# Consolidated Financial Statements
2016

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# Report of the Board of Directors and the CEO

The Consolidated Financial Statements of Landsbankinn hf. (the "Bank" or "Landsbankinn") for the financial year 2016 include the Bank and its subsidiaries (collectively referred to as the "Group"). Landsbankinn hf. was established on 7 October 2008. The Bank is a leading provider of financial services in the domestic market, offering a comprehensive range of financial products and services to individuals, corporates and institutional customers.

### Operations in 2016

Consolidated profit amounted to ISK 16,643 million for the financial year 2016. The Board of Directors proposes that a dividend of ISK 0.55 per outstanding share, total amount of ISK 13,006 million, be paid before end of March 2017. Additionally, the Board of Directors plans to propose to the Annual General Meeting (AGM) that an extraordinary dividend be paid in September 2017. Consolidated total equity amounted to ISK 251,231 million and total assets to ISK 1,111,157 million at year-end. The total capital ratio of the Group, calculated according to the Act on Financial Undertakings, was 30.2% at year-end 2016 compared with 30.4% at year-end 2015 (see Note 48).

Consolidated profit declined from ISK 36,460 million in 2015 to ISK 16,643 million in 2016, a year-on-year decrease of ISK 19,817 million. The lower profit in 2016 is mostly due to a significant yet expected decline in positive valuation adjustments on the loan portfolio. There is also a considerable decline in other net operating income as the result of lower gain on financial assets. However, the Bank's core operations are returning improved revenues in line with the Bank's strategy and costs remain stable. Net interest income increased by ISK 2,326 million and net fee and commission income rose by ISK 968 million. The average number of full-time equivalent positions during the year 2016 was 1,047, compared with 1,095 during 2015.

In the past two years a few companies have commenced litigation against the Bank, disputing the right of the Bank to an additional claim as a result of recalculations of foreign currency indexed loans in accordance with Central Bank interest rates instead of contractual interest rates in accordance with final receipts. In 2015, the Supreme Court confirmed the rulings of the District Court in favour of the Bank in two such cases. In 2016 and 2017, the Supreme Court ruled in another six cases, confirming the conclusions of the District Court in two cases but reversing the conclusions in four cases. In the latter four cases, the Supreme Court found the impact of the additional claim to be so severe for the companies involved that the Bank should absorb the disputed interest margin. In these cases, the Supreme Court thus upheld the claims of the companies. These rulings may set a precedent for cases involving other foreign currency indexed loans to companies, where circumstances are similar, yet further rulings are necessary to clarify the precedent. Consequently, expenses in the amount of ISK 5,435 million were recognised in the Consolidated Income Statement of the Bank at the end of Q4 2016 (see Note 3(e) and 38).

As disclosed in the Bank's Consolidated Financial Statements for 2015, the sale of the Bank's 38.62% shareholding in Valitor Holding hf. to Arion Bank hf. included, inter alia, an agreement of an additional consideration for the Bank's shares in Valitor. The accord is contingent upon the exercise of an option agreement between Visa Europe and Visa Inc. In April 2016, Visa Europe and Visa Inc. announced an amendment to the effect that the earn-out payment has been eliminated from the agreement and cash payments increased. The transaction was concluded in Q3 2016, once the relevant supervisory authorities had given their approval. Based on information and payment from Arion Bank hf., Landsbankinn has in these Annual Financial Statements recognised income of ISK 1,129 million as a result of the increased fair value of the additional consideration for the shares in Valitor Holding hf. (see Note 25).

In December 2016, the Bank initiated court proceedings against, inter alia, the payment card company Borgun hf., claiming recognition of tort liability in relation to the sale of the Bank's shares in the company in 2014.

In 2016, the Bank completed refinancing partially the 2020 maturity and fully the 2022 and 2026 maturities of the senior secured bond series issued to LBI hf. The refinancing was achieved with the issuance of senior unsecured bonds in the total amount of EUR 500 million, SEK 1,100 million and NOK 250 million. The bond issuance was on better terms and strengthened the Bank's liquidity further. The bonds are all issued under the Bank's 1,500 million Euro Medium Term Note (EMTN) programme and are listed on the Irish Stock Exchange (see Note 32).

In 2016, the Bank continued to issue indexed and non-indexed covered bond series under the Bank's ISK 100,000 million Covered Bond Programme and new bank bill series under the Bank's ISK 30,000 million Debt Issuance Programme. The total year-on-year increase amounts to ISK 22,144 million.

In 2016, the international credit rating agency Standard and Poor's (S&P) upgraded Landsbankinn's long and short-term ratings from BBB-/A-3 to BBB/A-2 with a positive outlook. The upgrade recognises the positive progress towards liberalisation of capital controls in Iceland and improvement in the operating environment of the Icelandic banks, with falling private sector leverage and improved access to foreign debt capital markets. In their report, S&P recognised the material improvement in Landsbankinn's capital position.

### Risk factors

Improving macroeconomic conditions and managerial efforts to mitigate credit risk had positive effects on the Bank's overall credit risk profile in 2016. Probability of default continued to decrease during the year, reaching 2.5% at year-end 2016, compared to 3.4% at the end of 2015, and a reduction of non-performing loans was affirmed. As a result of the improved credit risk profile, the Bank's economic capital for credit risk has decreased significantly in 2016.

The Bank's liquidity position remained strong throughout the year. The Bank continued to work towards diversifying its funding profile, in particular in foreign currency, by issuing unsecured bonds in EUR, SEK and NOK. The Bank used the proceeds primarily to repay maturities on secured bonds issued to LBI hf.

Market risk remains modest and well within the Bank's risk appetite. Total market risk decreased slightly in 2016 whereas foreign exchange risk decreased significantly due to a lower net currency position.

### Risk factors (continued)

The risk management section of the notes to the Financial Statements and Landsbankinn's report on risk and capital management Pillar III Risk Report analyse in detail the Group's risk management governance and the Bank's risk profile.

### Outlook

Landsbankinn Economic Research forecasts 5.5% GDP growth in Iceland in 2017, 4.0% in 2018 and 3.1% in 2019. The Central Bank has recently upgraded its forecast for 2017 from 4.1% to 4.5% and predicts an average growth of 2.8% in 2018 and 2019. Increased investment and private consumption are expected to be the principal drivers of growth in coming years. During the forecast period, which extends until the end of 2019, the near-term inflation outlook is positive but inflation is expected to pick up during the second half of 2017 and peak at close to 3.2% during the first half of 2018 due to substantial general wage increases over the coming years. Average inflation during the forecast period is expected to be around 2.9%.

### Other matters

On 20 April 2016 and 21 September 2016, the Bank paid dividends in two equal payments for the operating year 2015 to its shareholders in accordance with a resolution passed at the Bank's Annual General Meeting on 14 April 2016. The total dividend payments for the year 2015 amounted to ISK 28,538 million, equivalent to ISK 1.20 per share or ISK 0.60 per share per payment.

On 30 November 2016, the Board of Directors of Landsbankinn and Steinþór Pálsson, former CEO, agreed that Steinþór cease his employment with the Bank. Hreiðar Bjarnason, CFO and Deputy CEO, assumed the role of interim CEO until a new CEO could be hired and take up the position. On 23 January 2017, the Board of Directors announced it had hired Lilja Björk Einarsdóttir as the new CEO of Landsbankinn. She will assume the position as of 15 March 2017.

### Ownership

The total number of shareholders at year-end 2016 was 1,003, down from 1,835 at the beginning of 2016. The ten largest shareholders in the Bank at year-end 2016 as follows:

| Shareholders | | Number of shares (in ISK million) | % |
|---|---|---|---|
| Ríkissjóður Íslands | Icelandic State Treasury | 23,567.0 | 98.20% |
| Tryggingasjóður sparisjóðanna | Insurance fund | 10.0 | 0.04% |
| Lífeyrissjóður Vestmannaeyja | Pension fund | 5.0 | 0.02% |
| Vestmannaeyjabær | Local municipality | 3.5 | 0.01% |
| Vinnslustöðin hf. | Corporate | 1.7 | 0.01% |
| Helgi T. Helgason | Individual | 0.5 | 0.00% |
| Hreiðar Bjarnason | Individual | 0.5 | 0.00% |
| Árni Þ. Þorbjörnsson | Individual | 0.5 | 0.00% |
| Hrefna Ösp Sigfinnsdóttir | Individual | 0.4 | 0.00% |
| Steinþór Pálsson | Individual | 0.3 | 0.00% |
| **Top 10 total** | | **23,589.5** | **98.29%** |
| Other shareholders | | 58.6 | 0.24% |
| **Total shares outstanding** | | **23,648.2** | **98.53%** |
| Landsbankinn hf. | Own shares | 351.8 | 1.47% |
| **Total shares issued** | | **24,000.0** | **100.00%** |

Icelandic State Financial Investments (ISFI) manages the State's holding in the Bank on behalf of Ríkissjóður Íslands (the Icelandic State Treasury).

In September 2016, the Bank's Board of Directors decided to offer to buy back own shares in the Bank, in accordance with a resolution passed by the Bank's AGM on 14 April 2016. These buy-backs will amount to a maximum of 480 million shares, or the equivalent of 2% of issued share capital. The objective of the buy-back programme is to reduce the Bank's equity while at the same time offering shareholders an opportunity to sell their shares in the Bank in a transparent manner, as restrictions on the transfer of shares expired on 1 September 2016.

The Bank subsequently announced it would purchase shares from shareholders in accordance with a buy-back programme during three specified periods: from 19 September 2016 to 30 September 2016, from 31 October 2016 to 9 December 2016, and from 13 February 2017 to 24 February 2017.

In accordance with the AGM's decision, Landsbankinn has offered to buy back each share during the above-mentioned periods at a share price determined by the internal value of the Bank's shares, according to its most recently published results prior to the commencement of the repurchase period concerned. The purchase price of the shares may therefore change between repurchase periods depending on the outcome of the Bank's latest quarterly or annual results. At year-end 2016, the Bank had acquired ISK 133.5 million own shares in this manner at the average price of 10.41857, for a total amount of ISK 1,391million.

The Bank has complied with legal requirements to maintain a gender balance among senior executives since 2010. Since 2010, the target has been for both genders to be represented by at least 40% of senior executives. The Bank has to date successfully met this target and the positions of managing directors at Landsbankinn have been filled by women and men in equal numbers, except when that group was an odd number.

## Governance

Landsbankinn has placed great emphasis on enacting good corporate governance in accordance with the recommendations of the most recent Corporate Governance Guidelines issued in June 2015 (5th edition) by the Iceland Chamber of Commerce, NASDAQ Iceland and the Confederation of Icelandic Employers, with the exception of certain aspect of Section 5.4.1 of the Guidelines. Further details on the Bank's corporate governance in general and this exception are provided in the Annual Report of the Group for the year 2016 and on the Bank's website, www.landsbankinn.is. Each year, Landsbankinn reviews compliance with the Guidelines and whether the Bank's governance accords with the Guidelines.

## Corporate Social Responsibility

Corporate Social Responsibility (CSR) in promoting economic growth, social well-being and protection of the environment is an integral part of the overall strategy of Landsbankinn. CSR underwrites sustainability through competitiveness, the productive use of resources and good governance, inter alia, human rights, anti-fraud and anti-corruption measures. The Bank places key emphasis on integrating social responsibility in all levels of the Bank's operations by such means as adopting various international and recognised standards, including the principles of the United Nations Global Compact, the United Nations Environmental Programme Financial Initiative (UNEP FI), the United Nations Principles for Responsible Investment (UNPRI) and numerous other projects in the field of social responsibility. Every year, Landsbankinn's CSR report is published together with the Bank's Annual Report, disclosing the Bank's progress in terms of social responsibility and social performance indicators. The report is accessible in Icelandic on the Bank's website, www.landsbankinn.is.

## Statement by the Board of Directors and the CEO

The Consolidated Financial Statements of Landsbankinn hf. for the year ended 31 December 2016 have been prepared on a going-concern basis in accordance with International Financial Reporting Standards as adopted by the EU.

In our opinion, the Consolidated Financial Statements of Landsbankinn hf. give a true and fair view of the consolidated financial performance of the Group for the year 2016, its consolidated financial position as at 31 December 2016 and its consolidated cash flows for the year 2016.

Furthermore, in our opinion, the Consolidated Financial Statements of Landsbankinn hf. and the Report of the Board of Directors and the CEO give a fair view of the development and performance of the Group's operations and its position and describe the principal risks and uncertainties faced by the Group.

The Board of Directors of the Bank and the Chief Executive Officer hereby endorse the Consolidated Financial Statements of Landsbankinn hf. for the year 2016. The Board of Directors and the CEO recommend that the Consolidated Financial Statements of Landsbankinn hf. be approved at the Annual General Meeting of Landsbankinn hf.

Reykjavík, 9 February 2017.

Board of Directors

Helga Björk Eiríksdóttir

Chairman

Berglind Svavarsdóttir

Danielle Pamela Neben

Einar Þór Bjarnason

Hersir Sigurgeirsson

Jón Guðmann Pétursson

Magnús Pétursson

CEO

Hreiðar Bjarnason

# Independent Auditors' Report

**To the Board of Directors and Shareholders of Landsbankinn hf.**

### Opinion

We have audited the accompanying Consolidated Financial Statements of Landsbankinn hf. (hereafter the Group) for the year 2016. The Consolidated Financial Statements comprise the Report of the Board of Directors and CEO, the Statement of Income, the Statement of Financial Position, the Statement of Cash Flows, the Changes in Equity, a summary of significant accounting policies and other explanatory information.

In our opinion, the Consolidated Financial Statements present fairly, in all material respects, the consolidated results of operations of Landsbankinn hf. for the year 2016, its consolidated financial position as at December 31, 2016, and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU and the Financial Statements Act.

In accordance with the provisions of Article 104, paragraph 2 of the Icelandic Financial Statements Act No. 3/2006, we confirm that the Report of the Board of Directors and CEO accompanying the Consolidated Financial Statements includes at least the information required by the Financial Statements Act if not disclosed elsewhere in the Consolidated Financial Statements.

### Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our Report. We are independent of the Group in accordance with the Code of Ethics for Professional Accountants in Iceland, and we have fulfilled all ethical requirements therein. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the Consolidated Financial Statements for the year 2016. These matters were addressed in the context of our audit of the Consolidated Financial Statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

In our opinion the following matters were key audit matters:

*a) Credit risk, impairment of loans and advances to customers and recalculation of foreign currency indexed loans:*
We refer to the discussion on page 1 (Report of the Board of Directors and CEO), note 93.5 (e) on page 70 and note 93.5 (g) on page 71 (Significant accounting policies), note 3 (a) on page 13 and note 3 (e) on page 14 (Critical accounting estimates and judgements), note 38 on page 34 (Litigation) and notes 55 to 72 on page 44 to 54 (Credit risk).

We have defined impairment of loans and advances to customers as a key audit matter as the assumptions used in the impairment process are subjective and based on the Group's management's judgement. As loans and advances to customers are significant in the Consolidated Financial Statements, any change in criteria may have a significant impact on the Group's results of operations and financial position. Our work covered the impairment of both loans and advances to customers and loans to corporations and institutions. The assessment of the effects of legal proceedings, in relation to currency indexed loans, are also based on management's estimates and the assumptions are subject to critical judgement and may have a significant impact on the results of operations and financial position of the Group.

As part of the audit, we performed tests of key controls related to the impairment of the loan portfolio. The focus of these procedures included the analysis of loss events and assumptions used in the valuation. We examined information in the systems and models used by the Group to estimate impairment. We also assessed the manner in which management evaluated the results of the valuation and responded to deviations if they occurred.

We also performed substantive procedures on loan impairment, including assessing the Group's impairment methodology and whether the methodology is in compliance with International Financial Reporting Standards. We also chose a risk-based sample based on loan and customers' characteristics. Loans with a higher probability of default and loan loss, and that are more likely to go undetected by the Group were examined specifically. Underlying loan agreements were examined, underlying collateral verified and management´s assumptions were assessed.

Furthermore, we examined the manner in which the Group processes and manages the legal proceedings, in relation to currency indexed loans, that it is a party to. We examined and tested the assumptions applied by management to assess the effects that such legal proceedings have on the Group's results of operations and financial position. This work was based among other things on a consultation from a legal expert who was a member of the audit team.

*b) Valuation of level 3 financial assets:*
We refer to note 93.5 (f) on page 70 to 71 (Significant accounting policies), note 3 (b) on page 14 (Critical accounting estimates and judgements) and note 18 on page 21 (Fair value hierarchy).

Level 3 financial assets are assets that are measured at fair value using valuation techniques based on significant unobservable inputs. The valuation of level 3 financial assets is a subjective area as the assumptions on which the valuation is based on are not easily observable and subject to management's assessment to a great extent. Any changes made to the evaluation criteria could have a significant impact on the Group's results of operations and financial position.

### Key Audit Matters (continued)

In our audit, we examined the Group's valuation methodology and its compliance with International Financial Reporting Standards. We examined the Group's process in analysing and evaluating the assumptions used in the valuation process and examined the valuation models used. We selected a sample of financial assets for examination, focusing on the largest and most risk-bearing assets. Our work was based on the work of a valuation specialist who was a member of the audit team.

### Other Information

The Board of Directors and the CEO are responsible for all information presented by the Group, both the Consolidated Financial Statements as well as other information. The other information comprises the information included in the Annual Report, but does not include the Consolidated Financial Statements and our Auditor's Report thereon. Our opinion on the Consolidated Financial Statements does not cover the information in the Annual Report or other documents issued by the Group, and we do not express any form of assurance on the information in those documents thereon. In connection with our audit of the Consolidated Financial Statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the Consolidated Financial Statements, our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we conclude that there are material misstatements or inconsistencies therein, we are required to communicate the matter to the Board of Directors and take appropriate action depending on the severity of the misstatement.

### The Board of Directors and CEO's Responsibility for the Consolidated Financial Statements

The Board of Directors and CEO are responsible for the preparation and fair presentation of the Consolidated Financial Statements in accordance with International Financial Reporting Standards as adopted by the EU and the Financial Statements Act, and for such internal control as management determines is necessary to enable the preparation of Consolidated Financial Statements that are free from material misstatement, whether due to fraud or error.

In preparing the Consolidated Financial Statements, the Board of Directors and CEO are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors and CEO either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The Board of Directors and the Audit Committee are responsible for overseeing the Group's financial reporting process.

### Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the Consolidated Financial Statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an Auditor's Report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Consolidated Financial Statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the Consolidated Financial Statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group´s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management. Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exist related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our Auditor's Report to the related disclosures in the Consolidated Financial Statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our Auditor's Report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the Consolidated Financial Statements, including the disclosures, and whether the Consolidated Financial Statements represent the underlying transactions and events in a manner that achieves fair presentation
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the Consolidated Financial Statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

### Auditor's Responsibility for the Audit of the Consolidated Financial Statements (continued)

We communicated with the Board of Directors and the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identified during our audit.

We also provided the Board of Directors and the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and communicated with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Board of Directors and the Audit Committee, we determined those matters that were of most significance in the audit of the Consolidated Financial Statements of the current year and are therefore the key audit matters. We describe these matters in our Auditor's Report unless law or regulations precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our Report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

For and on behalf of Grant Thornton endurskoðun ehf.
Reykjavík, 9 February 2017

Davíð Arnar Einarsson
State Authorized Public Accountant

J. Sturla Jónsson
State Authorized Public Accountant

## Consolidated Income Statement for the Year ended 31 December 2016

| Notes | | 2016 | 2015 |
|---|---|---|---|
| | Interest income | 64,612 | 58,005 |
| | Interest expense | (29,962) | (25,681) |
| 5 | **Net interest income** | **34,650** | **32,324** |
| 6 | Net valuation adjustments and credit impairment charges | (318) | 18,216 |
| | **Net interest income after net valuation adjustments and credit impairment charges** | **34,332** | **50,540** |
| | Fee and commission income | 10,290 | 8,977 |
| | Fee and commission expense | (2,481) | (2,136) |
| 7 | **Net fee and commission income** | **7,809** | **6,841** |
| 8 | Net gain on financial assets designated at fair value through profit or loss | 1,416 | 8,924 |
| 9 | Net gain on financial assets and liabilities held for trading | 339 | 3,802 |
| 11 | Net foreign exchange (loss) gain | (179) | (1,277) |
| 12 | Other income and (expenses) | 4,500 | 3,533 |
| | **Other net operating income** | **6,076** | **14,982** |
| | **Total operating income** | **48,217** | **72,363** |
| 13 | Salaries and related expenses | 14,049 | 13,754 |
| 14 | Other operating expenses | 7,586 | 8,061 |
| 15 | Depreciation and amortisation | 611 | 663 |
| 34 | Contribution to the Depositors' and Investors' Guarantee Fund | 1,268 | 1,254 |
| | **Total operating expenses** | **23,514** | **23,732** |
| 25 | Share of profit of equity-accounted associates | 483 | 248 |
| | **Profit before tax** | **25,186** | **48,879** |
| 16 | Income tax | (5,570) | (9,402) |
| 17 | Tax on liabilities of financial institutions | (2,973) | (3,017) |
| | **Profit for the year** | **16,643** | **36,460** |
| | **Profit for the year attributable to:** | | |
| | **Owners of the Bank** | | |
| | Profit for the year | 16,633 | 36,460 |
| | **Profit for the year attributable to owners of the Bank** | **16,633** | **36,460** |
| | **Non-controlling interests** | | |
| | Profit for the year from operations | 10 | 0 |
| | **Profit for the year attributable to non-controlling interests** | **10** | **0** |
| | **Profit for the year** | **16,643** | **36,460** |
| | **Earnings per share:** | | |
| 37 | Basic and diluted earnings per share from operations (ISK) | **0.70** | **1.54** |
| | **Total basic and diluted earnings per share (ISK)** | **0.70** | **1.54** |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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# Consolidated Statement of Financial Position as at 31 December 2016

| Notes | | 2016 | 2015 |
|---|---|---|---|
| | **Assets** | | |
| 18, 19 | Cash and balances with Central Bank | 30,662 | 25,164 |
| 18, 20, 80 | Bonds and debt instruments | 154,892 | 203,684 |
| 21 | Equities and equity instruments | 26,688 | 29,192 |
| 18, 22 | Derivative instruments | 278 | 287 |
| 23, 80 | Loans and advances to financial institutions | 20,408 | 20,791 |
| 24, 80 | Loans and advances to customers | 853,417 | 811,549 |
| 25 | Investments in equity-accounted associates | 1,184 | 909 |
| 26 | Property and equipment | 5,452 | 5,658 |
| 27 | Intangible assets | 2,634 | 2,012 |
| 28 | Other assets | 8,093 | 7,457 |
| 29 | Assets classified as held for sale | 7,449 | 11,955 |
| | **Total assets** | **1,111,157** | **1,118,658** |
| | **Liabilities** | | |
| 30 | Due to financial institutions and Central Bank | 20,093 | 56,731 |
| 31 | Deposits from customers | 589,725 | 559,051 |
| 22 | Derivative instruments and short positions | 1,729 | 3,400 |
| 32, 80 | Borrowings | 223,944 | 209,344 |
| 33 | Deferred tax liabilities | 85 | 166 |
| 34 | Other liabilities | 22,867 | 23,278 |
| 29 | Liabilities associated with assets classified as held for sale | 1,095 | 1,518 |
| 35 | Subordinated liabilities | 388 | 639 |
| | **Total liabilities** | **859,926** | **854,127** |
| 36 | **Equity** | | |
| | Share capital | 23,648 | 23,782 |
| | Share premium | 120,847 | 122,105 |
| | Reserves | 10,875 | 6,000 |
| | Retained earnings | 95,834 | 112,614 |
| | **Total equity attributable to owners of the Bank** | **251,204** | **264,501** |
| | Non-controlling interests | 27 | 30 |
| | **Total equity** | **251,231** | **264,531** |
| | **Total liabilities and equity** | **1,111,157** | **1,118,658** |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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# Consolidated Statement of Changes in Equity for the Year ended 31 December 2016

| Notes | Change in equity for the year 2016 | Share capital | Share premium | Statutory reserve | Unrealized gains in subsidiaries and equity-accounted associates reserve | Financial assets designated at fair value through profit or loss reserve | Retained earnings | Total | Non-controlling interests | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Attributable to owners of the Bank | | | Reserves | | | | | |
| | Balance as at 1 January 2016 | 23,782 | 122,105 | 6,000 | | | 112,614 | 264,501 | 30 | 264,531 |
| | Profit for the year | | | | | | 16,633 | 16,633 | 10 | 16,643 |
| | Transferred to restricted retained earnings | | | | 4,583 | 292 | (4,875) | 0 | | 0 |
| | Purchase of own shares | (134) | (1,258) | | | | | (1,392) | | (1,392) |
| | Dividends paid | | | | | | (28,538) | (28,538) | | (28,538) |
| | Change in non-controlling interest in subsidiary | | | | | | | 0 | (13) | (13) |
| 36 | **Balance as at 31 December 2016** | **23,648** | **120,847** | **6,000** | **4,583** | **292** | **95,834** | **251,204** | **27** | **251,231** |
| | **Change in equity for the year 2015** | | | | | | | | | |
| | Balance as at 1 January 2015 | 23,687 | 121,275 | 6,000 | | | 99,841 | 250,803 | | 250,803 |
| | Profit for the year | | | | | | 36,460 | 36,460 | | 36,460 |
| | Dividends paid | | | | | | (23,687) | (23,687) | | (23,687) |
| | Merger consideration allocated to former guarantee capital owners of Sparisjóður Vestmannaeyja and Sparisjóður Norðurlands | 95 | 830 | | | | | 925 | | 925 |
| | Increase in non-controlling interests due to the merger of Landsbankinn and Sparisjóður Norðurlands | | | | | | | 0 | 30 | 30 |
| 36 | **Balance as at 31 December 2015** | **23,782** | **122,105** | **6,000** | **0** | **0** | **112,614** | **264,501** | **30** | **264,531** |

The accompanying notes are an integral part of these Consolidated Financial Statements.

Landsbankinn hf. Consolidated Financial Statements 2016 9 All amounts are in ISK million

# Consolidated Statement of Cash Flows for the Year ended 31 December 2016

| Notes | | 2016 | 2015 |
|---|---|---|---|
| | **Operating activities** | | |
| | Profit for the year | 16,643 | 36,460 |
| | Adjustments for non-cash items included in profit for the year | (30,144) | (51,728) |
| | Changes in operating assets and liabilities | (22,939) | 15,817 |
| | Interest received | 60,308 | 51,227 |
| | Interest paid | (28,747) | (24,238) |
| 10 | Dividends received | 1,401 | 4,230 |
| | Income tax and special tax on financial institutions paid | (10,791) | (10,978) |
| | **Net cash (used in) from operating activities** | **(14,269)** | **20,790** |
| | **Investing activities** | | |
| | Proceeds of shares in equity-accounted associates | (40) | 0 |
| | Acquisition of additional shares in subsidiaries and associates | 12 | (33) |
| 26 | Purchase of property and equipment | (351) | (274) |
| 26 | Proceeds from sale of property and equipment | 186 | 62 |
| 27 | Purchase of intangible assets | (852) | (597) |
| | **Net cash used in investing activities** | **(1,045)** | **(842)** |
| | **Financing activities** | | |
| | Proceeds from new long-term debt issue | 127,558 | 76,141 |
| 36 | Purchase of own shares | (1,392) | 0 |
| | Repayment of borrowings | (86,378) | (68,114) |
| | Repayment of subordinated loans | (252) | 0 |
| 36 | Dividends paid | (28,538) | (23,687) |
| | **Net cash from (used in) financing activities** | **10,998** | **(15,660)** |
| | Cash and cash equivalents as at the beginning of the year | 24,257 | 16,588 |
| | Net change in cash and cash equivalents | (4,316) | 4,288 |
| | Cash and cash equivalents acquired in business combination | 0 | 1,491 |
| | Effect of exchange rate changes on cash and cash equivalents held | 1,311 | 1,890 |
| | **Cash and cash equivalents as at 31 December** | **21,252** | **24,257** |
| | **Investing and financing activities not affecting cash flows** | | |
| | Assets acquired and liabilities assumed from Sparisjóður Vestmannaeyja and Sparisjóður Norðurlands | - | (621) |
| | Goodwill | - | (313) |
| | Own shares allocated to former guarantee capital owners of the savings banks Sparisjóður Vestmannaeyja and Sparisjóður Norðurlands | - | 926 |
| | **Cash and cash equivalents is specified as follows:** | | |
| 19 | Cash and balances with Central Bank | 30,662 | 25,164 |
| 23 | Bank accounts with financial institutions | 14,539 | 15,096 |
| 19 | Mandatory and special restricted balances with Central Bank | (23,949) | (16,003) |
| | **Cash and cash equivalents as at the end of the year** | **21,252** | **24,257** |

The accompanying notes are an integral part of these Consolidated Financial Statements.

Landsbankinn hf. Consolidated Financial Statements 2016 10 All amounts are in ISK million

# Consolidated Statement of Cash Flows for the Year ended 31 December 2016

| Notes | | 2016 | 2015 |
|---|---|---|---|
| | **Adjustments for non-cash items included in profit for the year** | | |
| 5 | Net interest income | (34,650) | (32,324) |
| 6, 70 | Net impairment and loss of guarantees | (5,117) | (4,440) |
| 6 | Reversals of loss from foreign currency linkage of loans and advances to customers | 5,435 | (13,776) |
| 8 | Net gain on financial assets designated at fair value through profit or loss | (1,416) | (8,924) |
| 9 | Net gain on financial assets and liabilities held for trading | (339) | (3,802) |
| 11 | Net foreign exchange gain | (1,132) | (613) |
| 26 | (Loss) gain on sale of property and equipment | (10) | 20 |
| 12 | Gain on repossessed collateral | (1,586) | (703) |
| 15 | Depreciation and amortisation | 611 | 663 |
| 25 | Share of profit of equity-accounted associates | (483) | (248) |
| 16 | Income tax | 5,570 | 9,402 |
| 17 | Tax on liabilities of financial institutions | 2,973 | 3,017 |
| | | **(30,144)** | **(51,728)** |
| | **Changes in operating assets and liabilities** | | |
| | Change in reserve requirement with Central Bank | (7,946) | (9,306) |
| | Change in bonds and equities | 44,507 | 47,865 |
| | Change in loans and advances to financial institutions | (4,026) | 32,145 |
| | Change in loans and advances to customers | (67,471) | (68,279) |
| | Change in assets of disposal groups | 659 | 5,772 |
| | Change in other assets | 361 | 11,110 |
| | Change in assets classified as held for sale | 3,541 | 5,423 |
| | Change in due to financial institutions and Central Bank | (36,209) | 3,160 |
| | Change in deposits from customers | 43,843 | (6,197) |
| | Change in tax liability | 81 | 231 |
| | Change in other liabilities | 146 | (5,752) |
| | Change in liabilities associated with assets classified as held for sale | (425) | (355) |
| | | **(22,939)** | **15,817** |

The accompanying notes are an integral part of these Consolidated Financial Statements.

Landsbankinn hf. Consolidated Financial Statements 2016 11 All amounts are in ISK million

All amounts are in ISK million

# Notes to the Consolidated Financial Statements

## General

### 1. Reporting entity

Landsbankinn hf. (hereinafter referred to as the "Bank" or "Landsbankinn") was founded on 7 October 2008. The Bank is a limited liability company incorporated and domiciled in Iceland. The Bank operates in accordance with Act No. 161/2002. The Bank is subject to supervision of the Financial Supervisory Authority (FME) in accordance with Act No. 87/1998, on Official Supervision of Financial Activities. The registered address of the Bank's office is Austurstræti 11, 155 Reykjavík.

The Consolidated Financial Statements of the Bank for the year ended 31 December 2016 include the Bank and its subsidiaries (collectively referred to as the "Group" and individually as "Group entities"). The Group's primary lines of business are corporate and personal banking, markets, asset management and other related services. The Group operates solely in Iceland.

The issue of these Consolidated Financial Statements was authorised by the Board of Directors and the CEO of the Bank on 9 February 2017.

### 2. Basis of preparation

#### Statement of compliance

These Consolidated Financial Statements for the year ended 31 December 2016 have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union.

Information regarding significant accounting policies can be found in Note 93.

#### Going concern

The Bank's management has assessed the Group's ability to continue as a going concern and it has a reasonable expectation that the Group has adequate resources to continue its operations. Accordingly, these Consolidated Financial Statements have been prepared on a going concern basis.

#### Basis of measurement

The Consolidated Financial Statements have been prepared on a historical cost basis except for the following:

- Financial assets and liabilities classified as held for trading are measured at fair value;
- Financial assets and liabilities designated at fair value through profit or loss are measured at fair value;
- Non-current assets and disposal groups classified as held for sale are measured at the lower of cost or fair value less costs to sell.

#### Functional and presentation currency

Items included in the financial statements of each individual Group entity are measured using the currency of the economic environment in which the respective entity operates (its functional currency). All amounts are presented in Icelandic *króna* (ISK), which is also the Bank's functional currency, rounded to the nearest million unless otherwise stated.

#### Use of estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Note 3 discusses estimates and assumptions which involve a substantial risk which could result in material adjustments to the carrying amounts of assets and liabilities during the next year.

### 3. Critical accounting estimates and judgements in applying accounting policies

#### (a) Impairment losses on loans and advances

To assess impairment, the Group reviews its loan portfolios on at least a quarterly basis. To determine whether an impairment loss should be recognised, the Group evaluates whether there is any observable data indicating a measurable decrease in estimated future cash flows from a portfolio of loans, before any decrease in individual loans becomes identifiable within that portfolio. The evidence may include either observable data indicating that an adverse change has occurred in the payment status of the borrowers in a group, or national or local economic conditions correlating with defaults on assets in the group. In order to schedule its future cash flows, management uses estimates based on historical loss experience, together with objective evidence of impairment in homogenous portfolios. The methodology and assumptions for estimating both the amount and timing of future cash flows are reviewed regularly in order to reduce potential discrepancies between loss estimates and actual loss experience.

## 3. Critical accounting estimates and judgements in applying accounting policies (continued)

### (b) Valuation of financial instruments

The fair value of financial instruments where no active market exists or where quoted prices are not otherwise available are determined by using valuation techniques. In these cases, the fair values are estimated from observable data in respect of similar financial instruments or using models. Where market observable inputs are not available, they are estimated based on appropriate assumptions. Where valuation techniques (for example, models) are used to determine fair value, they are validated and periodically reviewed by qualified and independent personnel of the Group. All models are certified before use, and calibrated to ensure that the outputs reflect actual data and comparative market prices. Wherever practical, models are confined to observable data; however, areas such as volatility, correlation and credit risk, whether own or counterparty, require management to make estimates. Changing assumptions on these factors could affect the reported fair value of financial instruments.

### (c) Assets classified as held for sale

The Group classifies assets and groups of assets together with related liabilities as held for sale:
• if such assets or disposal groups are immediately available for sale in their present condition, subject to terms that are usual and customary for selling such assets or disposal groups;
• if management is committed to selling such assets and is actively looking for a buyer;
• if the assets are being actively marketed at a reasonable sales price in relation to their fair value;
• if completion of the sale is expected within one year;
• if sale is considered highly probable.
However, events and circumstances may extend the period to complete the sale beyond one year. An extension of the period required to complete the sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the Group's control and the Group remains committed to its plan to sell the asset (or disposal group).

When classifying assets as held for sale the Group has determined that the classification criteria have been met.

### (d) Determination of control over investees

Management applies its judgement to determine whether the control indicators set out in Note 93.1 Consolidation, indicate that the Group controls an investee.

The Group acts as fund manager to a number of investment funds. When assessing whether to consolidate investment funds, the Group reviews all facts and circumstances to determine whether the Group, as fund manager, is acting as agent or principal. The Group is deemed to be a principal, and hence controls and consolidates the funds, when it acts as fund manager and cannot be removed without cause, has variable returns through significant unit holdings and/or a guarantee, and is able to influence the returns of the funds by exercising its power.

For further disclosure in respect of unconsolidated investment funds in which the Group acts as an agent see Note 43 Unconsolidated structured entities.

### (e) Foreign currency indexed loans

In accordance with the Group’s accounting policies, the Group recognised expenses for the potential impact of rulings of the Supreme Court on recalculation of foreign currency indexed loans in its Consolidated Income Statement as at year-end 2011 and at the end of the third quarter of 2012. In October 2015, the Supreme Court ruled in favour of the Bank in two cases (cases No. 34/2015 and 35/2015) where a company had brought lawsuits against the Bank demanding recalculation of previous recalculations of foreign currency indexed loans in accordance with Supreme Court rulings No. 600/2011 and No. 464/2012 relating to so-called final receipts of payment. In November 2015 and in January and May 2016, the District Court of Reykjavík ruled in favour of the Bank in seven similar disputes. In 2015, the Group's net reversal of loss on foreign currency linkage of loans and advances amounted to ISK 13,776 million. In 2016 and 2017, the Supreme Court confirmed the conclusions of the District Court in two of the seven cases (cases No. 34/2016 and 241/2016). However, in 2016 and 2017, the Supreme Court reversed the conclusions of the District Court in four of the seven cases (cases No. 82/2016, 149/2016, 150/2016 and 242/2016). In the latter cases, the Supreme Court found the impact of the additional claim to be so severe for the companies involved that the Bank should absorb the disputed interest margin, caused by illegal foreign currency indexation of the loans in question. In these cases, the Court thus upheld the claims of the companies, cf. Note 38. These rulings may set a precedent for cases involving other foreign currency indexed loans to companies, where circumstances are similar, yet further rulings are necessary to clarify the precedent. As a result, the assessment of the financial impact of the rulings might change to reflect future rulings. Consequently, expenses in the amount of ISK 5,435 million were recognised in the Consolidated Income Statement of the Bank at the end of Q4 2016.

## 4. Operating segments

Business segments are presented in accordance with internal reporting to the CEO and the Board of Directors, who are responsible for allocating resources to the reportable segments and assessing their financial performance.

The Group has four main business segments as at the end of the reporting period:

• **Personal Banking** provides financial services through the Bank's branch network to individuals and to small and medium-size businesses outside the capital city region.

• **Corporate Banking** provides financial services to corporate clients and to small and medium-size businesses in the capital city region.

• **Markets** provides brokerage services in securities, foreign currencies and derivatives, securities offerings and advisory services. Markets also handles market making for listed securities and foreign currencies. Markets provides a range of wealth and asset management products and services for individuals, corporations and institutional investors. Landsbréf hf., a subsidiary of the Bank, is included in Markets as an operating segment.

• **Treasury** incorporates the Bank's funding and liquidity management and market making in money markets and determines the Bank's internal pricing. Treasury also manages the Bank's exchange rate, interest rate and inflation risks, within limits that are set by the Board of Directors. The Bank allocates capital to the operating segments based on the Bank's target for a total capital ratio.

Support functions are comprised of Finance (excluding Treasury), Risk Management, Operations & IT, and the CEO's Office, whereby the CEO's Office is comprised of Human Resources, Marketing & Communications and Compliance. The Bank's Internal Audit department is also included in support functions; however, it is independent and reports directly to the Bank's Board of Directors.

Reconciliation consists of eliminations and transactions that cannot be allocated to any one segment.

Administrative expenses of the Group's support functions are allocated to appropriate business segments based on the underlying cost drivers. Expenses are allocated to the business units at market price level. Support functions supply services to business units and transactions are settled at unit prices or on an arm's-length basis, if possible, on the basis of consumption and activity.

The following table summarises each segment's financial performance as disclosed in the internal management reports on segment profits (loss) before tax. In these reports, all income statement items are reported on a net basis, including the total interest income and expense. Inter-segment pricing is determined on an arm's-length basis.

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Group's total revenue during the period from 1 January to 31 December 2016 and 2015.

## 4. Operating segments (continued)

| 1 January - 31 December 2016 | Personal Banking | Corporate Banking | Markets | Treasury | Support functions | Recon-ciliation | Total |
|---|---|---|---|---|---|---|---|
| Net interest income | 13,838 | 14,200 | 357 | 6,663 | 10 | (418) | **34,650** |
| Net valuation adjustments and credit impairment charges | 3,580 | (3,798) | - | (100) | - | - | **(318)** |
| Net fee and commission income | 3,488 | 818 | 4,043 | (330) | 110 | (320) | **7,809** |
| Other net operating income (expenses) | 899 | 262 | 356 | 2,277 | 1,902 | 380 | **6,076** |
| **Total operating income (expense)** | **21,805** | **11,482** | **4,756** | **8,510** | **2,022** | **(358)** | **48,217** |
| Operating expenses | (6,331) | (1,568) | (2,097) | (1,586) | (12,274) | 342 | **(23,514)** |
| Share of profit (loss) of equity-accounted associates | 515 | - | - | (32) | - | - | **483** |
| **Profit (loss) before cost allocation and tax** | **15,989** | **9,914** | **2,659** | **6,892** | **(10,252)** | **(16)** | **25,186** |
| Cost allocated from support functions to business segments | (4,931) | (3,550) | (1,312) | (1,192) | 10,985 | - | **0** |
| **Profit (loss) before tax** | **11,058** | **6,364** | **1,347** | **5,700** | **733** | **(16)** | **25,186** |
| | | | | | | | |
| Net revenue (expenses) from external customers | 25,077 | 20,677 | 4,421 | (3,579) | 1,979 | - | **48,575** |
| Net revenue (expenses) from other segments | (3,272) | (9,195) | 335 | 12,089 | 43 | - | **0** |
| **Total operating income** | **21,805** | **11,482** | **4,756** | **8,510** | **2,022** | **0** | **48,575** |
| | | | | | | | |
| **As at 31 December 2016** | | | | | | | |
| **Total assets** | 396,145 | 481,568 | 34,904 | 427,330 | 14,651 | (243,441) | **1,111,157** |
| **Total liabilities** | 347,267 | 384,892 | 29,005 | 327,552 | 14,651 | (243,441) | **859,926** |
| **Allocated capital** | 48,878 | 96,676 | 5,899 | 99,778 | - | | **251,231** |

| 1 January - 31 December 2015 | Personal Banking | Corporate Banking | Markets | Treasury | Support functions | Recon-ciliation | Total |
|---|---|---|---|---|---|---|---|
| Net interest income | 13,288 | 14,387 | 324 | 5,196 | 46 | (917) | **32,324** |
| Net valuation adjustments and credit impairment charges | 3,971 | 14,178 | (1) | 68 | - | - | **18,216** |
| Net fee and commission income | 3,500 | 701 | 3,253 | (397) | 40 | (256) | **6,841** |
| Other net operating income (expenses) | 1,903 | (665) | 1,956 | 9,756 | 1,278 | 754 | **14,982** |
| **Total operating income (expense)** | **22,662** | **28,601** | **5,532** | **14,623** | **1,364** | **(419)** | **72,363** |
| Operating expenses | (6,439) | (1,477) | (1,908) | (1,750) | (12,436) | 278 | **(23,732)** |
| Share of profit of equity-accounted associates | 153 | - | - | 53 | 42 | - | **248** |
| **Profit (loss) before cost allocation and tax** | **16,376** | **27,124** | **3,624** | **12,926** | **(11,030)** | **(141)** | **48,879** |
| Cost allocated from support functions to business segments | (5,242) | (4,106) | (1,176) | (869) | 11,393 | - | **0** |
| **Profit (loss) before tax** | **11,134** | **23,018** | **2,448** | **12,057** | **363** | **(141)** | **48,879** |
| | | | | | | | |
| Net revenue from external customers | 23,928 | 38,377 | 5,226 | 3,915 | 1,336 | - | **72,782** |
| Net revenue (expenses) from other segments | (1,266) | (9,776) | 306 | 10,708 | 28 | - | **0** |
| **Total operating income** | **22,662** | **28,601** | **5,532** | **14,623** | **1,364** | **0** | **72,782** |
| | | | | | | | |
| **As at 31 December 2015** | | | | | | | |
| **Total assets** | 375,884 | 477,249 | 31,463 | 460,817 | 20,294 | (247,049) | **1,118,658** |
| **Total liabilities** | 320,374 | 363,579 | 23,881 | 373,048 | 20,294 | (247,049) | **854,127** |
| **Allocated capital** | 55,510 | 113,670 | 7,582 | 87,769 | - | | **264,531** |

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## Notes to the Consolidated Income Statement

### 5. Net interest income

| Interest income | 2016 | 2015 |
|---|---|---|
| Cash and balances with Central Bank | 1,193 | 835 |
| Bonds and debt instruments classified as loans and receivables | 6,091 | 5,423 |
| Loans and advances to financial institutions | 225 | 282 |
| Loans and advances to customers | 57,078 | 51,405 |
| Other interest income | 25 | 60 |
| **Total** | **64,612** | **58,005** |

| Interest expense | | |
|---|---|---|
| Due to financial institutions and Central Bank | (1,036) | (1,214) |
| Deposits from customers | (20,066) | (17,175) |
| Borrowings | (7,842) | (7,048) |
| Other interest expense | (977) | (224) |
| Subordinated liabilities | (41) | (20) |
| **Total** | **(29,962)** | **(25,681)** |
| **Net interest income** | **34,650** | **32,324** |

Interest income and interest expense disclosed above arose on financial assets and financial liabilities that are not carried at fair value through profit or loss.

### 6. Net valuation adjustments and credit impairment charges

| | 2016 | 2015 |
|---|---|---|
| Net impairment | 4,798 | 5,044 |
| Reversal of impairment of guarantees | 319 | (604) |
| Reversals of foreign currency linkage loans and advances to customers | (5,435) | 13,776 |
| **Net valuation adjustments and credit impairment charges** | **(318)** | **18,216** |

| Valuation adjustments and impairment charges by customer type | | |
|---|---|---|
| Individuals | 2,885 | 1,547 |
| Corporates | (3,203) | 16,669 |
| **Net valuation adjustments and credit impairment charges** | **(318)** | **18,216** |

### 7. Net fee and commission income

| Fee and commission income | 2016 | 2015 |
|---|---|---|
| Markets | 3,870 | 3,097 |
| Loans and guarantees | 984 | 941 |
| Cards | 3,390 | 2,660 |
| Collection and payment services | 885 | 907 |
| Foreign trade | 755 | 910 |
| Other commissions and fees | 406 | 462 |
| **Total** | **10,290** | **8,977** |

| Fee and commission expense | | |
|---|---|---|
| Investment banking and capital markets | (297) | (364) |
| Cards | (1,199) | (769) |
| Other fees | (985) | (1,004) |
| **Total** | **(2,481)** | **(2,136)** |
| **Net fee and commission income** | **7,809** | **6,841** |

The net fee and commission income above excludes amounts that are otherwise included in determining the effective interest rate for financial assets and liabilities that are not at fair value through profit or loss. Moreover, it does not include any net fee and commission income relating to such financial assets and liabilities.

### 8. Net gain on financial assets designated at fair value through profit or loss

| | 2016 | 2015 |
|---|---|---|
| Bonds and debt instruments | 524 | 1,148 |
| Equities and equity instruments | 892 | 7,776 |
| **Total** | **1,416** | **8,924** |

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## 9. Net gain on financial assets and liabilities held for trading

| | 2016 | 2015 |
|---|---|---|
| Bonds and debt instruments | 1,016 | 1,630 |
| Equities and equity instruments | (438) | 1,895 |
| Derivatives and underlying hedges | (239) | 277 |
| **Total** | **339** | **3,802** |

## 10. Dividend income

Dividend income is recognised in the consolidated income statement in the following line items:

| | 2016 | 2015 |
|---|---|---|
| Net gain on financial assets designated at fair value through profit or loss | 1,084 | 3,976 |
| Net gain on financial assets and liabilities held for trading | 72 | 82 |
| **Total** | **1,156** | **4,058** |

## 11. Net foreign exchange (loss) gain

| **Assets** | 2016 | 2015 |
|---|---|---|
| Cash and balances with Central Bank | (265) | (163) |
| Bonds and debt instruments | (6,887) | (1,361) |
| Equities and equity instruments | (74) | (1,320) |
| Derivative instruments | 511 | (1,133) |
| Loans and advances to financial institutions | (3,776) | (1,370) |
| Loans and advances to customers | (31,006) | (9,024) |
| Other assets | (220) | (21) |
| **Total** | **(41,717)** | **(14,392)** |
| | | |
| **Liabilities** | | |
| Due to financial institutions and Central Bank | 399 | 274 |
| Deposits from customers | 13,144 | 5,588 |
| Borrowings | 27,731 | 7,208 |
| Other liabilities | 255 | 21 |
| Subordinated liabilities | 9 | 24 |
| **Total** | **41,538** | **13,115** |
| | | |
| **Net foreign exchange loss** | **(179)** | **(1,277)** |

The foreign exchange difference recognised during the year 2016 in the Consolidated Income Statement that arose on financial instruments not measured at fair value through profit or loss, amounted to a loss of ISK 35,267 million for financial assets (2015: loss of ISK 10,578 million) and a gain of ISK 41,538 million for financial liabilities (2015: gain of ISK 13,115 million).

## 12. Other income and expenses

| | 2016 | 2015 |
|---|---|---|
| Gain (loss) on sale of property and equipment | 10 | (14) |
| Gain on repossessed collateral | 2,025 | 703 |
| Gain on sale of equity-accounted associates | 1,129 | 2,468 |
| Other | 1,336 | 376 |
| **Total** | **4,500** | **3,533** |

## 13. Salaries and related expenses

| | 2016 | 2015 |
|---|---|---|
| Salaries | 10,761 | 10,504 |
| Contributions to defined pension plans | 1,646 | 1,561 |
| Social security contributions, special financial activities tax on salaries and other expenses | 1,642 | 1,689 |
| **Total salaries and related expenses** | **14,049** | **13,754** |
| | | |
| Number of full-time equivalent positions at year-end | 1,012 | 1,063 |
| Average number of full-time equivalent positions during the year | 1,047 | 1,095 |

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### 14. Other operating expenses

| | 2016 | 2015 |
|---|---|---|
| Information technology | 2,104 | 2,269 |
| Real estate and fixtures | 904 | 801 |
| Advertising and marketing expenses | 836 | 831 |
| Operating lease rentals | 554 | 659 |
| FME supervisory expenses | 359 | 353 |
| Contribution to the Debtor's Ombudsman | 83 | 104 |
| Audit and related services | 151 | 121 |
| Other professional services | 603 | 722 |
| Other operating expenses | 1,992 | 2,201 |
| **Total** | **7,586** | **8,061** |

| **Audit and related services** | 2016 | 2015 |
|---|---|---|
| Audit of financial statement and audit-related service | 88 | 73 |
| Review of interim financial statements and audit-related services | 63 | 48 |
| **Total** | **151** | **121** |

### 15. Depreciation and amortisation

| | 2016 | 2015 |
|---|---|---|
| Amortisation of property and equipment | 381 | 462 |
| Depreciation of intangible assets | 230 | 201 |
| **Total** | **611** | **663** |

### 16. Income tax

Income tax is recognised based on the tax rates and tax laws enacted by the end of the year, according to which the domestic corporate income tax rate was 20.0% (2015: 20.0%). An additional special income tax on financial institutions is recognised at a rate of 6% on an income tax base exceeding ISK 1,000 million in accordance with Act No. 165/2011, on Financial Activity Tax.

Income tax recognised in the income statement is specified as follows:

| | 2016 | 2015 |
|---|---|---|
| Current tax expense | (4,755) | (5,927) |
| Special income tax on financial institutions | (1,209) | (2,038) |
| Difference of prior year's imposed and calculated income tax | 48 | (50) |
| Deferred tax expense | 346 | (1,387) |
| **Total** | **(5,570)** | **(9,402)** |

The tax on Group profit differs to the following extent from the amount that would theoretically arise by the domestic corporate income tax rate:

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Profit before tax | | 25,186 | | 48,879 |
| Tax on liabilities of financial institutions | | (2,973) | | (3,017) |
| Profit before income tax | | 22,213 | | 45,862 |
| Income tax calculated using the domestic corporate income tax rate | 20.0% | (4,441) | 20.0% | (9,172) |
| Special income tax on financial institutions | 5.4% | (1,209) | 4.4% | (2,038) |
| Income not subject to tax | (2.6%) | 587 | (6.0%) | 2,758 |
| Non-deductible expenses | 3.8% | (843) | 1.6% | (724) |
| Other | (1.5%) | 336 | 0.5% | (226) |
| **Effective income tax** | **25.1%** | **(5,570)** | **20.5%** | **(9,402)** |

### 17. Tax on liabilities of financial institutions

On 31 December 2013 the Parliament of Iceland passed an amendment to Act No. 155/2010, on Special Tax on Financial Institutions, according to which financial institutions must pay annually a tax calculated as 0.376% (2015: 0.376%) of the carrying amount of total liabilities at year-end, excluding tax liabilities, in excess of ISK 50,000 million as determined for tax purposes. The special income tax on financial intitutions is a non-deductible expense.

| | 2016 | 2015 |
|---|---|---|
| Tax on liabilities of financial institutions | (2,973) | (3,017) |

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## Notes to the Consolidated Statement of Financial Position

### 18. Classification and fair value of financial assets and liabilities

According to IAS 39, financial assets and liabilities must be classified into specific categories which affect how they are measured after initial recognition. Each category's basis of subsequent measurement is specified below:
• Loans and receivables, measured at amortised cost;
• Financial assets and liabilities held for trading, measured at fair value;
• Financial assets designated at fair value through profit or loss, measured at fair value;
• Financial liabilities, measured at amortised cost.

Further details on fair value measurement of financial assets and liabilities can be seen in Note 93, Significant accounting policies.

The following table shows the classification of the Group's financial assets and liabilities according to IAS 39 and their fair values as at 31 December 2016:

| Financial assets | Loans and receivables | Held for trading | Designated at fair value | Liabilities at amortised cost | Total carrying amount | Fair value |
|---|---|---|---|---|---|---|
| Cash and balances with Central Bank | 30,662 | - | - | - | 30,662 | 30,662 |
| Bonds and debt instruments | 110,822 | 34,006 | 10,064 | - | 154,892 | 155,617 |
| Equities and equity instruments | - | 9,890 | 16,798 | - | 26,688 | 26,688 |
| Derivative instruments | - | 278 | - | - | 278 | 278 |
| Loans and advances to financial institutions | 20,408 | - | - | - | 20,408 | 20,408 |
| Loans and advances to customers | 853,417 | - | - | - | 853,417 | 858,187 |
| Other financial assets | 6,528 | - | - | - | 6,528 | 6,528 |
| **Total** | **1,021,837** | **44,174** | **26,862** | **0** | **1,092,873** | **1,098,368** |
| | | | | | | |
| **Financial liabilities** | | | | | | |
| Due to financial institutions and Central Bank | - | - | - | 20,093 | 20,093 | 20,093 |
| Deposits from customers | - | - | - | 589,725 | 589,725 | 589,790 |
| Derivative instruments and short positions | - | 1,729 | - | - | 1,729 | 1,729 |
| Borrowings | - | - | - | 223,944 | 223,944 | 225,520 |
| Other financial liabilities | - | - | - | 7,206 | 7,206 | 7,206 |
| Subordinated liabilities | - | - | - | 388 | 388 | 405 |
| **Total** | **0** | **1,729** | **0** | **841,356** | **843,085** | **844,743** |

The following table shows the classification of the Group's financial assets and liabilities according to IAS 39 and their fair values as at 31 December 2015:

| Financial assets | Loans and receivables | Held for trading | Designated at fair value | Liabilities at amortised cost | Total carrying amount | Fair value |
|---|---|---|---|---|---|---|
| Cash and balances with Central Bank | 25,164 | - | - | - | 25,164 | 25,164 |
| Bonds and debt instruments | 125,211 | 69,279 | 9,194 | - | 203,684 | 205,203 |
| Equities and equity instruments | - | 11,385 | 17,807 | - | 29,192 | 29,192 |
| Derivative instruments | - | 287 | - | - | 287 | 287 |
| Loans and advances to financial institutions | 20,791 | - | - | - | 20,791 | 20,791 |
| Loans and advances to customers | 811,549 | - | - | - | 811,549 | 816,495 |
| Other financial assets | 6,918 | - | - | - | 6,918 | 6,918 |
| **Total** | **989,633** | **80,951** | **27,001** | **0** | **1,097,585** | **1,104,050** |
| | | | | | | |
| **Financial liabilities** | | | | | | |
| Due to financial institutions and Central Bank | - | - | - | 56,731 | 56,731 | 56,730 |
| Deposits from customers | - | - | - | 559,051 | 559,051 | 558,958 |
| Derivative instruments and short positions | - | 3,400 | - | - | 3,400 | 3,400 |
| Borrowings | - | - | - | 209,344 | 209,344 | 210,147 |
| Other financial liabilities | - | - | - | 5,367 | 5,367 | 5,367 |
| Subordinated liabilities | - | - | - | 639 | 639 | 705 |
| **Total** | **0** | **3,400** | **0** | **831,132** | **834,532** | **835,307** |

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## 18. Classification and fair value of financial assets and liabilities (continued)

### Fair value hierarchy

The Group has used a valuation hierarchy for disclosure of inputs to valuation used to measure fair value. Fair value measurements of financial instruments are made on the basis of the following hierarchy:

• Level 1: Quoted prices are used for assets and liabilities traded in active markets. Unadjusted quoted prices are used as the measurement of fair value.

• Level 2: Valuation technique based on observable inputs. The most recent transaction prices in combination with generally accepted valuation methods are used to measure fair value of shares. However, the yield of actively traded bonds with the same duration is used as a benchmark for the valuation of bonds.

• Level 3: Valuation technique based on significant non-observable inputs. It covers all instruments for which the valuation technique includes inputs based on unobservable data and the unobservable inputs have significant effect on the instrument's valuation. For unlisted shares and bonds where there is no market data available, various generally accepted valuation techniques are used to measure fair value. Valuation using discounted cash flow or a comparison of peer companies' multiples are the most commonly used methods to calculate fair value of unlisted shares in addition to recent transactions and current market conditions.

Assumptions and inputs used in the valuation technique include risk-free and benchmark interest rates for estimating discount rates, credit spreads, bonds and equity prices, foreign currency exchange rates, market multipliers, market conditions for estimating future growth and other market indicators.

### Valuation framework

The Bank's Risk & Finance Committee oversees the Group's overall risk and is responsible for fair value measurements of financial assets and liabilities classified as Level 2 and 3 instruments. The Bank's Valuation group reports its valuation results to the Risk & Finance Committee for verification. The Valuation group is comprised of personnel from Risk Management, Treasury and Accounting. The Valuation group holds meetings monthly to determine the value of Level 2 and Level 3 financial assets and liabilities.

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities, carried at fair value in the Consolidated Statement of Financial Position, is categorised as at 31 December 2016:

| Financial assets | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Bonds and debt instruments | 35,555 | 8,337 | 178 | 44,070 |
| Equities and equity instruments | 10,808 | - | 15,880 | 26,688 |
| Derivative instruments | - | 278 | - | 278 |
| **Total** | **46,363** | **8,615** | **16,058** | **71,036** |

| Financial liabilities | | | | |
|---|---|---|---|---|
| Derivative instruments | - | 1,183 | - | 1,183 |
| Short positions | 546 | - | - | 546 |
| **Total** | **546** | **1,183** | **0** | **1,729** |

During the year 2016, there were no transfers between Level 1, Level 2 and Level 3.

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities, carried at fair value in the Consolidated Statement of Financial position, are categorised as at 31 December 2015:

| Financial assets | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Bonds and debt instruments | 69,477 | 8,553 | 443 | 78,473 |
| Equities and equity instruments | 11,069 | - | 18,123 | 29,192 |
| Derivative instruments | - | 287 | - | 287 |
| **Total** | **80,546** | **8,840** | **18,566** | **107,952** |

| Financial liabilities | | | | |
|---|---|---|---|---|
| Derivative instruments | - | 702 | - | 702 |
| Short positions | 2,698 | - | - | 2,698 |
| **Total** | **2,698** | **702** | **0** | **3,400** |

During the year 2015, there were no transfers of financial assets into Level 2 from other levels. However, financial assets were transferred between Level 1 and Level 3, in both directions, either because quoted prices for the assets became available in an active market or, conversely, quoted prices were no longer available and valuation inputs were non-observable.

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## 18. Classification and fair value of financial assets and liabilities (continued)

### Valuation framework (continued)

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities, not carried at fair value in the Consolidated Statement of Financial Position, are categorised as at 31 December 2016:

| Financial assets | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Cash and balances with Central Bank | - | 30,662 | - | 30,662 |
| Bonds and debt instruments | 100,347 | 11,200 | - | 111,547 |
| Loans and advances to financial institutions | - | 20,408 | - | 20,408 |
| Loans and advances to customers | - | - | 858,187 | 858,187 |
| Other financial assets | - | 6,528 | - | 6,528 |
| **Total** | **100,347** | **68,798** | **858,187** | **1,027,332** |

| Financial liabilities | | | | |
|---|---|---|---|---|
| Due to financial institutions and Central Bank | - | 20,093 | - | 20,093 |
| Deposits from customers | - | 589,790 | - | 589,790 |
| Borrowings | - | 225,520 | - | 225,520 |
| Other financial liabilities | - | 7,206 | - | 7,206 |
| Subordinated liabilities | - | 405 | - | 405 |
| **Total** | **0** | **843,014** | **0** | **843,014** |

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities, not carried at fair value in the Consolidated Statement of Financial Position, are categorised as at 31 December 2015:

| Financial assets | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Cash and balances with Central Bank | - | 25,164 | - | 25,164 |
| Bonds and debt instruments | 100,763 | 25,967 | - | 126,730 |
| Loans and advances to financial institutions | - | 20,791 | - | 20,791 |
| Loans and advances to customers | - | - | 816,495 | 816,495 |
| Other financial assets | - | 6,918 | - | 6,918 |
| **Total** | **100,763** | **78,840** | **816,495** | **996,098** |

| Financial liabilities | | | | |
|---|---|---|---|---|
| Due to financial institutions and Central Bank | - | 56,730 | - | 56,730 |
| Deposits from customers | - | 558,958 | - | 558,958 |
| Borrowings | - | 210,147 | - | 210,147 |
| Other financial liabilities | - | 5,367 | - | 5,367 |
| Subordinated liabilities | - | 705 | - | 705 |
| **Total** | **0** | **831,907** | **0** | **831,907** |

The following tables show the reconciliation of fair value measurement in Level 3 for the year 2016 and 2015:

| 1 January - 31 December 2016 | Bonds and debt instruments | Equities and equity instruments | Total financial assets |
|---|---|---|---|
| Carrying amount as at 1 January 2016 | 443 | 18,123 | 18,566 |
| Net gain on financial assets designated at fair value through profit or loss | 22 | 732 | 754 |
| Net foreign exchange gain (loss) | (14) | - | (14) |
| Purchases | 11 | 992 | 1,003 |
| Sales | (11) | (2,894) | (2,905) |
| Settlements | (273) | - | (273) |
| Dividend received | - | (1,073) | (1,073) |
| **Carrying amount as at 31 December 2016** | **178** | **15,880** | **16,058** |

| 1 January - 31 December 2015 | | | |
|---|---|---|---|
| Carrying amount as at 1 January 2015 | 8,031 | 21,908 | 29,939 |
| Net gain on financial assets designated at fair value through profit or loss | 330 | 7,644 | 7,974 |
| Net foreign exchange gain (loss) | (49) | (13) | (62) |
| Purchases | 9 | 372 | 381 |
| Sales | (7,922) | (688) | (8,610) |
| Acquired financial assets in business combinations | 51 | 265 | 316 |
| Settlements | (7) | - | (7) |
| Dividend received | - | (3,911) | (3,911) |
| Transfer into Level 3 | - | 1,114 | 1,114 |
| Transfers from Level 3 to Level 1 | - | (8,568) | (8,568) |
| **Carrying amount as at 31 December 2015** | **443** | **18,123** | **18,566** |

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## 18. Classification and fair value of financial assets and liabilities (continued)

### Valuation framework (continued)

The following table shows the line items in the Consolidated Income Statement where gains (losses), relating only to financial assets and liabilities held by the Group as at 31 December 2016 and 2015 and categorised in Level 3, were recognised:

| 1 January - 31 December 2016 | Bonds and debt instruments | Equities and equity instruments | Total |
|---|---|---|---|
| Net gain on financial assets designated at fair value through profit or loss | 20 | 734 | 754 |
| Net foreign exchange loss | (14) | - | (14) |
| **Total** | **6** | **734** | **740** |
| | | | |
| **1 January - 31 December 2015** | | | |
| Net gain on financial assets designated at fair value through profit or loss | 162 | 5,912 | 6,074 |
| Net foreign exchange loss | (6) | - | (6) |
| **Total** | **156** | **5,912** | **6,068** |

### Unobservable inputs in fair value measurement

The following table shows the unobservable inputs used in measuring fair value for the year 2016 and 2015.

| | | | | | Range of inputs | |
|---|---|---|---|---|---|---|
| **As at 31 December 2016** | **Assets** | **Liabilities** | **Valuation technique** | **Key unobservable inputs** | **Lower** | **Higher** |
| Bonds and debt instruments | 178 | - | See 1) below | See 1) below | n/a | n/a |
| Equities and equity instruments | 15,880 | - | See 2) below | See 2) below | n/a | n/a |
| | **16,058** | **0** | | | | |
| **As at 31 December 2015** | | | | | | |
| Bonds and debt instruments | 443 | - | See 1) below | See 1) below | n/a | n/a |
| Equities and equity instruments | 18,123 | - | See 2) below | See 2) below | n/a | n/a |
| | **18,566** | **0** | | | | |

The table above provides information on Level 3 financial assets and liabilities. A further description of the categories is given below:

1. Fair value of corporate bonds and claims on financial institutions in winding-up proceedings and other insolvent assets is estimated on the basis of an analysis of the estates' financial position and expected recovery. Reference is also made to prices in recent transactions. Given the nature of the valuation method, a range of key unobservable inputs is not available.

2. Equities and equity instruments classified as Level 3 assets, are unlisted and not traded in an active market and therefore subject to unobservable inputs for fair value measurements. Valuation using discounted cash flows, comparison of peer companies' multiples, analysis of financial position and results, outlook and recent transactions are the methods or inputs used to estimate fair value of investments in equities and equity instruments. Given the nature of the valuation method, a range of key unobservable inputs is not available.

### The effect of unobservable inputs in fair value measurement

Although the Group believes that its estimates of fair value are appropriate, the use of different valuation methodologies and assumptions could lead to different estimates of fair value. The following tables show how profit before tax would have been affected if one or more of the inputs for fair value measurements in Level 3 were changed to likely alternatives for the year 2016 and 2015:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| **Effect on profit before tax** | **Favourable** | **Unfavourable** | **Favourable** | **Unfavourable** |
| Bonds and debt instruments | 9 | (9) | 21 | (21) |
| Equities and equity instruments: | | | | |
| Equities | 465 | (603) | 261 | (79) |
| Mutual funds | 346 | (346) | 397 | (397) |
| Total equities and equity instruments | 811 | (949) | 658 | (476) |
| **Total** | **820** | **(958)** | **679** | **(497)** |

The effect on profit was calculated using methods suitable for the models used. Key unobservable inputs were changed by +/- 5%.

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## 19. Cash and balances with Central Bank

| | 2016 | 2015 |
|---|---|---|
| Cash on hand | 3,931 | 3,968 |
| Unrestricted balances with Central Bank | 2,782 | 5,193 |
| **Total cash and unrestricted balances with Central Bank** | **6,713** | **9,161** |
| | | |
| Restricted balances with Central Bank | 11,886 | 16,003 |
| Assets held with Central Bank, subject to special restrictions | 12,063 | - |
| **Total cash and balances with Central Bank** | **30,662** | **25,164** |

The Bank holds a mandatory reserve deposit account with the Central Bank of Iceland in compliance with the Central Bank's rules on Minimum Reserve Requirements No. 870/2015, with subsequent amendments. The average balance of this account for each reserve term must be equivalent at least to the mandatory reserve deposit requirement which amounted to ISK 11,886 million for December 2016 (December 2015: ISK 16,003 million).

The Bank holds an additional amount as a mandatory reserve with the Central Bank in compliance with Article 8 of Act No. 37/2016, on the Treatment of Króna-Denominated Assets Subject to Special Restrictions. This reserve is equivalent to at least the amount of the total balance of deposits subject to special restrictions for investment held with the Group and consists of certificates of deposit issued by the Central Bank.

## 20. Bonds

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| Bonds and debt instruments | Loans and receivables | Held for trading | Designated at fair value | Total | Loans and receivables | Held for trading | Designated at fair value | Total |
| **Domestic** | | | | | | | | |
| Listed | 110,822 | 9,024 | 8,681 | 128,527 | 125,211 | 36,468 | 8,782 | 170,461 |
| Unlisted | - | 41 | 1,383 | 1,424 | - | 911 | 412 | 1,323 |
| | **110,822** | **9,065** | **10,064** | **129,951** | **125,211** | **37,379** | **9,194** | **171,784** |
| **Foreign** | | | | | | | | |
| Listed | - | 24,941 | - | 24,941 | - | 31,900 | - | 31,900 |
| | **0** | **24,941** | **0** | **24,941** | **0** | **31,900** | **0** | **31,900** |
| | | | | | | | | |
| **Total bonds** | **110,822** | **34,006** | **10,064** | **154,892** | **125,211** | **69,279** | **9,194** | **203,684** |

Bonds are classified as "domestic" or "foreign" according to issuers' country of incorporation.

Bonds and debt instruments classified as loans and receivables as at 31 December 2016 and 2015 consist partly of the government bonds which the Bank received in settlement of the capital contribution in 2009. The bonds were listed on the Stock Exchange in Iceland during 2010.

## 21. Equities

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| Equities and equity instruments | Held for trading | Designated at fair value | Total | Held for trading | Designated at fair value | Total |
| **Domestic** | | | | | | |
| Listed | 9,889 | 450 | 10,339 | 11,383 | - | 11,383 |
| Unlisted | - | 16,229 | 16,229 | - | 17,777 | 17,777 |
| | **9,889** | **16,679** | **26,568** | **11,383** | **17,777** | **29,160** |
| **Foreign** | | | | | | |
| Listed | 1 | 119 | 120 | 2 | 30 | 32 |
| | **1** | **119** | **120** | **2** | **30** | **32** |
| | | | | | | |
| **Total equities** | **9,890** | **16,798** | **26,688** | **11,385** | **17,807** | **29,192** |

Equities are classified as "domestic" or "foreign" according to issuers' country of incorporation.

At year-end 2016, outstanding commitments of the Group in share subscriptions amounted to ISK 2.113 million (2015: ISK 2.305 million) altogether in seven entities. The entities invested in by the Group are required to redeem its shareholders with proceeds from the sale of assets.

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## 22. Derivative instruments and short positions

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| **Foreign exchange derivatives** | amount | Assets | Liabilities | amount | Assets | Liabilities |
| Currency forwards | 34,674 | 145 | 147 | 52,462 | 139 | 223 |
| Cross-currency interest rate swaps | 13,949 | 87 | 982 | 6,148 | 109 | 231 |
| | **48,623** | **232** | **1,129** | **58,610** | **248** | **454** |
| **Interest rate derivatives** | | | | | | |
| Interest rate swaps | 1,250 | 21 | - | 1,000 | 2 | 4 |
| Total return swaps | 462 | - | 2 | 4,192 | 29 | 12 |
| | **1,712** | **21** | **2** | **5,192** | **31** | **16** |
| **Equity derivatives** | | | | | | |
| Total return swaps | 5,333 | 24 | 45 | 5,815 | 8 | 107 |
| Equity options | 312 | 1 | 7 | 3,527 | - | 125 |
| | **5,645** | **25** | **52** | **9,342** | **8** | **232** |
| **Short positions** | | | | | | |
| Listed bonds | 457 | - | 546 | 2,162 | - | 2,698 |
| | **457** | **0** | **546** | **2,162** | **0** | **2,698** |
| **Total** | **56,437** | **278** | **1,729** | **75,306** | **287** | **3,400** |

The Group uses derivatives both for hedging and trading purposes.

## 23. Loans and advances to financial institutions

| | **2016** | **2015** |
|---|---|---|
| Bank accounts with financial institutions | 14,539 | 15,096 |
| Money market loans | 2,209 | 1,281 |
| Overdrafts | - | 1,482 |
| Other loans | 3,660 | 2,932 |
| **Total** | **20,408** | **20,791** |

## 24. Loans and advances to customers

| | **2016** | **2015** |
|---|---|---|
| Public entities | 10,028 | 8,969 |
| Individuals | 326,844 | 303,349 |
| Corporates | 537,496 | 532,888 |
| Allowance for impairment | (20,951) | (33,657) |
| **Total** | **853,417** | **811,549** |

During the reporting period, the Group was not permitted to sell or repledge any collateral in absence of default by the owner of the collateral.

Further disclosure on loans and advances to customers is provided in the risk management notes to these Consolidated Financial Statements.

## 25. Investments in associates

| **a) Investments in equity-accounted associates** | **2016** | **2015** |
|---|---|---|
| Carrying amount as at the beginning of the year | 909 | 777 |
| Acquisitions through business combination | - | 24 |
| Acquisition | 47 | 33 |
| Share of profit of equity-accounted associates | 483 | 248 |
| Disposals and dividend received | (255) | (173) |
| **Total** | **1,184** | **909** |

| **As at 31 December 2016*** | **Total assets** | **Total liabilities** | **Profit (loss)** | **Ownership interest** | **Share of profit of associates** | **Carrying amount** |
|---|---|---|---|---|---|---|
| Reiknistofa bankanna hf. | 4,292 | 2,544 | 163 | 39% | 45 | 675 |
| Greiðslumiðlun Íslands ehf. | 1,150 | 225 | 914 | 48% | 515 | 444 |
| Auðkenni ehf. | 292 | 41 | (84) | 26% | (77) | 65 |
| **Total** | **5,734** | **2,810** | **993** | | **483** | **1,184** |

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## 25. Investments in associates (continued)

### a) Investments in equity-accounted associates (continued)

| As at 31 December 2015* | Total assets | Total liabilities | Profit (loss) | Ownership interest | Share of profit of associates | Carrying amount |
|---|---|---|---|---|---|---|
| Reiknistofa bankanna hf. | 4,052 | 2,420 | 207 | 39% | 82 | 630 |
| Greiðslumiðlun Íslands ehf. | 922 | 397 | 452 | 48% | 208 | 231 |
| Auðkenni ehf. | 261 | 46 | (192) | 22% | (42) | 48 |
| **Total** | **5,235** | **2,863** | **467** | | **248** | **909** |

*The amounts for the years 2016 and 2015 in the tables are estimates, not actual amounts at the end of the respective years, if actual amounts were not readily available.

None of the above-mentioned associate companies are listed on the market.

As disclosed in the Bank's Consolidated Financial Statements for 2015, the sale of the Bank's 38.62% shareholding in Valitor Holding hf. to Arion Bank included, inter alia, an agreement on an additional consideration for the Bank's shares in Valitor. The accord was contingent upon the exercise of an option agreement between Visa Europe and Visa Inc.

On 21 April 2016, Visa Europe and Visa Inc. announced an amendment to the purchasing price of Visa Europe, brought on by criticism from European competition authorities. The amendment is to the effect that an earn-out of up to EUR 4,700 million (including interest), payable in cash 16 quarters following the option exercise date, was replaced with an increased initial cash payment of EUR 12,250 million, up from EUR 11,500 million, and a cash payment of EUR 1,120 million after a 3-year period. No change was made to the EUR 5,000 million preference shares in Visa Inc. The total value might amount to as much as EUR 18,370 million. The transaction was concluded in Q3 of 2016, once the relevant supervisory authorities had given their approval. Based on information and payment from Arion Bank, Landsbankinn has in these Consolidated Financial Statements recognised gain on sale of equity accounted associates as income ISK 1,139 million as a result of the increased fair value of the additional consideration for the shares in Valitor Holding hf.

### b) Investments in associates designated at fair value through profit or loss

One investment in an associate is wholly accounted for by the Group as a financial asset designated at fair value through profit or loss and presented in the consolidated statement of financial position in the line "Equities and equity instruments". This investment is a 23.0% share in Eyrir Invest hf. and the valuation technique used to measure the investment's fair value is based on significant non-observable inputs under Level 3 of the fair value hierarchy.

## 26. Property and equipment

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Buildings | Fixtures, equipment and vehicles | Total | Buildings | Fixtures, equipment and vehicles | Total |
| Carrying amount as at the beginning of the year | 3,570 | 2,088 | 5,658 | 3,494 | 2,197 | 5,691 |
| Acquisitions through business combination | - | - | 0 | 220 | 17 | 237 |
| Additions during the year | - | 351 | 351 | - | 274 | 274 |
| Sold during the year | (171) | (5) | (176) | (81) | (1) | (82) |
| Depreciation | (64) | (317) | (381) | (63) | (399) | (462) |
| **Carrying amount as at 31 December** | **3,335** | **2,117** | **5,452** | **3,570** | **2,088** | **5,658** |
| | | | | | | |
| Gross carrying amount | 3,819 | 5,228 | 9,047 | 3,990 | 4,882 | 8,872 |
| Accumulated depreciation | (484) | (3,111) | (3,595) | (420) | (2,794) | (3,214) |
| **Carrying amount as at 31 December** | **3,335** | **2,117** | **5,452** | **3,570** | **2,088** | **5,658** |
| Depreciation rates | 2-4% | 10-33% | | 2-4% | 10-33% | |

| **Official assessment value of buildings** | **2016** | **2015** |
|---|---|---|
| Official assessment value | 3,795 | 3,447 |
| Replacement value | 8,091 | 8,235 |

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## 27. Intangible assets

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Computer software licenses | Goodwill | Total | Computer software licenses | Goodwill | Total |
| Carrying amount as at the beginning of the year | 1,621 | 391 | 2,012 | 1,225 | - | 1,225 |
| Additions through business combinations | - | - | 0 | - | 391 | 391 |
| Additions | 852 | - | 852 | 597 | - | 597 |
| Amortisation | (230) | - | (230) | (201) | - | (201) |
| **Carrying amount** | **2,243** | **391** | **2,634** | **1,621** | **391** | **2,012** |
| | | | | | | |
| Gross carrying amount | 4,104 | 391 | 4,495 | 3,252 | 391 | 3,643 |
| Accumulated amortisation | (1,861) | - | (1,861) | (1,631) | - | (1,631) |
| **Carrying amount** | **2,243** | **391** | **2,634** | **1,621** | **391** | **2,012** |
| | | | | | | |
| Annual amortisation rates | 20-33% | | 20-33% | 20-33% | | 20-33% |

## 28. Other assets

| | 2016 | 2015 |
|---|---|---|
| Unsettled securities trading | 2,301 | 1,025 |
| Other accounts receivable | 4,227 | 5,893 |
| Sundry assets | 1,565 | 539 |
| **Total** | **8,093** | **7,457** |

## 29. Assets and liabilities classified as held for sale

### Assets classified as held for sale

| | 2016 | 2015 |
|---|---|---|
| Repossessed collateral | 6,356 | 10,095 |
| Assets of disposal groups | 1,093 | 1,860 |
| **Total** | **7,449** | **11,955** |

### Repossessed collateral

Repossessed collateral consists mainly of property and equipment resulting from collateral foreclosed by the Group as security for loans and advances. The Group's policy is to pursue timely realisation of the repossessed collateral in an orderly manner. The Group generally does not use the non-cash repossessed collateral for its own operations. Repossessed collateral is recognised as assets of either the Bank or its subsidiary Hömlur ehf.

| Repossessed collateral | 2016 | 2015 |
|---|---|---|
| Carrying amount as at the beginning of the year | 10,095 | 12,270 |
| Repossessed during the year | 3,646 | 6,760 |
| Disposed of during the year | (9,238) | (9,895) |
| Impairment and gain of sale | 1,853 | 960 |
| **Carrying amount as at the end of the year** | **6,356** | **10,095** |

### Assets of disposal groups classified as held for sale

Assets of disposal groups classified as held for sale consist of all the assets and liabilities of subsidiaries acquired by the Bank exclusively with a view to resale.

### Liabilities associated with assets classified as held for

| | 2016 | 2015 |
|---|---|---|
| Liabilities of disposal groups | 1,095 | 1,518 |
| **Total** | **1,095** | **1,518** |

## 30. Due to financial institutions and Central Bank

| | 2016 | 2015 |
|---|---|---|
| Loans and repurchase agreements with Central Bank | 85 | 80 |
| Loans and deposits from financial institutions | 8,599 | 56,651 |
| Deposits subject to special restrictions* | 11,409 | - |
| **Total** | **20,093** | **56,731** |

*in compliance with Article 8 of Act No. 37/2016, on the Treatment of Króna-Denominated Assets Subject to Special Restrictions

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## 31. Deposits from customers

| | 2016 | 2015 |
|---|---|---|
| Demand deposits | 367,215 | 345,645 |
| Term deposits | 221,856 | 213,406 |
| Deposits subject to special restrictions* | 654 | - |
| **Total** | **589,725** | **559,051** |

*in compliance with Article 8 of Act No. 37/2016, on the Treatment of Króna-Denominated Assets Subject to Special Restrictions

## 32. Borrowings

### Secured borrowings

| As at 31.12.2016 | Currency | Final maturity | Outstanding principal | Contractual interest rate (Base rate + Initial margin/ Step-up margin) | Carrying amount |
|---|---|---|---|---|---|
| BOND D | USD | 9.10.2020 | USD 170 million | LIBOR + 2.90% / 3.50% | 19,251 |
| BOND F | USD | 9.10.2024 | USD 271 million | LIBOR + 2.90% / 3.95% | 30,871 |
| **Total issued bonds to LBI hf.** | | | | | **50,122** |

| As at 31.12.2016 | Currency | Final maturity | Outstanding principal | Indexed/ Non-indexed | Contractual interest rate | Carrying amount |
|---|---|---|---|---|---|---|
| LBANK CB 17 | ISK | 23.10.2017 | 3,160 | Non-indexed | Fixed 6.0% | 3,189 |
| LBANK CB 19 | ISK | 17.9.2019 | 13,540 | Non-indexed | Fixed 6.8% | 13,873 |
| LBANK CB 21 | ISK | 30.11.2021 | 700 | Non-indexed | Fixed 5.5% | 691 |
| LBANK CBI 22 | ISK | 28.4.2022 | 17,780 | CPI-indexed | Fixed 3.0% | 18,462 |
| LBANK CBI 28 | ISK | 4.10.2028 | 2,380 | CPI-indexed | Fixed 3.0% | 2,371 |
| **Total covered bonds** | | | | | | **38,586** |
| **Total secured borrowings** | | | | | | **88,708** |

### Unsecured borrowings

| As at 31.12.2016 | Currency | Final maturity | Outstanding principal | Contractual interest rate | Carrying amount |
|---|---|---|---|---|---|
| LBANK 3 10/18 | EUR | 19.10.2018 | EUR 300 million | FIXED 3.0% | 35,864 |
| LBANK FLOAT 06/19 | SEK | 10.6.2019 | SEK 350 million | STIBOR + 2.6% | 4,345 |
| LBANK FLOAT 06/19 | NOK | 11.6.2019 | NOK 500 million | NIBOR + 2.6% | 6,564 |
| LBANK 1.375 11/20 | SEK | 24.11.2020 | SEK 750 million | FIXED 1.375% | 9,280 |
| LBANK FLOAT 11/20 | SEK | 24.11.2020 | SEK 250 million | STIBOR + 1.5% | 3,103 |
| LBANK 1.625 03/21 | EUR | 15.3.2021 | EUR 500 million | FIXED 1.625% | 59,357 |
| **Total EMTN issued** | | | | | **118,513** |

| As at 31.12.2016 | Currency | Final maturity | Outstanding principal | Indexed/ Non-indexed | Carrying amount |
|---|---|---|---|---|---|
| LBANK 170110 | ISK | 10.1.2017 | 2,340 | Non-indexed | 2,336 |
| LBANK 170210 | ISK | 10.2.2017 | 1,020 | Non-indexed | 1,013 |
| LBANK 170310 | ISK | 10.3.2017 | 1,040 | Non-indexed | 1,029 |
| LBANK 170410 | ISK | 10.4.2017 | 2,820 | Non-indexed | 2,775 |
| LBANK 170510 | ISK | 10.5.2017 | 2,780 | Non-indexed | 2,724 |
| LBANK 170612 | ISK | 12.6.2017 | 1,720 | Non-indexed | 1,677 |
| **Total bills issued** | | | | | **11,554** |

| As at 31.12.2016 | Carrying amount |
|---|---|
| Other unsecured loans | 5,169 |
| **Total other unsecured loans** | **5,169** |
| **Total unsecured borrowings** | **135,236** |
| **Total borrowings as at 31.12.2016** | **223,944** |

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## 32. Borrowings (continued)

### Secured borrowings

| As at 31.12.2015 | Currency | Final maturity | Outstanding principal | Contractual interest rate (Base rate + Initial margin/ Step-up margin) | Carrying amount |
|---|---|---|---|---|---|
| BOND D | USD | 9.10.2020 | USD 271 million | LIBOR + 2.90% / 3.50% | 35,369 |
| BOND E | EUR | 9.10.2022 | EUR 192 million | EURIBOR + 2.90% / 3.65% | 27,267 |
| BOND F | USD | 9.10.2024 | USD 271 million | LIBOR + 2.90% / 3.95% | 35,369 |
| BOND G | EUR | 9.10.2026 | EUR 192 million | EURIBOR + 2.90% / 4.05% | 27,267 |
| **Total issued bonds to LBI hf.** | | | | | **125,272** |

| As at 31.12.2015 | Currency | Final maturity | Outstanding principal | Indexed/ Non-indexed | Contractual interest rate | Carrying amount |
|---|---|---|---|---|---|---|
| LBANK CB 16 | ISK | 10.6.2016 | 3,360 | Non-indexed | Fixed 6.3% | 3,479 |
| LBANK CB 17 | ISK | 23.10.2017 | 1,740 | Non-indexed | Fixed 6.0% | 1,752 |
| LBANK CB 19 | ISK | 17.9.2019 | 7,220 | Non-indexed | Fixed 6.8% | 7,407 |
| LBANK CBI 22 | ISK | 28.4.2022 | 9,520 | CPI-indexed | Fixed 3.0% | 9,742 |
| **Total covered bonds** | | | | | | **22,380** |
| **Total secured borrowings** | | | | | | **147,652** |

### Unsecured borrowings

| As at 31.12.2015 | Currency | Final maturity | Outstanding principal | Contractual interest rate | Carrying amount |
|---|---|---|---|---|---|
| LBANK 3 10/18 | EUR | 19.10.2018 | EUR 300 million | FIXED 3.0% | 42,438 |
| LBANK FLOAT 06/19 | NOK | 11.6.2019 | NOK 250 million | NIBOR + 2.6% | 3,669 |
| LBANK FLOAT 06/19 | SEK | 10.6.2019 | SEK 250 million | STIBOR + 2.6% | 3,831 |
| **Total EMTN issued** | | | | | **49,938** |

| As at 31.12.2015 | Currency | Final maturity | Outstanding principal | Indexed/ Non-indexed | Carrying amount |
|---|---|---|---|---|---|
| LBANK 160310 | ISK | 10.3.2016 | 2,780 | Non-indexed | 2,746 |
| LBANK 160510 | ISK | 10.5.2016 | 2,460 | Non-indexed | 2,404 |
| LBANK 160610 | ISK | 10.6.2016 | 480 | Non-indexed | 466 |
| **Total bills issued** | | | | | **5,616** |

| As at 31.12.2015 | Carrying amount |
|---|---|
| Other unsecured loans | 6,138 |
| **Total other unsecured loans** | **6,138** |
| **Total unsecured borrowings** | **61,692** |
| **Total borrowings as at 31.12.2015** | **209,344** |

The secured foreign currency bonds consist of bonds issued by the Bank to LBI hf. as consideration and supplementary consideration for the assets and liabilities transferred from LBI hf. to the Bank in October 2008. Under an agreement between the Bank and LBI hf. in October 2015, the Bank has the option to convert the secured bonds, in part or in full, to senior unsecured bonds under the Bank's Euro Medium Term Note (EMTN) programme. The option is conditional on the Bank maintaining a specified minimum credit rating and is valid until March 2017. If the Bank exercises the option, the terms of the senior unsecured bonds will be determined with reference to market terms at the time of conversion.

Interest rate terms are 3M LIBOR for the USD-denominated bonds plus a margin of 2.9% until October 2018, stepping up to 3.5% for the 2020 tranche and 3.95% for the final maturity in 2024.

The Bank is obliged to pledge part of its loan portfolio as collateral for the secured bonds issued to LBI hf. as well as for the covered bonds it has issued. It must maintain a coverage ratio of at least 115% on the secured bonds issued to LBI hf. and at least 120% on the covered bonds. For further details on encumbered assets see Note 80.

On 15 April 2016, the Bank made a partial prepayment of the senior secured Bond E series in the amount of EUR 20 million, together with accrued interest.

On 15 September 2016, the Bank prepaid the remainder of the senior secured Bond E series and G series (EUR 172 million and EUR 192 million respectively), together with accrued interest. In addition, the Bank made a partial prepayment of USD 24 million towards the senior secured Bond D series, together with accrued interest.

On 25 November 2016 and on 5 December 2016, the Bank made further partial prepayments of the senior secured Bond D series in the total amount of USD 77 million, together with accrued interest.

Each covered bond series in ISK is issued under the Bank's ISK 100,000 million Covered Bond programme. These covered bonds are issued under a licence from the Icelandic FME and with reference to Act No. 11/2008 and FME Rules No. 528/2008. All covered bond series are listed and traded on NASDAQ Iceland.

The senior unsecured bonds LBANK 3 10/18 of EUR 300 million mature in October 2018 and carry a fixed coupon rate of 3.0%.

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## 32. Borrowings (continued)

On 12 April 2016, the Bank issued additional tranches of NOK 250 million and SEK 100 million in the senior unsecured bond series LBANK FLOAT 06/19. These tranches mature in June 2019 and carry 3-month NIBOR and STIBOR interest rates for the respective currencies plus a 2.6% margin.

On 15 September 2016, the Bank issued EUR 500 million in senior unsecured bonds. The bonds mature in March 2021, bear a fixed coupon rate of 1.625% and were priced at terms equivalent to a 190 basis point spread above mid-swaps in euros. The proceeds of this bond series were used to refinance the senior secured Bond D, E and G series, in addition to strengthening the Bank's liquidity further.

On 24 November 2016, the Bank completed a bond offering of SEK 1.000 million in senior unsecured bonds. The bonds mature in November 2020 and were issued in two tranches: SEK 750 million at a fixed rate of 1.375% and SEK 250 million at a floating rate of STIBOR, plus a 1.5% margin.

The senior unsecured bonds in foreign currencies are all issued under the Bank's 1,500 million Euro Medium Term Note (EMTN) programme and are listed on the Irish Stock Exchange.

All the outstanding unsecured non-indexed bank bills issued by the Bank have a maturity of less than one year. These ISK-denominated bills are issued under the Bank's ISK 30,000 million Debt Issuance Programme. All Landsbankinn's bill series are listed and traded on NASDAQ Iceland.

## 33. Deferred tax assets and liabilities

Recognised deferred tax assets and liabilities are attributable to the following:

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Assets | Liabilities | Net | Assets | Liabilities | Net |
| Property and equipment | - | (177) | (177) | - | (239) | (239) |
| Intangibles | - | (181) | (181) | - | (132) | (132) |
| Other assets | - | (13) | (13) | - | (19) | (19) |
| Deferred foreign exchange differences | 32 | - | 32 | 69 | - | 69 |
| Other items | 43 | - | 43 | - | (171) | (171) |
| Tax losses carried forward | 211 | - | 211 | 326 | - | 326 |
| | **286** | **(371)** | **(85)** | **395** | **(561)** | **(166)** |
| Set-off of deferred tax assets together with liabilities of the same taxable entities | (286) | 286 | - | (395) | 395 | - |
| **Deferred tax liabilities total** | **0** | **(85)** | **(85)** | **0** | **(166)** | **(166)** |

The deferred tax assets and liabilities are measured based on the tax rates and tax laws enacted by the end of 2016, according to which the domestic corporate income tax rate was 20% as at 31 December 2016 (2015: 20%).

The movements in temporary differences during the period were as follows:

| | | Recognised in income statement | | |
|---|---|---|---|---|
| **2016** | **Balance 1.1** | **Tax (expense) income** | **Changes from prior year** | **Balance 31.12** |
| Property and equipment | (239) | 62 | - | (177) |
| Intangibles | (132) | (49) | - | (181) |
| Other assets | (19) | 6 | - | (13) |
| Deferred foreign exchange differences | 69 | (37) | - | 32 |
| Other items | (171) | 214 | - | 43 |
| Tax losses carried forward | 326 | (115) | - | 211 |
| **Total** | **(166)** | **81** | **0** | **(85)** |

| **2015** | **Balance 1.1** | **Tax (expense) income** | **Acquisitions through business combination** | **Balance 31.12** |
|---|---|---|---|---|
| Property and equipment | (284) | 39 | 6 | (239) |
| Intangibles | (38) | (94) | - | (132) |
| Other assets | 186 | (205) | - | (19) |
| Deferred foreign exchange differences | (148) | 217 | - | 69 |
| Other items | (128) | (43) | - | (171) |
| Tax losses carried forward | 495 | 1,048 | (1,217) | 326 |
| **Total** | **83** | **962** | **(1,211)** | **(166)** |

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## 34. Other liabilities

| | 2016 | 2015 |
|---|---|---|
| Potential excess payments on lease and loan agreements | 1,443 | 2,586 |
| Unsettled securities trading | 4,779 | 2,312 |
| Withholding tax | 2,873 | 2,451 |
| Accounts payable | 677 | 184 |
| Contribution to the Depositors' and Investors' Guarantee Fund | 307 | 285 |
| Tax on liabilities of financial institutions | 2,973 | 3,017 |
| Current tax liabilities | 5,838 | 7,966 |
| Non controlling interests - Funds | 883 | 752 |
| Sundry liabilities | 3,094 | 3,725 |
| **Total** | **22,867** | **23,278** |

Unsettled securities transactions were settled in less than three days from the reporting date.

*Unpaid premiums to the Depositors' and Investors' Guarantee Fund (TIF)*

According to Act No. 98/1999, on Deposit Guarantees and Investors' Compensation Scheme, as subsequently amended, the Bank is to pay each quarter a non-refundable general and variable premium to the TIF. The general premium amounts to the equivalent of 0.225% annually of all deposits, as defined by the Act, or equivalent to 0.05625% on each quarterly due date. The variable premium is determined by a risk factor assigned to the Bank by the FME and may at maximum be equal to the general premium.

Acting on a joint proposal from FME and the Central Bank of Iceland, the Fund may collect a supplementary premium if its assets are not sufficient to cover payments when the Fund's obligation to render payment becomes effective. TIF may also collect a supplementary premium to cover costs, instalments and interest payments on its loans. Such a supplementary payment, however, may never exceed 0.6% of the Bank's insured deposits.

The Bank only recognises a liability for premiums to TIF equivalent to the amount the Bank is obliged by law to pay at the end of each accounting period. This is the premium which the Bank is to pay during the current quarter for the preceding quarter. Other premiums to be paid by the Bank to the Fund during later periods are dependent upon the Bank's future activities and therefore are not recognised as a liability on the accounting date.

## 35. Subordinated liabilities

| As at 31.12.2016 | Currency | Final maturity | Remaining principal in currencies | Indexed/ Non-indexed | Contractual interest rate (Base rate + Margin) | Carrying amount |
|---|---|---|---|---|---|---|
| Subordinated bonds unlisted | ISK | 1.12.2017 | 25.3 | | REIBOR + 4% | 25 |
| Subordinated loan | JPY | 1.12.2023 | JPY 49,1 million | | LIBOR + 5% | 48 |
| Subordinated loan | CHF | 1.12.2023 | CHF 0,3 million | | LIBOR + 5% | 37 |
| Subordinated loan | ISK | 13.9.2017 | 59.1 | CPI-indexed | Fixed 7,0% | 61 |
| Subordinated loan | ISK | 18.9.2017 | 6.4 | CPI-indexed | Fixed 7,0% | 7 |
| Subordinated loan | ISK | 21.9.2017 | 19.3 | CPI-indexed | Fixed 7,0% | 20 |
| Subordinated loan | ISK | 22.9.2017 | 52.0 | CPI-indexed | Fixed 7,0% | 54 |
| Subordinated loan | ISK | 1.12.2017 | 8.2 | CPI-indexed | Fixed 7,0% | 8 |
| Subordinated bonds unlisted | ISK | 22.11.2019 | 120.5 | CPI-indexed | Fixed 5,0% | 128 |
| **Total subordinated liabilities** | | | | | | **388** |

| As at 31.12.2015 | Currency | Final maturity | Remaining principal in currencies | Indexed/ Non-indexed | Contractual interest rate (Base rate + Margin) | Carrying amount |
|---|---|---|---|---|---|---|
| Subordinated bonds unlisted | ISK | 1.12.2017 | 50.6 | | REIBOR + 4% | 51 |
| Subordinated loan | EUR | 2.12.2020 | EUR 0,2 million | | LIBOR + 5% | 27 |
| Subordinated loan | JPY | 2.12.2020 | JPY 101,1 million | | LIBOR + 5% | 109 |
| Subordinated loan | CHF | 2.12.2020 | CHF 0,7 million | | LIBOR + 5% | 89 |
| Subordinated loan | JPY | 1.12.2023 | JPY 49,1 million | | LIBOR + 5% | 53 |
| Subordinated loan | CHF | 1.12.2023 | CHF 0,3 million | | LIBOR + 5% | 43 |
| Subordinated loan | ISK | 13.9.2017 | 59.1 | CPI-indexed | Fixed 7,0% | 60 |
| Subordinated loan | ISK | 18.9.2017 | 6.4 | CPI-indexed | Fixed 7,0% | 6 |
| Subordinated loan | ISK | 21.9.2017 | 19.3 | CPI-indexed | Fixed 7,0% | 19 |
| Subordinated loan | ISK | 22.9.2017 | 52.0 | CPI-indexed | Fixed 7,0% | 52 |
| Subordinated loan | ISK | 1.12.2017 | 8.2 | CPI-indexed | Fixed 7,0% | 8 |
| Subordinated bonds unlisted | ISK | 22.11.2019 | 120.0 | CPI-indexed | Fixed 5,0% | 121 |
| **Total subordinated liabilities** | | | | | | **639** |

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## 35. Subordinated liabilities (continued)

The subordinated liabilities are comprised of liabilities assumed by the Bank in two separate mergers, with savings banks Sparisjóður Vestmannaeyja and Sparisjóður Norðurlands on 29 March 2015 and 4 September 2015, respectively. The subordinated liabilities thus assumed share characteristics of equity in that they are subordinated to other Group liabilities and are included in equity in equity ratio calculations, see Note 48, Capital base, risk-weighted and capital ratios. The outstanding amounts of the subordinated liabilities are subject to regulatory amortisation whereby the amount eligible for Tier 2 capital treatment is amortised on a straight-line basis over the final 5 years to maturity.

## 36. Equity

*Share capital*

As of 31 December 2016, ordinary shares authorised and issued by the Bank totalled 24 billion, while outstanding shares were 23.6 billion; each share has a par value of ISK 1. Each ordinary share conveys one vote at general meetings of the Bank. All share capital is fully paid up.

On 15 September 2016, the Bank's Board of Directors decided to offer to buy back own shares in the Bank, in accordance with a resolution passed by the Bank's AGM on 14 April 2016. These buy-backs will amount to a maximum of 480 million shares, or the equivalent of 2% of issued share capital. The objective of the buy-back programme is to reduce the Bank's equity while at the same time offering shareholders an opportunity to sell their shares in the Bank in a transparent manner, as restrictions on the transfer of shares expired on 1 September 2016.

The Bank subsequently announced it would purchase shares from shareholders in accordance with a buy-back programme during three specified periods: from 19 September 2016 to 30 September 2016, from 31 October 2016 to 9 December 2016, and from 13 February 2017 to 24 February 2017.

In accordance with the AGM's decision, Landsbankinn offered to buy back each share during the above-mentioned periods at a share price determined by the internal value of the Bank's shares, according to its most recently published results prior to the commencement of the repurchase period concerned. The purchase price of the shares may therefore change between repurchase periods depending on the outcome of the Bank's latest quarterly or annual results.

At the end of the first half of 2016, equity attributable to owners of the Bank was ISK 247,250 million and outstanding share capital was 23,782 million shares. In the first buy-back period, from 19 September 2016 to 30 September 2016, the Bank acquired ISK 119,9 million own shares at a share price of ISK 10.3966, for a total amount of ISK 1,247 million.

At the end of the third quarter of 2016, equity attributable to owners of the Bank was ISK 251,106 million and outstanding share capital was 23,662 million shares. In the second buy-back period, from 31 October 2016 to 9 December 2016, the Bank acquired ISK 13.6 million own shares at a share price of ISK 10.6123, for a total amount of ISK 144 million.

*Share premium*

Share premium represents the difference between the ISK amount received by the Bank when issuing share capital and the nominal amount of the shares issued, less costs directly attributable to issuing the new shares, net of any related tax benefit.

*Statutory reserve*

The statutory reserve is established in accordance with the Public Limited Companies Act, No. 2/1995, which stipulates that the Bank must allocate profits to the statutory reserve until the reserve is equal to one-quarter of the Bank's share capital.

*Retained earnings*

In June 2016, the Icelandic parliament passed an amendment to Act No. 3/2006, on Annual Financial Statements. The amendment entered into force immediately and applies to the financial year commencing 1 January 2016. As interpretation of the Act is still unclear, disclosure of retained earnings in the Condenced Consolidated Interim Financial Statements of Landsbankinn for the year 2017 may change following further clarification of proper interpretation of the Act. The amendment requires, *inter alia* , that retained earnings be separated into two categories: restricted and unrestricted retained earnings. Unrestricted retained earnings consist of undistributed profits and losses accumulated by the Group since the foundation of the Bank, less transfers to the Bank's statutory reserve and restricted retained earnings.

*Dividend*

The Annual General Meeting of Landsbankinn's shareholders for the operating year 2015, held on 14 April 2016, approved the Board's proposal to pay dividends to shareholders in the amount of ISK 1.20 per share for the year 2015. The dividend was paid in two equal payments, each in the amount of ISK 0.60 per share, on 20 April 2016 and 21 September 2016. Total dividend payments on the outstanding shares amounted to ISK 28,538 million.

### 36. Equity (continued)

*Restriction of dividend payments*

According to the Public Limited Companies Act, No. 2/1995, it is only permissible to allocate as dividend profit in accordance with approved annual financial statements for the immediate past financial year, profit carried forward from previous years, and free funds after deducting loss which has not been met, and the funds which according to law or Articles of Association must be contributed to a reserve fund or for other use. Furthermore, under the amendment to Act No. 3/2006, on Annual Financial Statements, from June 2016 it is only permissible to allocate as dividend profit from unrestricted retained earnings.

Additionally, according to the Act on Financial Undertakings, No. 161/2002, the Icelandic Financial Supervisory Authority can impose proportionate restrictions on the Bank's dividend payments, if the Bank's capital adequacy ratio falls below the total capital requirement plus capital buffers, see Note 47 Capital requirements.

## Other notes

### 37. Earnings per share

| Profit for the year | 2016 | 2015 |
|---|---|---|
| Profit for the year attributable to owners of the Bank | 16,633 | 36,460 |

Diluted earnings per share are calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares.

| Number of shares | 2016 | 2015 |
|---|---|---|
| Number of ordinary shares issued at beginning of year | 24,000 | 24,000 |
| Average number of own shares | (261) | (273) |
| **Weighted average number of shares outstanding** | **23,739** | **23,727** |
| | | |
| **Basic and diluted earnings per share from operations (ISK)** | **0.70** | **1.54** |

The Bank's basic and diluted earnings per share are equal as the Bank has not issued any options, warrants, convertibles or other potential sources of dilution.

### 38. Litigation

The Bank and its subsidiaries are from time to time party to litigation cases which arise in the ordinary course of business. Some of these cases are material in the sense that management considers that they may have a significant impact on the amounts disclosed in the Group's financial statements and are not comparable to other, previously closed, cases. All the material cases disclosed as open in the Group's financial statements at year-end 2015 were open at year-end 2016.

Inflation-indexation of financial obligations

1) In January 2013, a customer commenced litigation against the Bank, seeking acknowledgement of the unlawfulness of a consumer price indexation provision in a bond issued by him to the Bank and that it is not permissible for the Bank to revalue the principal amount of the bond on a monthly basis in accordance with the consumer price index. The District Court of Reykjavík on 19 February 2016 acquitted the Bank of the plaintiff's claims. The aspect of the case concerning whether the Bank may revalue the principal amount of the bond on a monthly basis in accordance with the consumer price index has been appealed to the Supreme Court. The Bank has submitted its reasoning before the Supreme Court, claiming confirmation of the ruling of the District Court. The case will be heard before the Supreme Court on 20 February 2017.

Investigation of the Icelandic Competition Authority into lending terms

2) In March 2013, the Icelandic Competition Authority submitted to the Bank its preliminary assessment concerning certain preferential terms and conditions offered during 2004-2010 by Landsbanki Íslands hf. (now LBI ehf.) and, subsequently, by the Bank, in 2004 to 2010, to clients for retail banking services, in particular for household mortgage loans. In June 2013, the Bank gave its response and refuted allegations of a breach of competition rules. In September 2015, the Bank and the Authority entered into discussions on the resolution of the case. On 7 July 2016, the Authority introduced initial proposals for measures to strengthen competition in the financial market. On 21 November 2016, the Authority submitted to the Bank a draft settlement in the case. The Bank presented to the Authority its preliminary view on the draft on 24 November 2016.

Claim for damages by a payment card company

3) In June 2013, a payment card company commenced litigation against the Bank and certain other financial undertakings claiming tort liability in the amount of around ISK 1.2 billion, plus interest. The plaintiff argues that the defendants are liable in tort for alleged violation of competition rules. The Bank refutes the allegations and the claims. Assessors were appointed by the District Court of Reykjavik to appraise certain aspects of the case and work on the appraisal was completed on 30 June 2016. The Bank submitted its defence in the case on 6 October 2016 and requested, together with other defendants, a revised appraisal. The case was heard by the District Court on 18 November 2016 and postponed until 1 March 2017.

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## 38. Litigation (continued)

Recalculation of foreign currency indexed loans

4) In October 2015, the Supreme Court ruled in favour of the Bank in two cases (cases No. 34/2015 and 35/2015) where a company had brought lawsuits against the Bank demanding recalculation of previous recalculations of foreign currency indexed loans in accordance with Supreme Court rulings No. 600/2011 and No. 464/2012 relating to so-called final receipts of payment. In November 2015 and in January and May 2016, the District Court of Reykjavík ruled in favour of the Bank in seven similar disputes. In 2016 and 2017, the Supreme Court confirmed the conclusions of the District Court in two of the seven cases (cases No. 34/2016 and 241/2016). However, in 2016 and 2017, the Supreme Court reversed the conclusions of the District Court in four of the seven cases (cases No. 82/2016, 149/2016, 150/2016 and 242/2016). In the latter cases, the Supreme Court found the impact of the additional claim to be so severe for the companies involved that the Bank should absorb the disputed interest margin, caused by illegal foreign currency indexation of the loans in question. In these cases, the Court thus upheld the claims of the companies. These rulings may set a precedent for cases involving other foreign currency indexed loans to companies, where circumstances are similar, yet further rulings are necessary to clarify the precedent. As a result, the assessment of the financial impact of the rulings might change to reflect future rulings. Consequently, expenses in the amount of ISK 5,435 million were recognised in the Consolidated Income Statement of the Bank at the end of Q4 2016.

## 39. Leasing

### Operating lease commitments where the Group is lessee

In cases where the Group is a lessee, the future minimum lease payments under non-cancellable operating leases on 31 December were as follows:

| | 2016 | 2015 |
|---|---|---|
| Less than one year | 530 | 519 |
| Between one and five years | 1,088 | 1,243 |
| More than five years | 1,508 | 1,681 |
| **Total** | **3,126** | **3,443** |

### Operating lease commitments where the Group is legal lessor

The Group acts as the legal lessor whereby tools and equipment are purchased and leased to third parties under arrangements that in substance are loans and advances accounted for under IAS 39 in the Consolidated Financial Statements of the Group.

The future minimum lease payments expected to be received under non-cancellable operating leases on 31 December were as follows:

| | 2016 | 2015 |
|---|---|---|
| Less than one year | 35 | 63 |
| Between one and five years | 152 | 161 |
| **Total** | **187** | **224** |

### Finance lease commitments where the Group is lessor

The Group acts as lessor whereby items of plant and equipment are leased to third parties under arrangements qualifying as finance leases. Finance lease receivables are included within loans and advances to customers.

The net investment in finance lease receivables was as follows:

| At 31 December 2016 | Gross investment in finance lease | Future finance income | Present value of minimum lease |
|---|---|---|---|
| Less than one year | 72 | (5) | 67 |
| Between one and five years | 42 | (3) | 39 |
| **Total** | **114** | **(8)** | **106** |
| **At 31 December 2015** | | | |
| Less than one year | 368 | (26) | 342 |
| Between one and five years | 52 | (4) | 48 |
| **Total** | **420** | **(30)** | **390** |

Unguaranteed residual value at year-end 2016 is nil (2015: nil).

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## 40. Fiduciary activities

The Group provides asset custody, asset management, investment management and advisory services. All of them require the Group to make decisions on the handling, acquisition or disposal of financial instruments. Assets in Bank custody are not reported in the Consolidated Financial Statements, since they are not assets of the Bank. One aspect of these services is that the Group is involved in approving objectives and criteria for investing assets in its custody. As of 31 December 2016, financial assets managed by the Group amounted to ISK 361 billion (2015: ISK 297 billion). Custody accounts amounted to ISK 1.025 billion (2015: ISK 1.041 billion).

## 41. Interest in subsidiaries

The main subsidiaries held directly or indirectly by the Group as at 31 December 2016 were as detailed in the table below. This includes those subsidiaries that are most significant in the context of the Group's business. See Note 93.1 (a) for further information on the accounting policies governing the consolidation of subsidiaries.

**Main subsidiaries as at 31 December 2016**

| 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 |

*Hömlur ehf. is a parent of a number of subsidiaries, which are neither individually nor combined significant in the context of the Group's business.

The Group does not have significant restrictions on its ability to access or use its assets and settle its liabilities other than those resulting from the supervisory framework. The Group did not have any material non-controlling interests as at 31 December 2016.

## 42. Consolidated structured entities

Structured entities are assessed for consolidation in accordance with the accounting policy set out in Note 93.2. Financial investments under control are presented in the following balance sheet lines:

| Assets | 2016 | 2015 |
|---|---|---|
| Bonds and debt instruments | 342 | 368 |
| Equities and equity instruments | 698 | 606 |
| Other assets | 4 | - |

| Liabilities | 2016 | 2015 |
|---|---|---|
| Non controlling interests - Funds | 883 | 752 |
| Other liabilities | 6 | 4 |

The Bank holds majority of the units in the investment funds managed by Landsbréf. These funds are consolidated like subsidiaries in the Bank's Consolidated Financial Statements, with the exception that minority interests are recognised among Other liabilities instead of Equity. The reason for this distinction is that the holders of the units may request redemption of their shareholding and therefore the units do not meet the requirements of the definition of equity.

## 43. Unconsolidated structured entities

Where the Group acts as an agent for the investor, it does not consolidate the investment funds. When the Group holds investments in unconsolidated investment funds, they are classified as financial investments designated at fair value through profit or loss. The fair value of these investments represents the Group's maximum exposure to loss from its investments into such unconsolidated investment funds.

| | | | Total assets | |
|---|---|---|---|---|
| Type of structured entity | Nature and purpose | Interest held by the Group | 2016 | 2015 |
| Investment funds | To generate fees from managing assets on behalf of third party investors. | Management fees | 113,417 | 83,727 |
| | These vehicles are financed through the issue of units to investors | Investment in units issued by fund | | |

The following table shows an analysis of the carrying amounts of interests held by the Group in unconsolidated structured entities. The Group's maximum exposure to loss is the carrying amount of the assets held.

| | Carrying amount | |
|---|---|---|
| Investment securities | 2016 | 2015 |
| Investment funds | 1,265 | 1,283 |
| **Total** | **1,265** | **1,283** |

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## 44. Guarantees / Off-balance sheet exposures within the Group

These guarantees are provided in the normal course of banking business. The Group's maximum exposures to credit risk as at 31 December 2016 were as follows:

| | Carrying amount | |
|---|---|---|
| **Off-balance sheet exposure 31 December** | **2016** | **2015** |
| Financial guarantees | 442 | 1,351 |
| Undrawn overdraft/credit card facilities and loan facilities | 1,563 | 1,697 |

## 45. Related party transactions

### Related parties

The Icelandic State Treasury, on behalf of the Icelandic State, holds 98.2% of the shares in the Bank. Government bodies and public institutions qualifying as related parties are the Ministry of Finance, the ISFI (Icelandic State Financial Investments), and entities and institutions related to them.

Transactions between the Bank and its subsidiaries meet the definition of related party transactions. All transactions with subsidiaries are eliminated on consolidation and are thus not disclosed in the Group's Consolidated Financial Statements. Further details about the main subsidiaries can been seen in Note 41, Interest in subsidiaries.

The key management personnel of the Bank and their close family members meet the definition of related parties as do, and in some cases, the key management personnel of the Bank's subsidiaries The key management personnel of the Bank are the members of the Board of Directors, the CEO, managing directors and other managers with the authority and responsibility to organise, manage and control the Bank's activities. The Minister for Finance and the Board of Directors of Icelandic State Financial Investments meet the definition of related parties due to the scope of their authority to influence Bank policy.

### Transactions with related parties

### Transactions with the Icelandic government and government-related entities

The Group’s products and services are offered to the Icelandic government and government-related entities in competition with other vendors and under generally accepted commercial terms. In a similar manner, the Bank and other Group entities purchase products and services from government-related entities at market price and otherwise under generally accepted commercial terms. The nature of and amounts outstanding with public entities are disclosed in Note 61, under Public entities.

In March 2016, the Icelandic State Treasury took over Íslandsbanki. Following the takeover a settlement was reached with the Icelandic Competition Authority to the effect that both banks will continue to operate as independent competitors in the financial market. The takeover qualifies as a merger under Icelandic competition law, as the Icelandic State Treasury has control over the two banks as of the time of the takeover. The Bank has a traditional bank-to-bank relationship with Íslandsbanki under generally accepted commercial terms. The nature of and amounts outstanding with financial institutions, including Íslandsbanki, are disclosed in Note 61, under Financial institutions.

### Transactions with other related parties

The following table presents the total amounts of loans to key management personnel and parties related to them and loans to associates of the Group:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| **Loans in ISK million** | **Balance as at 31 December** | **Highest amount outstanding** | **Balance as at 31 December** | **Highest amount outstanding** |
| Key management personnel | 136 | 142 | 139 | 211 |
| Parties related to key management personnel | 31 | 59 | 36 | 97 |
| Associates | 14,917 | 21,192 | 20,633 | 20,838 |
| Other | 123 | 127 | 126 | 130 |
| **Total** | **15,207** | **21,520** | **20,934** | **21,276** |

No specific allowance for impairment was recognised in respect of these loans.

No pledges or commitments have been given or received in respect of these transactions during the period. There are no leasing transactions between related parties during the period.

## 45. Related party transactions (continued)

### Transactions with other related parties (continued)

The following table presents the total amounts of deposits received from key management personnel and parties related to them and associates of the Group:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| **Deposits in ISK million** | **Balance as at 31 December** | **Highest amount outstanding** | **Balance as at 31 December** | **Highest amount outstanding** |
| Key management personnel | 105 | 298 | 68 | 207 |
| Parties related to key management personnel | 31 | 227 | 22 | 193 |
| Associates | 1,132 | 15,624 | 2,835 | 3,516 |
| Other | 501 | 7,479 | 344 | 2,114 |
| **Total** | **1,769** | **23,628** | **3,269** | **6,030** |

The following table presents the total amount of guarantees to key management personnel and parties related to them and associates of the Group:

| **Guarantees in ISK million** | **Balance as at 31 December 2016** | **Balance as at 31 December 2015** |
|---|---|---|
| Key management personnel | - | - |
| Parties related to key management personnel | - | 4 |
| Associates | - | - |
| **Total** | **0** | **4** |

All of the above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third party counterparties.

### Effect on income statement

The following table presents the total amount of interest income and expense recognised by the Group in relation to key management personnel and parties related to them and associates of the Group:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| **Interest income and expense** | **Interest income** | **Interest expense** | **Interest income** | **Interest expense** |
| Key management personnel | 5 | 2 | 7 | 1 |
| Parties related to key management personnel | 1 | 0 | 2 | 1 |
| Associates | 783 | 31 | 797 | 7 |
| Other | 6 | 24 | 9 | 7 |
| **Total** | **795** | **57** | **815** | **16** |

The following table presents the total amount of other income and expense recognised by the Group in relation to key management personnel and parties related to them and associates of the Group:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| **Other income and expense** | **Other income** | **Other expense** | **Other income** | **Other expense** |
| Associates | - | 668 | - | 664 |
| **Total** | **0** | **668** | **0** | **664** |

All of the above transactions were made in the ordinary course of business and substantially the same terms, including interest rates and collaterals, as those prevailing at the time for comparable transactions with the third party counterparties.

## 45. Related party transactions (continued)

**The following table presents the total amount of compensation to Directors, CEOs and Managing Directors for the year 2016:**

| Salary and benefits for the year 2016 | Salary and benefits* | Defined contri-butions** | Total |
|---|---|---|---|
| Helga Björk Eiríksdóttir, Chairman of the Board of Directors | 8.6 | 0.9 | 9.5 |
| Magnús Pétursson, Vice-chairman of the Board of Directors | 5.0 | 0.5 | 5.5 |
| Berglind Svavarsdóttir, Director | 4.4 | 0.5 | 4.9 |
| Danielle Pamela Neben, Director | 6.6 | 0.5 | 7.1 |
| Einar Þór Bjarnason, Director | 4.4 | 0.5 | 4.9 |
| Hersir Sigurgeirsson, Director | 4.4 | 0.5 | 4.9 |
| Jón Guðmann Pétursson, Director | 4.4 | 0.5 | 4.9 |
| Samúel Guðmundsson, Alternate Director | 0.9 | 0.1 | 1.0 |
| Tryggvi Pálsson, former Chairman of the Board of Directors | 3.2 | 0.3 | 3.5 |
| Eva Sóley Guðbjörnsdóttir, former Vice-chairman of the Board of Directors | 2.5 | 0.3 | 2.8 |
| Jóhann Hjartarson, former Director | 2.2 | 0.2 | 2.4 |
| Jón Sigurðsson, former Director | 2.2 | 0.2 | 2.4 |
| Kristján Þórarinn Davíðsson, former Director | 2.2 | 0.2 | 2.4 |
| Ásbjörg Kristinsdóttir, former Alternate Director | 0.4 | - | 0.4 |
| Tinna Laufey Ásgeirsdóttir, former Alternate Director | 0.5 | - | 0.5 |
| Steinþór Pálsson, former CEO*** | 24.5 | 7.4 | 31.9 |
| Hreiðar Bjarnason, interim CEO & CFO | 29.8 | 5.6 | 35.4 |
| Five Managing Directors of the Bank's divisions | 153.8 | 28.8 | 182.6 |
| **Total** | **260.0** | **47.0** | **307.0** |

*Benefits are non-monetary benefits such as the use of cars owned by the Group.

**Includes both private and statutory contributions to independent pension funds without further obligation.

***In 2016, an agreement on termination of employment was reached with the former CEO. All estimated contractual termination payments have been recognised as expense in the income statement for the year 2016.

In 2016 the total monthly average salary and benefits of the former CEO and current interim CEO of the Bank amounted to ISK 2.3 million and the average monthly salary and benefits of Managing Directors of the Bank's divisions amounted to ISK 2.6 million. At year-end 2016, the former CEO of the Bank holds 0.3 million shares in the Bank, the current interim CEO & CFO holds 0.5 million shares and five Managing Directors of the Bank's divisions hold a total of 1.5 million shares in the Bank.

**The following table presents the total amount of compensation to Directors, CEOs and Managing Directors for the year 2015:**

| Salary and benefits for the year 2015 | Salary and benefits* | Defined contri-butions** | Total |
|---|---|---|---|
| Tryggvi Pálsson, Chairman of the Board of Directors | 9.3 | 0.9 | 10.2 |
| Eva Sóley Guðbjörnsdóttir, Vice-chairman of the Board of Directors | 7.2 | 0.7 | 7.9 |
| Danielle Pamela Neben, Director | 6.3 | 0.5 | 6.8 |
| Helga Björk Eiríksdóttir, Director | 6.3 | 0.6 | 6.9 |
| Kristján Þórarinn Davíðsson, Director | 6.3 | 0.6 | 6.9 |
| Jón Sigurðsson, Director | 6.3 | 0.6 | 6.9 |
| Jóhann Hjartarson, Director | 6.3 | 0.6 | 6.9 |
| Tinna Laufey Ásgeirsdóttir, Alternate Director | 0.5 | - | 0.5 |
| Árni Guðmundur Hauksson, Alternate Director | 0.4 | - | 0.4 |
| Steinþór Pálsson, CEO | 19.0 | 5.8 | 24.8 |
| Six Managing Directors of the Bank's divisions and one former Managing Director of the Bank's divisions*** | 190.9 | 35.5 | 226.4 |
| **Total** | **258.8** | **45.8** | **304.6** |

*Benefits are non-monetary benefits in the form of use of cars owned by the Group.

**Includes both private and statutory contributions to independent pension funds without further obligation.

***In 2015, the employment of one managing director was terminated by mutual agreement. All termination benefits related thereto have been recognised as expense in the income statement for the year 2015.

In 2015 the total monthly average salary and benefits of the CEO of the Bank amounted to ISK 1.6 million and the average monthly salary and benefits of Managing Directors of the Bank's divisions amounted to ISK 2.3 million. At year-end 2015, the CEO of the Bank holds 0.3 million shares in the Bank and six Managing Directors of the Bank's divisions and one former hold a total of 2.4 million shares in the Bank.

**Transactions with the Minister of Finance and members of the Board of Directors of the ISFI**

The Minister of Finance and the members of the Board of Directors of the ISFI did not receive any salaries or similar payments from the Group during the year 2016. The Group did not enter into any transactions with these persons or close members of their families, other than lending and deposit taking during the normal course of commercial banking operations.

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### 46. Events after the reporting period

No events have arisen after the reporting period of these financial statements that require amendments or additional disclosures in the Consolidated Financial Statements for the year ended 31 December 2016.

## Capital management

### 47. Capital requirements

The Group's capital management policies and practices ensure that the Group has sufficient capital to cover the risks associated with its activities on a consolidated basis. The capital management framework of the Group comprises four interdependent areas: capital assessment, risk appetite/capital target, capital planning, and reporting/monitoring. The Group regularly monitors and assesses its risk profile in its most important business areas on a consolidated basis and for the most important risk types. Risk appetite sets out the level of risk the Group is willing to take in pursuit of its business objectives.

The Group's capital requirements are defined in Icelandic law and regulations, on the one hand, and by the Icelandic FME, on the other. The requirements are based on the European legal framework for capital requirements (CRD IV and CRR) implementing the Basel III capital framework. The regulatory minimum capital requirement under Pillar I of the Basel framework is 8% of Risk-Weighted Assets (RWA) for credit risk, market risk and operational risk. In conformity with Pillar II A of the Basel framework, the Bank annually assesses its own capital needs through the Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP results are subsequently reviewed by the FME in the Supervisory Review and Evaluation Process (SREP). The Group's Total Capital Requirement, as determined by the FME, is the sum of Pillar I and Pillar II A requirements.

On 14 April 2015, the Icelandic Financial Stability Council defined the Bank as a systematically important institution in Iceland.

In July 2015, legislation amending the Icelandic Act on Financial Undertakings No. 161/2002 entered into force, implementing capital buffer requirements under CRD IV. Under the new legal framework, the FME can impose proportionate restrictions on a credit institution's dividend payments, variable remuneration to employees and/or other payments of similar nature, if its capital adequacy ratio falls below the total capital requirement plus capital buffers.

In September 2016, legislation further amending the Act on Financial Undertakings, No. 161/2002, entered into force, whereby a minimum 3.0% leverage ratio requirement was implemented.

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 | |
|---|---|---|
| | 31.12.2015 | 31.12.2014 |
| Pillar I | 8.0% | 8.0% |
| Pillar II A | 6.0% | 6.3% |
| **Minimum capital requirement** | **14.0%** | **14.3%** |
| | | |
| Systemic risk buffer | 2.7% | 3.0% |
| Capital buffer for systematically important institutions | 2.0% | 2.0% |
| Countercyclical capital buffer | 0.9% | 0.0% |
| Capital conservation buffer | 2.5% | 2.5% |
| **Combined buffer requirement** | **8.1%** | **7.5%** |
| | | |
| **Total capital requirement** | **22.1%** | **21.8%** |

* As a part of the annual SREP, the FME requires the Bank to maintain a capital ratio that reflects the fully phased-in capital buffers.

On 22 January 2016 (and on 3 October 2016), the Icelandic Financial Stability Council made recommendations to the FME, in accordance with the new legislation, to formally impose the new CRD IV capital buffers in the following steps:

| | 1.4.2016 | 1.6.2016 | 1.1.2017 | Q1 2017 | Q4 2017 |
|---|---|---|---|---|---|
| Systemic risk buffer* | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% |
| Capital buffer for systematically important institutions | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% |
| Countercyclical capital buffer* | 0.00% | 0.00% | 0.00% | 1.00% | 1.25% |
| Capital conservation buffer | 1.00% | 1.75% | 2.50% | 2.50% | 2.50% |
| **Total capital buffers** | **6.00%** | **6.75%** | **7.50%** | **8.50%** | **8.75%** |

* The systemic risk buffer and the countercyclical capital buffer only apply to domestic assets

The Bank's target for the Group's minimum total capital ratio is to maintain at all times a total capital ratio above the fully phased-in FME total capital requirement, in addition to a management capital buffer that is defined in the Bank's risk appetite. 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.

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### 48. Capital base, risk-weighted assets and capital ratios

The following table shows the Group's capital base, risk-weighted assets and capital ratios. The calculations are in accordance with Chapter X of the Act on Financial Undertakings, No. 161/2002.

The Group uses the standardised approach to calculate the risk-weighted assets for credit risk and market risk, and the basic indicator approach for operational risk.

| Capital base | 2016 | 2015 |
|---|---|---|
| Share capital | 23,648 | 23,782 |
| Share premium | 120,847 | 122,105 |
| Reserves | 10,875 | 6,000 |
| Retained earnings | 95,834 | 112,614 |
| **Total equity attributable to owners of the Bank** | **251,204** | **264,501** |
| Intangible assets | (2,634) | (2,012) |
| **Common equity Tier 1 capital (CET1)** | **248,570** | **262,489** |
| Non-controlling interests | 27 | 30 |
| **Tier 1 capital** | **248,597** | **262,519** |
| Subordinated liabilities | 388 | 639 |
| Regulatory amortisation | (203) | (157) |
| General credit risk adjustment | 4,024 | - |
| **Tier 2 capital** | **4,209** | **482** |
| | | |
| **Total capital base** | **252,806** | **263,001** |
| | | |
| **Risk-weighted assets** | | |
| Credit risk | 728,428 | 737,720 |
| Market risk | 16,519 | 31,919 |
| Operational risk | 91,811 | 95,843 |
| **Total risk-weighted assets** | **836,758** | **865,482** |
| | | |
| CET1 ratio | 29.7% | 30.3% |
| Tier 1 capital ratio | 29.7% | 30.3% |
| Total capital ratio | 30.2% | 30.4% |

### 49. Leverage ratio

The following table shows the Group's leverage ratio as at 31 December 2016 and 31 December 2015. The requirements are based on the European legal framework for capital requirements (CRD IV and CRR) implementing the Basel III capital framework. Subject to Article 30(a) of Act No. 161/2002, on Financial Undertakings, a minimum leverage ratio of 3.0% is required.

| Leverage ratio | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Tier 1 capital | 248,597 | 262,519 |
| Leverage exposure | | |
| - On-balance sheet exposure (excluding derivatives) | 1,110,879 | 1,118,371 |
| - Derivative instrument exposure | 278 | 287 |
| - Potential future exposure on derivatives | 835 | 714 |
| - Off-balance sheet exposure | 113,267 | 103,456 |
| - Regulatory adjustments to Tier 1 capital | (2,634) | (2,012) |
| **Total leverage exposure** | **1,222,625** | **1,220,816** |
| **Leverage ratio** | **20.3%** | **21.5%** |

## Economic capital

### 50. Economic capital framework

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

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## 50. Economic capital framework (continued)

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

The following summarises how the Group calculates its EC for these risks:

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 in the trading book.

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 in the trading book 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 in the trading book 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 Group's net FX position. The time horizon is one year.

Operational risk:
EC for operational risk is calculated using the basic indicator approach, which means that it equals the Group's capital requirement.

Concentration risk:
EC for single name concentration is calculated by adjusting for the granularity and non-homogeneity in the loan 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. The model calculates the industry concentration risk for the loan portfolio and subtracts the industry concentration risk for Iceland to get the EC add-on for industry concentration.

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 99.9% of interest rate and inflation risk factor changes estimated by a Monte Carlo simulation model.

Business risk:
EC for business risk is calculated using an internal model, which is based on the volatility of the Group's income, before profit or loss due to any other material risk.

Legal and regulatory risk:
EC for legal and regulatory risk is calculated by adding the potential loss of on-going disputes. The significance of a dispute is weighted by its status within the legal system.

## 51. Economic capital by risk type

The Group made changes to its economic capital framework in 2016 as a new method was introduced for calculating economic capital due to industry concentration risk. The Group also made a few key changes which affected credit risk economic capital measurement; the Group implemented a special rating grade model for larger corporates, which is developed and based on more recent data than the previous model; and updated the LGD measurement which is calibrated according to internal historical loss data. Both of these implementations reduce to some extent the economic capital due to credit risk but other reduction is a result of decreased probability of default and overall improved quality of the loan portfolio.

### 51. Economic capital by risk type (continued)

| Economic capital ISK million | 2016 | 2015 |
|---|---|---|
| Credit risk - Loans to customers and credit institutions | 53,835 | 64,239 |
| Credit risk - Other assets | 6,769 | 7,719 |
| Market risk | 1,396 | 1,531 |
| Currency risk | 875 | 3,933 |
| Operational risk | 7,345 | 7,667 |
| Single name concentration risk | 4,784 | 6,109 |
| Industry concentration risk | 2,600 | 4,665 |
| Interest rate risk and inflation risk in the banking book | 15,889 | 10,575 |
| Business risk | 3,672 | 3,834 |
| Legal and regulatory risk | 1,579 | 1,862 |
| **Total** | **98,744** | **112,134** |
| EC/RWA | 11.8% | 13.0% |

| | Weighted average | | | |
|---|---|---|---|---|
| **Credit risk as at 31 December 2016** | **Probability of default (PD)** | **Loss given default (LGD)** | **Exposure at default (EAD)** | **Economic capital (EC)** |
| Financial institutions | 0.2% | 45.0% | 23,040 | 584 |
| Public entities | 0.2% | 45.0% | 134,713 | 135 |
| Individuals, small and medium-sized enterprises | 3.5% | 26.9% | 383,686 | 12,989 |
| Corporates | 2.4% | 38.4% | 566,046 | 40,127 |
| **Total** | **2.5%** | **35.4%** | **1,107,485** | **53,835** |
| **Credit risk as at 31 December 2015*** | | | | |
| Financial institutions | 0.1% | 45.0% | 22,229 | 646 |
| Public entities | 0.1% | 45.0% | 134,221 | 537 |
| Individuals, small and medium-sized enterprises | 4.2% | 31.2% | 380,548 | 14,960 |
| Corporates | 3.9% | 42.1% | 551,686 | 48,097 |
| **Total** | **3.4%** | **38.7%** | **1,088,684** | **64,239** |

*Small and medium-sized entities are businesses the total liability of which is less than ISK 75 million and which meet the definition of the Recommendation of the European Commission No. 2003/361/EC, of small and medium-sized entities.

## Risk management

### 52. Risk management structure

#### Risk committees

The Group's risk management governance structure as at year-end 2016 is as follows:

**Board of Directors**

**Supervision by the Board of Directors and its sub-committees:**

- Audit Committee
- Remuneration Committee
- Risk 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 Operations & IT, Head of Compliance, Director of Operational Risk |

The Board of Directors of the Bank 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.

## 52. Risk management structure (continued)

### Risk committees (continued)

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 Group's overall 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.

### Risk Management Division

The Bank'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 veto rights on those credit applications. Confirmation by Credit Management implies that Credit Management has reviewed the credit application and does not exercise its veto rights. Credit applications 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 Group 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, monitoring and reporting on market risk, liquidity risk and interest rate risk in the Group's banking book. The Department develops and maintains the Bank's market risk models and maintains the Group's Market Risk Policy and Liquidity Risk Policy as well as implementing proccesses to measure and monitor market risk and liquidity risk within the Group. Market Risk is also responsible for monitoring all derivatives trading the Bank enters into, both for hedging and trading purposes, as well as FX balance monitoring for the Group.

• 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 continuity plans. The Department is partly responsible for the security system for the online bank. The Operational Risk Department leads the work on the Bank's certification under the ISO 2701 standard for information security.

• Restructuring is responsible for corporate and individual debt restructuring - both for over-indebted individuals as well 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 foreclosure or as a part of debt restructuring. In addition the Department sells cars, equipment and other items that the Bank has acquired through foreclosure.

The Compliance function monitors, advises and handles instruction on Landsbankinn's actions to combat money laundering and terrorist financing, and specific aspects of the implementation of laws on securities trading, including measures to minimise conflict of interest. Compliance also implements work procedures to control, monitor and assess compliance risk in the Bank's operation. Compliance is one of the Group's support functions and a part of its corporate culture.

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 in accomplishing its objectives.

## 53. Risk appetite

The Group's risk appetite has been reviewed, revised and implemented for 2017. The Group's risk policy is as follows:

Landsbankinn provides universal financial services to customers. For this purpose, the Bank has set itself 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 evaluate and manage. Landsbankinn aims to be comparable with leading banks in the Nordic countries in similar fields.

Landsbankinn 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. Landsbankinn pursues long-term business relationships and aims to avoid being linked to transactions that might damage its reputation.

### 53. Risk appetite (continued)

The Bank seeks to ensure diversified and sound financing and a sustainable risk profile in its 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.

Landsbankinn'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 Landsbankinn and its customers in mind. Efficient follow-up on decisions and risk monitoring are integral to the Bank's operations.

### 54. Risk assessment

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 risks 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 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.

The Group is exposed to the following material risks which arise from financial instruments:
· Credit risk
· Operational risk
· Market risk
    -Currency risk
    -Interest rate risk
    -Other market risk
· Liquidity risk

The table below 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 measured based on allocation of Economic Capital within the Group.

| 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 |

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

The above material risks are addressed in the following notes.

## Credit risk

### 55. Credit risk identification

Credit risk is defined as the risk that one party to a financial instrument will cause a financial loss for the other party by failing 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.

## 56. Credit risk 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 going 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 takes information such as industry classification, financial accounts and payment behaviour into account.

The following table shows the Group's internal mapping from internal rating grade to S&P rating grades:

| | 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% | 99.99% |
| 0 | D | In default | In default |

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.

LGD is measured using an internal LGD model for the purpose of EC calculations. The internal LGD model, which takes into account more types of collateral and is more sensitive to the collateralisation level than the Basel model, was updated and calibrated to historical loss data in 2016.

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.

## 57. Credit risk 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. The colour classification is the following:

- Green: the customer are considered as performing without signs of repayment problems;
- Yellow: the customer shows indication of deteriorating financial strength, which could lead to financial difficulties;
- Orange: the customer is or has been in financial difficulties or default;
- Red: the customer is in default and in legal collection and/or restructuring.

The Credit Risk & Economic Capital Department within Risk Management is together with the business units responsible for the colour classification of customers.

## 58. Credit risk 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 its 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.

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## 58. Credit risk management and policy (continued)

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.

## 59. Credit risk 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 important 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.

### 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.

## 60. 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.

## 61. Maximum exposure to credit risk and concentration by industry sectors

The following tables show the Group's maximum credit risk exposure at 31 December 2016 and 2015. 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.

The Group uses the ISAT 08 industry classification for corporate customers.

| | | | | Corporations | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **As at 31 December 2016** | **Financial institutions** | **Public entities*** | **Individuals** | **Fisheries** | **Construction and real estate companies** | **Holding companies** | **Retail** | **Services** | **ITC**** | **Manu-facturing** | **Agriculture** | **Other** | **Carrying amount** |
| Cash and balances with Central Bank | - | 30,662 | - | - | - | - | - | - | - | - | - | - | **30,662** |
| Bonds and debt instruments | 2,031 | 142,956 | - | - | 8,294 | 80 | - | - | - | - | - | 1,531 | **154,892** |
| Derivative instruments | 220 | 14 | - | - | - | 24 | - | - | - | - | - | 20 | **278** |
| Loans and advances to financial institutions | 20,408 | - | - | - | - | - | - | - | - | - | - | - | **20,408** |
| Loans and advances to customers | - | 9,783 | 320,690 | 123,626 | 188,327 | 40,490 | 42,235 | 74,743 | 19,220 | 24,167 | 10,135 | 1 | **853,417** |
| Other financial assets | 3,246 | 282 | 301 | - | 1,329 | 61 | 5 | 1,008 | 2 | 290 | 3 | 1 | **6,528** |
| **Total on-balance sheet exposure** | **25,905** | **183,697** | **320,991** | **123,626** | **197,950** | **40,655** | **42,240** | **75,751** | **19,222** | **24,457** | **10,138** | **1,553** | **1,066,185** |
| | | | | | | | | | | | | | |
| **Off-balance sheet exposure** | **5,640** | **16,385** | **29,109** | **17,421** | **49,953** | **2,392** | **18,704** | **15,999** | **4,159** | **9,996** | **1,149** | **382** | **171,289** |
| Financial guarantees and underwriting commitments | 2,022 | 634 | 819 | 6,345 | 3,648 | 64 | 2,959 | 2,179 | 895 | 525 | 10 | 365 | 20,465 |
| Undrawn loan commitments | - | 9,080 | - | 7,295 | 42,301 | 1,392 | 10,724 | 6,052 | 2,017 | 7,246 | 249 | - | 86,356 |
| Undrawn overdraft/credit card facilities | 3,618 | 6,671 | 28,290 | 3,781 | 4,004 | 936 | 5,021 | 7,768 | 1,247 | 2,225 | 890 | 17 | 64,468 |
| | | | | | | | | | | | | | |
| **Maximum exposure to credit risk** | **31,545** | **200,082** | **350,100** | **141,047** | **247,903** | **43,047** | **60,944** | **91,750** | **23,381** | **34,453** | **11,287** | **1,935** | **1,237,474** |
| | | | | | | | | | | | | | |
| Percentage of carrying amount | 2.5% | 16.2% | 28.3% | 11.4% | 20.0% | 3.5% | 4.9% | 7.4% | 1.9% | 2.8% | 0.9% | 0.2% | 100% |

* Public entities consist of central government, state-owned enterprises, Central Bank and municipalities.

** ITC consists of corporations in the information, technology and communication industry sectors.

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**61. Maximum exposure to credit risk and concentration by industry sectors (continued)**

| As at 31 December 2015 | Financial institutions | Public entities* | Individuals | Corporations: Fisheries | Construction and real estate companies | Holding companies | Retail | Services | ITC** | Manu-facturing | Agriculture | Other | Carrying amount |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Cash and balances with Central Bank | - | 25,164 | - | - | - | - | - | - | - | - | - | - | **25,164** |
| Bonds and debt instruments | 1,356 | 192,275 | - | - | 8,516 | 123 | - | - | - | - | - | 1,414 | **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 | 47,612 | 36,021 | 60,469 | 15,502 | 27,205 | 10,118 | 75 | **811,549** |
| Other financial assets | 4,178 | 582 | 438 | 8 | 866 | 31 | 119 | 452 | 1 | 230 | 1 | 12 | **6,918** |
| **Total on-balance sheet exposure** | **26,372** | **226,761** | **291,400** | **159,612** | **164,824** | **47,766** | **36,140** | **60,921** | **15,503** | **27,435** | **10,119** | **1,540** | **1,068,393** |
| **Off-balance sheet exposure** | **689** | **16,940** | **25,095** | **23,018** | **43,835** | **1,158** | **15,615** | **15,537** | **3,797** | **9,597** | **620** | **154** | **156,055** |
| Financial guarantees and underwriting commitments | 26 | 1,422 | 777 | 7,210 | 2,022 | 60 | 2,278 | 1,993 | 1,070 | 653 | 27 | 99 | 17,637 |
| Undrawn loan commitments | - | 8,111 | 100 | 11,511 | 37,647 | 723 | 6,888 | 6,726 | 1,584 | 6,518 | 167 | - | 79,975 |
| Undrawn overdraft/credit card facilities | 663 | 7,407 | 24,218 | 4,297 | 4,166 | 375 | 6,449 | 6,818 | 1,143 | 2,426 | 426 | 55 | 58,443 |
| **Maximum exposure to credit risk** | **27,061** | **243,701** | **316,495** | **182,630** | **208,659** | **48,924** | **51,755** | **76,458** | **19,300** | **37,032** | **10,739** | **1,694** | **1,224,448** |
| Percentage of carrying amount | 2.2% | 19.9% | 25.8% | 14.9% | 17.0% | 4.0% | 4.2% | 6.2% | 1.6% | 3.0% | 0.9% | 0.1% | 100% |

* Public entities consist of central government, state-owned enterprises, Central Bank and municipalities.

** ITC consists of corporations in the information, technology and communication industry sectors.

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## 62. Collateral and loan-to-value by industry sectors

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. 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.

| | LTV ratio - Fully collateralised | | | | | LTV ratio - Partially collateralised | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| As at 31 December 2016 | 0% - 25% | 25% - 50% | 50% - 75% | 75% - 100% | Total | >100% | Collateral value* | Without collateral | Allowance for impairment | Maximum exposure to credit risk |
| Financial institutions | - | - | - | - | - | - | - | 26,047 | - | 26,047 |
| Public entities | 42 | 263 | 758 | 255 | 1,318 | 1,174 | 544 | 23,922 | (246) | 26,168 |
| Individuals | 20,188 | 60,457 | 145,319 | 52,366 | 278,330 | 16,035 | 9,374 | 61,589 | (6,154) | 349,800 |
| **Corporates** | **21,535** | **81,606** | **191,261** | **143,241** | **437,643** | **166,424** | **94,963** | **53,583** | **(14,551)** | **643,099** |
| Fisheries | 8,657 | 32,701 | 68,975 | 21,827 | 132,160 | 8,125 | 5,207 | 1,231 | (467) | 141,049 |
| Construction and real estate companies | 2,006 | 10,258 | 47,886 | 79,549 | 139,699 | 87,348 | 54,130 | 15,724 | (4,490) | 238,281 |
| Holding companies | 6,336 | 4,723 | 17,310 | 1,857 | 30,226 | 5,382 | 2,353 | 7,933 | (659) | 42,882 |
| Retail | 865 | 6,939 | 9,787 | 18,212 | 35,803 | 21,067 | 5,663 | 5,272 | (1,201) | 60,941 |
| Services | 2,218 | 16,392 | 23,697 | 14,005 | 56,312 | 26,516 | 14,583 | 14,003 | (6,090) | 90,741 |
| Information, technology and communication | 56 | 659 | 5,006 | 91 | 5,812 | 11,733 | 8,054 | 5,997 | (164) | 23,378 |
| Manufacturing | 360 | 9,078 | 17,079 | 5,533 | 32,050 | 796 | 492 | 2,683 | (1,368) | 34,161 |
| Agriculture | 1,037 | 743 | 1,521 | 2,160 | 5,461 | 5,392 | 4,472 | 542 | (112) | 11,283 |
| Other | - | 113 | - | 7 | 120 | 65 | 9 | 198 | - | 383 |
| **Total** | **41,765** | **142,326** | **337,338** | **195,862** | **717,291** | **183,633** | **104,881** | **165,141** | **(20,951)** | **1,045,114** |
| **As at 31 December 2015**** | | | | | | | | | | |
| Financial institutions | - | - | - | - | - | - | - | 21,481 | - | 21,481 |
| Public entities | 18 | 342 | 805 | 521 | 1,686 | 508 | 221 | 22,915 | (230) | 24,879 |
| Individuals | 18,251 | 47,954 | 115,324 | 47,331 | 228,861 | 18,679 | 12,188 | 80,905 | (12,389) | 316,056 |
| **Corporates** | **13,630** | **89,559** | **165,125** | **135,410** | **403,724** | **177,066** | **104,552** | **66,226** | **(21,038)** | **625,979** |
| Fisheries | 5,993 | 43,208 | 64,924 | 46,250 | 160,375 | 19,725 | 12,332 | 5,077 | (2,644) | 182,534 |
| Construction and real estate companies | 1,527 | 7,436 | 31,330 | 45,447 | 85,740 | 99,599 | 56,834 | 20,616 | (6,756) | 199,199 |
| Holding companies | 3,098 | 8,044 | 31,107 | 3,054 | 45,303 | 1,930 | 1,132 | 2,549 | (1,037) | 48,745 |
| Retail | 551 | 1,672 | 11,569 | 21,016 | 34,807 | 14,153 | 8,102 | 4,725 | (2,049) | 51,636 |
| Services | 1,312 | 11,799 | 11,547 | 9,191 | 33,848 | 26,817 | 16,297 | 21,153 | (5,764) | 76,054 |
| Information, technology and communication | 125 | 143 | 5,750 | 456 | 6,474 | 6,375 | 4,235 | 7,536 | (285) | 20,100 |
| Manufacturing | 403 | 16,223 | 7,398 | 5,615 | 29,640 | 5,723 | 4,112 | 3,618 | (2,180) | 36,801 |
| Agriculture | 621 | 1,034 | 1,428 | 4,381 | 7,465 | 2,744 | 1,508 | 845 | (322) | 10,732 |
| Other | - | - | 72 | - | 72 | - | - | 107 | (1) | 178 |
| **Total** | **31,899** | **137,855** | **281,254** | **183,262** | **634,271** | **196,253** | **116,961** | **191,527** | **(33,657)** | **988,395** |

*If LTV is less than 100% the loan is considered fully secured. If LTV is greater than 100% the loan is partially collateralised and the respective collateral value is shown in the table.

**The comparative amounts have been restated due to changes in LTV calculation since year-end 2015. In previous calculations of LTV, a haircut was applied to the value of collateral.

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## 63. Collateral types

The following tables show the different types of collateral held by the Group against credit exposures. Residential property is the principal collateral held against loans to individuals. Construction projects and commercial property are the main real estate collateral held against loans to corporates. The collateral value amounts are assigned to claim value amounts. The value of each individual collateral item held cannot exceed the maximum credit exposure of the corresponding individual claim. Changes in collateral value amounts between periods result either from changes in the underlying value of collateral or changes in the credit exposure.

| As at 31 December 2016 | Real estate | Vessels | Deposits | Securities | Other* | Total |
|---|---|---|---|---|---|---|
| Public entities | 1,692 | - | 41 | - | 123 | 1,856 |
| Individuals | 270,629 | 221 | 584 | 3,262 | 14,024 | 288,720 |
| **Corporates** | **271,474** | **93,714** | **3,835** | **57,720** | **102,542** | **529,285** |
| Fisheries | 12,010 | 91,101 | 152 | 16,205 | 20,948 | 140,416 |
| Construction and real estate companies | 179,155 | 104 | 1,088 | 2,680 | 7,185 | 190,212 |
| Holding companies | 5,528 | - | 870 | 26,572 | 507 | 33,477 |
| Retail | 16,161 | 11 | 562 | 1,066 | 23,981 | 41,781 |
| Services | 40,368 | 2,443 | 640 | 1,651 | 28,078 | 73,180 |
| Information, technology and communication | 603 | - | 121 | 5,738 | 7,375 | 13,837 |
| Manufacturing | 10,104 | 50 | 384 | 3,808 | 12,023 | 26,369 |
| Agriculture | 7,545 | 5 | 2 | - | 2,332 | 9,884 |
| Other | - | - | 16 | - | 113 | 129 |
| **Total** | **543,795** | **93,935** | **4,460** | **60,982** | **116,689** | **819,861** |

| As at 31 December 2015** | Real estate | Vessels | Deposits | Securities | Other* | Total |
|---|---|---|---|---|---|---|
| Public entities | 1,523 | - | 53 | - | 99 | 1,675 |
| Individuals | 230,530 | 261 | 206 | 3,113 | 7,594 | 241,704 |
| **Corporates** | **223,265** | **113,111** | **1,291** | **66,522** | **97,316** | **501,505** |
| Fisheries | 15,038 | 112,314 | 90 | 14,778 | 29,222 | 171,442 |
| Construction and real estate companies | 139,612 | 78 | 356 | 761 | 3,865 | 144,672 |
| Holding companies | 4,994 | 12 | 27 | 39,962 | 1,726 | 46,721 |
| Retail | 14,436 | 11 | 156 | 1,696 | 25,675 | 41,974 |
| Services | 33,445 | 679 | 225 | 489 | 14,565 | 49,403 |
| Information, technology and communication | 551 | 3 | 81 | 2,635 | 7,440 | 10,710 |
| Manufacturing | 8,509 | 11 | 350 | 6,201 | 12,374 | 27,445 |
| Agriculture | 6,608 | 3 | 6 | - | 2,449 | 9,066 |
| Other | 72 | - | - | - | - | 72 |
| **Total** | **455,318** | **113,372** | **1,550** | **69,635** | **105,009** | **744,884** |

* Other includes collateral like financial claims, invoices, liquid assets, vehicles, machines, aircrafts and inventories.

**The comparative amounts have been restated. Previously the collateral value amounts reflected the value of the individual collateral held regardless of the claim amount. Amounts in this table are of an informative nature only and do not have any effect on the amounts reported by the Group in the Income Statement or Statement of Financial Position.

## 64. Loans and advances by geographical area

Geographical segmentation is based on the customer's country of residence rather than the location of the creditor.

| As at 31 December 2016 | Domestic | Foreign | Carrying amount |
|---|---|---|---|
| Loans and advances to financial institutions | 1,878 | 18,530 | 20,408 |
| Loans and advances to customers | 808,917 | 44,500 | 853,417 |
| **Total** | **810,795** | **63,030** | **873,825** |

| As at 31 December 2015 | Domestic | Foreign | Carrying amount |
|---|---|---|---|
| Loans and advances to financial institutions | 3,189 | 17,602 | 20,791 |
| Loans and advances to customers | 758,033 | 53,516 | 811,549 |
| **Total** | **761,222** | **71,118** | **832,340** |

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## 65. Loans and advances credit monitoring

The following tables show the credit risk monitoring split on colour classification. Further details on the credit risk monitoring and colour classification can be seen in Note 57, Credit risk control and monitoring.

| As at 31 December 2016 | Green | Yellow | Orange | Red | Carrying amount |
|---|---|---|---|---|---|
| Financial institutions | 20,408 | - | - | - | 20,408 |
| Public entities | 8,992 | 470 | 55 | 266 | 9,783 |
| Individuals | 286,877 | 11,503 | 16,573 | 5,737 | 320,690 |
| **Corporates** | **463,201** | **36,014** | **13,006** | **10,723** | **522,944** |
| Fisheries | 119,346 | 3,297 | 660 | 323 | 123,626 |
| Construction and real estate companies | 163,690 | 17,092 | 4,839 | 2,706 | 188,327 |
| Holding companies | 38,654 | 1,069 | 646 | 121 | 40,490 |
| Retail | 37,072 | 2,994 | 1,339 | 830 | 42,235 |
| Services | 62,064 | 5,983 | 4,147 | 2,549 | 74,743 |
| Information, technology and communication | 18,646 | 406 | 140 | 28 | 19,220 |
| Manufacturing | 17,745 | 1,796 | 469 | 4,157 | 24,167 |
| Agriculture | 5,983 | 3,377 | 766 | 9 | 10,135 |
| Other | 1 | - | - | - | 1 |
| **Total** | **779,478** | **47,987** | **29,634** | **16,726** | **873,825** |

| As at 31 December 2015 | Green | Yellow | Orange | Red | Carrying amount |
|---|---|---|---|---|---|
| Financial institutions | 20,791 | - | - | - | 20,791 |
| Public entities | 7,823 | 676 | - | 239 | 8,738 |
| Individuals | 247,263 | 12,621 | 21,804 | 9,273 | 290,961 |
| **Corporates** | **432,941** | **42,802** | **19,680** | **16,427** | **511,850** |
| Fisheries | 151,629 | 1,417 | 3,728 | 2,740 | 159,514 |
| Construction and real estate companies | 118,606 | 23,222 | 7,066 | 6,440 | 155,334 |
| Holding companies | 43,871 | 2,749 | 785 | 207 | 47,612 |
| Retail | 30,364 | 3,271 | 1,577 | 809 | 36,021 |
| Services | 47,340 | 7,205 | 4,809 | 1,115 | 60,469 |
| Information, technology and communication | 14,573 | 497 | 288 | 144 | 15,502 |
| Manufacturing | 18,038 | 3,566 | 1,198 | 4,403 | 27,205 |
| Agriculture | 8,445 | 875 | 229 | 569 | 10,118 |
| Other | 75 | - | - | - | 75 |
| **Total** | **708,818** | **56,099** | **41,484** | **25,939** | **832,340** |

## 66. Credit quality of financial assets

| | Gross carrying amount | | | | | |
|---|---|---|---|---|---|---|
| As at 31 December 2016 | Neither past due nor individually impaired | Past due but not individually impaired | Individually impaired | Total | Allowance for impairment | Carrying amount |
| Cash and balances with Central Bank | 30,662 | - | - | 30,662 | - | 30,662 |
| Bonds and debt instruments | 154,731 | 161 | - | 154,892 | - | 154,892 |
| Derivative instruments | 278 | - | - | 278 | - | 278 |
| Loans and advances to financial institutions | 20,408 | - | - | 20,408 | - | 20,408 |
| Loans and advances to customers | 815,881 | 24,437 | 34,050 | 874,368 | (20,951) | 853,417 |
| Other financial assets | 6,528 | - | - | 6,528 | - | 6,528 |
| **Total** | **1,028,488** | **24,598** | **34,050** | **1,087,136** | **(20,951)** | **1,066,185** |
| **As at 31 December 2015** | | | | | | |
| Cash and balances with Central Bank | 25,164 | - | - | 25,164 | - | 25,164 |
| Bonds and debt instruments | 203,299 | 385 | - | 203,684 | - | 203,684 |
| Derivative instruments | 287 | - | - | 287 | - | 287 |
| Loans and advances to financial institutions | 20,791 | - | - | 20,791 | - | 20,791 |
| Loans and advances to customers | 767,837 | 20,569 | 56,800 | 845,206 | (33,657) | 811,549 |
| Other financial assets | 6,918 | - | - | 6,918 | - | 6,918 |
| **Total** | **1,024,296** | **20,954** | **56,800** | **1,102,050** | **(33,657)** | **1,068,393** |

The allowance for impairment includes both the allowance for individual impairment and the allowance for collective impairment.

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## 67. Loans and advances neither past due nor individually impaired

The following tables show the credit quality, measured by rating grade, of loans and advances neither past due nor individually impaired. Further details on rating grades can be seen in Note 56, Credit risk assessment.

| | Rating grades | | | | | |
|---|---|---|---|---|---|---|
| As at 31 December 2016 | 10-7 | 6-4 | 3-1 | 0 | Unrated | Gross carrying amount |
| Financial institutions | 20,408 | - | - | - | - | 20,408 |
| Public entities | 6,448 | 3,029 | 32 | 5 | - | 9,514 |
| Individuals | 112,366 | 154,564 | 36,527 | 339 | 914 | 304,710 |
| **Corporates** | **35,410** | **423,118** | **41,078** | **1,274** | **777** | **501,657** |
| Fisheries | 12,655 | 105,283 | 4,869 | 35 | - | 122,842 |
| Construction and real estate companies | 429 | 163,077 | 15,596 | 892 | 413 | 180,407 |
| Holding companies | - | 34,503 | 4,769 | - | 245 | 39,517 |
| Retail | 9,976 | 27,667 | 2,978 | 253 | 21 | 40,895 |
| Services | 6,947 | 53,077 | 9,254 | 42 | 54 | 69,374 |
| Information, technology and communication | 227 | 18,583 | 358 | 12 | - | 19,180 |
| Manufacturing | 4,395 | 13,517 | 1,789 | 40 | - | 19,741 |
| Agriculture | 781 | 7,410 | 1,465 | - | 44 | 9,700 |
| Other | - | 1 | - | - | - | 1 |
| **Total** | **174,632** | **580,711** | **77,637** | **1,618** | **1,691** | **836,289** |

| | Rating grades | | | | | |
|---|---|---|---|---|---|---|
| As at 31 December 2015 | 10-7 | 6-4 | 3-1 | 0 | Unrated | Gross carrying amount |
| Financial institutions | 19,152 | 1,639 | - | - | - | 20,791 |
| Public entities | 7,608 | 643 | 183 | - | 15 | 8,449 |
| Individuals | 97,898 | 130,886 | 37,303 | 516 | 3,999 | 270,602 |
| **Corporates** | **60,608** | **308,401** | **117,125** | **2,638** | **14** | **488,786** |
| Fisheries | 17,558 | 108,078 | 29,642 | 1,810 | - | 157,088 |
| Construction and real estate companies | 5,696 | 81,660 | 60,340 | 552 | 2 | 148,250 |
| Holding companies | - | 38,692 | 8,657 | - | - | 47,349 |
| Retail | 11,036 | 16,205 | 7,226 | 26 | - | 34,493 |
| Services | 15,973 | 31,437 | 7,609 | 250 | 2 | 55,271 |
| Information, technology and communication | 4,669 | 10,173 | 595 | - | - | 15,437 |
| Manufacturing | 4,820 | 14,938 | 2,034 | - | - | 21,792 |
| Agriculture | 856 | 7,214 | 950 | - | 10 | 9,030 |
| Other | - | 4 | 72 | - | - | 76 |
| **Total** | **185,266** | **441,569** | **154,611** | **3,154** | **4,028** | **788,628** |

## 68. Loans and advances past due but not individually impaired

The following table shows the gross carrying amount of loans and advances to financial institutions and customers that have failed to make payments which had become contractually due by one or more days.

| As at 31 December 2016 | Past due 1-5 days | Past due 6-30 days | Past due 31 - 60 days | Past due 61 - 90 days | Past due over 90 days | Gross carrying amount |
|---|---|---|---|---|---|---|
| Public entities | - | - | - | 50 | - | 50 |
| Individuals | 2,459 | 4,561 | 3,134 | 1,241 | 1,509 | 12,904 |
| Corporations | 4,932 | 3,307 | 1,143 | 643 | 1,458 | 11,483 |
| **Total** | **7,391** | **7,868** | **4,277** | **1,934** | **2,967** | **24,437** |
| **As at 31 December 2015** | | | | | | |
| Public entities | - | 4 | - | 55 | - | 59 |
| Individuals | 114 | 6,346 | 4,132 | 1,197 | 1,244 | 13,033 |
| Corporations | 53 | 3,741 | 1,490 | 799 | 1,394 | 7,477 |
| **Total** | **167** | **10,091** | **5,622** | **2,051** | **2,638** | **20,569** |

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## 69. Loans and advances by industry sectors

The tables below show credit exposure, allowances and impairment by industry sectors and customer segment.

| | | | | Individually impaired | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Of which performing | | Of which non-performing* | | |
| As at 31 December 2016 | Gross carrying amount | Gross not individually impaired | Collective allowance | Gross carrying amount | Individual allowance | Gross carrying amount | Individual allowance | Carrying amount |
| Financial institutions | 20,408 | 20,408 | - | - | - | - | - | 20,408 |
| Public entities | 10,028 | 9,565 | (48) | - | - | 464 | (198) | 9,783 |
| Individuals | 326,844 | 317,614 | (1,499) | 2,170 | (738) | 7,059 | (3,916) | 320,690 |
| **Corporates** | **537,496** | **513,139** | **(2,476)** | **9,953** | **(4,446)** | **14,404** | **(7,630)** | **522,944** |
| Fisheries | 124,094 | 123,314 | (145) | 326 | (71) | 452 | (250) | 123,626 |
| Construction and real estate companies | 192,819 | 186,529 | (1,204) | 2,352 | (1,347) | 3,938 | (1,941) | 188,327 |
| Holding companies | 41,148 | 40,503 | (251) | 156 | (35) | 489 | (372) | 40,490 |
| Retail | 43,436 | 41,629 | (224) | 756 | (291) | 1,050 | (685) | 42,235 |
| Services | 80,833 | 71,762 | (401) | 3,601 | (2,029) | 5,471 | (3,661) | 74,743 |
| Information, technology and communication | 19,383 | 19,308 | (115) | 27 | (6) | 49 | (43) | 19,220 |
| Manufacturing | 25,535 | 19,929 | (91) | 2,695 | (632) | 2,912 | (646) | 24,167 |
| Agriculture | 10,247 | 10,164 | (45) | 40 | (35) | 43 | (32) | 10,135 |
| Other | 1 | 1 | - | - | - | - | - | 1 |
| **Total** | **894,776** | **860,726** | **(4,023)** | **12,123** | **(5,184)** | **21,927** | **(11,744)** | **873,825** |

| | | | | Individually impaired | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Of which performing | | Of which non-performing* | | |
| As at 31 December 2015 | 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 | - | - | - | - | - | 20,791 |
| Public entities | 8,969 | 8,507 | (8) | 429 | (204) | 32 | (18) | 8,738 |
| Individuals | 303,349 | 283,634 | (1,967) | 4,937 | (2,273) | 14,777 | (8,147) | 290,961 |
| **Corporates** | **532,888** | **496,265** | **(3,482)** | **23,167** | **(9,813)** | **13,458** | **(7,745)** | **511,850** |
| Fisheries | 162,160 | 157,546 | (224) | 1,762 | (901) | 2,853 | (1,519) | 159,517 |
| Construction and real estate companies | 162,090 | 150,708 | (1,431) | 6,468 | (2,618) | 4,914 | (2,708) | 155,333 |
| Holding companies | 48,649 | 47,671 | (343) | 266 | (155) | 713 | (540) | 47,612 |
| 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 |
| Information, technology and communication | 15,787 | 15,526 | (137) | 12 | (3) | 249 | (145) | 15,502 |
| Manufacturing | 29,384 | 22,052 | (231) | 6,466 | (1,335) | 867 | (615) | 27,204 |
| Agriculture | 10,440 | 9,631 | (71) | 571 | (166) | 237 | (85) | 10,117 |
| Other | 76 | 76 | (1) | - | - | - | - | 75 |
| **Total** | **865,997** | **809,197** | **(5,457)** | **28,533** | **(12,290)** | **28,267** | **(15,910)** | **832,340** |

*Non-performing past due more than 90 days

All amounts are in ISK million

### 70. Allowance for impairment on loans and advances to financial institutions and customers and other financial assets

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Individual allowance | Collective allowance | Total | Individual allowance | Collective allowance | Total |
| Balance at the beginning of the year | (28,200) | (5,457) | (33,657) | (33,731) | (7,716) | (41,447) |
| New provisions | (4,676) | - | (4,676) | (10,646) | - | (10,646) |
| New provisions due to merger | - | - | 0 | (2,863) | (491) | (3,354) |
| Reversals | 8,469 | 1,434 | 9,903 | 12,821 | 2,565 | 15,386 |
| Provisions used to cover write-offs | 7,479 | - | 7,479 | 6,570 | - | 6,570 |
| Translation difference | - | - | 0 | (351) | 185 | (166) |
| **Balance at the end of the year** | **(16,928)** | **(4,023)** | **(20,951)** | **(28,200)** | **(5,457)** | **(33,657)** |

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Customers | Financials | Total | Customers | Financials | Total |
| New provisions | (4,676) | - | (4,676) | (10,646) | - | (10,646) |
| Write-offs | (9,663) | - | (9,663) | (7,601) | - | (7,601) |
| Provisions used to cover write-offs | 7,479 | - | 7,479 | 6,570 | - | 6,570 |
| Reversals | 9,903 | - | 9,903 | 15,386 | - | 15,386 |
| Recoveries | 2,207 | - | 2,207 | 2,146 | - | 2,146 |
| Translation difference | - | - | 0 | (166) | - | (166) |
| Impairment loss for the period | 5,250 | 0 | 5,250 | 5,689 | 0 | 5,689 |
| Impairment of financial institutions and other | - | (452) | (452) | - | (645) | (645) |
| **Net impairment loss for the year** | **5,250** | **(452)** | **4,798** | **5,689** | **(645)** | **5,044** |

### 71. Renegotiated loans

In regard to financial restructuring of customers, the Group has put remedies in place for those experiencing financial difficulties and also presented procedures for financial restructuring. These restructuring approaches include extended and modified repayment arrangements and approved external management plans.

### 72. Large exposures

As at 31 December 2016, three customer groups were rated as large exposures in accordance with FME's Rules on Large Exposures Incurred by Financial Undertakings, No. 625/2013. Customers are rated as large exposures if their total obligations, or those of financially or administratively connected parties, exceed 10% of the Group's capital base. No exposure may attain the equivalent of 25% of the capital base. The following table shows the Group's large exposures after credit mitigation:

| As at 31 December 2016 | Number of large exposures | Large exposures |
|---|---|---|
| Large exposures between 10% and 20% of the Group's capital base | 2 | 51,310 |
| Large exposures between 0% and 10% of the Group's capital base | 1 | - |
| **Total** | **3** | **51,310** |
| | | |
| Total large exposures to capital base | | 20% |
| | | |
| **As at 31 December 2015** | | |
| Large exposures between 10% and 20% of the Group's capital base | 2 | 66,094 |
| Large exposures between 0% and 10% of the Group's capital base | 1 | 212 |
| **Total** | **3** | **66,306** |
| | | |
| Total large exposures to capital base | | 25% |

### 73. Bonds and debt instruments

A breakdown of the Group's bond portfolio, by Standard & Poor's rating, is as follows:

| Carrying amount | 2016 | 2015 |
|---|---|---|
| AAA/AA+/AA/AA- | 24,941 | 31,900 |
| BBB+ | 107,337 | 135,212 |
| BBB/BBB- | 12,547 | 1,356 |
| Lower than BBB- | - | 24,875 |
| Unrated | 10,067 | 10,340 |
| **Total** | **154,892** | **203,684** |

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## 73. Bonds and debt instruments (continued)

The following table shows the carrying amounts of bonds for which the issuers have failed, by one or more days, to make a payment when it was contractually due:

| As at 31 December 2016 | Past due 0 - 90 days | Past due over 90 days | Carrying amount |
|---|---|---|---|
| Holding companies | - | 70 | 70 |
| Other | - | 91 | 91 |
| **Total** | **0** | **161** | **161** |
| | | | |
| **As at 31 December 2015** | | | |
| Holding companies | - | 85 | 85 |
| Other | - | 300 | 300 |
| **Total** | **0** | **385** | **385** |

## 74. Derivative instruments

The following table summarises the Group's exposure in derivative instruments, classified by the Bank into equivalent Standard & Poor's ratings by counterparty:

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| | amount | Assets | Liabilities | amount | Assets | Liabilities |
| AAA/AA+/AA/AA- | 6 | - | - | - | - | - |
| A+/A/A- | 28,534 | 180 | 191 | 33,936 | 41 | 145 |
| BBB+ | 8,784 | 28 | 21 | 15,530 | 7 | 208 |
| BBB/BBB- | 3,100 | 24 | 2 | 783 | - | 4 |
| Unrated | 15,556 | 46 | 969 | 22,895 | 239 | 345 |
| **Total** | **55,980** | **278** | **1,183** | **73,144** | **287** | **702** |

## 75. Offsetting financial assets and financial liabilities

The following table shows reconciliation to the net amounts of financial assets and financial liabilities. Those financial assets and financial liabilities are subject to offsetting, enforceable master netting agreements and similar agreements.

**As at 31 December 2016**

Financial assets subject to offsetting, enforceable master netting arrangement and similar agreements

| | Financial assets subject to netting agreements | | | Netting not recognised on balance sheet | | | | |
|---|---|---|---|---|---|---|---|---|
| Types of financial assets | Financial assets | Financial liabilities | Net amount | Financial liabilities | Collateral received | Net financial assets with netting agreements | Financial assets not subject to netting agreements | Net amount on balance sheet |
| Derivatives | 265 | - | 265 | (79) | (46) | 140 | 13 | 278 |

Financial liabilities subject to offsetting, enforceable master netting arrangement and similar agreements

| | Financial liabilities subject to netting agreements | | | Netting not recognised on balance sheet | | | | |
|---|---|---|---|---|---|---|---|---|
| Types of financial liabilites | Financial liabilities | Financial assets | Net amount | Financial assets | Collateral pledged | Net financial liabilities with netting agreements | Financial liabilities not subject to netting agreements | Net amount on balance sheet |
| Derivatives | (1,090) | - | (1,090) | 79 | 117 | (894) | (93) | (1,183) |
| Short positions | (546) | - | (546) | - | 546 | - | - | (546) |
| **Total** | **(1,636)** | **0** | **(1,636)** | **79** | **663** | **(894)** | **(93)** | **(1,729)** |

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### 75. Offsetting financial assets and financial liabilities (continued)

**As at 31 December 2015**

Financial assets subject to offsetting, enforceable master netting arrangement and similar agreements

| | Financial assets subject to netting agreements | | | Netting not recognised on balance sheet | | | | |
|---|---|---|---|---|---|---|---|---|
| **Types of financial assets** | **Financial assets** | **Financial liabilities** | **Net amount** | **Financial liabilities** | **Collateral received** | **Net financial assets with netting agreements** | **Financial assets not subject to netting agreements** | **Net amount on balance sheet** |
| Derivatives | 285 | - | 285 | (43) | (230) | 12 | 2 | 287 |

Financial liabilities subject to offsetting, enforceable master netting arrangement and similar agreements

| | Financial liabilities subject to netting agreements | | | Netting not recognised on balance sheet | | | | |
|---|---|---|---|---|---|---|---|---|
| **Types of financial liabilities** | **Financial liabilities** | **Financial assets** | **Net amount** | **Financial assets** | **Collateral pledged** | **Net financial liabilities with netting agreements** | **Financial liabilities not subject to netting agreements** | **Net amount on balance sheet** |
| Derivatives | (564) | - | (564) | 43 | (127) | (648) | (139) | (702) |
| Short positions | (2,698) | - | (2,698) | - | 2,698 | - | - | (2,698) |
| **Total** | **(3,262)** | **0** | **(3,262)** | **43** | **2,571** | **(648)** | **(139)** | **(3,400)** |

## Liquidity risk

### 76. 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.

### 77. Liquidity risk management

A liquidity management policy for the Bank and its subsidiaries is in place. The objective of the liquidity management policy is to ensure, even in times of stress, that sufficient liquid assets and funding capacity are available to meet financial obligations in a timely manner and at reasonable cost. Furthermore, the liquidity management policy is to describe the manner in which the Group identifies, evaluates, measures, monitors, manages and reports its liquidity. Enforcing this policy has the further objective of minimising fluctuations in liquidity. The policy is built on a framework published in Basel III standards on liquidity risk measurement where the main metric for measuring liquidity risk is the Liquidity Coverage Ratio (LCR) and the Net Stable Funding ratio (NSFR). The objective of the LCR 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. NSFR 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 and to limit overreliance on short-term wholesale funding.

The Group complies with the liquidity and funding rules set by the Central Bank of Iceland No. 1031/2014 and No. 1032/2014 as well as following guidelines No. 2/2010 from the Icelandic Financial Supervisory Authority on best practice for managing liquidity in banking organisation. Rules No. 1031/2014 require the Group to maintain a LCR minimum of 90% total and 100% for foreign currencies at the end of year 2016 and rules No, 1032/2014 set requirements for a minimum of 90% NSFR in foreign currencies at year-end 2016. The minimum requirement for both ratios, LCR total and NSFR in foreign currencies, will increase by 10 percentage points every year until it reaches 100% in the year 2017. The Group submits monthly reports on its liquidity and funding position to the Central Bank of Iceland and the FME.

The Group has implemented a risk appetite where these rules and guidelines as well as inner requirements within the Bank set benchmarks for liquidity management.

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 assesses whether the liquidity management process is designed properly and operating effectively.

The Group monitors intraday liquidity risk, short-term 30 day liquidity risk, medium and longer-term liquidity risk and risk arising from mismatches of longer term assets and liabilities.

The Group's liquidity management process includes: projecting expected cash flows in a maturity profile rather than relying merely on contractual maturities, monitoring balance sheet liquidity, monitoring and managing the maturity profile of liabilities and off-balance sheet commitments, monitoring the concentration of liquidity risk in order to avoid undue reliance on large financing counterparties, projecting cash flows arising from future business, and maintaining liquidity and contingency plans which outline measures to take in the event of difficulties arising from liquidity crisis.

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### 77. Liquidity risk management (continued)

Market Risk conducts weekly stress tests by applying various hypothetical scenarios on the Group's liquidity position to ensure that it has adequate liquidity to withstand stressed conditions. Different assumptions are drawn for each stress test to estimate the impact of a variety of market conditions, in particular the lifting of capital controls in Iceland and how that would impact the Group's deposit base.

The key indicator of short-term liquidity risk is measured by the liquidity coverage ratio (LCR) which shows the ratio of high quality liquid assets to expected total net cash outflows over the next 30 days under a specified stress scenario. High quality liquid assets are comprised of cash at hand, balances with the Central Bank, assets eligible for repo transactions with the Central Bank and zero percent risk-weighted foreign government bonds. Estimated inflow and outflow weights, according to former liquidity rules No. 1031/2014, are applied to the total balance amount for each asset and liability group measured in the ratio, reflecting the next 30 calendar days. The calculations for the ratio at year-end 2016 and 2015 are shown in the following table:

| | Total | | Foreign currencies | |
|---|---|---|---|---|
| **Liquidity coverage ratio 31.12.2016** | **Unweighted** | **Weighted** | **Unweighted** | **Weighted** |
| Level 1 liquid assets | 143,977 | 143,977 | 26,221 | 26,221 |
| Level 2 liquid assets and information items | 28,749 | 5,589 | 11,177 | 5,589 |
| **Total liquid assets** | **172,726** | **149,566** | **37,398** | **31,810** |
| Deposits | 391,508 | 123,148 | 36,126 | 14,123 |
| Borrowing | 2,787 | 2,787 | 447 | 447 |
| Other outflows | 173,532 | 31,002 | 29,879 | 2,561 |
| **Total outflows (0-30 days)** | **567,827** | **156,937** | **66,452** | **17,131** |
| Loans and advances to financial institutions | 18,707 | 16,732 | 18,680 | 16,704 |
| Other inflows | 54,673 | 23,547 | 28,642 | 14,317 |
| Limit on inflows | - | - | - | (18,173) |
| **Total inflows (0-30 days)** | **73,380** | **40,279** | **47,322** | **12,848** |
| **Liquidity coverage ratio** | | **128%** | | **743%** |

| | Total | | Foreign currencies | |
|---|---|---|---|---|
| **Liquidity coverage ratio 31.12.2015** | **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 | - | 42 | - |
| **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 |
| **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 | - | - | - | - |
| **Total inflows (0-30 days)** | **65,950** | **33,816** | **25,736** | **20,339** |
| **Liquidity coverage ratio** | | **113%** | | **360%** |

The Group has categorised its deposit base into nine different groups representing different levels of stickiness. Stickiness is a method that is used to estimate the stability of the Group's deposit base. The Bank for International Settlements (BIS) defines stickiness as tendency of funding not to run off quickly under stress. The deposit groups are based on methodology in the liquidity rules set by the Central Bank of Iceland and are reflected in the Group's internal liquidity stress tests where a concentration charge is applied to account for possible outflows. Run off rates and amounts for these deposit groups are shown in the following table:

| | 0-30 day deposits balance by groups | | | | | |
|---|---|---|---|---|---|---|
| **Total deposits* by groups as at 31. December 2016** | **Less stable deposits** | **Applied run-off rate** | **Stable deposits** | **Applied run-off rate** | **Term deposits** | **Total deposits** |
| **Groups** | | | | | | |
| 1. Individuals | 113,198 | 10% | 56,038 | 5% | 98,305 | 267,541 |
| 2. Small and medium size corporates | 48,619 | 10% | 9,291 | 5% | 4,832 | 62,742 |
| 3. Operational deposits | - | 25% | - | 5% | - | - |
| 4. Large corporates | 67,833 | 40% | - | 20% | 13,038 | 80,871 |
| 5. Government, municipalities and Central Bank | 30,565 | 40% | 259 | 20% | 651 | 31,475 |
| 6. Financial institutions in resolution process | 10,361 | 100% | - | - | 28,330 | 38,691 |
| 7. Financial institutions | 39,266 | 100% | - | - | 61,968 | 101,234 |
| 8. Other foreign counterparties | 14,226 | 100% | 2,100 | 25% | 4,370 | 20,696 |
| 9. Pledged accounts | - | - | 6,569 | - | - | 6,569 |
| **Total deposits** | **324,068** | | **74,257** | | **211,494** | **609,819** |

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

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### 77. Liquidity risk management (continued)

| Total deposits* by groups as at 31. December 2015 | 0-30 day deposits balance by groups | | | | | |
|---|---|---|---|---|---|---|
| | Less stable deposits | Applied run-off rate | Stable deposits | Applied run-off rate | Term deposits | Total deposits |
| **Groups** | | | | | | |
| 1. Individuals | 89,491 | 10% | 70,745 | 5% | 86,602 | 246,838 |
| 2. Small and medium size corporates | 46,315 | 10% | 10,187 | 5% | 4,609 | 61,111 |
| 3. Operational deposits | 7,069 | 25% | 169 | 5% | 229 | 7,467 |
| 4. Large corporates | 61,185 | 40% | 367 | 20% | 25,645 | 87,197 |
| 5. Government, municipalities and Central Bank | 29,124 | 40% | - | 20% | 642 | 29,766 |
| 6. Financial institutions in resolution process | 19,273 | 100% | - | - | 48,321 | 67,594 |
| 7. Financial institutions | 63,417 | 100% | - | - | 38,566 | 101,983 |
| 8. Other foreign counterparties | 9,581 | 100% | 1,862 | 25% | 2,383 | 13,826 |
| **Total deposits** | **325,455** | | **83,330** | | **206,997** | **615,782** |

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

The Group measures the net stable funding ratio (NSFR) as another key indicator for longer-term liquidity risk. The following table shows the values of the NSFR for foreign currencies at year-end 2016 and 2015:

| | As at 31 December 2016 | As at 31 December 2015 |
|---|---|---|
| Net stable funding ratio FX | 154% | 136% |

### 78. Maturity analysis of financial assets and liabilities

The following tables only take into account the contractual maturity of the Group's assets and liabilities but do not account for measures that the Group could decide upon to convert assets into cash at hand by liquidation either through sale or participation in Central Bank operations. Furthermore all instant access deposits are categorised as outflows in the first time bucket. Further information on the Group's liquidity management can be found in Note 77.

The amounts in the maturity analyses as at year-end 2016 and 2015 are allocated to maturity buckets in respect of remaining contractual maturity (i.e. based on the timing of future cash flows according to contractual terms). For loans and advances in moratorium or in the process of liquidation the Group estimates the amounts from the historical recovery rate. For bonds issued by companies in moratorium or in the process of liquidation the amounts presented are future cash flows estimated as their fair value at the reporting date. These bonds and loans all fall in the time span of 1-5 years.

Amounts presented in the maturity analyses are the undiscounted future cash flows receivable and payable by the Group, including both principal and interest cash flows. These amounts differ from the carrying amounts presented in the statement of financial position, which are based on discounted rather than undiscounted future cash flows. If an amount receivable or payable is not fixed, the amount presented in the maturity analyses has been determined by reference to the relevant interest rates and exchange rates prevailing at the reporting date. For inflation-linked assets and liabilities the Group uses a constant yearly inflation according to the 12-month inflation at the reporting date. When there is a choice of when an amount shall be paid, future cash flows are calculated on the basis of the earliest date at which the Group can be required to pay, which is the worst case scenario from Group perspective. An example of this is that demand deposits are included in the earliest time span. Where the Group is committed to have amounts available in installments, each installment is allocated to the earliest period in which the Group might be required to pay. Thus undrawn loan commitments are included in the time span together with the earliest date at which such loans may be drawn. For financial guarantee contracts issued by the Group, the amount included in the maturity analysis is the guarantee's maximum amount, allocated to the earliest period in which the guarantee might be called.

Nonetheless, the Group's expected cash flows on demand deposits vary significantly from the amounts presented in the maturity analyses. Demand deposits from customers have short contractual maturities but are considered a relatively stable financing source with expected maturity exceeding one year, see Note 77, and also it is not expected that every committed loan will be drawn down immediately. The Group conducts, as mentioned in Note 77, a weekly stress test to estimate the impact of fluctuating market conditions and deposit withdrawals.

Amounts presented in non-derivative financial assets and non-derivative financial liabilities include all spot deals at year-end 2016 and 2015. When managing liquidity risk the Group regards spot deals as non-derivative assets or liabilities.

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### 78. Maturity analysis of financial assets and liabilities (continued)

The following table shows a maturity analysis of the Group's financial instruments as at 31 December 2016:

| Non-derivative financial assets | 0-1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | No maturity | Total | Carrying amount |
|---|---|---|---|---|---|---|---|---|
| Cash and balances with Central Bank | 30,662 | - | - | - | - | - | 30,662 | 30,662 |
| Bonds and debt instruments | 6,308 | 17,499 | 8,022 | 125,637 | 18,154 | - | 175,620 | 154,892 |
| Equities and equity instruments | - | - | - | - | - | 26,688 | 26,688 | 26,688 |
| Loans and advances to financial institutions | 18,749 | - | 1,660 | - | - | - | 20,409 | 20,408 |
| Loans and advances to customers | 41,840 | 53,626 | 143,754 | 335,886 | 730,522 | - | 1,305,628 | 853,417 |
| Other financial assets | 6,528 | - | - | - | - | - | 6,528 | 6,528 |
| **Total** | **104,087** | **71,125** | **153,436** | **461,523** | **748,676** | **26,688** | **1,565,535** | **1,092,595** |
| **Derivative financial assets** | | | | | | | | |
| **Gross settled derivatives** | | | | | | | | 254 |
| Inflow | 12,701 | 2,929 | 1,964 | 10,899 | - | - | 28,493 | |
| Outflow | (12,586) | (2,913) | (1,929) | (10,711) | - | - | (28,139) | |
| Total | **115** | **16** | **35** | **188** | **0** | **0** | **354** | **254** |
| **Net settled derivatives** | 24 | - | - | - | - | - | 24 | 24 |
| **Total** | **139** | **16** | **35** | **188** | **0** | **0** | **378** | **278** |
| **Non-derivative financial liabilities** | | | | | | | | |
| Due to financial institutions and Central Bank | (12,785) | (7,521) | (79) | (84) | - | - | (20,469) | (20,093) |
| Deposits from customers | (440,858) | (94,601) | (36,168) | (14,237) | (4,688) | - | (590,552) | (589,725) |
| Short positions | - | - | (39) | (163) | (799) | - | (1,001) | (546) |
| Borrowings | (10,234) | (16,266) | (20,278) | (186,892) | (58,333) | - | (292,003) | (223,944) |
| Other financial liabilities | (7,206) | - | - | - | - | - | (7,206) | (7,206) |
| Subordinated liabilities | - | (8) | (176) | (142) | (84) | - | (410) | (388) |
| **Total** | **(471,083)** | **(118,396)** | **(56,740)** | **(201,518)** | **(63,904)** | **0** | **(911,641)** | **(841,902)** |
| **Off-balance sheet items** | | | | | | | | |
| Financial guarantees and underwriting commitments | (1,059) | (1,904) | (7,456) | (4,941) | (5,105) | - | (20,465) | |
| Undrawn loan commitments | (86,356) | - | - | - | - | - | (86,356) | |
| Undrawn overdraft/credit card commitments | (64,468) | - | - | - | - | - | (64,468) | |
| **Total** | **(151,883)** | **(1,904)** | **(7,456)** | **(4,941)** | **(5,105)** | **0** | **(171,289)** | |
| **Derivative financial liabilities** | | | | | | | | |
| **Gross settled derivatives** | | | | | | | | (1,136) |
| Inflow | 15,748 | 2,225 | 3,956 | 188 | - | - | 22,117 | |
| Outflow | (15,887) | (2,299) | (4,877) | (213) | - | - | (23,276) | |
| Total | **(139)** | **(74)** | **(921)** | **(25)** | **0** | **0** | **(1,159)** | **(1,136)** |
| **Net settled derivatives** | (47) | - | - | - | - | - | (47) | (47) |
| **Total** | **(186)** | **(74)** | **(921)** | **(25)** | **0** | **0** | **(1,206)** | **(1,183)** |
| **Net liquidity position** | **(518,926)** | **(49,233)** | **88,354** | **255,227** | **679,667** | **26,688** | **481,777** | **249,788** |

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## 78. Maturity analysis of financial assets and liabilities (continued)

The following table shows a maturity analysis of the Group's financial instruments as at 31 December 2015:

| Non-derivative financial assets | 0-1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | No maturity | Total | Carrying amount |
|---|---|---|---|---|---|---|---|---|
| Cash and balances with Central Bank | 25,164 | - | - | - | - | - | 25,164 | 25,164 |
| Bonds and debt instruments | 19,854 | 14,307 | 13,333 | 167,971 | 23,239 | - | 238,704 | 203,684 |
| Equities and equity instruments | - | - | - | - | - | 29,192 | 29,192 | 29,192 |
| Loans and advances to financial institutions | 17,631 | 1,481 | - | 1,679 | - | - | 20,791 | 20,791 |
| Loans and advances to customers | 71,038 | 43,679 | 157,912 | 336,746 | 657,174 | - | 1,266,549 | 811,549 |
| Other financial assets | 6,361 | - | - | 558 | - | - | 6,919 | 6,918 |
| **Total** | **140,048** | **59,467** | **171,245** | **506,954** | **680,413** | **29,192** | **1,587,319** | **1,097,298** |
| | | | | | | | | |
| **Derivative financial assets** | | | | | | | | |
| **Gross settled derivatives** | | | | | | | | 250 |
| Inflow | 22,164 | 967 | 2,045 | 3,415 | - | - | 28,591 | |
| Outflow | (22,138) | (968) | (1,954) | (3,379) | - | - | (28,439) | |
| Total | **26** | **(1)** | **91** | **36** | **0** | **0** | **152** | **250** |
| **Net settled derivatives** | 37 | - | - | - | - | - | 37 | 37 |
| **Total** | **63** | **(1)** | **91** | **36** | **0** | **0** | **189** | **287** |
| | | | | | | | | |
| **Non-derivative financial liabilities** | | | | | | | | |
| Due to financial institutions and Central Bank | (45,474) | (1,238) | (5,347) | (5,665) | (45) | - | (57,769) | (56,731) |
| Deposits from customers | (380,818) | (111,663) | (33,492) | (32,739) | (3,564) | - | (562,276) | (559,051) |
| Short positions | (58) | (34) | (126) | (1,224) | (3,445) | - | (4,887) | (2,698) |
| Borrowings | (1,045) | (55) | (14,965) | (122,448) | (112,040) | - | (250,554) | (209,344) |
| Other financial liabilities | (5,367) | - | - | - | - | - | (5,367) | (5,367) |
| Subordinated liabilities | - | (9) | (31) | (553) | (96) | - | (689) | (639) |
| **Total** | **(432,762)** | **(112,999)** | **(53,961)** | **(162,629)** | **(119,190)** | **0** | **(881,542)** | **(833,830)** |
| | | | | | | | | |
| **Off-balance sheet items** | | | | | | | | |
| Financial guarantees and underwriting commitments | (698) | (1,593) | (3,484) | (7,529) | (4,333) | - | (17,637) | |
| Undrawn loan commitments | (79,975) | - | - | - | - | - | (79,975) | |
| Undrawn overdraft/credit card commitments | (58,443) | - | - | - | - | - | (58,443) | |
| **Total** | **(139,116)** | **(1,593)** | **(3,484)** | **(7,529)** | **(4,333)** | **0** | **(156,055)** | |
| | | | | | | | | |
| **Derivative financial liabilities** | | | | | | | | |
| **Gross settled derivatives** | | | | | | | | (583) |
| Inflow | 26,951 | - | 975 | 2,970 | - | - | 30,896 | |
| Outflow | (27,091) | - | (1,096) | (3,146) | - | - | (31,333) | |
| Total | **(140)** | **0** | **(121)** | **(176)** | **0** | **0** | **(437)** | **(583)** |
| **Net settled derivatives** | (119) | - | - | - | - | - | (119) | (119) |
| **Total** | **(259)** | **0** | **(121)** | **(176)** | **0** | **0** | **(556)** | **(702)** |
| | | | | | | | | |
| **Net liquidity position** | **(432,026)** | **(55,126)** | **113,770** | **336,656** | **556,890** | **29,192** | **549,355** | **263,053** |

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### 79. Maturity analysis of financial assets and liabilities by currency

The following table shows a maturity analysis of the Group's financial instruments by currency of denomination as at 31 December 2016:

| Non-derivative financial assets | 0-1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | No maturity | Total | Carrying amount |
|---|---|---|---|---|---|---|---|---|
| Total in foreign currencies | 53,801 | 37,204 | 38,406 | 101,541 | 10,800 | 115 | 241,867 | 230,076 |
| ISK | 50,286 | 33,921 | 115,030 | 359,982 | 737,876 | 26,573 | 1,323,668 | 862,519 |
| **Total** | **104,087** | **71,125** | **153,436** | **461,523** | **748,676** | **26,688** | **1,565,535** | **1,092,595** |
| **Derivative financial assets** | | | | | | | | |
| Total in foreign currencies | (593) | 16 | 1,812 | 118 | - | - | 1,353 | 254 |
| ISK | 732 | - | (1,777) | 70 | - | - | (975) | 24 |
| **Total** | **139** | **16** | **35** | **188** | **0** | **0** | **378** | **278** |
| **Non-derivative financial liabilities** | | | | | | | | |
| Total in foreign currencies | (56,752) | (1,783) | (4,440) | (168,035) | (34,000) | - | (265,010) | (232,506) |
| ISK | (414,331) | (116,613) | (52,300) | (33,483) | (29,905) | - | (646,631) | (609,396) |
| **Total** | **(471,083)** | **(118,396)** | **(56,740)** | **(201,518)** | **(63,904)** | **0** | **(911,641)** | **(841,902)** |
| **Off-balance sheet items** | | | | | | | | |
| Total in foreign currencies | (19,754) | (1,641) | (4,960) | (2,064) | (419) | - | (28,838) | |
| ISK | (132,129) | (263) | (2,496) | (2,877) | (4,686) | - | (142,451) | |
| **Total** | **(151,883)** | **(1,904)** | **(7,456)** | **(4,941)** | **(5,105)** | **0** | **(171,289)** | |
| **Derivative financial liabilities** | | | | | | | | |
| Total in foreign currencies | 808 | 813 | 3,956 | 188 | - | - | 5,765 | (1,136) |
| ISK | (994) | (887) | (4,877) | (213) | - | - | (6,971) | (47) |
| **Total** | **(186)** | **(74)** | **(921)** | **(25)** | **0** | **0** | **(1,206)** | **(1,183)** |
| **Net liquidity position in foreign currencies** | **(22,490)** | **34,609** | **34,774** | **(68,252)** | **(23,619)** | **115** | **(44,863)** | **(3,312)** |
| **Net liquidity position in ISK** | **(496,436)** | **(83,842)** | **53,580** | **323,479** | **703,285** | **26,573** | **526,640** | **253,100** |
| **Net liquidity position** | **(518,926)** | **(49,233)** | **88,354** | **255,227** | **679,666** | **26,688** | **481,777** | **249,788** |

The following table shows a maturity analysis of the Group's financial instruments by currency of denomination as at 31 December 2015:

| Non-derivative financial assets | 0-1 month | 1-3 months | 3-12 months | 1-5 years | Over 5 years | No maturity | Total | Carrying amount |
|---|---|---|---|---|---|---|---|---|
| Total in foreign currencies | 50,931 | 34,260 | 71,675 | 131,664 | 21,926 | 31 | 310,487 | 290,135 |
| ISK | 89,117 | 25,207 | 99,570 | 375,290 | 658,487 | 29,161 | 1,276,832 | 807,163 |
| **Total** | **140,048** | **59,467** | **171,245** | **506,954** | **680,413** | **29,192** | **1,587,319** | **1,097,298** |
| **Derivative financial assets** | | | | | | | | |
| Total in foreign currencies | (292) | 38 | 424 | 2,999 | - | - | 3,169 | 250 |
| ISK | 355 | (39) | (333) | (2,963) | - | - | (2,980) | 37 |
| **Total** | **63** | **(1)** | **91** | **36** | **0** | **0** | **189** | **287** |
| **Non-derivative financial liabilities** | | | | | | | | |
| Total in foreign currencies | (64,143) | (1,413) | (11,934) | (129,876) | (100,649) | - | (308,015) | (271,825) |
| ISK | (368,619) | (111,586) | (42,027) | (32,753) | (18,542) | - | (573,527) | (562,005) |
| **Total** | **(432,762)** | **(112,999)** | **(53,961)** | **(162,629)** | **(119,190)** | **0** | **(881,542)** | **(833,830)** |
| **Off-balance sheet items** | | | | | | | | |
| Total in foreign currencies | (20,072) | (1,188) | (937) | (7,001) | (267) | - | (29,465) | |
| ISK | (119,044) | (405) | (2,547) | (528) | (4,066) | - | (126,590) | |
| **Total** | **(139,116)** | **(1,593)** | **(3,484)** | **(7,529)** | **(4,333)** | **0** | **(156,055)** | |
| **Derivative financial liabilities** | | | | | | | | |
| Total in foreign currencies | 198 | - | 140 | 2,470 | - | - | 2,808 | (583) |
| ISK | (457) | - | (261) | (2,646) | - | - | (3,364) | (119) |
| **Total** | **(259)** | **0** | **(121)** | **(176)** | **0** | **0** | **(556)** | **(702)** |
| **Net liquidity position in foreign currencies** | **(33,378)** | **31,697** | **59,368** | **256** | **(78,990)** | **31** | **(21,016)** | **17,977** |
| **Net liquidity position in ISK** | **(398,648)** | **(86,823)** | **54,402** | **336,400** | **635,879** | **29,161** | **570,371** | **245,076** |
| **Net liquidity position** | **(432,026)** | **(55,126)** | **113,770** | **336,656** | **556,889** | **29,192** | **549,355** | **263,053** |

The amounts in the maturity analysis as at 31 December 2016 and 31 December 2015 are allocated to maturity buckets in respect of remaining contractual maturity (i.e. based on the timing of future cash flows according to contractual terms). Exceptions to this are loans and advances to customers and bonds issued by companies in moratorium or in the process of liquidation as disclosed in Note 78.

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### 80. Encumbered assets

The following tables show the Group’s total encumbered and unencumbered assets in 2016 and 2015.

| | Collateral pledged against | | | | |
|---|---|---|---|---|---|
| As at 31 December 2016 | Covered bonds | Issued bonds to LBI hf. | Other* | Un-encumbered | Total |
| Cash and balances with Central Bank | 96 | - | - | 30,566 | 30,662 |
| Bonds and debt instruments | - | - | 8,562 | 146,330 | 154,892 |
| Equities and equity instruments | - | - | - | 26,688 | 26,688 |
| Derivative instruments | - | - | - | 278 | 278 |
| Loans and advances to financial institutions | - | - | 1,970 | 18,438 | 20,408 |
| Loans and advances to customers | 52,810 | 60,800 | - | 739,807 | 853,417 |
| Investments in equity-accounted associates | - | - | - | 1,184 | 1,184 |
| Property and equipment | - | - | - | 5,452 | 5,452 |
| Intangible assets | - | - | - | 2,634 | 2,634 |
| Other assets | - | - | - | 8,093 | 8,093 |
| Assets classified as held for sale | - | - | - | 7,449 | 7,449 |
| **Total** | **52,906** | **60,800** | **10,532** | **986,919** | **1,111,157** |

| | Collateral pledged against | | | | |
|---|---|---|---|---|---|
| As at 31 December 2015 | Covered bonds | Issued bonds to LBI hf. | Other* | Un-encumbered | Total |
| Cash and balances with Central Bank | 308 | - | - | 24,856 | 25,164 |
| Bonds and debt instruments | - | - | 23,617 | 180,067 | 203,684 |
| Equities and equity instruments | - | - | - | 29,192 | 29,192 |
| Derivative instruments | - | - | - | 287 | 287 |
| Loans and advances to financial institutions | - | - | 1,220 | 19,571 | 20,791 |
| Loans and advances to customers | 28,027 | 150,812 | - | 632,710 | 811,549 |
| Investments in equity-accounted associates | - | - | - | 909 | 909 |
| Property and equipment | - | - | - | 5,658 | 5,658 |
| Intangible assets | - | - | - | 2,012 | 2,012 |
| Other assets | - | - | - | 7,457 | 7,457 |
| Assets classified as held for sale | - | - | - | 11,955 | 11,955 |
| **Total** | **28,335** | **150,812** | **24,837** | **914,674** | **1,118,658** |

*Other represents assets pledged as collateral to the Central Bank of Iceland to secure settlement in the Icelandic clearing systems, assets pledged as collateral to secure trading lines and credit support for GMRA and ISDA master agreements and other pledges of similar nature.

## Market risk

### 81. Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in market prices. Market risk arises from open positions in currency, equity 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, credit spreads, foreign exchange rates and equity prices. Other market risk is defined as equity price risk and inflation risk, each of which is disclosed in the following notes.

### 82. Market risk management

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 and proprietary position-taking as part of asset and liability management and funding transactions, managed by Treasury. Treasury is also responsible for daily liquidity management, creating exposure to market risk.

The Board of Directors is responsible for determining the Group's overall risk appetite, including for market risk. The CEO of the Bank appoints the Risk & Finance Committee, which is responsible for developing detailed market risk management policies and setting market risk limits. Treasury and the Market Making department within Markets are responsible for managing market-related positions under the supervision of Market Risk. The objective of market risk management is to identify, locate and monitor market risk exposures and analysing and reporting to appropriate parties.

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### 82. Market risk management (continued)

Market risks arising from trading and non-trading activities are monitored and reported on a daily, weekly and monthly basis to the head of each business unit along with a comprehensive biannual risk report to the Board of Directors. The Group's market risk is thereby measured and monitored on a daily basis, and Market Risk monitors the limits set in the Group's risk appetite and submits these and other market risk measurements and concerns to the Risk & Finance Committee every other week. Several indicators are used, including daily profits and losses, delta positions and net positions across different attributes such as the currency and issuer.

The Group 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 requirements regulations. The following table summarises the Group's exposure to market risk as at 31 December 2016 and 2015.

| | 2016 | 2015 |
|---|---|---|
| **Market risk factor** | **% of RWA** | **% of RWA** |
| Equity price risk | 1.1% | 0.7% |
| Interest rate risk | 0.4% | 0.2% |
| Foreign exchange risk | 0.5% | 2.8% |
| **Total** | **2.0%** | **3.7%** |

The currency risk in the Groups trading portfolios is disclosed together with that in its non-trading portfolios in Notes 88-89, together with the related sensitivity analysis.

### 83. Equity price risk

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, in listed ISK equities. The Group's non-trading portfolio contains listed and unlisted equities as part of asset and liability management. Further details can be seen in Note 21 and Note 85-86.

### 84. Interest rate risk

Interest rate risk is the risk that the fair value or future cash flow of financial instruments will fluctuate due to changes in market interest rates.

Changes in interest rates for the Group's assets and liabilities, other than those in its trading portfolios, have an impact on its interest rate margin. This risk results primarily from duration mismatches between assets and liabilities. Interest rate risk is managed principally by monitoring interest rate gaps. Interest rate risk is managed centrally within the Group by the Treasury of the Bank, and is monitored by Market Risk.

The following tables summarise the Group's exposure to interest rate risk. The tables include interest-bearing financial assets and liabilities at their carrying amounts, while off-balance sheet amounts are the notional amounts of the derivative instruments, see Note 22. The amounts presented are categorised by the earlier of either the contractual repricing or the maturity date.

| **As at 31 December 2016** | **Up to 3 months** | **3-12 months** | **1-5 years** | **Over 5 years** | **Carrying amount** |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Cash and balances with Central Bank | 30,662 | - | - | - | 30,662 |
| Bonds and debt instruments | 131,569 | 3,212 | 10,012 | 10,099 | 154,892 |
| Derivative instruments | 278 | - | - | - | 278 |
| Loans and advances to financial institutions | 18,748 | 1,660 | - | - | 20,408 |
| Loans and advances to customers | 625,538 | 100,029 | 78,192 | 49,658 | 853,417 |
| Other financial assets | 6,528 | - | - | - | 6,528 |
| **Total** | **813,323** | **104,901** | **88,204** | **59,757** | **1,066,185** |
| | | | | | |
| **Financial liabilities** | | | | | |
| Due to financial institutions and Central Bank | (20,093) | - | - | - | (20,093) |
| Deposits from customers | (583,092) | (5,022) | (1,517) | (94) | (589,725) |
| Derivative instruments and short positions | (1,183) | (17) | (74) | (455) | (1,729) |
| Borrowings | (79,316) | (14,009) | (109,785) | (20,834) | (223,944) |
| Other financial liabilities | (7,206) | - | - | - | (7,206) |
| Subordinated liabilities | (238) | (150) | - | - | (388) |
| **Total** | **(691,128)** | **(19,198)** | **(111,376)** | **(21,383)** | **(843,085)** |
| | | | | | |
| Net on-balance sheet position | 122,195 | 85,703 | (23,172) | 38,374 | 223,100 |
| Net off-balance sheet position | 153 | (153) | 0 | 0 | |
| | | | | | |
| **Total interest repricing gap** | **122,348** | **85,550** | **(23,172)** | **38,374** | |

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## 84. Interest rate risk (continued)

| As at 31 December 2015 | Up to 3 months | 3-12 months | 1-5 years | Over 5 years | Carrying amount |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Cash and balances with Central Bank | 25,164 | - | - | - | 25,164 |
| Bonds and debt instruments | 184,340 | 510 | 9,562 | 9,272 | 203,684 |
| Derivative instruments | 287 | - | - | - | 287 |
| Loans and advances to financial institutions | 20,791 | - | - | - | 20,791 |
| Loans and advances to customers | 565,715 | 113,628 | 90,328 | 41,878 | 811,549 |
| Other financial assets | 6,360 | - | 558 | - | 6,918 |
| **Total** | **802,657** | **114,138** | **100,448** | **51,150** | **1,068,393** |
| | | | | | |
| **Financial liabilities** | | | | | |
| Due to financial institutions and Central Bank | (46,345) | (10,378) | (8) | - | (56,731) |
| Deposits from customers | (549,398) | (7,607) | (2,046) | - | (559,051) |
| Derivative instruments and short positions | (703) | (67) | (492) | (2,138) | (3,400) |
| Borrowings | (137,414) | (10,591) | (51,597) | (9,742) | (209,344) |
| Other financial liabilities | (5,367) | - | - | - | (5,367) |
| Subordinated liabilities | (493) | - | (146) | - | (639) |
| **Total** | **(739,720)** | **(28,643)** | **(54,289)** | **(11,880)** | **(834,532)** |
| | | | | | |
| Net on-balance sheet position | 62,937 | 85,495 | 46,159 | 39,270 | 233,861 |
| Net off-balance sheet position | 359 | (176) | (183) | 0 | |
| | | | | | |
| **Total interest repricing gap** | **63,296** | **85,319** | **45,976** | **39,270** | |

## 85. Sensitivity analysis for trading portfolios

The management of market risk in the trading book is supplemented by monitoring sensitivity of the trading portfolios to various scenarios in equity prices and interest rates.

The following table shows the Group's sensitivity to parallel shifts in interest rate curves through changes in the fair value of its trading portfolios at year-end 2016 and 2015.

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| Currency (ISK million) | Parallel shift in yield curve in basis points | Effect of downward shift | Effect of upward shift | Parallel shift in yield curve in basis points | Effect of downward shift | Effect of upward shift |
| ISK, non-CPI indexed | 100 | 119 | (110) | 100 | 34 | (34) |
| ISK, CPI indexed | 50 | 65 | (61) | 50 | 37 | (36) |
| **Total** | | **184** | **(171)** | | **71** | **(70)** |

The following table shows how the Group's profit (loss) before tax would have been affected by a change of +/-5% in the price of equities and equity instruments in the trading book held by the Group at year-end:

| | 2016 | | 2015* | |
|---|---|---|---|---|
| Currency (ISK million) | Increase | Decrease | Increase | Decrease |
| ISK | 226 | (226) | 213 | (213) |
| **Total** | **226** | **(226)** | **213** | **(213)** |

*The comparative amounts have been restated since year-end 2015. The previous sensitivity analysis was based on a +/- 10% price change.

The Group's equity would have been affected to the same extent as the income statement, but net of income tax. This is because the increase (decrease) in profit before tax would have affected retained earnings.

## 86. Sensitivity analysis for non-trading portfolios

The management of interest rate risk is supplemented by monitoring the sensitivity of financial assets and liabilities to various interest rate scenarios. The Group employs a monthly stress test of the interest rate risk in the Group's banking book by measuring the effect on of shifting the interest rate curves for every currency on economic value.

### 86. Sensitivity analysis for non-trading portfolios (continued)

The following table shows how the net present value of the Group's cashflow in the non-trading portfolios for the next 12 months would have been affected by a parallel shift in all interest rate curves, with all other variables held constant, as related to risk exposure at year-end 2016 and 2015.

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| Currency (ISK million) | Parallel shift in yield curve in basis points | Effect of downward shift | Effect of upward shift | Parallel shift in yield curve in basis points | Effect of downward shift | Effect of upward shift |
| ISK, unindexed | 400 | 225 | (226) | 400 | (168) | 168 |
| ISK, CPI indexed | 240 | 505 | (421) | 240 | 254 | (254) |
| EUR | 200 | 381 | (376) | 200 | 250 | (250) |
| Other | 200 | 39 | (43) | 200 | 261 | (261) |
| **Total** | | **1,150** | **(1,066)** | | **597** | **(597)** |

The following table shows how the Group's profit (loss) before tax would have been affected by a change of +/-5% in the price of equities which are classified into Level 1 or Level 2, as defined in Note 18 and of +/-5% in the key unobservable inputs used in valuation of equities which are classified into Level 3, as defined in Note 18, in the price of equities in the non-trading book at year-end.

| | 2016 | | 2015 | |
|---|---|---|---|---|
| Currency (ISK million) | Increase | Decrease | Increase | Decrease |
| ISK | 944 | (1,081) | 790 | (608) |
| Other | 3 | - | 2 | (2) |
| **Total** | **947** | **(1,081)** | **792** | **(610)** |

The Group's equity would have been affected to the same extent as the income statement, but net of income tax. This is because the increase (decrease) in profit before tax would have affected retained earnings.

### 87. CPI indexation risk (all portfolios)

The consumer price index (CPI) indexation risk is the risk that the fair value or future cash flows of CPI-linked financial instruments may fluctuate due to changes in the Icelandic CPI. The Group has a considerable imbalance in its CPI-linked assets and liabilities. To mitigate this imbalance the Bank offers non-CPI-linked loans, CPI-linked deposits, CPI-linked secured bonds as well as CPI-linked interest rate swaps.

CPI indexation risk is managed centrally within the Group by Treasury, and is monitored by Market Risk. The following table summarizes the Group's CPI imbalance, calculated as the difference between CPI-linked financial assets and liabilities, as at year-end 2016 and 2015.

| Carrying amount | 2016 | 2015 |
|---|---|---|
| **Assets** | | |
| Bonds and debt instruments | 10,518 | 10,125 |
| Loans and advances to financial institutions | 1,660 | - |
| Loans and advances to customers | 319,013 | 273,648 |
| **Total** | **331,191** | **283,773** |
| **Liabilities** | | |
| Due to financial institutions and Central Bank | (160) | (1) |
| Deposits from customers | (102,417) | (103,797) |
| Short positions | (546) | (1,135) |
| Borrowings | (20,833) | (9,742) |
| Subordinated liabilities | (278) | (267) |
| **Total** | **(124,234)** | **(114,942)** |
| Total on-balance sheet position | 206,955 | 168,832 |
| Total off-balance sheet position | 63 | 174 |
| **Total CPI indexation balance** | **207,018** | **169,006** |

Management of the Group's CPI indexation risk is supplemented by monitoring the sensitivity of the Group's overall position in CPI-indexed financial assets and liabilities net on-balance sheet to various inflation/deflation scenarios. As an example, a 1% change in the CPI applied to the inflation risk exposures in existence at 31 December 2016, with no change in other variables, would have changed net interest income by ISK 2.070 million (31 December 2015: ISK 1,688 million). The Group's equity would have been affected by the same amount as the income statement, but net of income tax. This is because the increase/decrease in net interest income would have affected retained earnings. However, 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 medium and longer term.

## 88. Currency risk (all portfolios)

The Group follows Rules No. 950/2010, on Foreign Exchange Balances, as set by the Central Bank of Iceland. The Rules stipulate that an institution's foreign exchange balance (whether long or short) must always be within 15% of its capital base, in each currency and for all currencies combined. The Group submits daily and monthly reports to the Central Bank with information on its foreign exchange balance.

The Group's combined net foreign exchange balance as at 31 December 2016 was +1.38% of the Group's capital base (31.12.2015: +9.06%).

## 89. Concentration of currency risk

The following tables summarise the Group's exposure to currency risk as at year-end 2016 and 2015. The off-balance sheet amounts shown are the notional amounts of the Group's derivative instruments.

Amounts presented under assets and liabilities include all spot deals as at year-end 2016 and 2015. When managing currency risk the Group regards spot deals as non-derivative assets or liabilities.

| As at 31 December 2016 | EUR | GBP | USD | JPY | CHF | Other | Total |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances with Central Bank | 358 | 175 | 287 | 16 | 32 | 225 | 1,093 |
| Bonds and debt instruments | 10,803 | 6,296 | 18,426 | - | - | - | 35,525 |
| Equities and equity instruments | 50 | - | 59 | - | - | 6 | 115 |
| Derivative instruments | 57 | 56 | 115 | - | - | 5 | 233 |
| Loans and advances to financial institutions | 10,783 | 2,075 | 3,004 | 302 | 17 | 2,502 | 18,683 |
| Loans and advances to customers | 93,433 | 3,808 | 61,063 | 4,481 | 4,058 | 6,772 | 173,615 |
| Other assets | 789 | - | 6 | - | - | 252 | 1,047 |
| **Total** | **116,273** | **12,410** | **82,960** | **4,799** | **4,107** | **9,762** | **230,311** |
| | | | | | | | |
| **Liabilities** | | | | | | | |
| Due to financial institutions and Central Bank | (22) | (43) | (32) | - | - | (26) | (123) |
| Deposits from customers | (27,390) | (11,648) | (12,558) | (200) | (872) | (3,508) | (56,176) |
| Derivative instruments and short positions | (117) | (327) | (498) | - | - | (187) | (1,129) |
| Borrowings | (98,786) | - | (50,122) | - | - | (24,896) | (173,804) |
| Other liabilities | (1,118) | (111) | (810) | (2) | (18) | (569) | (2,628) |
| Subordinated liabilities | - | - | - | (48) | (37) | - | (85) |
| **Total** | **(127,433)** | **(12,129)** | **(64,020)** | **(250)** | **(927)** | **(29,186)** | **(233,945)** |
| | | | | | | | |
| Net on-balance sheet position | (11,160) | 281 | 18,940 | 4,549 | 3,180 | (19,424) | **(3,634)** |
| Net off-balance sheet position | 13,989 | (238) | (18,631) | (4,490) | (3,063) | 19,547 | **7,114** |
| | | | | | | | |
| **Net currency position** | **2,829** | **43** | **309** | **59** | **117** | **123** | **3,480** |

| As at 31 December 2015 | EUR | GBP | USD | JPY | CHF | Other | Total |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances with Central Bank | 462 | 234 | 246 | 21 | 39 | 276 | 1,278 |
| Bonds and debt instruments | 7,124 | 12,508 | 37,428 | - | - | - | 57,060 |
| Equities and equity instruments | - | - | 2 | - | - | 29 | 31 |
| Derivative instruments | 77 | 6 | 164 | - | - | - | 247 |
| Loans and advances to financial institutions | 11,696 | 1,038 | 2,156 | 485 | 31 | 2,191 | 17,597 |
| Loans and advances to customers | 109,633 | 11,379 | 70,384 | 5,371 | 6,389 | 8,229 | 211,385 |
| Other assets | 2,659 | - | 99 | - | - | 26 | 2,784 |
| **Total** | **131,651** | **25,165** | **110,479** | **5,877** | **6,459** | **10,751** | **290,382** |
| | | | | | | | |
| **Liabilities** | | | | | | | |
| Due to financial institutions and Central Bank | (115) | (43) | (10,891) | - | - | (46) | (11,095) |
| Deposits from customers | (40,482) | (13,449) | (18,062) | (81) | (1,927) | (3,490) | (77,491) |
| Derivative instruments and short positions | (112) | (103) | (208) | - | - | (32) | (455) |
| Borrowings | (101,214) | - | (70,739) | - | - | (9,396) | (181,349) |
| Other liabilities | (1,056) | (63) | (390) | - | (2) | (341) | (1,852) |
| Subordinated liabilities | (27) | - | - | (162) | (132) | - | (321) |
| **Total** | **(143,006)** | **(13,658)** | **(100,290)** | **(243)** | **(2,061)** | **(13,305)** | **(272,563)** |
| | | | | | | | |
| Net on-balance sheet position | (11,355) | 11,507 | 10,189 | 5,634 | 4,398 | (2,554) | **17,819** |
| Net off-balance sheet position | 23,224 | (9,622) | (5,562) | (5,231) | (3,740) | 6,907 | **5,976** |
| | | | | | | | |
| **Net currency position** | **11,869** | **1,885** | **4,627** | **403** | **658** | **4,353** | **23,795** |

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### 90. Sensitivity to currency risk

The following table shows how other net operating income would have been affected by a 5% depreciation/appreciation of the ISK against each foreign currency, with all other variables held constant. The sensitivity analysis is applied to the Group's overall position in foreign currency on-balance sheet as disclosed in Note 89.

| | 2016 | | 2015* | |
|---|---|---|---|---|
| **Currency (ISK million)** | **-5%** | **+5%** | **-5%** | **+5%** |
| EUR | 141 | (141) | 594 | (594) |
| GBP | 2 | (2) | 95 | (95) |
| USD | 15 | (15) | 232 | (232) |
| JPY | 3 | (3) | 20 | (20) |
| CHF | 6 | (6) | 33 | (33) |
| Other | 6 | (6) | 218 | (218) |
| **Total** | **173** | **(173)** | **1,190** | **(1,190)** |

*The comparative amounts have been restated since year-end 2015. The previous sensitivity analysis was based on a 10% depreciation/appreciation.

The Group's equity would have been affected to the same extent as the income statement, but net of income tax. This is because the increase/decrease in other net operating income would have affected retained earnings.

### 91. Foreign exchange rates used

The following foreign exchange rates were used by the Group:

| | At 31 December 2016 | At 31 December 2015 | % change | Average for 1.1-31.12 2016 | Average for 1.1-31.12 2015 |
|---|---|---|---|---|---|
| EUR/ISK | 119.20 | 141.30 | (15.6%) | 133.30 | 146.26 |
| GBP/ISK | 139.69 | 192.22 | (27.3%) | 164.31 | 201.02 |
| USD/ISK | 113.05 | 129.73 | (12.9%) | 120.92 | 131.51 |
| JPY/ISK | 0.97 | 1.08 | (10.2%) | 1.10 | 1.09 |
| CHF/ISK | 111.25 | 130.53 | (14.8%) | 122.36 | 136.31 |
| CAD/ISK | 84.28 | 93.40 | (9.8%) | 91.09 | 102.95 |
| DKK/ISK | 16.03 | 18.94 | (15.4%) | 17.90 | 19.61 |
| NOK/ISK | 13.13 | 14.72 | (10.8%) | 14.36 | 16.33 |
| SEK/ISK | 12.44 | 15.39 | (19.2%) | 14.13 | 15.66 |

## Operational risk

### 92. Operational risk

Operational risk is the risk of financial losses resulting from the failure or inadequacy of internal processes or systems, from employee error or from external events. Operational risk includes legal risks, but excludes reputational risks. It is therefore inherent in all areas of business activities.

Whereas the Managing Director of each division is responsible for that division's operational risk, the daily management of operational risk is overseen by the general managers of each department. The Bank establishes, maintains and coordinates its operational risk management framework on a Group level. This framework complies with the Basel Committee's 2011 publication "Principles for the Sound Management of Operational Risk". The Bank ensures that operational risk management stays consistent throughout the Bank by upholding a system of prevention and control that entails detailed procedures, permanent supervision and insurance policies, together with active monitoring by the Internal Audit function. By managing operational risk in this manner, the Bank intends to ensure that all of the Bank's business units are kept aware of any operational risks, that a robust monitoring system remains in place and that controls are implemented efficiently and effectively.

## Accounting policies

### 93. Significant accounting policies

The Consolidated Financial Statements have been prepared using uniform accounting policies for like transactions and other events in similar circumstances. The accounting policies applied by the Group in the Consolidated Financial Statements are the same as those applied by the Group in its Consolidated Financial Statements as at and for the year ended 31 December 2015.

The principal accounting polices used in preparing these Consolidated Financial Statements are set out in notes 93.1 to 93.41

### 93.1 Consolidation

#### (a) Subsidiaries

Subsidiaries are investees controlled by the Group. The Group controls an investee if it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The Group is considered to have power over an entity when it has existing rights that give it the current ability to direct the relevant activities. For the Group to have power over an entity, it must have the practical ability to exercise those rights.

Where voting rights are not relevant in deciding whether the Group has power over an entity, the assessment of control is based on all facts and circumstances. This includes circumstances in which protective rights held become substantive and lead to the Group having power over an investee.

Subsidiaries are fully consolidated from the date on which control is obtained, and are de-consolidated from the date on which control ceases.

The acquisition method is used to account for business combinations by the Group. The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred, except for costs related to the issue of debt and equity instruments. Identifiable assets acquired and liabilities assumed in a business combination are initially measured at their fair value on the acquisition date. A contingent liability of an acquiree is only recognised in a business combination if such a liability represents a present obligation and arises from a past event, and its fair value can be measured reliably. More information about how the Group accounts for goodwill acquired in a business combination is disclosed further in this note.

Intercompany transactions, balances, and unrealised gains on transactions between Group entities are eliminated in the Consolidated Financial Statements. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. The accounting policies of subsidiaries have been changed where this was necessary to ensure consistency with the accounting policies adopted by the Group.

#### (b) Non-controlling interests

Non-controlling interests represent the portion of profit or loss and equity not owned, directly or indirectly, by the Bank. Such interests are presented separately in the consolidated income statement and are included in equity in the consolidated statement of financial position, separately from equity attributable to owners of the Bank. The Group chooses on an acquisition-by-acquisition basis whether to measure non-controlling interests in an acquiree at fair value or according to the proportion of non-controlling interests in the acquiree's net assets. Changes in the Bank's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions. In such circumstances the carrying amounts of the controlling and non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Bank.

#### (c) Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, related non-controlling interests and other components of equity. Any resulting gain or loss is recognised in the income statement. Any interest retained in the former subsidiary is measured at fair value when control is lost.

### 93.2 Structured entities

Structured entities are entities that have been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

The Group acts as investment manager or investment advisor to a number of investment funds for Landsbréf-branded funds. The purpose of these investment funds is to generate fees from managing assets on behalf of third-party investors by providing investment strategies. These investment funds are financed through the issue of units to investors. The Group has no contractual obligation to provide financial support to these structured entities.

From time to time, the Group makes seed capital investments in certain fund products in order to establish track records for new products, to test new investment strategies or to launch new products at a viable minimum size.

When assessing whether to consolidate investment funds, the Group reviews all facts and circumstances to determine whether the Group, as fund manager, is acting as agent or principal. The Group is deemed to be a principal, and hence controls and consolidates the funds, when it acts as fund manager and cannot be removed without cause, has variable returns through significant unit holdings and/or a guarantee, and is able to influence the returns of the funds by exercising its power.

## 93. Significant accounting policies (continued)

### 93.3 Associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds, directly or indirectly, between 20 and 50 percent of the voting power of another entity. The Group accounts for investments in associates either using the equity method or as financial assets designated at fair value through profit or loss, as described further in this note.

*Equity-accounted associates*

Investments in equity-accounted associates are accounted for using the equity method from the date on which significant influence is obtained and are initially recognised at cost. Goodwill relating to an investment in an associate is included in the carrying amount of the investment. Any excess of the Group's share of net fair value of the associate's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the Group's share of the associate's profit or loss in the period which the investment is acquired. Investments in associates which are accounted for by the Group using the equity method are presented in the consolidated statement of financial position in the line "Investments in equity-accounted associates".

Because goodwill included in the carrying amount of an investment in an associate is not recognised separately, it is not separately tested for impairment according to the requirements for goodwill impairment testing in IAS 36, Impairment of Assets. Instead, the entire carrying amount of the investment is tested for impairment under IAS 36 by comparing its recoverable amount with its carrying amount, whenever application of the requirements in IAS 39, Financial Instruments: Recognition and Measurement, indicates the investment may be impaired.

The Group's share of its equity-accounted associates' post-acquisition profits or losses is recognised in the income statement, and its share of movements in their reserves is recognised in the Group's equity reserves. Cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies of associates have been changed where this was necessary to ensure consistency with the accounting policies adopted by the Group.

*Associates designated at fair value through profit or loss*

The Group designates certain investments in associates upon initial recognition at fair value through profit or loss and they are accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement. The Group measures such investments at fair value, with changes in fair value recognised in the consolidated income statement in the line "Net gain on financial assets designated at fair value through profit or loss" in the period of the change.

### 93.4 Foreign currency translation

Transactions in foreign currencies are translated into the functional currency of the respective Group entity at the spot exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are measured at amortised cost or fair value, as applicable, in their respective foreign currencies and are retranslated into the functional currency at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. All foreign currency differences arising on retranslation are recognised in the income statement.

### 93.5 Financial assets and liabilities

#### (a) Recognition

The Group initially recognises loans and advances, deposits and debt securities issued on the date at which they are originated. All other financial assets and liabilities are initially recognised on the date at which the Group becomes a party to contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on the date at which the Group committed itself to purchasing or selling the asset.

A financial asset or financial liability is initially measured at fair value plus, for an item not subsequently measured at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

#### (b) Classification

The Group classifies all financial assets either as loans and receivables or at fair value through profit or loss. The Group classifies all financial liabilities either at fair value through profit or loss or at amortised cost.

A financial asset or liability is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Financial assets held for trading consist of debt, equity and derivative instruments. Financial liabilities held for trading consist of derivative liabilities and short positions, i.e. obligations to deliver financial assets borrowed by the Group and sold to third parties.

## 93. Significant accounting policies (continued)

### 93.5 Financial assets and liabilities (continued)

#### (b) Classification (continued)

The Group designates certain financial assets, including certain investments in associates, upon initial recognition at fair value through profit or loss when the financial assets are part of portfolios of financial instruments which are managed and reported to senior management on a fair value basis in accordance with the Group's documented risk management or investment strategy.

Loans and advances are financial assets with fixed or determinable payments that are not quoted in an active market which the Group originates or acquires with no intention of trading them.

#### (c) Derecognition

The Group derecognises a financial asset when the contractual rights to cash flows from the asset expire, or when the Group transfers the rights to receive contractual cash flows relating to the financial asset in a transaction which substantially transfers all the risks and rewards of owning that asset. Any interest in transferred financial assets created or retained by the Group is recognised as a separate asset or liability.

The Group enters into transactions whereby it transfers assets recognised in its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets, or a portion of them. In cases where all or substantially all of the risks and rewards are retained, then transferred assets are not derecognised. Asset transfers whereby all or substantially all risks and rewards are retained include, for example, securities lending and repurchase transactions.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or when they expire.

#### (d) Offsetting

Financial assets and liabilities are set off and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to set off these amounts and intends either to settle on a net basis or to realise the asset and simultaneously settle the liability.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions such as in the Group's trading activity.

#### (e) Amortised cost measurement

The amortised cost of a financial asset or liability is the amount of the financial asset or liability, as measured at initial recognition, minus principal repayments, plus or minus cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

#### (f) Fair value measurement

Fair value is the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

The fair value of a liability reflects its non-performance risk. The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The Group measures the fair value of an instrument using quoted prices in an active market for that instrument, if available. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions at an arm's-length basis. Where available, the relevant market's closing price determines the fair value of financial assets held for trading and of assets designated at fair value through profit or loss; this will generally be the last trading price. If an asset or a liability measured at fair value has a bid price and an ask price, then the Group measures assets and long positions at a bid price and liabilities and short positions at an ask price.

If a market for a financial instrument is not active, the Group establishes fair value using a valuation technique. Valuation techniques include using recent arm's-length transactions between knowledgeable, willing parties, if available, reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates every factor that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Bank has a valuation committee which estimates fair value by applying models and incorporating observable market information and professional judgement. The Group calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available, observable market data.

Should the transaction price differ from the fair value of other observable, current market transactions in the same instrument or be based on a valuation technique whose variables include only data from observable markets, the Group immediately recognises the difference between the transaction price and fair value (a Day 1 profit or loss). In cases where fair value is determined using data which is not observable, the difference between the transaction price and the model value is recognised in the income statement depending on the individual circumstances of the transaction but not later than when the inputs become observable, or when the instrument is derecognised.

## 93. Significant accounting policies (continued)

### 93.5 Financial assets and liabilities (continued)

#### (f) Fair value measurement (continued)

The fair value of financial assets and liabilities is determined based on different methods and assumptions depending on what financial asset or liability are being valued. For all financial assets and liabilities the foreign currency exchange rates used are from observable markets both for spot and forward contracts and futures in the world's major currencies.

#### (g) Impairment of financial assets

*Impairment of loans and advances*

At each reporting date, the Group assesses whether there is any objective evidence that a loan or loan portfolio is impaired. A loan or loan portfolio is considered impaired and impairment losses are incurred only when there is objective evidence of impairment as a result of one or more events occurring after initial recognition of the asset ("loss events") and these loss events impact future cash flows that can be estimated reliably for the loan or group of loans.

Objective evidence of impairment includes observable data on the following loss events:

• significant financial difficulties of the borrower or issuer;
• a breach of contract, such as defaulting on instalments or on interest or principal payments;
• the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a refinancing concession that the lender would not otherwise consider;
• it becomes probable that the borrower will enter into bankruptcy or undergo other financial reorganisation;
• observable data indicate a measurable decrease in estimated future cash flows from a group of loans since the initial recognition of those assets, even if the decrease cannot yet be identified with individual financial assets within the group, including adverse changes in the payment status of borrowers in the group or a general deterioration of economic conditions connected to that group of loans.

The Group defines loans that are individually significant and assesses first whether objective evidence of their impairment exists, and then makes individual or collective assessments for loans and advances that have not been defined as individually significant. If the Group determines that no objective evidence of impairment exists for a significant loan, it includes this loan in a group of loans with similar credit risk characteristics and collectively assesses them for impairment. Individual significant assets for which an impairment loss is recognised are not included in collective impairment assessments.

If there is objective evidence that an impairment loss has been incurred on loans or advances, the amount of the loss is measured as the difference between the asset's carrying amount and its recoverable value. The recoverable value is the present value of estimated future cash flows, excluding future credit losses that have not been incurred, discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced by the amount of impairment, using an allowance account, and the amount of the loss is recognised in the line item "Net valuation adjustments and credit impairment charges" in the income statement. In the case of loans with variable interest rates, the discount rate for measuring impairment losses is the current effective interest rate.

The present value calculated for estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure, less the costs involved in obtaining and selling the collateral, whether or not foreclosure is probable.

In order to conduct a collective valuation of impairment, loans are grouped on the basis of similar credit risk characteristics on the basis of the Group's grading process, which considers asset type, collateral type, industry, past-due status and other relevant factors. These characteristics are appropriate for estimating future cash flows in groups of such loans by indicating the debtors' ability to pay every amount due according to contractual terms.

Groups of loans are collectively valuated for impairment on the basis of expected cash flows and of peer review regarding assets with similar credit risk characteristics. Such peer review is also adjusted on the basis of current observable data, in order to reflect the effects of current conditions that did not affect the period on which peer review was originally based and to remove the effects of previous loss factors which no longer exist.

Estimates of changes in future cash flows in groups of assets are consistent with changes in observable data from period to period, for example changes in property prices, payment status, or other factors indicative of trends in the probability and magnitude of Group losses. The Group regularly reviews its methodology and assumptions for estimating future cash flows in order to minimise discrepancies between estimated losses and actual loss experience.

When a loan is uncollectible, it is written off against the provision for loan impairment in the statement of financial position. Loans are written off after all the necessary procedures have been completed, as set out in Group lending policies, and the amount of loss has been determined. Any subsequent recovery of an amount previously written off is recognised in the income statement in the line item "Net valuation adjustments and credit impairment charges".

If the amount of the impairment loss decreases in the subsequent period and the decrease can be related objectively to an event occurring after the original impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of reversal is recognised in the income statement in the line item "Net valuation adjustments and credit impairment charges".

## 93. Significant accounting policies (continued)

### 93.5 Financial assets and liabilities (continued)

#### (g) Impairment of financial assets (continued)

*Renegotiated loans*

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and an agreement of new loan terms. Loans which are impaired and whose terms are renegotiated are not considered to be new loans. Once the terms have been renegotiated these loans are no longer considered past due and any subsequent impairment is measured using the original effective interest rate as calculated before the modification of terms. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. These loans continue to be subject to individual or collective impairment assessment. Loans which are not individually impaired and whose terms are renegotiated are accounted for as new loans. Accordingly, the original loans are derecognised and the renegotiated loans are recognised as new loans.

### 93.6 Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents are defined as cash, unrestricted balances with the Central Bank and unrestricted balances with financial institutions. The carrying amount of balances with the Central Bank is a reasonable approximation of their fair value.

### 93.7 Bonds and debt instruments

Bonds which are classified at fair value through profit or loss are recognised at fair value in the statement of financial position both initially and subsequently to initial recognition. Transaction costs are recognised directly in the income statement. Gains and losses arising from changes in fair value are recognised directly in the consolidated income statement in the line items "Net gain on financial assets and liabilities held for trading" and "Net gain on financial assets designated at fair value through profit or loss", respectively. The gains and losses include interest income on bonds but exclude foreign exchange gains and losses, which are included in the line item "Net foreign exchange (loss) gain".

Bonds which are classified as loans and receivables are initially measured at fair value plus directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the bonds and it is recognised in the line item "Interest income" in the income statement. Quoted prices are generally available for government bonds and certain corporate securities. Where this information is not available, fair value is estimated by adding credit spreads to quoted market rates for similar bonds or relevant interest rate curves. For bonds issued by defaulting or greatly distressed parties recovery values are used for estimating the fair value. These estimated are based on statement of financial position information or expert opinion.

Interest rates are principally benchmark interest rates such as the London Inter-Bank Offered Rate (LIBOR) and quoted interest rates in the swap, bond and futures markets. Where available, credit spreads are derived from prices of credit default swaps (CDS) or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services. Counterparty credit spreads are estimated based on the creditworthiness of the counterparty when differing from the assumed counterparty in the market.

### 93.8 Equities

Equities which are classified at fair value through profit or loss are recognised at fair value in the statement of financial position both initially and subsequently to initial recognition. Transaction costs are recognised directly in the income statement. Gains and losses arising from changes in fair value are recognised directly in the consolidated income statement in the line items "Net gain on financial assets and liabilities held for trading" and "Net gain on financial assets designated at fair value through profit or loss", respectively. Foreign exchange gains and losses, are included in the line item "Net foreign exchange (loss) gain". Quoted prices are generally readily available for equity shares listed on the world's stock exchanges and for major indices on such shares. When this information is not available the fair value is estimated based on market prices and earning multiples from similar securities, recent transactions or by using discounted cash flow methods.

### 93.9 Derivative instruments

Derivatives are initially recognised in the statement of financial position at fair value, with transaction costs being recognised in the income statement. The fair value of derivative instruments is determined using valuation methods whose most significant inputs is volatility, which are obtained from broker quotations, pricing services or derived from option prices. Subsequently, derivatives are carried at fair value, with all fair value changes recognised in the line item "Net gain on financial assets and liabilities held for trading" in the income statement, except for fair value changes of derivative currency forwards and net foreign exchange differences arising from OTC currency options, which are included in the line item "Net foreign exchange (loss) gain" in the income statement. In the statement of financial position, derivatives with positive fair values are recognised as assets and derivatives with negative fair values are recognised as liabilities. The Group does not apply hedge accounting.

### 93.10 Embedded derivatives

Derivatives may be embedded in another contractual arrangement (a host contract). The Group accounts for an embedded derivative separately from the host contract when:

• the host contract is not itself carried at fair value through profit or loss;

• the terms of the embedded derivative would meet the definition of a derivative if they were contained in a separate contract

• the economic characteristics and risk of the embedded derivative are not closely related to the economic characteristics and risk of the host contract.

Separated embedded derivatives are measured at fair value, with all change in fair value recognised in profit or loss unless they form part of a qualifying cash flow or net investment-hedging relationship. Separated embedded derivatives are presented in the statement of financial position together with the host contracts.

## 93. Significant accounting policies (continued)

### 93.11 Loans and advances

Loans and advances are initially measured at fair value plus directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received based on future recovery of the loans. The recovery rates and loss given default are used as input into valuation models as an indicator of severity of losses on default. Expected future cash flows are discounted at current market rates to determine fair value. Accrued interest is included in the carrying amount of loans and advances. Interest income on loans and advances is recognised in the line item "Interest income" in the income statement and foreign exchange differences in the line item "Net foreign exchange (loss) gain".

Loans and advances to financial institutions include inter-bank placements and items in the course of collection. The carrying amount of floating rate placements and overnight deposits is a reasonable approximation of their fair value.

### 93.12 Property and equipment

All property and equipment is recognised at cost, less accumulated depreciation and accumulated impairment losses. The cost includes expenditures directly attributable to acquiring these assets.

Subsequent costs are included in an asset's carrying amount only if it is probable that future economic benefits associated with the item will flow to the Group and if these costs can be reliably measured. All other repairs and maintenance are charged to the income statement of the financial period in which their costs are incurred.

Depreciation of any property and equipment is calculated using the straight-line method. This method is applied to the depreciable amount of the assets, which is their cost less their residual value over their estimated useful lives, as follows:

| | |
|---|---|
| Buildings | 25-50 years |
| Computer hardware | 3 years |
| Other equipment and motor vehicles | 3-10 years |

The assets' residual values and useful lives are reviewed annually and adjusted where appropriate.

Gains and losses on disposals are determined by comparing the sale price of an asset with its carrying amount on the date of sale. Gains and losses are included in the item "Other income and expenses" in the income statement.

### 93.13 Intangible assets

#### Computer software

Computer software is capitalised on the basis of cost to acquire or develop and bring into service. Computer software recognised as an intangible asset is amortised over its useful life, which is estimated to be 3 - 5 years.

The costs associated with maintaining computer software are recorded as expenses at the time they are incurred.

#### Goodwill

Goodwill is recognised as an asset only if acquired in a business combination. It is recognised as of the acquisition date and measured as the aggregate of (a) the fair value of the consideration transferred, (b) the recognised amount of any non-controlling interest in the acquiree, and (c) the fair value of any previously held equity interest in the acquiree, less the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as at the acquisition date. The consideration transferred includes the fair value of assets transferred, liabilities incurred and equity interests issued by the Group. In addition, consideration transferred includes the fair value of any contingent consideration. Following initial recognition, goodwill is measured at cost, less any accumulated impairment losses. Goodwill is generally reviewed for impairment annually, but more frequently if events or changes in circumstances indicate a potential impairment of the carrying amount. For the purpose of impairment testing, goodwill is allocated as of the acquisition date to each of the Group's cash-generating units (CGUs) or group of CGUs which are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. Each unit to which this goodwill is allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. Where goodwill is attached to a particular unit of a CGU (or of a group of CGUs) and part of the operations within that unit is disposed of, the goodwill that is associated with the operations disposed of is included in the carrying amount of these operations when determining the gain or loss incurred upon disposing of the operations.

### 93.14 Intangible assetsImpairment of non-financial assets

Assets with an indefinite useful life are not subject to amortisation but are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is either an asset's fair value less selling costs or its value in use, whichever is higher. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). With the exception of goodwill, non-financial assets are reviewed at each reporting date for any possible reversal of impairment.

### 93.15 Income tax

#### (a) Income tax

Income tax is recognised based on the domestic corporate income tax rates and tax laws that have been enacted at the reporting date. Income tax recognised in these Consolidated Financial Statements comprises current and deferred tax.

#### (b) Current tax

Current tax comprises the expected tax payable on the taxable income for the current year and, if applicable, adjustments to the tax payable or receivable in respect of previous years. Current tax is measured based on the domestic corporate income tax rates and tax laws that have been enacted or substantively enacted at the reporting date.

#### (c) Deferred tax

Deferred tax assets are recognised when it is probable that future taxable profit will be available against which deductible temporary differences can be utilised.

Deferred income tax is recognised in full as a liability, based on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Consolidated Financial Statements. However, deferred income tax is not recognised if it arises from the initial recognition of an asset or liability in a transaction other than a business combination, which at the time of the transaction affects neither the Group's accounting nor its taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

### 93.16 Assets and liabilities classified as held for sale

The Group classifies non-current assets (or groups of assets together with related liabilities) as held for sale when their carrying amount will be recovered principally through a sale transaction. This is usually the case with collateral foreclosed by the Group which it holds as security for loans and advances, including assets and liabilities of subsidiaries over which the Group obtains control through foreclosure of collateral and/or financial restructuring.

A non-current asset (or group of assets together with related liabilities) is considered to be recovered principally through a sale transaction when the asset's sale is highly probable and it is available for immediate sale in its present condition, subject to ordinary and customary terms on the sale of such assets. Management must be committed to the sale and must actively market the asset for sale at a price that is reasonable in relation to its current fair value. A further condition is that the sale is expected to qualify for recognition as completed within one year from the date of classification.

Assets and disposal groups classified as held for sale are measured at the lower of their carrying amount and their fair value less costs to sell. Additional net assets that become part of a disposal group, for example due to profits generated by the disposal group, increase the carrying amount of the disposal group but not in excess of the fair value less costs to sell of the disposal group as determined at each reporting date.

In the case of single assets classified by the Group as held for sale the Group determines their fair value less costs to sell by reference to the current market price at each reporting date. In the case of subsidiaries classified as held for sale, the Group determines the fair value of disposal groups based on discounted cash flow methodologies. Costs to sell are deemed to be only the costs which are directly attributable to the disposal of the disposal groups, excluding finance costs and income tax expense.

### 93.17 Deposits

Deposits from customers and financial institutions are the primary source of funding for the Group. The deposits consist of demand deposits and term deposits. Deposits are initially measured at fair value plus any directly attributable transaction costs. Subsequently, they are measured at their amortised cost using the effective interest method. The fair value of a financial liability with a demand feature, such as demand deposits, is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

### 93.18 Secured borrowings

The secured borrowings consist of senior bonds denominated in foreign currencies which the Bank has issued specifically to LBI hf. and series of marketable indexed and non-indexed covered bonds denominated in ISK which have been issued by the Bank and admitted for trading on NASDAQ Iceland. The senior bonds were issued to LBI hf. in December 2014 following an agreement on the extension of the repayment schedule of bonds originally issued by the Bank to LBI hf. in October 2010 and April 2013. The original bonds were issued as a consideration and an additional consideration for the assets and liabilities transferred from LBI hf. to the Bank on 9 October 2008. The covered bonds are issued under the Bank's ISK 100,000 million Covered Bond Programme. The Bank is obliged to pledge part of its loan portfolio as collateral for the secured borrowings. It must maintain a coverage ratio of at least 115% on the secured bonds issued to LBI hf. and at least 120% on the covered bonds.

The secured bonds are initially measured at fair value plus directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the bonds and is recognised in the line "Interest expense" in the income statement. Foreign exchange gains and losses are included in the line "Net foreign exchange (loss) gain".

## 93. Significant accounting policies (continued)

### 93.19 Unsecured borrowings

The unsecured borrowings consist of senior bonds denominated in foreign currencies and marketable bank bills denominated in ISK. The bonds are issued by the Bank under the Bank's 1,500 million Euro Medium Term Note (EMTN) Programme and are listed on the Irish Stock Exchange. The bank bills are, however, issued by the Bank under its ISK 30,000 million Debt Issuance Programme and listed on NASDAQ Iceland.

The unsecured bonds and bank bills are initially measured at fair value less directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the bonds and is recognised in the line "Interest expense" in the income statement. The unsecured senior bonds were issued to refinance fully or partly the maturities of the senior secured bonds in foreign currencies which the Bank issued specifically to LBI hf.

### 93.20 Subordinated liabilities

The subordinated liabilities are comprised of liabilities assumed by Landsbankinn through two separate mergers with the savings banks Sparisjóður Vestmannaeyja and Sparisjóður Norðurlands. The subordinated liabilities thus assumed share characteristics of equity in that they are subordinated to other Group liabilities and are included in equity in equity ratio calculation. The outstanding amounts of the subordinated liabilities are subject to regulatory amortisation whereby the amount eligible for Tier 2 capital treatment is amortised on a straight-line basis over the final 5 years to maturity.

Subordinated liabilities are initially recognised at fair value less transaction costs and are subsequently measured at amortised cost using the effective interest method. Accrued interest is recognised as part of the carrying amount of subordinated liabilities.

### 93.21 Short positions

Short positions are obligations of the Group to deliver financial assets borrowed by the Group and sold to third parties. These obligations are initially recognised in the statement of financial position at fair value, with transaction costs being recognised in the income statement. Subsequently, they are carried at fair value, with all fair value changes recognised in the income statement in the line item "Net gain on financial assets and liabilities held for trading". The short positions are in Icelandic government bonds with readily available quoted market prices.

### 93.22 Repurchase and reverse repurchase agreements

Repurchase agreements consist of repo and reverse repo transactions with other banks. Repo transactions combine the spot purchase or sale of securities with their forward sale or repurchase, the counterparty being identical in both cases.

Securities originally sold by the Bank under repurchase agreements continue to be recognised and measured as financial assets in the Bank's financial statements, as the Bank retains all risks and rewards connected with the ownership of securities it sells under repurchase agreements. Inflows of liquidity from repo transactions are recognised in the financial statements of the Bank as financial liabilities to counterparties. Interest payments are recognised as interest expense in net interest income. Inflows are measured either at fair value using the fair value option or at amortised cost.

Conversely, securities originally bought by the Bank under reverse repurchase agreements are not recognised and measured as financial assets in the Bank's financial statements, as the counterparty retains all risks and rewards connected with the ownership of securities bought by the Bank under repurchase agreements. Outflows of liquidity arising from reverse repos are accounted for as claims on counterparties. Interest payments in reverse repos are recognised as interest income under net interest income. Repurchase agreements and reverse repurchase agreements are initially measured at fair value less transaction costs and subsequently either at fair value using the fair value option or at amortised cost.

### 93.23 Collateral swaps

Collateral swaps consist of collateral swaps with other banks whereby the collateral provided is in the form of securities. In essence, collateral swaps are a form of securities lending whereby the Bank borrows relatively liquid securities from another bank in exchange for a pledge of less liquid securities. The securities borrowed by the Bank from the counterparty are not recognised and measured as financial assets in the Bank's financial statements, as the counterparty retains all risks and rewards connected with the ownership of the securities. However, the securities lent to the counterparty by the Bank continue to be recognised and measured as financial assets in the Bank's financial statements, as the Bank retains all risks and rewards connected with the ownership of the securities. The Bank pays a fee to the lender to compensate for the risk of holding less liquid collateral. Interest and expenses from collateral swaps are recognised in net interest income. Collateral swaps are initially measured at fair value less transaction costs and subsequently at amortised cost.

### 93.24 Financial guarantee contracts

Financial guarantee contracts are contracts requiring the issuer to make specified payments to reimburse the holder for a loss it will incur if a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are issued by the Group to banks, financial institutions or other parties on behalf of Group customers so that they can secure loans, overdrafts and other banking facilities.

## 93. Significant accounting policies (continued)

### 93.24 Financial guarantee contracts (continued)

Financial guarantees issued by the Group are primarily bank guarantees and documentary letters of credit. Fees of long-term guarantees are claimed up-front periodically over the life of each guarantee, initially at the inception of a guarantee. Fees of short-term guarantees are in essence claimed up-front at inception. Fee income arising from the guarantees is recognised over time as the fees become payable. Provisions for losses on guarantees are subject to the uncertainty of assessing the extent to which guarantees may be called upon. For this purpose outstanding bank guarantees and documentary letters of credit are assessed quarterly in respect of credit losses and recognition of provisions. The provision assessment is based on experience with similar transactions and the history of past losses, supplemented by management judgement.

### 93.25 Contingent liabilities and provisions

The Group does not recognise contingent liabilities as liabilities in the statement of financial position, other than contingent liabilities which are assumed in a business combination and which have a fair value that can be measured reliably. A contingent consideration transferred by the Group in a business combination is recognised at its acquisition-date fair value. The Group classifies the obligation to pay contingent considerations as liability or equity and accounts for changes in fair value in accordance with applicable IFRS's.

Provisions for expenditures such as those related to legal claims or restructuring are recognised as incurred when (i) the Group has as a result of past events a present legal or constructive obligation to pay, (ii) it is more likely than not that an outflow of resources will be required to settle the obligation, and (iii) the amount has been reliably estimated.

Provisions are measured at the present value of the expenditures expected for settling the obligation. A pre-tax rate is used which reflects current market assessments of the time value of money and the risks specific to the obligation. Any increase in the provision due to the passage of time is recognised as interest expense.

### 93.26 Pension liabilities

When the savings banks Sparisjóður Vestmannaeyja and Sparisjóður Norðurlands merged with Landsbankinn in 2015, the Bank took over pension obligations towards the former employees and part of the current employees of these savings banks. The pension liability is calculated annually by an actuary. The increase in the liability in 2016 is expensed in the income statement with salaries and related expenses.

### 93.27 Employee benefits

All Group entities have defined contribution plans, with the entities paying a fixed contribution to publicly or privately administered pension plans on a mandatory and contractual basis. The Group has no further payment obligations once these contributions have been paid. The contributions are recognised as an expense when they become due. The Group has no defined benefit pension plan.

### 93.28 Share capital

#### (a) Share issue costs

Costs directly attributable to the issue of new shares are presented separately in equity as a deduction from share premium.

#### (b) Dividends on ordinary shares

Dividends on ordinary shares are recognised in equity during the period in which they are approved by the Bank's shareholders' meeting.

### 93.29 Fiduciary activities

The Group acts as a custodian, holding or placing assets on behalf of individuals, institutions and pension funds, including various mutual funds managed by the Group. These assets, together with the income arising from them, are excluded from these financial statements, since they are not assets of the Group.

### 93.30 Interest income and expense

The interest income, expense and inflation indexation presented in the Consolidated Income Statement consist of interest income and expense from financial assets and liabilities measured at amortised cost.

The interest income and expense is recognised in the Consolidated Income Statement using the effective interest method. The effective interest rate is the rate that discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Group estimates future cash flows considering all contractual terms of the financial instrument but it does not consider any future credit losses. The calculation of the effective interest rate includes all fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

### 93.31 Net impairment loss on loans and advances

Impairment charges relating to loans and advances to financial institutions and customers are presented in the Consolidated Income Statement under the item "Net valuation adjustments and credit impairment charges". Once impairment has been recognised, subsequent interest income is recognised at the rate of interest used for discounting future cash flows when measuring impairment losses.

## 93. Significant accounting policies (continued)

### 93.32 Fee and commission income and expense

Fees and commissions are generally recognised on an accrual basis as the related services are performed. Arrangement fees are generally deferred together with related direct costs and recognised as an adjustment to the effective interest rate of a loan. Commissions and fees for participation in negotiating a transaction for a third party, such as arrangement of transactions with equities or other securities or the purchase or sale of businesses, are recognised upon completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportioned basis. Asset management fees related to investment funds are recognised rateably over the period when the service is provided. The same principle for reporting income is applied to other custody services that are continuously provided over an extended period of time.

### 93.33 Net gain on financial assets designated at fair value through profit or loss

The net gain on financial assets designated at fair value through profit or loss relates to financial assets designated by the Group at fair value through profit or loss and includes:
• All realised and unrealised changes in fair value;
• Interest income on an accrual basis;
• Dividend income, which is recognised when the Group's right to receive payment is established.

### 93.34 Net gain on financial assets and liabilities held for trading

The net gain on financial assets and liabilities held for trading relates to financial assets and liabilities classified by the Group as held for trading and includes:
• All realised and unrealised changes in fair value;
• Interest income on an accrual basis;
• Dividend income, which is recognised when the Group's right to receive payment is established;
• Foreign exchange gains and losses arising from derivative financial assets and liabilities, except for changes in fair value of derivative currency forwards and net foreign exchange differences arising from OTC currency options, which are included in the line item "Net foreign exchange (loss) gain" in the income statement.

### 93.35 Net foreign exchange (loss) gain

Net foreign exchange gain (loss) includes all gains and losses arising from settlement of transactions in foreign currencies and translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, including non-derivative financial assets and liabilities classified as held for trading and financial assets designated at fair value through profit or loss. Foreign exchange gains and losses arising from derivative financial assets and liabilities are included in the line item "Net gain on financial assets and liabilities held for trading", except for fair value changes of derivative currency forwards and net foreign exchange differences arising from OTC currency options, which are included in the line item "Net foreign exchange (loss) gain" in the income statement.

### 93.36 Other income and expenses

Other income and expenses include, *inter alia* , revenue arising from recharging agreements and gains and losses on repossessed collateral and property and equipment.

### 93.37 Leases

#### (a) When a Group entity is the lessee

The leases into which the Group enters as a lessee are primarily operating leases. Over the period of the lease, payments for operating leases are charged to the income statement on a straight-line basis, in the line item "Other operating expenses".

If an operating lease is terminated before the lease period has expired, any payment to the lessor required by way of penalty is recognised as an expense in the period in which termination occurs.

#### (b) When a Group entity is the lessor

When assets are held subject to a finance lease, the present value of lease payments is recognised as a receivable, under loans and advances to customers. Finance income from such a lease is recognised over the term of the lease, using a method that reflects a constant periodic rate of return on the Group's net investment in the lease.

### 93.38 Discontinued operations

The Group presents discontinued operations in a separate line of the Consolidated Income Statement if an entity or a component of an entity has been disposed of or is classified as held for sale and:
• Represents a major separate line of business;
• Is a part of a single co-ordinated plan to dispose of a major separate line of business;
• Is a subsidiary acquired exclusively with a view to resale.

The profit from discontinued operations disclosed in the Consolidated Income Statement consists of (a) post-tax profit or loss from discontinued operations and (b) post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or the disposal groups constituting the discontinued operation. A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting, from the rest of the Group's operations and cash flows.

## 93. Significant accounting policies (continued)

### 93.39 Earnings per share

The Group presents basic and diluted earnings per share data for its ordinary shares. Basic earnings per share is calculated by dividing the profit or loss that is attributable to ordinary shareholders of the Bank by the weighted average number of shares outstanding during the period. The Bank's basic and diluted earnings per share are equal as the Bank has not issued any options, warrants, convertibles or other potential sources of dilution.

### 93.40 Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components, whose operating results are reviewed regularly by the Executive Board (being the chief operating decision-maker) to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

### 93.41 New standards, amendments to standards and interpretations of standards

The Group has adopted amendments to accounting standards which became effective for the first time in 2016. The amendments had an insignificant impact on the Consolidated Financial Statements. The International Accounting Standards Board (IASB) has also issued new IFRS standards and amendments to standards which have not yet taken effect. The following is a summary of the new standards which are likely to affect the Group's Consolidated Financial Statements.

IFRS 9 - Financial instruments. The IASB released IFRS 9 Financial Instruments (2014), completing its project to replace IAS 39 Financial Instruments: Recognition and Measurement. The new standard introduces extensive changes to previous guidance on the classification and measurement of financial assets and introduces a new 'expected credit loss' model for the impairment of financial assets.

IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018. The Group does not intend to early-adopt IFRS 9 and work is currently under way in assessing the standard's impact on the Consolidated Financial Statements. At this point, it is difficult to ascertain with any certainty the financial impact of implementing the standard. The Bank has carried out qualified impact analysis on various aspects of its business based on current economic conditions, and first results indicate that the implementation of the standard will not have a substantial financial impact on impairment and the Bank's economic capital.

The implementation of IFRS 9 is a priority for the Group. Its Risk & Finance Committee is responsible for implementation of the standard. The IFRS 9 Steering Committee (SteerCo) was established in 2015. SteerCo is responsible for the design and delivery of target state business processes, governance and organisational design to support the implementation of IFRS 9. SteerCo is comprised of the CFO, the CRO and personnel from Risk Management, Operation & IT and Accounting.

Financial assets and financial liabilities are classified into three principal groups under IFRS 9:

- Financial assets classified at amortised cost
- Fair value through other comprehensive income, FVTCI
- At fair value through profit or loss, FVTPL

Assessment underlying the classification of an asset is made on the basis of both the Group's business model for managing the financial assets in question and their contractual cash flow characteristics. Implementation of the principles for classification and measurement of financial assets and liabilities in IFRS 9 is not expected to lead to significant reclassifications between fair value and amortised cost. Work on reclassification will be completed in the year 2017.

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new model applies to financial assets that are not measured at fair value through profit or loss, including loans, lease and trade receivables, debt securities, contract assets under IFRS 15 and specified financial guarantees and loan commitment issues.

A Valuation Team is responsible for assessing impairment on loans and receivables. The Valuation Team is comprised of the CEO, the Managing Directors of Finance, Risk Management and Corporate Banking. Assessment of loan impairment is based on calculation of expected credit loss and should reflect:

- a subjective and probability-weighted amount, based on the assessment of several possible outcomes;
- time value of money;
- substantiated information available on the reporting date on past events, current conditions and economic outlook forecasts, without unwarranted costs or effort.

Impairment is determined as 12-month expected credit loss (ECL) or lifetime ECL based on identification of an increase in credit risk or lack thereof. ECL is the assessment of probability of credit loss over a defined future period. ECL can be assessed for the coming 12-month period (Stage 1) or for the lifetime of the loan (Stages 2 and 3).

Loans are classified by risk level, or Stages 1 to 3, based on an assessment of the underlying credit risk. An impairment assessment is calculated for the lifetime of loans classified as risk level Stage 2 or 3; for a 12-month period for Stage 1.

## 93. Significant accounting policies (continued)

### 93.41 New standards, amendments to standards and interpretations of standards (continued)

Loans in arrears and/or individually impaired are classified as Stage 3. Loans with a significant increase in credit risk are classified as Stage 2 and all other loans as Stage 1.

Interest revenue calculations vary based on the risk level Stage of the loan, with interest revenue calculated on the gross carrying amount of assets for risk level Stage 1 and Stage 2. For the highest risk level, Stage 3, interest revenue is calculated on the net carrying amount of the asset.

IFRS 15 - Revenue from Contracts with Customers establishes a comprehensive framework for those factors which need to be taken into consideration in determining how revenue is recognised; that is for determining whether, to what amount and when revenue is recognised. The standard replaces existing guidelines on recognition of revenue, including IAS 18 Revenue, IAS 11 Construction Contracts and several related interpretations. The principal points of IFRS 15 are the following:

• IFRS 15 prescribes the accounting treatment for revenue from sale of goods and services to customers. As a general rule, a company is to recognise revenue up to a certain amount which reflects the price the company expects to receive in exchange for goods and services provided to customers. The standard also requires additional disclosures.

• IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, but has not yet been approved by the EU. The Group does not intend to early-adopt IFRS 15 and work is currently underway on assessing the standard's impact on the Consolidated Financial Statements.

IFRS 16 - Leases. The IASB issued IFRS 16 - Leases in January 2016 and it becomes effective as of January 2019. IFRS 16 will replace IAS 17 - Leases. The adoption of the new standard will result in only minor changes to the financial reporting of lessors. For lessees, the financial reporting will be substantially altered, as all leasing contracts (apart from short-term leasing contracts and leasing contracts for small assets) will now be recognised on the balance sheet as right-of-use assets. Initially, the lease liability and the right-of-use asset will be measured at the present value of the lease payments (defined as unavoidable payments). A right-of-use asset is then depreciated in a similar manner as other assets, usually on a straight-line basis over the lease period. The standard also requires additional disclosures.

The Group does not intend to early-adopt the standard and work is currently underway on assessing the standard's impact on the Consolidated Financial Statements. The standard requires new assets and liabilities to be recognised under the operating lease commitments of the Group, as lessee, which are disclosed in Note 39. In addition, the nature of expenses related to those leases will now change as IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and interest expense on lease liabilities. No significant impact is expected on the Consolidated Financial Statements upon transition.

At transiton date the Group as a lessee can either apply the standard using a:

- Retrospective approach; or
- Modified retrospective approach with optional practical expedients.

The Group is currently assessing the optional practical expedients and their potential impact on the Consolidated Financial Statements and the number of contracts identified as leases on transition.

## Consolidated Key Figures

### 94. Operations by years

| Operations | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| Interest income | 64,612 | 58,005 | 53,735 | 63,224 | 64,661 |
| Interest expense | (29,962) | (25,681) | (25,662) | (28,910) | (29,077) |
| **Net interest income** | **34,650** | **32,324** | **28,073** | **34,314** | **35,584** |
| Net adjustments in valuation of loans and advances | (318) | 18,216 | 20,128 | 13,053 | (4,391) |
| **Net interest income after adjustments in valuation** | **34,332** | **50,540** | **48,201** | **47,367** | **31,193** |
| Fee and commission income | 10,290 | 8,977 | 7,737 | 8,451 | 7,696 |
| Fee and commission expense | (2,481) | (2,136) | (1,901) | (3,160) | (3,248) |
| **Net fee and commission income** | **7,809** | **6,841** | **5,836** | **5,291** | **4,448** |
| **Other operating income** | **6,076** | **14,982** | **9,112** | **12,923** | **13,500** |
| **Net operating income** | **48,217** | **72,363** | **63,149** | **65,581** | **49,141** |
| Salaries and related expenses | (14,049) | (13,754) | (13,567) | (17,304) | (13,176) |
| Administrative expenses | (8,197) | (8,724) | (9,487) | (8,868) | (9,887) |
| Contribution to the Depositors' and Investors' Guarantee Fund | (1,268) | (1,254) | (1,034) | (1,079) | (1,042) |
| **Operating expenses** | **(23,514)** | **(23,732)** | **(24,088)** | **(27,251)** | **(24,105)** |
| **Share of profit of associates, net of income tax** | **483** | **248** | **465** | **2,712** | **2,449** |
| **Pre-tax profit** | **25,186** | **48,879** | **39,526** | **41,042** | **27,485** |
| Income and bank tax | (8,543) | (12,419) | (9,789) | (12,283) | (4,125) |
| **Profit from continuing operations** | **16,643** | **36,460** | **29,737** | **28,759** | **23,360** |
| **Profit for the year from discontinued operations, net of income tax** | **0** | **0** | **0** | **0** | **2,134** |
| **Net profit** | **16,643** | **36,460** | **29,737** | **28,759** | **25,494** |
| **Attributable to:** | | | | | |
| Shareholders of Landsbankinn | 16,633 | 36,460 | 29,737 | 28,750 | 25,439 |
| Minority interests | 10 | - | - | 9 | 55 |

| Balance sheet | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| Cash and cash balances with Central Bank | 30,662 | 25,164 | 10,160 | 21,520 | 25,898 |
| Bonds and debt instruments | 154,892 | 203,684 | 243,589 | 290,595 | 228,208 |
| Equities and equity instruments | 26,688 | 29,192 | 29,433 | 36,275 | 36,881 |
| Loans and advances to financial institutions | 20,408 | 20,791 | 49,789 | 67,916 | 64,349 |
| Loans and advances to customers | 853,417 | 811,549 | 718,355 | 680,468 | 666,087 |
| Other assets | 17,641 | 16,323 | 28,832 | 29,719 | 38,044 |
| Assets classified as held for sale | 7,449 | 11,955 | 18,212 | 25,023 | 25,320 |
| **Total assets** | **1,111,157** | **1,118,658** | **1,098,370** | **1,151,516** | **1,084,787** |
| | | | | | |
| Due to financial institutions and Central Bank | 20,093 | 56,731 | 53,827 | 167,218 | 98,718 |
| Deposits from customers | 589,725 | 559,051 | 551,435 | 456,662 | 421,058 |
| Borrowings | 223,944 | 209,344 | 207,028 | 239,642 | 221,791 |
| Contingent bond | - | - | - | - | 87,474 |
| Other liabilities | 24,681 | 26,844 | 32,443 | 42,750 | 29,687 |
| Liabilities associated with assets classified as held for sale | 1,095 | 1,518 | 2,834 | 3,885 | 893 |
| Subordinated liabilities | 388 | 639 | - | - | - |
| Equity | 251,231 | 264,531 | 250,803 | 241,359 | 225,166 |
| **Total liabilities and equity** | **1,111,157** | **1,118,658** | **1,098,370** | **1,151,516** | **1,084,787** |

Landsbankinn hf. Consolidated Financial Statements 2016 80 All amounts are in ISK million

## Consolidated Key Figures

### 95. Operations by quarters (unaudited)

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| **Operations** | **Q4*** | **Q3** | **Q2** | **Q1** | **Q4*** | **Q3** | **Q2** | **Q1** |
| Interest income | 16,241 | 15,528 | 18,071 | 14,772 | 13,329 | 16,000 | 15,938 | 12,738 |
| Interest expense | (7,798) | (6,932) | (7,926) | (7,306) | (6,037) | (7,166) | (7,009) | (5,469) |
| **Net interest income** | **8,443** | **8,596** | **10,145** | **7,466** | **7,292** | **8,834** | **8,929** | **7,269** |
| Reversals of loss from foreign currency linkage of loans and advances to customers | (5,435) | - | - | - | 6,512 | 9,145 | 134 | (2,015) |
| Net impairment gain (loss) | 379 | 2,144 | 1,964 | 311 | (630) | 1,948 | 115 | 3,611 |
| Reversal of impairment of guarantees | 319 | - | - | - | - | (604) | - | - |
| **Net adjustments in valuation** | **(4,737)** | **2,144** | **1,964** | **311** | **5,882** | **10,489** | **249** | **1,596** |
| **Net interest income after net adjustments in valuation** | **3,706** | **10,740** | **12,109** | **7,777** | **13,174** | **19,323** | **9,178** | **8,865** |
| Fee and commission income | 2,638 | 2,634 | 2,487 | 2,531 | 2,332 | 2,322 | 2,274 | 2,049 |
| Fee and commission expense | (738) | (619) | (573) | (551) | (630) | (577) | (521) | (408) |
| **Net fee and commission income** | **1,900** | **2,015** | **1,914** | **1,980** | **1,702** | **1,745** | **1,753** | **1,641** |
| Net gain on financial assets designated at fair value through profit or loss | 450 | 135 | 788 | 43 | 2,422 | 852 | 1,838 | 3,812 |
| Net gain on financial assets and liabilities held for trading | 508 | (669) | 254 | 246 | 905 | 1,173 | 1,273 | 451 |
| Net foreign exchange gain (loss) | (212) | 25 | (154) | 162 | (58) | (748) | (147) | (324) |
| Other income and (expenses) | 619 | 793 | 1,779 | 1,309 | 3,294 | (188) | 189 | 238 |
| **Other net operating income** | **1,365** | **284** | **2,667** | **1,760** | **6,563** | **1,089** | **3,153** | **4,177** |
| **Total operating income** | **6,971** | **13,039** | **16,690** | **11,517** | **21,439** | **22,157** | **14,084** | **14,683** |
| Salaries and related expenses | 3,640 | 3,096 | 3,559 | 3,754 | 3,407 | 3,466 | 3,179 | 3,702 |
| Other operating expenses | 1,843 | 1,760 | 1,940 | 2,043 | 2,223 | 1,757 | 2,011 | 2,070 |
| Depreciation and amortisation | 152 | 165 | 148 | 146 | 167 | 167 | 165 | 164 |
| Contribution to the Depositors' and Investors' Guarantee Fund | 297 | 305 | 356 | 310 | 284 | 203 | 421 | 346 |
| **Total operating expenses** | **5,932** | **5,326** | **6,003** | **6,253** | **6,081** | **5,593** | **5,776** | **6,282** |
| Share of profit of equity-accounted associates, net of income tax | 37 | 71 | 371 | 4 | (9) | 145 | 103 | 9 |
| **Profit before tax** | **1,076** | **7,784** | **11,058** | **5,268** | **15,349** | **16,709** | **8,411** | **8,410** |
| Income tax | (130) | (1,937) | (2,288) | (1,215) | (2,725) | (3,953) | (1,546) | (1,178) |
| Tax on liabilities of financial institutions | (703) | (745) | (787) | (738) | (577) | (748) | (872) | (820) |
| **Profit for the period** | **243** | **5,102** | **7,983** | **3,315** | **12,047** | **12,008** | **5,993** | **6,412** |
| | | | | | | | | |
| **Balance sheet** | **31.12.16** | **30.09.16** | **30.06.16** | **31.03.16** | **31.12.15** | **30.09.15** | **30.06.15** | **31.03.15** |
| Cash and cash balances with Central Bank | 30,662 | 52,822 | 43,997 | 23,228 | 25,164 | 27,120 | 38,719 | 14,347 |
| Bonds and debt instruments | 154,892 | 168,029 | 157,898 | 195,175 | 203,684 | 235,788 | 248,604 | 250,005 |
| Equities and equity instruments | 26,688 | 30,896 | 29,042 | 29,381 | 29,192 | 26,467 | 25,498 | 33,354 |
| Loans and advances to financial institutions | 20,408 | 16,835 | 21,885 | 15,221 | 20,791 | 46,511 | 68,707 | 86,951 |
| Loans and advances to customers | 853,417 | 837,494 | 827,241 | 814,669 | 811,549 | 807,033 | 761,290 | 735,479 |
| Other assets | 17,641 | 19,653 | 21,523 | 21,255 | 16,323 | 20,070 | 17,104 | 34,638 |
| Assets classified as held for sale | 7,449 | 8,073 | 8,258 | 7,771 | 11,955 | 12,815 | 12,747 | 17,606 |
| **Total assets** | **1,111,157** | **1,133,802** | **1,109,844** | **1,106,700** | **1,118,658** | **1,175,804** | **1,172,669** | **1,172,380** |
| Due to financial institutions and Central Bank | 20,093 | 41,307 | 34,643 | 42,606 | 56,731 | 49,550 | 62,428 | 57,019 |
| Deposits from customers | 589,725 | 583,715 | 556,841 | 545,208 | 559,051 | 624,924 | 621,023 | 624,063 |
| Borrowings | 223,944 | 220,800 | 220,837 | 217,658 | 209,344 | 207,699 | 212,792 | 210,902 |
| Other liabilities | 24,681 | 34,913 | 48,310 | 31,445 | 26,844 | 38,854 | 34,710 | 43,140 |
| Liabilities associated with assets classified as held for sale | 1,095 | 1,514 | 1,510 | 1,305 | 1,518 | 1,518 | 1,450 | 2,969 |
| Subordinated liabilities | 388 | 407 | 412 | 632 | 639 | 775 | 414 | 427 |
| Equity | 251,231 | 251,146 | 247,291 | 267,846 | 264,531 | 252,484 | 239,852 | 233,860 |
| **Total liabilities and equity** | **1,111,157** | **1,133,802** | **1,109,844** | **1,106,700** | **1,118,658** | **1,175,804** | **1,172,669** | **1,172,380** |

*The first three quarter results for the years 2016 and 2015 were reviewed by the Bank's independent auditors.

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## Consolidated Key Figures

### 96. Key figures and ratios

| | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| Return on equity before taxes (average equity) | 9.9% | 19.9% | 16.7% | 17.6% | 14.0% |
| Return on equity after taxes (average equity) | 6.6% | 14.8% | 12.5% | 12.4% | 12.0% |
| Capital adequacy ratio | 30.2% | 30.4% | 29.5% | 26.7% | 25.1% |
| Cost-income ratio | 48.4% | 43.8% | 56.0% | 42,9%* | 45.0% |
| Operating expenses as a ratio of average total assets | 2.1% | 2.1% | 2.1% | 2,0%* | 2.2% |
| Interest spread | 2.3% | 2.2% | 1.9% | 2.4% | 2.6% |
| Loans / deposits | 144.7% | 145.2% | 130.3% | 149.0% | 158.2% |
| Deposits / total assets | 53.1% | 50.0% | 50.2% | 39.7% | 38.8% |
| Number of full-time positions at year-end | 1,012 | 1,063 | 1,126 | 1,183 | 1,233 |
| Earnings per share | 0.70 | 1.54 | 1.26 | 1.22 | 1.06 |
| Dividend per share | 1.20 | 1.00 | 0.84 | 0.42 | 0.00 |
| Leverage ratio | 20.4% | 21.5% | | | |
| Liquidity coverage ratio (LCR) | 128% | 113% | 131% | 102% | |
| Net stable funding ratio (NSFR) | 154% | 136% | 134% | | |

*Adjusted for one-off items

| Key figures and ratios | Definition |
|---|---|
| Return on equity before taxes | Profit before taxes / average total equity |
| Return on equity after taxes | Profit after taxes / average to |
| Adjusted return on equity after taxes | (Profit after taxes - tax on liabilities of financial institutions - positive net valuations *0,74) / average total equity |
| Total capital ratio | Capital base (CET1 + AT1 + T2) / risk weighted assets |
| Cost-income ratio | Total operating expenses / (total operating income - net valuation adjustments) |
| Interest spread as a ratio of assets and liabilities | (Interest income / average total assets) - (interest expenses / average total liabilities) |
| Loans/ deposits | Loans and advances to customers/ deposits from customers |
| Deposits / total assets | Deposits from customers/ total assets |
| Number of full-time equivalent positions at year-end | Number of full-time equivalent positions at year-end |
| Earnings per share | Profit for the year attributable to owners of the Bank / Weighted average number of shares outstanding |
| Dividend per share | Dividends paid/ number of shares outstanding |
| Common equity Tier 1 capital (CET1) | Total equity - deductions (intangible assets, deferred tax assets) |
| Additional Common equity Tier 1 capital (AT1) | Capital instruments under Tier 1 other than (CET1) |
| Tier 1 capital (T1) | Common equity Tier 1 capital + additional Common equity Tier 1 capital |
| Tier 2 capital (T2) | Common equity Tier 1 capital + additional Common equity Tier 1 capital + subordinated liabilities - regulatory amortisation + general credit risk adjustment |
| Leverage ratio | Common equity Tier 1 capital + additional Common equity Tier 1 capital / (total assets + off balance sheet items) |
| Liquidity coverage ratio (LCR) | High quality liquid assets / total net liquidity outflows over 30 days |
| Net stable funding ratio (NSFR) | Available amount of stable funding / required amount of stable funding |

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