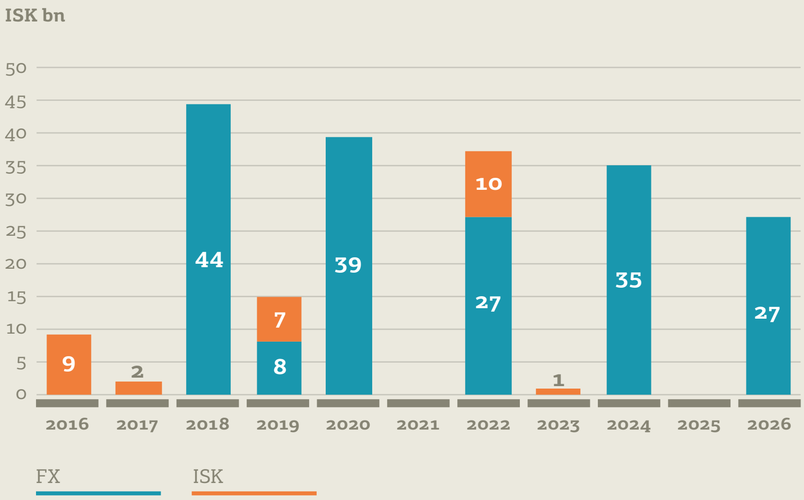
Covered bonds

As at 31 December 2015	Currency	Final maturity	Remaining principal	Fixed contractual interest rate
LBANK CB 16	ISK	10/06/16	3,420	6.30%
LBANK CB 17	ISK	23/10/17	1,800	6.00%
LBANK CB 19	ISK	17/09/19	7,280	6.80%
LBANK CBI 22	ISK	28/04/22	9,580	3.00%

Maturity profile



remain unchanged at a 2.9% margin until October 2018, stepping up to a 3.5% margin for the 2020 tranche to end at a 4.05% margin for the final maturity in 2026.

The Bank used to the proceeds from EUR 300 million EMTN issuance in October 2015 to make early repayments on the bonds that mature in October 2016 and partially on bonds that mature in October 2018. The Bank also prepaid the remaining outstanding amounts of the October 2018 maturity from which LBI hf. in turn invested the proceeds in foreign currency term deposits at the Bank, maturing in October 2018 and at terms equal to 150 basis points above interbank rates. Details on the secured bonds are shown in a table on page 77.

6.5.2.3 Covered bonds

The Bank has set up a ISK 100 billion covered bonds programme, the purpose of which is to provide funding for the Bank's mortgage loan portfolio and hedge the Bank's fixed interest rate risk exposure. The Bank issued one new series of bonds in 2015, LBANK CBI 22, a seven year CPI-linked fixed rate bond, as well as tap issues to pre-

Bills

As at 31 December 2015	Currency	Final maturity	Remaining principal
LBANK 16 0310	ISK	10/03/16	2,780
LBANK 16 0510	ISK	10/05/16	2,460
LBANK 16 0610	ISK	10/06/16	500

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existing issued bond series. At year-end 2015 the total nominal value of covered bonds outstanding amounted to ISK 22,080 million, up from 7,500 million ISK at year-end 2014 as shown in table on page 78.

6.5.2.4 Bills

The Bank set up an ISK 30 billion debt issuance programme in May 2015. The Bank will primarily issue bills under the programme and issued three series of bills in 2015 as shown in table on page 78.

Details on the Bank's maturity profile are shown in the chart on page 78.

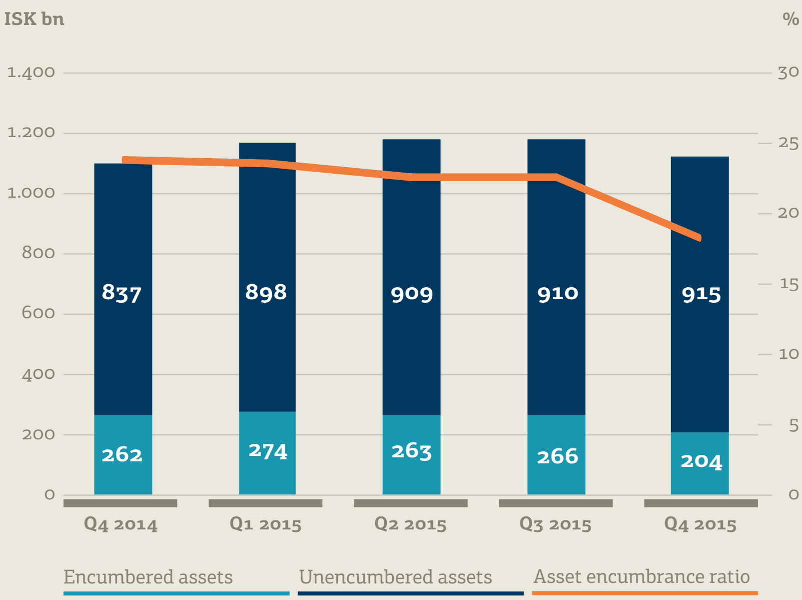
6.5.3 Asset encumbrance ratio

The Group's liquidity and funding risk framework includes measures of encumbered assets as a ratio to total assets. Encumbered assets are mainly comprised of loans and advances which are pledged against covered bonds and secured bonds issued by the Bank. Other encumbered assets are pledged as collateral to the Central Bank, pledged as collateral to secure trading lines and credit support for GMRA/ISDA master agreements and other pledges of similar nature.

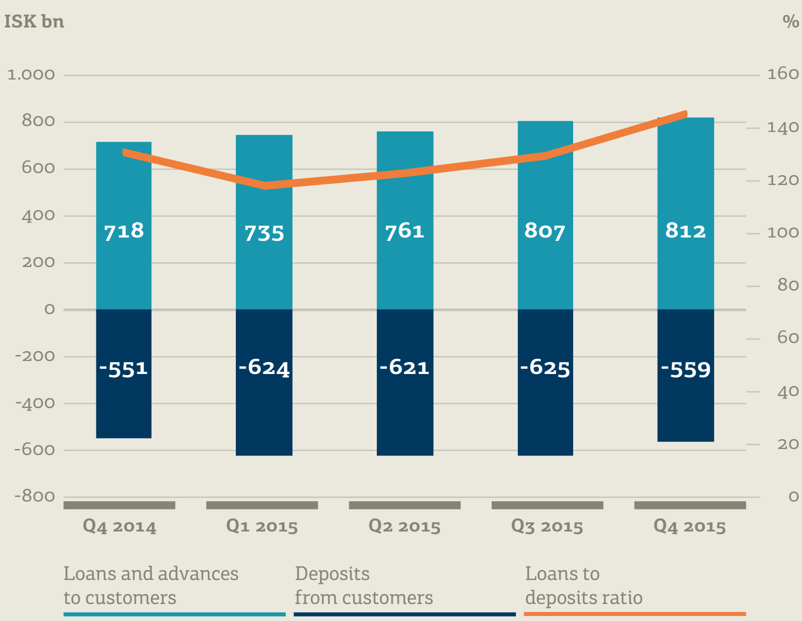
The asset encumbrance ratio was significantly reduced in Q4 following a prepayment of secured bonds issued to LBI hf. as is shown in the figure on the right hand side.

The ratio of loans to deposits is another indicator monitored within the Group's funding risk framework.

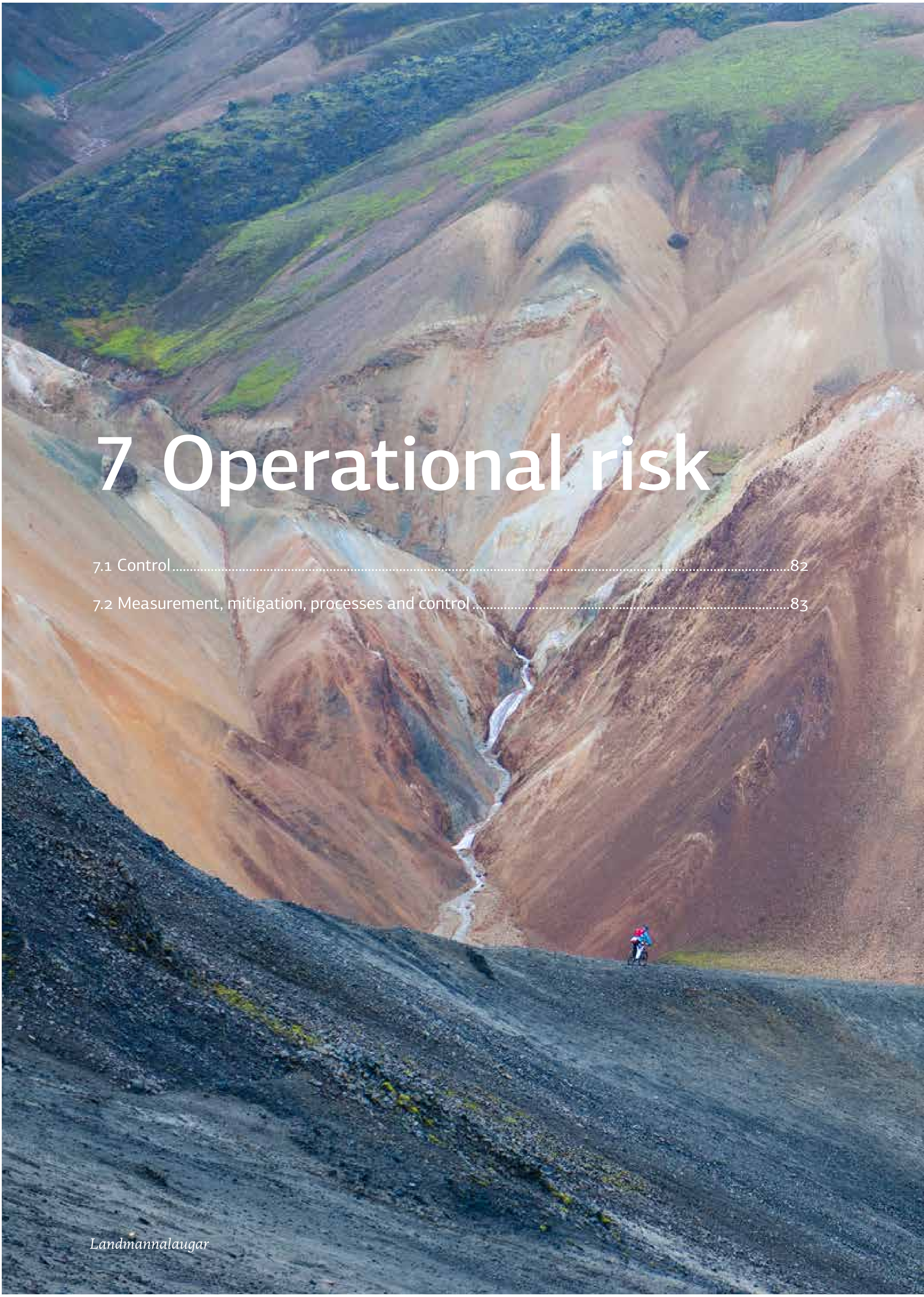
Asset encumbrance ratio



Loans to deposits ratio



As can be seen on the chart above, the ratio increased in 2015 reflecting increased lending to customers.



7 Operational risk

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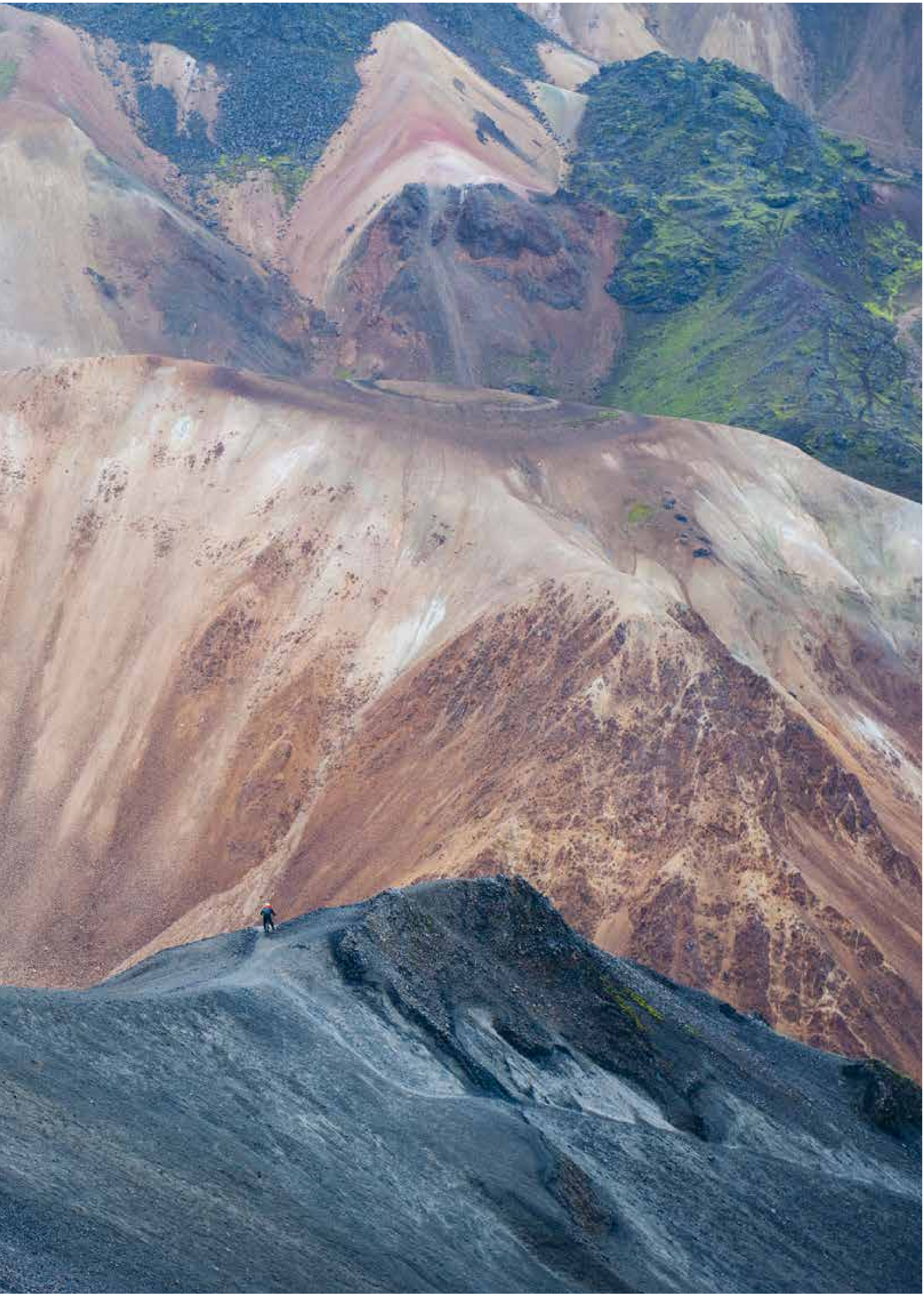


Operational risk

The Bank is exposed to operational risk through its activities. Loss may result from inadequate or failed internal processes, people and systems, or from external events. This includes factors such as legal and compliance risk and IT risk.

Legal and compliance risk is the risk to earnings and capital arising from failure to comply with statutory or regulatory obligations whereas IT risk deals with the risk of failure in IT systems. Both factors are relevant in the Bank's current environment.

The Bank identifies the types of operational risk to which it is exposed in order to better understand its operational risk profile and assess its vulnerability to these risks. The aim is to identify and assess the operational risk inherent in all existing or new material products, activities, processes and systems.

Effective operational risk identification and assessment processes are crucial in establishing a framework for operational risk monitoring and control.

In identifying operational risk, the Bank examines both internal and external factors that could adversely affect its performance and prevent the achievement of its objectives, such as:

- Risk culture, human resource management practices, organizational changes and employee turnover
- The nature of the Bank's customers, products, contractors and activities, including sources of business, distribution mechanisms and volume of transactions
- The design, implementation, review and operation of the processes and systems involved in the operating cycle of the Bank's products and activities
- The external operating environment and industry trends, including political, legal, technological and economic factors, as well as the competitive environment and market structure

7.1 Control

The Board of Directors sets the Bank's policy regarding operational risk and risk appetite. Detailed rules on operational risk are in two parts. The first part is approved by the Board; the second part by the CEO. The rules set out the policy regarding operational risk, the roles and responsibilities of stakeholders in the Bank and the operational risk tolerance in terms of limits.

Managers are responsible for the operational risk in their departments. The Operational Risk Committee is a venue for decisions and discussions on operational risk, this includes IT risk and physical security. Rules and procedures connected to operational risk are approved by the committee.

The Operational Risk Department is a part of the Risk Management Division and is responsible for developing and maintaining the framework for managing operational risk and supporting the organization in the implementation of the framework. Part of this framework are the business continuity plans of the Bank as well as the security system for the online bank. The Department is also responsible for the ISO 27001 certification of the Bank.

Internal Audit is responsible for auditing the effectiveness of the operational risk framework and the work of the Operational Risk Department.

Operational risk measurements are reported to the Board in a comprehensive manner as a part of the regular reporting done by Risk Management. Managing directors review semi-annual reports on the key risk indicators relevant to operations under their control.

7.2 Measurement, mitigation, processes and control

In order to understand the effects of the exposures to operational risks the Bank continually assesses its operational risks. A number of tools are used to identify and assess operational risk.

- Self-assessment. The Bank assesses its operations and activities against a menu of potential risk vulnerabilities. As a part of this internally driven procedure, the Bank has set up a well-documented process to identify strengths and weaknesses in the operational risk environment. The self-assessment is done by senior directors for operations under their control and then reported up to managing directors. This is done on a two year cycle and more often if there are material changes in the operational risk environment of departments. The self-assessment identifies control gaps, enabling appropriate corrective action to be taken;
- Risk mapping. This process involves mapping all reported incidents by risk type and to business units. This exercise reveals areas of weakness, leads to corrective action and assists in prioritizing subsequent management action;
- Key risk indicators (KRIs) are statistics and/or metrics, often financial, which can provide insight into the Bank's risk position. These indicators are reviewed periodically to alert the Bank of changes that indicate risk concerns;
- The Bank is certified in adherence to ISO 27001, the international standard on information security. This standard helps the Bank in assessing and monitoring operational risk in the certified areas.

"Execution, delivery and process management" has had the largest number of events, 27 in 2013, 49 in 2014 and 34 in 2105.

The Bank categorizes operational incidents into deviation from rules or processes, weakness in processes or systems, external circumstances or security violations.

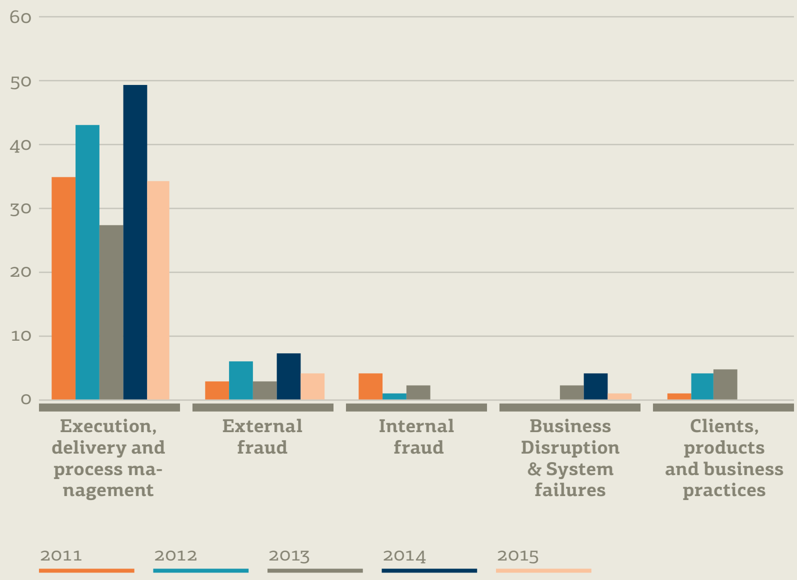
7.2.1 Mitigation

The Bank utilizes insurance as a part of its mitigation technique when it comes to operational risk. This is done through a Bankers' Comprehensive Crime policy.

Clear procedures are in place regarding the mitigating actions that result from self-assessment. There are separate procedures in place for how the Bank handles operational incidents and corrective and mitigating actions resulting from these incidents.

The architecture of the Bank's information systems is based on two mirrored data centres, primary and secondary, located in two different buildings linked with high speed communication. This setup allows the Bank to run its core systems with access to mission critical data even though one data centre (for instance the primary data centre) becomes unusable. In the event of a failure, core systems will switch automatically from one site (the failed one) to the other.

Number of loss incidents based on Basel II classification



There are business continuity plans in place for all operations considered to be mission critical to the Bank. These plans are all tested on a yearly basis, apart from the IT Department's plan which is tested more frequently.

7.2.2 Control and monitoring

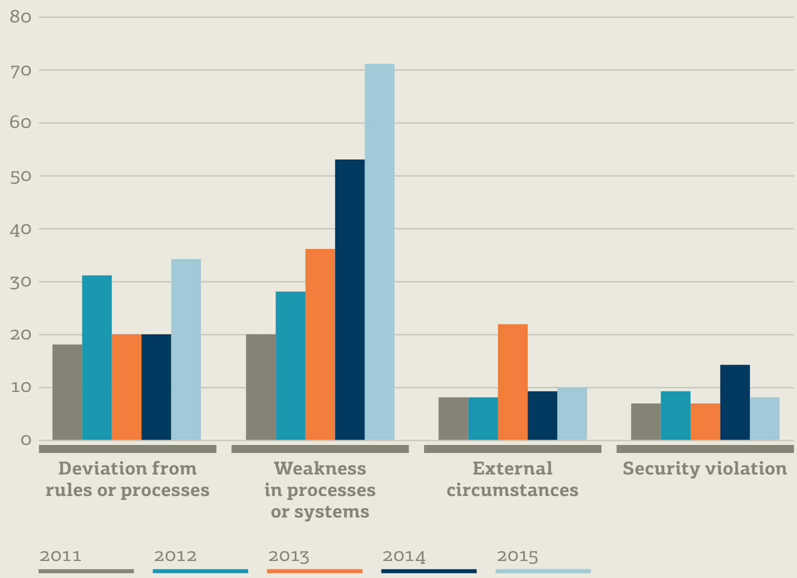
The Board and the CEO set detailed policy on operational risk governance and responsibilities. Day-to-day management of operational risk is a part of all managers' responsibilities and they are also responsible for monitoring and controlling the operational risk in their departments. Managers evaluate operational risk through risk self-assessment, focusing on key risks identified with top-down management involvement.

Information security, physical security, education and training activities are important components of the management of operational risk and close co-operation is maintained with the relevant departments involved in these processes. Internal Audit and Compliance are key functions in the framework which the Bank has established to monitor and control operational risk.

Incident reporting, auditing and follow-up is an important part of operational risk management as the identification and remedial action helps to limit losses resulting from inadequate and failed processes. The Operational Risk Department is responsible for business continuity management and for maintaining the Bank's disaster recovery plans.

A number of documents, policies, rules and work procedures cover key aspects of the responsibilities of the Operational Risk Department. Those include the Bank's policy on information security, rules on operational risk, rules on information security, rules on operational risk assessment and rules on documents and document handling.

Operational incidents



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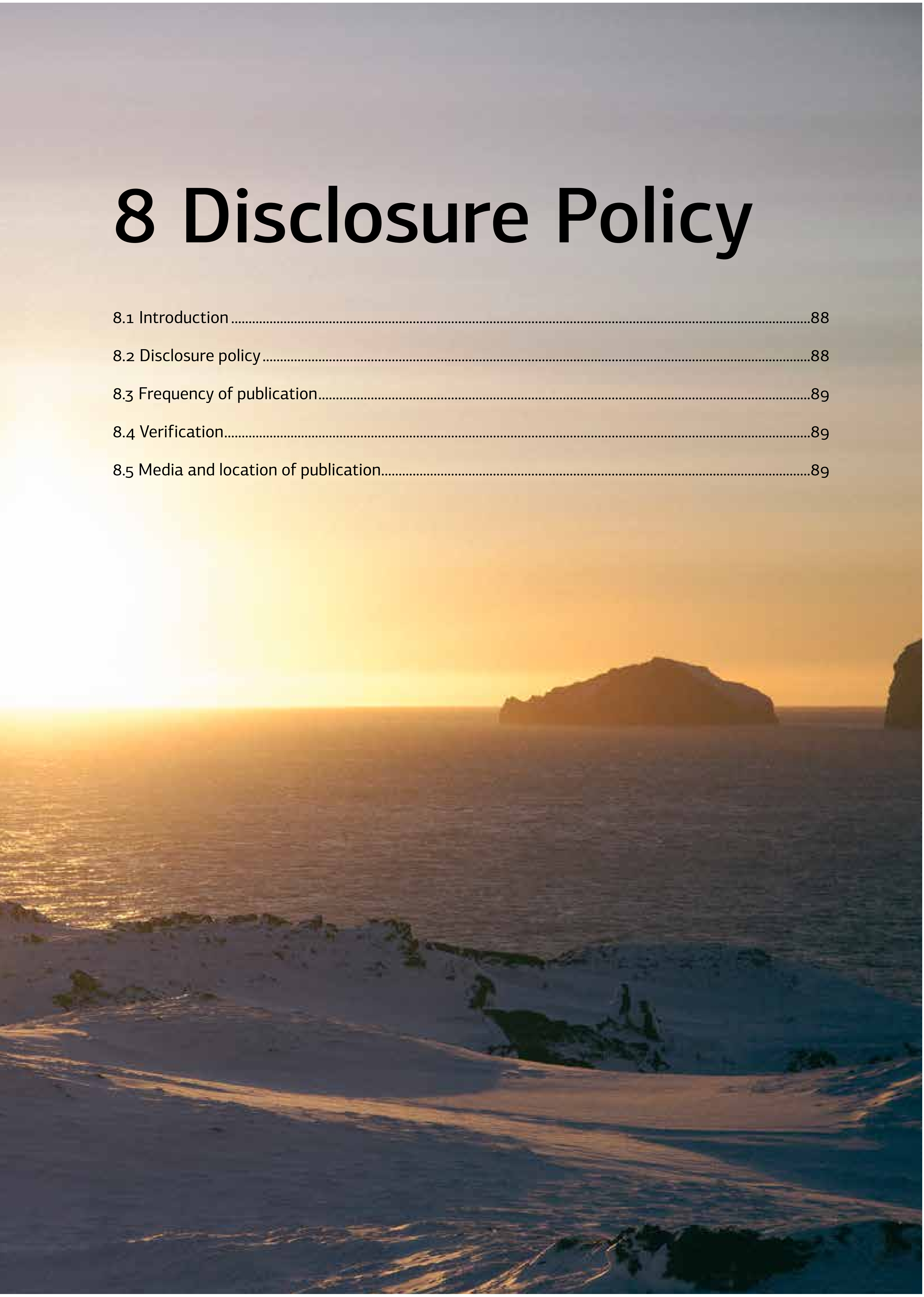

8 Disclosure Policy

Disclosure Policy

8.1 Introduction

The Basel II Accord, implemented in the European Union through the Capital Requirements Directive (CRD 2006/48&49/EC ('the Directive')) establishes a revised regulatory capital framework across Europe governing the amount and nature of capital that must be maintained by credit institutions. The Directive is included in Icelandic financial legislation as part of the European Economic Area (EEA) agreement, but discrete national requirements for Icelandic banks on Pillar III disclosures have not yet been determined by the Icelandic Financial Supervisory Authority (FME).

The Basel II framework consists of three 'Pillars':

- Pillar I sets out the minimum capital amount that meets the firm's credit, market and operational risk;
- Pillar II requires the firm to assess whether its Pillar I capital is adequate to meet its risks (Internal Capital Adequacy Assessment Process, ICAAP) and is subject to annual review by the FME in the Supervisory Review and Evaluation Process (SREP);
- Pillar III requires disclosure of specified information about the underlying risk management controls and capital position.

This publication, Risk and Capital Management 2015, reviews the Group's organisation and processes relating the identification and management of the risk type characteristic of a financial group with its type of business concept. It also describes the Group's risk position on the basis of the requirements under Pillar III.

8.2 Disclosure policy

In accordance with the Directive, the Group has adopted a formal disclosure policy in that it will comply with the requirement to publicly disclose relevant information.

The rules provide that one or more of the required disclosures may be omitted if it is believed that the information is immaterial. Materiality is based on the criteria that the omission or misstatement of material information would be likely to change or influence the assessment or decision of a user relying on that information for the purposes of making economic decisions. If disclosure is considered to be immaterial, it will be stated in the relevant section.

One or more of the required disclosures may be omitted where it is believed that the information is regarded as proprietary or confidential. Proprietary information is that which, if it were shared, would undermine a competitive position. Information is considered to be confidential where there are obligations binding the Group to confidentiality with customers and counterparties. If information is omitted for either of these reasons, it will be stated in the relevant section along with the rationale. Further general information on the subject of required disclosures will be published where appropriate.

8.3 Frequency of publication

The disclosures will be reviewed on an annual basis at a minimum and, if appropriate, more frequently. Disclosures will be published as soon as is practicable following any revisions.

8.4 Verification

The disclosures have been put together to explain the basis of preparation and disclosure of certain capital requirements and provide information about the management of certain risks and for no other purposes. They do not constitute any form of audited financial statement and have been produced solely for the purpose of Pillar III. They should not be relied upon in making judgements about the Group. The disclosures will only be subject to external verification to the extent that they are equivalent to those made under accounting requirements.

The disclosures are reviewed and approved by the Group's Board of Directors and Executive Board.

This publication, Risk and Capital Management 2015, has not been audited by external auditors. However, it has been appropriately verified internally and includes information from the audited 2015 Consolidated Financial Statements. There may be some discrepancy between financial information in the Consolidated Financial Statement 2015 and information in the Risk and Capital Management 2015 as the report has been prepared in accordance with the Capital Requirements Directive and the Basel II capital framework, rather than in accordance with IFRS.

8.5 Media and location of publication

The disclosures will be published on the Landsbankinn website and will also be made available upon written request to Investor Relations, ir@landsbankinn.is.

9 Appendix

9.1 Landsbankinn's 2015 Remuneration report

9.1.1 Introduction

Landsbankinn emphasises hiring and employing exceptional personnel. The aim of the remuneration policy is to make Landsbankinn a desirable workplace for qualified employees to ensure the Bank's competitiveness, continued development and acceptable profitability. The remuneration policy shall support sound operations in the long term and not encourage unreasonable risk-taking. It is the Bank's aim that the terms of employment of executives and other employees are competitive without being leading in the market. In determining terms of employment, responsibility and performance shall be taken into account, as well as equal rights perspectives.

9.1.2 Governance

The remuneration policy of Landsbankinn shall be approved by its Board of Directors. Furthermore, the remuneration policy shall be submitted to the Bank's Annual General Meeting (AGM) for approval or rejection. The remuneration policy may be reviewed more than annually and any amendments submitted to a shareholders' meeting for approval. The remuneration policy serves as an indicative guideline for the Bank and the Board of Directors. The Board of Directors shall enter any deviations from the remuneration policy and substantiation thereof in the minutes. Deviations shall be presented to the Bank's next AGM.

The Remuneration Committee of Landsbankinn is comprised of three board members. The role of the Remuneration Committee is to guide the Board of Directors and CEO in deciding on the terms of employment of key executives and to advise on the remuneration policy. The Committee shall ensure that the terms of employment of the Bank's executives are within the framework provided by the remuneration policy and report on its implementation yearly in connection with the Bank's AGM. The Committee shall monitor the developments of collective bargaining agreements, trends in salary expenses and number of employees. The Board of Directors has issued

Terms of Reference for the Committee in which its role and duties are defined.

In the year 2015 the Remuneration committee members are Tryggvi Pálsson (Chairman), Helga Björk Eiríksdóttir and Jóhann Hjartarson.

9.1.3 Remuneration policies for Landsbankinn Board of Directors and CEO

Board members shall receive set monthly remuneration in accordance with the decision of the AGM each year as provided for in Article 79 of Act No. 2/1995, on Public Limited Companies. In determining the remuneration amount, consideration shall be taken to the hours spent on the job, the responsibilities borne by the board members and the company's performance. The Remuneration Committee presents the Board of Directors with a substantiated proposal for remuneration to Board members in the coming operating year. The Board of Directors deliberates on the Committee's proposal and submits a final proposal on remuneration to the AGM. The Bank reimburses Directors domiciled outside the capital region for travel expenses. Board members may not conclude severance agreements with the Bank.

The Board of Directors appoints the Bank's CEO. The terms of employment of the CEO shall be competitive with the terms offered managers in larger companies and in the financial market without leading the market.
The CEO hires the Bank's key executives and their terms of employment shall be competitive without leading the market.

However, the National Treasury of Iceland being the largest shareholder in the Bank, the CEO's terms of salary and employment conditions are subject to the Senior Civil Servant's Salary Board's decision. The Senior Civil Servant's Salary Board is an independent board which is entrusted with the task of deciding salaries and remuneration of senior state officials.

Landsbankinn makes public the terms of employment of Directors and key executives in its annual report.


Brúarhlöður

CRD, annex XII, part 2, point 6 c)

Credit exposure (EAD)	2014	2015	
ISK million	At 31 December	Average	At 31 December
Standardised approach for credit risk			
Central governments and central banks	186,940	202,322	167,524
Corporate customers	384,705	428,803	451,128
Institutions	50,088	56,390	22,243
Regional governments and local authorities	10,870	9,577	8,575
Retail customers	126,934	129,501	129,776
Exposures secured by real property	228,538	257,370	265,208
Standardised approach for credit risk, total	**988,076**	**1,083,963**	**1,044,455**

9.2 Further disclosures required under Pillar III

This appendix addresses further disclosure requirements stipulated by the EU Capital Requirements Directive (CRD).

9.2.1 Credit risk

In this section the Group in some cases reports exposure values as Exposure at Default (EAD). This is addressed specifically where applicable. Risk and Capital Management 2015, section 4, on the other hand, is based on accounting data.

CRD, annex XII, part 2, point 6 e)

Credit exposure (EAD) broken down by industry

At 31 December 2015 (ISK million)	Financial institutions	Public entities	Individuals	Fisheries	Construction and real estate companies	Holding companies	Retail	Services	ITC	Manu-facturing	Agriculture	Other	Total
Standardised approach for credit risk													
Central governments and central banks	-	167,524	-	-	-	-	-	-	-	-	-	-	**167,524**
Corporate	-	15,948	3,219	157,142	128,217	24,592	29,383	49,105	15,515	22,105	5,857	45	**451,128**
Institutions	22,243	-	-	-	-	-	-	-	-	-	-	-	**22,243**
Regional governments and local authorities	-	8,399	18	-	-	-	-	115	43	-	-	-	**8,575**
Retail	-	151	81,911	3,512	12,725	2,225	6,839	14,838	1,093	2,935	3,499	50	**129,776**
Retail exposures secured by real property	-	163	209,513	3,032	32,807	1,253	4,499	9,304	149	3,608	852	28	**265,208**
Standardised approach for credit risk total	**22,243**	**192,186**	**294,660**	**163,686**	**173,749**	**28,070**	**40,721**	**73,361**	**16,800**	**28,648**	**10,208**	**123**	**1,044,455**

CRD, annex XII, part 2, point 6 e)

Credit exposure (EAD) broken down by industry

At 31 December 2014 (ISK million)	Financial institutions	Public entities	Individuals	Fisheries	Construction and real estate companies	Holding companies	Retail	Services	ITC	Manu-facturing	Agriculture	Other	**Total**
Standardised approach for credit risk													
Central governments and central banks	-	186,940	-	-	0	-	-	-	-	-	-	-	**186,940**
Corporate	-	6,507	3,261	153,910	81,506	38,703	28,103	29,994	17,142	19,346	4,911	1,322	**384,705**
Institutions	50,088	-	-	-	-	-	-	-	-	-	-	-	**50,088**
Regional governments and local authorities	-	10,105	38	-	143	-	-	539	45	-	-	-	**10,870**
Retail	-	101	82,777	3,247	11,611	1,936	7,267	12,470	839	3,211	3,433	43	**126,934**
Retail exposures secured by real property	-	333	158,980	6,091	33,018	3,972	6,521	14,320	266	4,265	707	65	**228,538**
Standardised approach for credit risk total	**50,088**	**203,987**	**245,056**	**163,248**	**126,278**	**44,610**	**41,891**	**57,322**	**18,292**	**26,822**	**9,052**	**1,429**	**988,076**

CRD, annex XII, part 2, point 6 f)

Credit exposure (EAD) broken down by maturity

At 31 December 2015 (ISK million)	< 1 year	≥ 1 year < 2 years	≥ 2 years < 3 years	≥ 3 years < 4 years	≥ 4 years < 5 years	≥ 5 years	Total
Standardised approach for credit risk							
Central governments and central banks	60,418	40	106,887	20	19	140	**167,524**
Corporate	133,769	47,350	48,401	43,872	57,249	120,487	**451,128**
Institutions	22,104	3	40	6	56	34	**22,243**
Regional governments and local authorities	688	44	131	236	2,044	5,431	**8,575**
Retail	40,863	4,665	6,050	8,172	7,851	62,175	**129,776**
Retail exposures secured by real property	9,383	1,879	3,564	4,900	2,882	242,601	**265,208**
Standardised approach for credit risk, total	**267,227**	**53,981**	**165,072**	**57,206**	**70,101**	**430,868**	**1,044,455**

CRD, annex XII, part 2, point 6 f)

Credit exposure (EAD) broken down by maturity

At 31 December 2014 (ISK million)		≥ 1 year	≥ 2 years	≥ 3 years	≥ 4 years		**Total**
	< 1 year	< 2 years	< 3 years	< 4 years	< 5 years	≥ 5 years	
Standardised approach for credit risk							
Central governments and central banks	73,793	6,412	19	106,690	3	23	**186,940**
Corporate	122,997	48,851	43,191	43,881	40,131	85,655	**384,705**
Institutions	50,027	3	14	19	1	24	**50,088**
Regional governments and local authorities	2,104	429	2,074	84	288	5,891	**10,870**
Retail	45,649	4,106	6,976	6,860	7,702	55,641	**126,934**
Retail exposures secured by real property	6,418	5,331	2,895	1,111	8,745	204,038	**228,538**
Standardised approach for credit risk, total	**300,987**	**65,132**	**55,169**	**158,644**	**56,872**	**351,272**	**988,076**

Loans and advances by industry sectors

				Individually impaired				
				Of which performing		Of which non-performing		
31/12/15	Gross carrying amount	Gross not individually impaired	Collective allowance	Gross carrying amount	Individual allowance	Gross carrying amount	Individual allowance	Carrying amount
Financial institutions	20,791	20,791	0	0	0	0	0	20,791
Public entities	8,969	8,507	-8	429	-204	32	-18	8,738
Individuals	303,349	283,635	-1,967	4,937	-2,273	14,777	-8,147	290,962
Corporates	532,888	496,264	-3,482	23,167	-9,813	13,458	-7,745	511,849
Construction and real estate companies	162,090	150,708	-1,431	6,468	-2,618	4,914	-2,708	155,334
Holding companies	48,649	47,671	-343	266	-155	713	-540	47,612
Fisheries	162,160	157,545	-224	1,762	-901	2,853	-1,519	159,515
Manufacturing	29,384	22,052	-231	6,466	-1,335	867	-615	27,205
Agriculture	10,440	9,631	-71	571	-166	237	-85	10,118
ITC	15,787	15,526	-137	12	-3	249	-145	15,502
Retail	38,069	35,198	-325	1,489	-923	1,382	-800	36,021
Services	66,233	57,857	-719	6,133	-3,712	2,243	-1,333	60,469
Other	76	76	-1	0	0	0	0	75
Total	**865,997**	**809,197**	**-5,457**	**28,533**	**-12,290**	**28,267**	**-15,910**	**832,340**

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Loans and advances by industry sectors

				Individually impaired				
				Of which performing		Of which non-performing		
31/12/14	Gross carrying amount	Gross not individually impaired	Collective allowance	Gross carrying amount	Individual allowance	Gross carrying amount	Individual allowance	Carrying amount
Financial institutions	49,789	49,789	0	0	0	0	0	49,789
Public entities	13,831	13,717	-25	59	-57	56	-42	13,708
Individuals	254,955	228,952	-2,240	7,118	-3,776	18,884	-10,007	238,932
Corporates	491,015	439,910	-5,452	37,612	-12,196	13,494	-7,653	465,715
Construction and real estate companies	119,926	109,274	-1,552	6,119	-2,850	4,534	-2,644	112,880
Holding companies	45,451	31,250	-603	13,443	-1,451	758	-535	42,861
Fisheries	162,507	150,959	-637	8,881	-4,497	2,667	-1,350	156,023
Manufacturing	30,837	24,323	-433	5,276	-1,015	1,238	-629	28,760
Agriculture	9,269	8,785	-104	126	-122	358	-293	8,751
ITC	20,454	20,219	-486	86	-61	149	-109	19,798
Retail	42,198	37,788	-491	2,752	-1,621	1,657	-968	39,118
Services	59,228	56,167	-1,137	929	-579	2,133	-1,125	56,387
Other	1,145	1,145	-8	0	0	0	0	1,137
Total	**809,590**	**732,368**	**-7,716**	**44,789**	**-16,029**	**32,434**	**-17,702**	**768,144**

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The tables below show the Group's maximum credit risk exposure at 31 December 2015 and 2014. For on-balance sheet assets, the exposures set out below are based on net carrying amounts as reported in the statement of financial position. Off-balance sheet amounts in the tables below are the maximum amounts the Group might have to pay for guarantees, loan commitments in their full amount, and undrawn overdraft and credit card facilities.

At 31 December 2015	**Financial institutions**	**Public entities***	**Individuals**	**Fisheries**	**Construction and real estate companies**	**Services**	**Retail**	**Holding companies**	**Manufacturing**	**Agriculture**	**Information, technology and communication**	**Other**	**Carrying amount**
Cash and balances with Central Bank	-	25,164	-	-	-	-	-	-	-	-	-	-	25,164
Bonds and debt instruments	1,356	192,275	-	-	8516	-	-	123	-	-	-	1414	203,684
Derivative instruments	47	2	1	90	108	-	-	-	-	-	-	39	287
Loans and advances to financial institutions	20,791	-	-	-	-	-	-	-	-	-	-	-	20,791
Loans and advances to customers	-	8,738	290,961	159,514	155,334	60,469	36,021	47,612	27,205	10,118	15,502	75	811,549
Other financial assets	4,178	582	438	8	866	452	119	31	230	1	1	12	6,918
Total on-balance sheet exposure	**26,372**	**226,761**	**291,400**	**159,612**	**164,824**	**60,921**	**36,140**	**47,766**	**27,435**	**10,119**	**15,503**	**1,540**	**1,068,393**
Off-balance sheet exposure	**689**	**16,940**	**25,095**	**23,018**	**43,835**	**15,537**	**15,615**	**1,158**	**9,597**	**620**	**3,797**	**154**	**156,055**
Financial guarantees and underwriting commitments	26	1,422	777	7,210	2,022	1,993	2,278	60	653	27	1,070	99	17,637
Undrawn loan commitments	-	8,111	100	11,511	37,647	6,726	6,888	723	6,518	167	1,584	-	79,975
Undrawn overdraft/Credit card facilities	663	7,407	24,218	4,297	4,166	6,818	6,449	375	2,426	426	1,143	55	58,443
Maximum exposure to credit risk	**27,061**	**243,701**	**316,495**	**182,630**	**208,659**	**76,458**	**51,755**	**48,924**	**37,032**	**10,739**	**19,300**	**1,694**	**1,224,448**
Percentage of carrying amount	2.2%	19.9%	25.8%	14.9%	17.0%	6.2%	4.2%	4.0%	3.0%	0.9%	1.6%	0.1%	100.0%

*Public entities consist of central government, state-owned enterprises, central banks and municipalities

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At 31 December 2014	Financial institu-tions	Public entities*	Indi-viduals	Fisheries	Construc-tion and real estate companies	Services	Retail	Holding compa-nies	Manufac-turing	Agricul-ture	Information, technology and commu-nication	Other	Carrying amount
Cash and balances with Central Bank		10,160											10,160
Bonds and debt instruments	101	221,293			13345			7,808				1042	243,589
Derivative instruments	38		7					1				32	78
Loans and advances to financial institutions	49,789												49,789
Loans and advances to customers	-	13,708	238,932	156,023	112,880	56,387	39,118	42,861	28,760	8,751	19,798	1,137	718,355
Other financial assets	913	343	331		614	711	130	71	16,554	1	3	62	19,733
Total on-balance sheet exposure	**50,841**	**245,504**	**239,270**	**156,023**	**126,839**	**57,098**	**39,248**	**50,741**	**45,314**	**8,752**	**19,801**	**2,273**	**1,041,704**
Off-balance sheet exposure	**2,648**	**13,688**	**22,507**	**28,197**	**33,802**	**12,652**	**11,143**	**5,150**	**8,974**	**525**	**3,423**	**706**	**143,415**
Financial guarantees and underwriting commitments	45	611	572	7,740	1,917	2,250	2,240	3,525	559	37	673	331	20,500
Undrawn loan commitments	0	7,238	0	17,956	29,877	578	4,926	913	6,510	182	1,763	174	70,117
Undrawn overdraft/Credit card facilities	2,603	5,839	21,935	2,501	2,008	9,824	3,977	712	1,905	306	987	201	52,798
Maximum exposure to credit risk	**53,489**	**259,192**	**261,777**	**184,220**	**160,641**	**69,750**	**50,391**	**55,891**	**54,288**	**9,277**	**23,224**	**2,979**	**1,185,119**
Percentage of carrying amount	4.5%	21.9%	22.1%	15.5%	13.6%	5.9%	4.3%	4.7%	4.6%	0.8%	2.0%	0.3%	100.00%

*Public entities consist of central government, state-owned enterprises, central banks and municipalities

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The loan-to-value (LTV) ratio expresses the maximum exposure of credit risk (gross carrying amount of loans and off-balance sheet items) as a percentage of the total value of collateral less a haircut. Loan-to-value is one of the key risk factors assessed when qualifying borrowers for a loan. The risk of default is always at the forefront of lending decisions, and the likelihood of a lender absorbing a loss in the foreclosure process increases as the collateral value decreases. A high LTV indicates that there are smaller buffers to protect against price falls or increases in the loan if repayments are not made and interest is added to the outstanding balance.

31/12/15	LTV Ratio – Fully collateralised					LTV Ratio – Partially collateralised				
	0% - 25%	25% - 50%	50% - 75%	75% - 100%	Total	>100%	Collateral value	Without collateral	Allowance for impairment	Maximum exposure to credit risk
Financial institutions	0	0	0	0		0	0	21,481	0	21,481
Public entities	17	67	216	923	1,223	3,878	345	20,808	-230	25,678
Individuals	12,845	29,481	47,567	79,042	168,934	75,991	56,067	83,519	-12,388	316,057
Corporates	6,862	20,236	69,093	137,952	234,143	328,608	191,538	83,467	-21,039	625,180
Fisheries	1,033	5,042	8,804	32,590	47,469	136,514	72,158	21,942	-6,756	199,169
Construction and real estate companies	950	399	3,815	11,805	16,969	30,179	17,956	2,659	-1,037	48,769
Holding companies	2,241	10,493	46,380	62,142	121,256	54,853	42,378	9,069	-2,644	182,533
Retail	564	673	1,310	12,326	14,874	13,463	8,216	10,644	-2,180	36,801
Services	473	525	1,091	2,115	4,204	5,946	3,912	910	-322	10,739
ITC	113	94	106	42	356	11,603	6,551	7,625	-285	19,300
Manufacturing	317	821	3,972	6,464	11,575	34,667	18,461	7,442	-2,049	51,635
Agriculture	1,171	2,187	3,615	10,468	17,441	41,311	21,835	23,019	-5,764	76,007
Other	0	0	0	0	0	72	71	157	-1	228
Total	**19,724**	**49,784**	**116,875**	**217,917**	**404,300**	**408,477**	**247,950**	**209,275**	**-33,657**	**988,396**

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31/12/14	LTV Ratio – Fully collateralised					LTV Ratio – Partially collateralised				
	0% - 25%	25% - 50%	50% - 75%	75% - 100%	Total	>100%	Collateral value	Without collateral	Allowance for impairment	Maximum exposure to credit risk
Financial institutions	0	0	0	0	0	0	0	52,438	0	52,438
Public entities	36	86	198	807	1,127	2,767	437	23,626	-124	27,396
Individuals	9,553	19,669	30,984	57,321	117,527	76,566	52,710	83,369	-16,022	261,439
Corporates										
Fisheries	3,715	13,169	22,288	55,862	95,033	84,488	59,605	11,184	-6,484	184,221
Construction and real estate companies	903	2,586	6,605	25,102	35,195	107,463	60,068	11,069	-7,046	146,682
Holding companies	268	184	2,021	11,463	13,937	30,422	16,525	6,241	-2,590	48,011
Retail	168	2,384	2,250	8,704	13,505	32,111	18,744	7,725	-3,080	50,261
Services	742	1,929	3,869	7,640	14,180	39,746	21,702	17,955	-2,841	69,040
ITC	47	65	61	50	223	15,891	7,032	7,762	-656	23,220
Manufacturing	141	521	4,659	4,424	9,744	20,396	12,465	9,670	-2,077	37,734
Agriculture	413	579	1,544	809	3,345	5,228	3,415	1,222	-519	9,275
Other	1	0	0	0	1	1,097	942	754	-8	1,844
Total	**15,986**	**41,171**	**74,478**	**172,182**	**303,816**	**416,175**	**253,645**	**233,016**	**-41,447**	**911,561**

Landsbankinn 2015 All amounts are in ISK million 103

9,2,2 Market risk

CRD, annex XII, part 2, point 10 c)

The Group uses a valuation hierarchy for disclosure of inputs to valuation used to measure fair value in accordance with international accounting standards (IFRS).

At 31 December 2015				
Financial assets	Quoted prices (unadjusted)	Observable inputs	Unobservable inputs	Total
Bonds and debt instruments	69,477	8,553	443	78,473
Equities and equity instruments	11,069	0	18,123	29,192
Derivative instruments	0	287	0	287
Total	**80,546**	**8,840**	**18,566**	**107,952**

Financial liabilities	Quoted prices (unadjusted)	Observable inputs	Unobservable inputs	Total
Derivative instruments	0	702	0	702
Short positions	2,698	0	0	2,698
Total	**2,698**	**702**	**0**	**3,400**

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At 31 December 2014

Financial assets	Quoted prices (unadjusted)	Observable inputs	Unobservable inputs	Total
Bonds and debt instruments	107,418	15,066	8,031	130,515
Equities and equity instruments	7,525	0	21,908	29,433
Derivative instruments	0	78	0	78
Total	**114,943**	**15,144**	**29,939**	**160,026**

Financial liabilities	Quoted prices (unadjusted)	Observable inputs	Unobservable inputs	Total
Derivative instruments	0	332	0	332
Short positions	5,077	0	0	5,077
Total	**5,077**	**332**	**0**	**5,409**

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CRD, annex XII, part 2, point 12 a) - e)

Equities outside the trading book are valued at fair value, with value adjustment in the income statement. For information on separation of equity exposure into trading/non-trading portfolios, see Section 5.4.1.

The following tables show the reconciliation for fair value measurement in equities valued using unobservable inputs.

2015	
Equities and equity instruments	Unobservable inputs
Carrying amount at 1 January 2015	21,908
Total gains (losses) recognised in income statement	7,631
Purchases	372
Sales	-688
Acquired financial assets in business combinations	265
Settlements	0
Dividend received	-3,911
Transfers into Level 3	1,114
Transfers from Level 3 to Level 1	-8,568
Carrying amount at 31 December 2015	**18,123**

2014	
Equities and equity instruments	Unobservable inputs
Carrying amount at 1 January 2014	28,064
Total gains (losses) recognised in income statement	5,894
Purchases	360
Sales	-15,889
Settlements	0
Dividend received	-1,054
Reclassification from investments in equity-accounted associates	4,533
Carrying amount at 31 December 2014	**21,908**

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9,2,3 The use of special instruments or methodologies

CRD, annex XII, part 3, point 1 (e) (i-iii)

By rating category	Credit exposure (EAD)		Exposure-weighted (EAD) Average LGD [%]		Exposure weighted (EAD) Average risk weight [%]	
Corporate customers	At 31 December 2015	At 31 December 2014	At 31 December 2015	At 31 December 2014	At 31 December 2015	At 31 December 2014
IRB-F approach						
10	959	0	45	56	15	19
9	1,310	18,266	44	44	26	25
8	10,476	18,429	33	43	39	38
7	52,425	23,358	42	41	59	59
6	39,033	42,533	44	38	85	85
5	105,731	109,276	44	43	112	112
4	159,573	121,993	39	42	140	140
3	95,936	77,513	43	42	184	177
2	10,033	31,135	43	44	235	229
1	7,941	20,539	44	44	258	271
0	29,442	24,120	47	47	0	0

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CRD, annex XII, part 3, point 1 (e) (iv-v) & point 2 (d)

By rating category	Off Balance (EAD)		Exposure weighted (EAD) Average ccf [%]		Credit exposure (EAD) covered by guarantors	
Corporate customers	At 31 December 2015	At 31 December 2014	At 31 December 2015	At 31 December 2014	At 31 December 2015	At 31 December 2014
IRB-F approach						
10	46	0	49	20	0	0
9	3	5,236	20	49	0	0
8	886	2,683	49	50	0	0
7	5,924	2,369	49	49	0	0
6	6,608	2,395	49	49	0	0
5	7,838	11,101	48	49	0	16
4	10,728	8,777	51	49	1,050	891
3	8,712	5,499	50	49	0	23
2	308	363	49	49	19	14
1	232	370	50	44	0	20
0	328	545	49	49	0	0

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CRD, annex XII, part 3, point 2 (e)-(g)

Credit exposure (EAD) secured on collateral received (after volatility adjustment)

At 31 December 2015

Approach		Guarantees	Credit derivatives	Eligable financial collateral	Real property	Other eligable collateral	Total
IRB-F	Corporate customers	1,068	-	25,940	73,891	-	100,899
	IRB approach, total	1,068	-	25,940	73,891	-	100,899

At 31 December 2014

Approach		Guarantees	Credit derivatives	Eligable financial collateral	Real property	Other eligable collateral	Total
IRB-F	Corporate customers	754	-	14,747	101,778	-	117,279
	IRB approach, total	754	-	14,747	101,778	-	117,279

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