

Landsbankinn hf.
(incorporated in Iceland as a limited liability company)
ISK 100,000,000,000
Covered Bond Programme

Under this ISK 100,000,000,000 Covered Bond Programme (the “**Programme**”), Landsbankinn hf., (the “**Issuer**”) may from time to time issue Covered Bonds (the “**Covered Bonds**”) in accordance with the Icelandic Act on Covered Bonds, No. 11/2008 (the “**Act on Covered Bonds**”), any relevant executive orders (*Ice. “stjórnvaldsákvæðanir”*) and appurtenant regulations as may be supplemented, amended, modified or varied from time to time (as well as any judicial decisions and administrative pronouncements, all of which are subject to change, including with retroactive effect), (together the “**Covered Bonds Legislation**”) denominated in any currency as determined by the Issuer.

The Covered Bonds may be issued in bearer form (“**Bearer Covered Bonds**”), registered form (“**Registered Covered Bonds**”), uncertificated book entry form cleared through the Icelandic Securities Depository (the “**ISD**”) or any other clearing system as decided by the Issuer (“**VS System Covered Bonds**”). The maximum aggregate nominal amount of all Covered Bonds from time to time outstanding under the Programme will not exceed ISK 100,000,000,000 (or its equivalence in other currencies calculated as described herein). The Covered Bonds may be issued on a continuing basis. The Financial Supervisory Authority, Iceland (the “**FME**”) granted the Issuer a licence dated 29 April 2013 to issue Covered Bonds.

This Base Prospectus (the “**Base Prospectus**”) has been approved by the FME in its capacity as competent authority under the Act on Securities Transactions, No. 108/2007 (the “**Act on Securities Transactions**”) as a base prospectus for the purposes of Article 5(4) of Directive 2003/71/EC (the “**Prospectus Directive**”) and Article 45 of the Act on Securities Transactions for the purpose of giving information with regard to the issue of Covered Bonds under the Programme.

Applications may be made for new series of Covered Bonds issued under the Programme to be admitted to trading on a regulated market for the purposes of Directive 2004/39/EC (the “**MiFID**”) which has been implemented in Iceland through the Act on Securities Transactions and Act on Stock Exchanges No. 110/2007 within 12 months of the date of this Base Prospectus.

Notice of the aggregate nominal amount of Covered Bonds, interest (if any) payable in respect of Covered Bonds, the issue price of Covered Bonds and any other terms and conditions not contained herein which are applicable to each Tranche (as defined in *Terms and Conditions of the Covered Bonds*) of Covered Bonds will be set out in the Final Terms, which, with respect to Covered Bonds admitted to trading on a regulated market can be found on the Issuer’s website, [www.landsbankinn.is](http://www.landsbankinn.is/sertryggd-skuldabref) (<http://www.landsbankinn.is/sertryggd-skuldabref>).

Prospective investors should have regard to the factors described in the section entitled *Risk Factors* in the Base Prospectus for a discussion of those factors to be considered in connection with an investment in the Covered Bonds.

The Covered Bonds have not been and will not be registered under the U.S. Securities Act of 1933, as amended (the “**US Securities Act**”) and are subject to U.S. tax law requirements. Subject to certain exceptions, the Covered Bonds may not be offered, sold or delivered within the United States or to a U.S. person.

The Issuer may decide that Covered Bonds may be issued in a form not contemplated by the Terms and Conditions of the Covered Bonds described herein, in which event, a supplement to the Base Prospectus conforming with Article 46 of the Act on Securities Transactions, will be made available which will describe the effect of the agreement reached in relation to such Covered Bonds.



Landsbankinn hf.
The date of the Base Prospectus is 9 December 2014.

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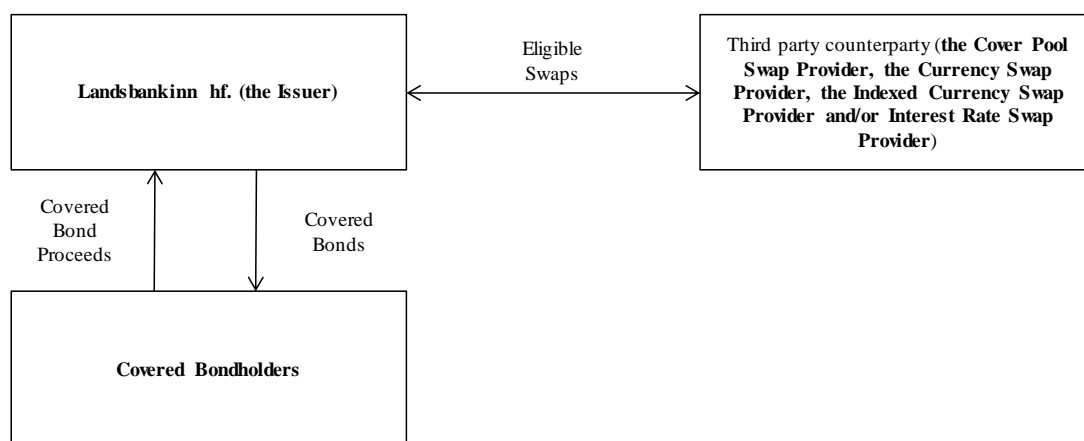
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OVERVIEW OF THE PROGRAMME

The following is a brief overview (the “**Overview**”) and it should be read in conjunction with the rest of this Base Prospectus dated 9 December 2014, including any information incorporated by reference, and read together with the Final Terms. This Overview constitutes a general description of the Programme for the purposes of Article 22.5(3) of Commission Regulation (EC) No. 809/2004 implementing the Prospectus Directive.

Words and expressions defined in the Terms and Conditions (*1. Definitions*) and in the chapter Important Information (*Abbreviations and definitions*) of this Base Prospectus shall have the same meanings in this Overview.



Description: ISK 100,000,000,000 Covered Bond Programme.

THE PARTIES:

Issuer: Landsbankinn hf., Reg. No. 471008-0280, registered office at Austurstræti 11, 155 Reykjavík, Iceland.

The Issuer operates pursuant to the provisions of the Act on Financial Undertakings, No. 161/2002, the Act on Public Limited Companies, No. 2/1995 and the Act on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc., No. 125/2008.

The Issuer is a leading Icelandic financial institution with total assets of ISK 1,201 billion at the end of September 2014. The Issuer offers a full range of financial services and is the market leader in the Icelandic financial service sector with the largest branch network, counting 32 branches and outlets.

Independent Inspector: The issuer shall appoint an Independent Inspector to supervise the issuance of covered bonds licensed by the FME and the FME must approve his/her appointment in accordance with the Act on Covered Bonds.

The Independent Inspector shall ensure that the Register is properly maintained and updated and shall therefore verify that bonds and derivative agreements are correctly registered; only eligible assets and substitute collateral are included in the cover pool; the value of the assets registered in the cover pool and the valuation thereof is in accordance with the Act on

Covered Bonds and the Rules on Covered Bonds; that LTV calculations are correctly updated upon significant decrease in the market value of mortgaged assets; and that the matching rules are complied with.

The Independent Inspector shall once a year provide the FME with a written report regarding his/her surveillance. Furthermore, the Independent Inspector shall as soon as possible notify the FME should he/she become aware of any matters which could affect the FME's assessment of the issuer's position in general.

An Independent Inspector to supervise the issuance of the Covered Bonds has been appointed and approved by the FME pursuant to an agreement with PwC.

Cover Pool Swap Provider: The Issuer may enter into Cover Pool Swap Agreements with third party counterparties in their respective capacities as Cover Pool Swap Provider under a Cover Pool Swap Agreement. A Cover Pool Swap enables the Issuer to convert ISK interest payments (less a client margin) received by the Issuer in respect of assets (other than Swaps) registered to the Cover Pool into floating or fixed payments (as the case may be) payments linked to the interest rate payable on the Covered Bonds.

Currency Swap Provider: The Issuer may enter into Currency Swap Agreements with third party counterparties in their respective capacities as Currency Swap Provider under a Currency Swap Agreement. A Currency Swap enables the Issuer to hedge currency risks arising from (a) Covered Bonds which are issued in currencies other than ISK and (b) assets (other than Mortgage Bonds) which are registered to the Cover Pool and are denominated in currencies other than ISK.

Indexed Currency Swap Providers: The Issuer may enter into Indexed Currency Swap Agreements with third party counterparties in their respective capacities as Indexed Currency Swap Provider under an Indexed Currency Swap Agreement. Indexed Currency Swaps enable the Issuer to hedge currency and inflation risks arising from (i) Covered Bonds which are issued in currencies other than ISK and not indexed linked and (ii) assets which are registered to the Cover Pool and are denominated in ISK and index linked.

Interest Rate Swap Providers: The Issuer may enter into Interest Rate Swap Agreements with third party counterparties in their respective capacities as Interest Rate Swap Provider under an Interest Rate Swap Agreement. Interest Rate Swaps enable the Issuer to hedge interest rate risk in ISK and/or other currencies to the extent that these have not already been hedged by the Cover Pool Swap or a Currency Swap.

Fiscal and Transfer Agent Landsbankinn hf. or any successor agent appointed as such.

KEY FEATURES:

FME Licensing: FME granted the Issuer a licence dated 29 April 2013 to issue Covered Bonds.

Status of the Covered Bonds: The Covered Bonds constitute direct, unconditional, unsubordinated and secured obligations of the Issuer issued in accordance with the Act on

Covered Bonds and appurtenant regulations and rank *pari passu* among themselves and with all other obligations of the Issuer that have been provided the same priority as debt instruments issued pursuant to the Act on Covered Bonds (save for certain obligations required to be preferred by law) (other than subordinated obligations, if any), from time to time outstanding. Senior Debt (if any) ranks thereafter. To the extent that claims in relation to the Covered Bonds, related derivative contracts and Senior Debt (if any) are not met out of the assets of the Cover Pool or the proceeds arising from it, the residual claims will rank *pari passu* with the claims of all other unsubordinated creditors of the Issuer (other than those preferred by law) in all other respects.

Issuer Covenants:

Negative Pledge

In accordance with the Act on Covered Bonds, the Issuer undertakes, so long as any of the Covered Bonds, Receipts or Coupons remain outstanding, that it will not, and that it will procure that none of its Relevant Subsidiaries will, create or have outstanding any mortgage, charge, pledge, lien or other security interest over the assets in the Cover Pool, other than any lien arising by operation of law (if any).

Maintenance of the Issuer's Cover Pool

For so long as the Covered Bonds are outstanding, the value of the Cover Pool will not at any time be less than the total aggregate outstanding principal amount of all Covered Bonds issued under the Programme plus an Overcollateralization of 20 per cent.

For the avoidance of doubt, the Issuer shall not at any time reduce the Overcollateralization which applies to the Programme if to do so would result in any credit rating then applying to the Covered Bonds by any rating agency appointed by the Issuer in respect of the Covered Bonds being reduced, removed, suspended or placed on credit watch.

Composition of the Issuer's Cover Pool

For so long as any of the Covered Bonds are outstanding the Issuer shall ensure that the Cover Pool maintained or to be maintained by the Issuer shall at all times comply with the requirements of the Act on Covered Bonds.

Interest Cover

The amounts of interest received by the Issuer in respect of the Cover Pool and under the related derivative contracts entered into by the Issuer shall be at least equal to or exceed the amounts payable by the Issuer under the Covered Bonds and the related derivative contracts entered into by the Issuer.

The Register:

The issuer of covered bonds must maintain a register of the issued covered bonds, and the cover pool, together with related derivative agreements in accordance with the Act on Covered Bonds. The register must, among other things include the following information; (1) the nominal value, interest terms, and final maturity of the covered bonds; (2) the types of assets in the cover pool; and (3) in respect of each mortgage bond in the cover pool, the name of the underlying borrower, their ID./Reg. No., the nominal value of the loan, date of issue, maturity, terms of instalments and interest.

Furthermore, the register shall show the appraisal of the collateral security in the cover pool, when the appraisal was carried out and the premises used. Bonds in a cover pool must be endorsed showing they are part of a cover pool and have been entered into the register as provided for in Chapter VI of the Act on Covered Bonds. The endorsement shall also indicate that the debt instrument is to secure priority rights of a specific class of covered bonds.

In the event of bankruptcy of an issuer of covered bonds, covered bondholders and derivative agreement counterparties are entitled to rights of priority to the assets in the cover pool that are registered in the register, as well as over the funds that originate from those assets.

Composition of the Cover Pool:

Requirements for assets that make up the cover pool are set out in the Act on Covered Bonds. A cover pool will consist of assets, which include bonds secured by various types of mortgages, on other registered assets, Government Bonds, receivables in the form of certain derivative agreements and substitute collateral. Assets in the cover pool are to be kept separate from other business operations of the issuer.

Currencies:

The Covered Bonds may be issued in any currency as determined by the Issuer.

Form of the Covered Bonds:

The Covered Bonds will be issued in bearer form (Bearer Covered Bonds), registered form (Registered Covered Bonds), or, in the case of VS System Covered Bonds, uncertificated book entry form, as specified in the applicable Final Terms and, in the case of definitive Covered Bonds, serially numbered, in the Specified Currency and the Specified Denomination(s). The Covered Bonds will be in the Specified Currency and the Specified Denomination(s). Covered Bonds of one Specified Denomination may not be exchanged for Covered Bonds of another Specified Denomination.

The Covered Bonds may take the form of an Inflation Linked Annuity Covered Bond, an Inflation Linked Equal Principal Payment Covered Bond, a Fixed Rate Covered Bond, a Floating Rate Covered Bond, a Zero Coupon Covered Bond or a combination of any of the foregoing, depending upon the Interest Basis and Redemption/Payment Basis shown in the applicable Final Terms.

Terms of the Covered Bonds:

The terms of the Covered Bonds will be set out in the Terms and Conditions of the Covered Bonds, as completed by the applicable Final Terms.

Redenomination:

Where redenomination is specified in the applicable Final Terms as being applicable, the Issuer may redenominate certain Covered Bonds in euro or other Specified Currency. The relevant provisions applicable to such redenomination are contained in Condition 5 of the Terms and Conditions.

Maturities:

The Maturity Date of the Covered Bonds is specified in the applicable Final Terms.

Extendable obligations under the Covered Bonds:

Following the failure by the Issuer to pay the Final Redemption Amount of a Series of Covered Bonds on their Maturity Date, payment of such amounts shall be automatically deferred. This will occur if the Final Terms for a relevant Series of Covered Bonds provides that such Covered Bonds are subject to an extended maturity date on which the payment of all or (as applicable) part of the Final Redemption Amount payable on the Maturity

Date will be deferred in the event that the Final Redemption Amount is not paid in full on the Maturity Date.

To the extent that the Issuer has sufficient funds available to pay in part the relevant Final Redemption Amount in respect of the relevant Series of Covered Bonds, the Issuer shall make partial payment of the relevant Final Redemption Amount as described in Condition 8.12(f). Payment of all unpaid amounts shall be deferred automatically until the applicable Extended Maturity Date, provided that any amount representing the Final Redemption Amount due and remaining unpaid on the Maturity Date may be paid by the Issuer on any Interest Payment Date thereafter up to (and including) the relevant Extended Maturity Date.

The Issuer is not required to notify the Covered Bondholders of such automatic deferral. The Extended Maturity Date and the applicable Rate of Interest will be specified in the relevant Final Terms. Interest will continue to accrue on any unpaid amount and be payable on each Interest Payment Date falling after the Maturity Date up to (and including) the Extended Maturity Date. In these circumstances, failure by the Issuer to make payment in respect of the Final Redemption Amount on the Maturity Date shall not constitute a default in payment by the Issuer. However, failure by the Issuer to pay the Final Redemption Amount or the balance thereof on the Extended Final Maturity Date and/or interest on such amount on any Interest Payment Date falling after the Maturity Date up to (and including) the Extended Maturity Date shall constitute a default in payment by the Issuer.

Furthermore, in relation to all amounts constituting accrued interest due and payable on each Interest Payment Date falling after the Maturity Date up to (and including) the Extended Maturity Date, as provided in the applicable Final Terms, the Issuer may pay such interest pursuant to the Floating Rate set out in the applicable Final Terms notwithstanding that the relevant Covered Bond was a Fixed Rate Covered Bond as at its relevant Issue Date.

In addition, following deferral of the Maturity Date, the Interest Payment Dates and Interest Periods may change as set out in the applicable Final Terms.

Issue Price:

The Issue Price is set out in the applicable Final Terms and is generally expressed as a percentage of the nominal amount of the Covered Bonds, at which a Tranche of Covered Bonds will be issued.

Interest:

The Covered Bonds may take the form of an Inflation Linked Annuity Covered Bond, an Inflation Linked Equal Principal Payment Covered Bond, a Fixed Rate Covered Bond, a Floating Rate Covered Bond, a Zero Coupon Covered Bond or a combination of any of the foregoing, depending upon the Interest Basis and Redemption/Payment Basis shown in the applicable Final Terms.

Interest Periods, Rates of interest and the terms of and/or amounts payable on redemption may differ depending on the Covered Bonds being issued and such terms will be specified in the applicable Final Terms.

**Inflation Linked Annuity
Covered Bonds:**

Inflation Linked Annuity Covered Bonds pay an Annuity Amount on such date or dates as decided by the Issuer and set out in the Final Terms. Calculation of Principal Payments, Interest Payments and Index Ratio are as

set out in the Final Terms.

Inflation Linked Equal Principal Payment Covered Bonds including Covered Bonds with one Payment of Principal on Maturity Date:

Inflation Linked Equal Principal Payment Covered Bonds pay an Equal Payment Amount on such date or dates as decided by the Issuer and set out in the Final Terms. Calculation of Principal Payments, Interest Payments, Principal Amount Outstanding and Index Ratio are as set out in the Final Terms.

Fixed Rate Covered Bonds:

Fixed Rate Covered Bonds pay a fixed Rate of Interest on such date or dates as may be agreed between the Issuer and the relevant Dealer as specified in the applicable Final Terms and on redemption calculated on the basis of such Day Count Fraction as may be agreed between the Issuer and the relevant Dealer.

Floating Rate Covered Bonds:

Floating Rate Covered Bonds bear interest at a rate determined:

- (i) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the ISDA Definitions; or
- (ii) on the basis of a Reference Rate appearing on the agreed screen page of a commercial quotation service; or
- (iii) on such other basis as may be agreed between the Issuer and the relevant Dealer, or as set out in the applicable Final Terms.

Zero Coupon Covered Bonds:

Zero Coupon Covered Bonds will be offered and sold at a discount to their nominal amount and will not bear interest.

Redemption:

Unless previously redeemed or purchased and cancelled, each Inflation Linked Annuity Covered Bond and each Inflation Linked Equal Payment Covered Bond, including Covered Bonds with one payment of Principal on Maturity Date, will, subject to Condition 7.1(a) or (b) (as applicable) of the Terms and Conditions, be redeemed in one or more amounts, calculated in accordance with the formula specified in the applicable Final Terms, in the relevant Specified Currency on the relevant Interest Payment Dates.

If an Issuer Call or Investor Put is specified in the applicable Final Terms, the Issuer or Covered Bondholder may redeem all or some only of the Covered Bonds then outstanding on any Optional Redemption Date as set forth in the Terms and Conditions and applicable Final Terms of the Covered Bonds.

If the Covered Bonds become illegal and/or invalid, the Covered Bonds of all Series may be redeemed at the option of the Issuer in whole, but not in part, at any time as set forth in the Terms and Conditions of the Covered Bonds.

Denomination of Covered Bonds:

In respect of a Series of Covered Bonds, the denomination or denominations of such Covered Bonds are at the minimum amount of EUR 100,000 as specified in the applicable Final Terms.

Taxation:

All payments of principal and interest in respect of the Covered Bonds and Coupons by the Issuer will be made without, or deduction for or on account of, any present or future taxes, duties assessments or governmental charges of whatever nature imposed or levied by or on behalf of Iceland or any political subdivision or any authority or agency thereof or therein having

power to tax unless such withholding or deduction is required by law. In such event, the Issuer will pay such additional amount as shall be necessary in order that the net amounts received by the holders of the Covered Bonds and Coupons after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Covered Bonds or Coupons, as the case may be, in the absence of such withholding or deduction, except that no such additional amounts shall be payable with respect to any Covered Bond or Coupon:

- a) in respect of any demand made for payment in Iceland; or
- b) in respect of any demand made for payment by or on behalf of a holder who is liable for such taxes, duties, assessments or governmental charges in respect of such Covered Bond or Coupon by reason of it having some connection with Iceland other than the mere holding of such Covered Bond or Coupon; or
- c) in respect of any demand made for payment more than thirty days after the Relevant Date except to the extent that the holder thereof would have been entitled to an additional amount on making such demand for payment on or before the expiry of such period of thirty days; or
- d) in respect of any demand made for payment by or on behalf of a holder who would be able to avoid such withholding or deduction by making a demand in respect of the Covered Bond or Coupon to another Paying Agent in a Member State of the European Union.

where such withholding or deduction is required to be made based on provisions of the Act on Withholding of Public Levies at Source No. 45/1987, as amended, the Act on Withholding of Tax on Financial Income No. 94/1996, as amended, and Article 3 of the ITA, and any other legislation, laws or regulations, replacing or supplementing the same.

Insolvency of the Issuer:

In the event of insolvency of the Issuer, the Covered Bonds remain outstanding in accordance with the Terms and Conditions of the Covered Bonds.

In the event of bankruptcy of an issuer of covered bonds, covered bondholders and derivative agreement counterparties are entitled to rights of priority to the assets in the cover pool that are registered in the Register, as well as over the funds that originate from those assets.

Use of Proceeds:

The net proceeds for each issue of Covered Bonds issued under the Programme will be for general funding purposes of the Issuer or other if stated in the Final Terms.

Rating:

Covered Bonds issued under the Programme may or may not have a rating by a rating agency as stated in the applicable Final Terms.

Clearing Systems:

Covered Bonds issued under the Programme will be cleared through the ISD, Euroclear, Clearstream, Luxembourg and/or any other clearing system as

specified in the relevant Final Terms.

Listing:

Covered Bonds may be admitted to trading on a regulated market as specified in the applicable Final Terms. FME has approved this Base Prospectus and applications may be made for new series of Covered Bonds issued under the Programme to be admitted to trading on a regulated market within 12 months of the date of this Base Prospectus.

Governing law:

The Covered Bonds (except for the ISD System Covered Bonds), the Receipts, the Coupons are governed by, and shall be construed in accordance with, English law except for Condition 3 of the Terms and Conditions, which will be governed by, and construed in accordance with Icelandic law.

The Issuer irrevocably agrees that any dispute arising out of the Programme, the Covered Bonds, the Coupons, the Receipts shall be subject to the exclusive jurisdiction of the Courts of England.

The ISD System Covered Bonds will be governed by, and construed in accordance with Icelandic law.

Risk Factors:

There are certain risk factors that may affect the Issuer and its ability to fulfill its obligations under Covered Bonds issued under the Programme such as general economic and business conditions in Iceland and globally, credit risk, market risk, liquidity risk, operational risk and legal risk.

There are certain risk factors that are material for the purpose of assessing the risk of the Covered Bonds issued under the Programme, such as the fact that the Covered Bonds may not be a suitable investment for all investors, legal risk, risks relating to the structure of the Covered Bonds, the Cover Pool and certain market risks.

RISK FACTORS

The following factors may affect the ability of Landsbankinn hf., Reg. No. 471008-0280, Austurstræti 11, 155 Reykjavík, Iceland (the “**Issuer**” and “**Landsbankinn**”) to fulfil its obligations under the Covered Bonds issued under the Programme. Most of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring. Factors which are material for the purpose of assessing the market risks associated with Covered Bonds issued under the Programme are also described below.

The Issuer believes that the factors described below represent the principal risks inherent in investing in Covered Bonds issued under the Programme, but the inability of the Issuer to pay interest, principal or other amounts on or in connection with any Covered Bonds may occur for other reasons which may not be considered significant risks by the Issuer based on information currently available to it or which it may not currently be able to anticipate. Prospective investors should also read the detailed information set out elsewhere in this Base Prospectus and draw their own conclusions prior to making any investment decision.

RISKS RELATING TO THE ISSUER, INCLUDING ITS BUSINESS AND THE ABILITY OF THE ISSUER TO FULFIL ITS OBLIGATIONS UNDER THE COVERED BOND PROGRAMME

As a result of its business activities, the Issuer is exposed to a variety of risks, the most significant of which are credit risk, market risk, liquidity risk and operational risk. Failure to control these risks could result in material adverse effects on the Issuer’s business, financial condition and operating results.

The Issuer’s financial results are significantly affected by general economic and other business conditions in Iceland and globally

These conditions include changing economic cycles that affect demand for investment and banking products. These cycles are also influenced by global political events, such as terrorist acts, war and other hostilities, as well as by market-specific events, such as shifts in consumer confidence and consumer spending, the rate of unemployment, industrial output, labour or social unrest and political uncertainty.

The Issuer’s business activities are dependent on the level of banking, finance and financial services required by its customers. In particular, levels of borrowing depend on customer confidence, employment trends, state of the economy and market interest rates at each time. As the Issuer currently conducts most of its business in Iceland, its performance is influenced by the level and cyclical nature of business activity in Iceland, which is in turn affected by both domestic and international economic and political events. There can be no assurance that a weakening in the Icelandic economy will not have a material effect on the Issuer’s future financial results.

In addition, market perceptions and reports regarding the Icelandic economy or its performance may influence general economic and business conditions in Iceland due to the small size of the Icelandic economy. These perceptions and reports may have an adverse effect on the Issuer’s business, financial condition and results of operations.

The Issuer’s retail and corporate banking business may be affected during recessionary conditions, as there may be less demand for loan products or certain customers may face financial problems and the Issuer may experience higher loan defaults. The impact of the economy and business climate on the credit quality of borrowers and counterparties can affect the recoverability of loans and amounts due from counterparties. Interest rate increases may also impact the demand for mortgages and other loan products and credit quality. The Issuer’s investment banking, securities trading, asset management and private banking services, as well as its investments in, and sales of products linked to, financial assets, will be affected by several factors, such as the liquidity of global financial markets, the level and volatility of equity prices and interest rates, investor sentiment, inflation and the availability and cost of credit, which are related to the economic cycle. These conditions may have an adverse effect on the Issuer’s business, financial condition and results of operations.

The Issuer operates in a competitive market and increased competition by Icelandic or foreign banks could increase downward pressure on interest rate margins. The Issuer operates in a market which has changed rapidly in recent years, with increased competition. The main competitors are Arion Bank hf., Íslandsbanki hf., MP banki hf. and the Icelandic Housing Financing Fund (the “**HFF**”). There is always a risk of new entrants to the market, foreign or domestic, or for smaller competitors to merge and increase their strength. Such competition could develop in individual market sectors, or in the market as a whole. The Issuer has a high market share, which it intends to maintain. The Issuer makes every effort to ensure that its product range, service and prices are competitive, and must constantly monitor its competitors and their offerings. However, there is always a risk that the Issuer could lose its competitive edge and that new products could fail to meet the demands of the market or compete with competitors’ products. All of the above could undermine the Issuer’s income generation and may have an adverse effect on the Issuer’s business, financial condition and results of operations.

Icelandic State Financial Investments is the largest shareholder of the Issuer. This may affect the Issuer and its business

As at the date of this Base Prospectus, the largest shareholder of the Issuer is the Icelandic State Financial Investments (the “**ISFI**”) which holds a 97.9 per cent. shareholding on behalf of the National Treasury of Iceland. The Icelandic Parliament has authorised the sale of up to 27.9 per cent. of ISFI’s shareholding which would reduce ISFI’s shareholding to 70 per cent. ISFI, on behalf of the National Treasury of Iceland, may sell or otherwise dispose of all, or part of, its shareholding in the Issuer to any private or public entity, although it is expected that ISFI will remain a significant shareholder of the Issuer. Any such sale or disposal, and any conditions attaching to it, could affect the Issuer’s business, financial condition and results of operations.

In certain areas Icelandic legislation provides for special rules that are relevant for the Issuer due to the fact that the Icelandic State has the majority of shareholdings in the Issuer. These rules do not apply for the Issuer’s main competitors as they are not majority owned by the Icelandic State. These rules may impose heavier regulatory burden on the Issuer compared to its competitors and thus have a negative impact on the Issuer’s competitive position. These rules are provided for in Article 79(a) of the Act on Companies No. 2/1995 (remuneration policy excludes the Issuer’s CEO), Article 6 of the Act on the Icelandic National Audit Office No. 86/1997 (the Issuer’s auditor is the National Audit Office), Article 6 of the Act on the Senior Civil Servant’s Board No. 47/2006 (the Senior Civil Servant’s Salary Board determines the remuneration of the Issuer’s CEO), Article 2 of the Information Act No. 140/2012 (the Issuer is subject to the Act but can obtain a temporary exemption from falling under the scope of the Act), and Article 14 of the Act on Public Archives No. 77/2014 (the Issuer is subject to the Act).

Although economic growth has returned in recent years, the Issuer is vulnerable to a range of economic risks that face the Icelandic banking system

In early October 2008, the Icelandic economy experienced a serious banking crisis when the three large commercial banks, Glitnir banki hf., Landsbanki Íslands hf. and Kaupthing Bank hf. (together the “**Old Banks**”), were taken into special resolution regimes on the basis of Act No. 125/2008 (the “**Emergency Act**”) passed by the Icelandic Parliament. Since then, the Icelandic economy and the financial system have taken a number of steps forward. Economic growth has been quite robust compared to other developed countries in recent years. According to Statistics Iceland, the average economic growth in Iceland in the years 2011 to 2013 was 2.2 per cent. and last year’s economic growth was 3.5 per cent. due to strong export growth. The economic forecast for the next years should further strengthen the stability of the Icelandic banks. A recent Organisation for Economic Co-operation and Development (the “**OECD**”) report is forecasting 2.7 per cent. economic growth in 2014 and 3.2 per cent. in 2015 compared with 1.2 per cent. and 1.7 per cent. respectively for the Euro area. Household and corporate debt has continued to decline, owing to restructuring, write-downs and increased income. According to the Central Bank of Iceland (the “**Central Bank**”), household debt declined by 5 per cent. of Gross Domestic Product (“**GDP**”) in 2013 as compared to 3 per cent. of GDP in 2012. Corporate debt amounted to 113 per cent. of GDP at the end of 2013 compared to 143 per cent. in the end of 2012. At present, the corporate debt ratio is slightly lower than in the end of 2003.

The economic upswing and improved private sector financial conditions are reflected in the position of Icelandic banks, which strengthened further in 2013, with good returns on equity and total assets, declining levels of non-performing loans and rising capital ratios. Banking system liquidity has remained strong. As of the end of 2013, the capital ratio of the three largest Icelandic commercial banks was 26.1 per cent. but the ratio grew by one percentage point between the years and is well above the FME's required minimum.

Even though progress has been made and the financial stability of the Icelandic banks has strengthened, the following should be taken into account.

- *Removal of capital controls.* In November 2008, the Central Bank introduced capital controls. Their main objective was to prevent capital flight from Iceland and devaluation of the Icelandic króna (“ISK”) which would have had a large negative impact on debt levels of large parts of Icelandic households and corporates with foreign denominated and index-linked debt. These capital controls are now being relaxed in accordance with a capital controls liberalisation strategy established in March 2011. Even though capital controls are being relaxed, no deadline or firm future date has been established as to when they will be lifted completely. Should the capital controls be removed too quickly, it could lead to rapid and severe depreciation of the domestic currency resulting in increased inflation and through that have a negative impact on index-linked loans to households. Such depreciation would also cause disruption to the Icelandic economy and financial system resulting in lower consumption and a big strain on customers with foreign currency loans. The Icelandic banking system is largely funded by deposits. By lifting the capital controls, a large chunk of these deposits could be withdrawn putting a stress on the Icelandic banking system as a whole. The Central Bank has emphasised that lifting the controls will be done with great care and without putting financial stability at risk.
- *Possible depreciation of the ISK.* Even though the existence of the capital controls decreases the risk of a sharp depreciation of the ISK, lifting of the capital controls and other risk factors can put pressure on the ISK. The Icelandic export sector is not very diversified and large parts of Icelandic exports are in only three major exports sectors: aluminium, seafood and tourism. Negative shocks which would decrease export revenues in any of those sectors could have a big impact on the balance of payments and put pressure on the ISK.
- *The deposits funding of the Icelandic banks.* A large part of Icelandic banks' funding comes from deposits. In October 2008, the Icelandic government stated that all deposits in banks domiciled in Iceland were guaranteed by the state. Even though this statement has never been entered into law by the Icelandic Parliament, the statement has probably had some effect on deposits. Should the statement be withdrawn, this could have an impact on the funding and the business of the Icelandic banks.

In addition to the risk factors above, there are other economic risk factors facing the Icelandic banking system such as the effects of the sovereign debt crisis in Europe and instability or deterioration of the international financial markets.

The restructuring of the Icelandic banking system involves risk that could materially affect the Issuer

The Issuer, Íslandsbanki hf. and Arion Bank hf. (together the “**New Banks**”) are the three largest commercial banks in Iceland and were established after the banking crisis in 2008. The Issuer can be differentiated from the other two banks by its ownership, as the Issuer is 97.9 per cent. owned by the ISFI.

The Icelandic banking system is small and the New Banks have limited opportunities for growth in the near term. It is also unlikely that the New Banks will grow through international operations in the near future. The New Banks could also be adversely affected if other developments in the Icelandic economy or in world affairs result in further slowing of growth in Iceland's economy.

In addition, the guarantee by the Icelandic Government of deposits in domestic commercial and savings banks that has been in place since October 2008 has never been enacted into law by the Icelandic Parliament, and the basis of this guarantee is an announcement from the Prime Minister's Office of 6 October 2008 stating that

deposits in domestic commercial and savings banks and their branches in Iceland will be fully covered. This announcement has since been repeated by subsequent governments and the European Free Trade Association Surveillance Authority has not objected to the guarantee under the European Economic Area (the “EEA”) State Aid rules to date. It is assumed that the blanket guarantee will be gradually lifted when the banking market both domestic and foreign has stabilised. However, a sudden lifting of the guarantee, with or without regulatory intervention, could have an impact on deposit holders and the outflow of deposits held by the Issuer.

The occurrence of any of the factors described above could seriously undermine Iceland’s economy and confidence in the banking system in Iceland and could have a material adverse effect on the Issuer’s business, financial condition and operating results.

Icelandic laws and rules on foreign exchange - capital controls

On 28 November 2008, the Icelandic Parliament passed Act No. 134/2008 (the “**Amending Act**”), amending the Act on Foreign Exchange No. 87/1992, as amended (the “**Foreign Exchange Act**”) granting the Central Bank powers to intervene in the currency market with the view of stabilising the foreign exchange rate of the ISK. For this purpose, the Central Bank issued new Rules on Foreign Exchange No. 1082 of 28 November 2008 (the “**Rules on Foreign Exchange**”) imposing stringent capital controls on cross-border movement of capital and related foreign exchange transactions. The Rules on Foreign Exchange were codified with the adoption of Act No. 127/2011 in 2011 amending the Foreign Exchange Act. The Foreign Exchange Act has since then been amended four times, in regards to the capital controls, with one amendment Act in March 2012, two amendment Acts in March 2013 and one amendment Act in June 2014. The general regime on the capital controls is set out in Article 13 a. – n. of the Foreign Exchange Act. The Foreign Exchange Act is supplemented by the Rules on Foreign Exchange, which have been reviewed and amended several times since 28 November 2008. Current Rules on Foreign Exchange are rules No. 565/2014.

In general, the capital controls in the Foreign Exchange Act restrict the outflow of foreign currency from Iceland except in the case of a payment for goods or services. All financial transactions leading to currency outflow are prohibited unless explicitly permitted. More specifically, these rules include provisions restricting certain transactions, including lending and borrowing between resident and non-resident parties, as well as currency-derivatives of any kind and the acquisition by domestic parties of financial instruments nominated in foreign currency. Furthermore, these rules make it compulsory for residents to “repatriate” all of their foreign currency.

The Foreign Exchange Act provides for several general exemptions from the capital controls. Commercial banks are provided with a general exemption from certain provisions of the Foreign Exchange Act and, consequently, the capital controls. Accordingly, commercial banks, savings banks and credit institutions operating under a FME licence are exempt from restrictions on borrowing and lending between national and foreign parties, the restriction on assuming liability for payments between national and foreign parties, and the requirement to repatriate all foreign currency.

In addition to the general exemptions, the Foreign Exchange Act provides for specific exemptions from the capital controls, subject to the Central Bank’s approval. An application for any such exemptions must be made to the Central Bank and the estimated process time of such applications is approximately eight weeks.

However, in the case of the winding-up, bankruptcy or insolvency of the Issuer, the exemptions from the Foreign Exchange Act may not apply and, therefore, restrictions will be effected in respect of payments of foreign currency due under the Covered Bonds, whether by reason of the Foreign Exchange Act, the Act on Bankruptcy No. 21/1991 or applicable provisions under the Act on Financial Undertakings, No. 161/2002 (the “**Act on Financial Undertakings**”) which may effectively prohibit the outflow of foreign currency from Iceland.

Subject to the preceding paragraph, the payment by the Issuer of interest on the relevant Interest Payment Date and of principal on the relevant Maturity Date will, therefore, be exempt from the restrictions of the Foreign Exchange Act under the general exemption. However, it is not clear whether the general exemption covers

prepayments and, therefore, whether it covers the payment of an Early Redemption Amount or an Optional Redemption Amount under the Covered Bonds.

The amendments made to the Foreign Exchange Act in March 2012 by Act No. 17/2012 imposed further restrictions on the outflow of foreign currency. This involved two amendments to the capital controls regime, among others, in response to a perceived increase in circumvention of the currency controls. Preceding these amendments, an investor could change its interests in the principal amortisation and indexation payments under a Consumer Price Index (“**CPI**”) indexed annuity bond into foreign currency and transfer such payments out of the Icelandic economy. This legislation removed the previous exemption provided for such payments which are now subject to the general capital controls regime, meaning that only interest payments remain within the exemption. Furthermore, the wide exemptions for payments by the winding-up committees of the failed Icelandic banks to creditors were removed and are now subject to the Central Bank’s approval.

Two additional amendments were made to the Foreign Exchange Act in March 2013. Amendments by Act No. 16/2013 implemented certain changes to the currency control regime, including the removal of the expiration date of the capital controls, from the Foreign Exchange Act. Moreover, these amendments imposed limits on the exemptions which the Central Bank can apply and the extent to which these may now be subject to prior consultation with the relevant ministry. These limits primarily relate to financial institutions or legal entities under the control of the FME through winding-up proceedings or legal entities with a balance sheet exceeding ISK 400 billion and where the transaction may have a substantial effect on the debt position of the economy or concerns ownership of a commercial bank. Amendments by Act No. 35/2013 primarily related to general exemptions and enhanced authorisations in favour of the Central Bank. Both of these amendments to the Foreign Exchange Act enhanced the Central Bank’s surveillance of foreign exchange, including in relation to payments of interest, indexation, dividends and contractual maturities. The Central Bank also received authorisation to collect certain information, which may extend to any relevant third party, and to impose fines.

The Foreign Exchange Act was further amended on 16 May 2014 with the enactment of Act No. 67/2014. With this amendment act, three changes were made to the Foreign Exchange Act. The first change limited the definition of dividend within the meaning of the Foreign Exchange Act. The second change clarified what shall be considered to be a contractual payment within the meaning of Article 13 j. of the Foreign Exchange Act. The third change introduced a new provision that provides that a legal person may be fined for violations of the Foreign Exchange Act and rules set on its basis regardless of whether the violation derived from negligent or intentional acts by the management or employees of the legal person.

On 25 March 2011, in a report to the minister of economic affairs on the Capital account liberalisation strategy, the Central Bank proposed a new strategy for the gradual removal of the remaining capital controls in phases, subject to three conditions which are: macroeconomic stability, an adequate level of foreign reserves and a sound financial system.

The restrictions on capital movement imposed in Iceland constitute protective measures under Article 43 of the EEA agreement (the “**EEA Agreement**”) and have as such been notified to the European Free Trade Association (the “**EFTA**”) Standing Committee under the procedures provided for in Protocol 18 of the EEA Agreement in conjunction with Protocol 2 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (the “**Surveillance and Court Agreement**”). Following a referral by the District Court of Reykjavík, the Court of Justice of the EFTA States (the “**EFTA Court**”) issued a reasoned opinion on 14 December 2011, case E-3/11, whereby the EFTA Court ruled that it had competence according to the EEA Agreement and the Surveillance and Court Agreement to review the rules on currency restrictions, *inter alia*, in light of the general principle of proportionality. The EFTA Court further declared that at the time in question the rules in question were proportionate. However, this ruling of the EFTA Court does not preclude further scrutiny of the above currency controls by the relevant EEA institutions at any time.

Prospective investors in Covered Bonds issued under the Programme must therefore consider the risk of further changes to the above currency controls and the impact this may have on the Issuer’s business and an investment in the Covered Bonds.

Should one or more of the Issuer's counterparties fail to fulfil its obligations, it may result in material adverse effects on the Issuer's business, financial condition and results of operations

Granting of credit is the Issuer's major source of income and credit risk is the Issuer's most significant risk factor. Credit risk is defined as the risk that a party to a financial instrument, be it a client, customer or market counterparty will cause a financial loss to the Issuer by failing to fulfil its obligations.

Adverse changes in the credit quality of the Issuer's customers and counterparties or a general deterioration in Icelandic or global economic conditions, or arising from systematic risks in the financial systems, could affect the recoverability and value of the Issuer's assets and require an increase in the Issuer's provision for bad and doubtful debts and other provisions. Specific issues and events where credit risk could adversely affect revenues in 2014 and subsequent years include but are not limited to:

- *Concentration of loan portfolio in certain sectors could adversely affect the Issuer.* The Issuer's loan portfolio is relatively concentrated in key sectors. These are households, fisheries, construction and real estate companies. Downturns in these sectors that would influence customers' ability to meet their obligations may have an adverse effect on the Issuer's business, financial condition and results of operations.
- *Deterioration of economic conditions could increase the required loan impairment for the Issuer.* Higher unemployment rate, reduced personal disposable income levels and increased personal and corporate insolvency rates may reduce customers' ability to repay loans. This, in addition to depressed asset valuations could have an impact on the adequacy of the Issuer's loss reserves and future impairment charges.

The Issuer is exposed to a range of market risks, the most significant being equity, interest rate, foreign exchange and indexation

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.

Changes in interest rate levels, inflation, yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs. Changes in currency rates affect the value of assets and liabilities denominated in foreign currencies and may affect income from foreign exchange dealing. The performance of financial markets may cause changes in the value of the Issuer's investment and trading portfolios.

- *Increased volatility in the equity markets.* The Issuer's equity risk comes from both proprietary and securities trading. Elevated uncertainty in the financial markets could lead to increased volatility in the equity markets. This could lead to a devaluation of equities and investment funds held by the Issuer and have an adverse effect on the Issuer's business, financial condition and results of operations.
- *A major portion of the Issuer's assets and liabilities are interest-related.* The Issuer's interest rate risk arises from the impact of interest rate changes on the Issuer's assets and liabilities, since a major portion of the Issuer's assets and liabilities are interest-related in one manner or another. The Issuer's limited access to capital markets could have a negative effect on the Issuer's revenues as it may be unable to correct interest rate imbalances between assets and liabilities, based on the timing of interest rate reset or maturity. For example risks can arise if there are fixed and variable interest rate items in the same maturity bracket; this may lead to open interest rate positions on the assets or liabilities side. This could then affect the Issuer's profitability. The Issuer may also be limited in his ability to adjust interest rates applied to customers due to competitive pressures.
- *Increased volatility in the foreign exchange markets.* The Issuer's foreign exchange risk arises from exposure to unanticipated changes in the exchange rate between currencies and limitations to mitigate the

foreign exchange risk due to capital controls. Increased volatility in the foreign exchange markets could have an adverse effect on the Issuer's business, financial condition and results of operations.

The Issuer follows Rules No. 950/2010 on Foreign Exchange Balances, as set by the Central Bank of Iceland (the "**Rules on Foreign Exchange Balances**"). The Rules on Foreign Exchange Balances stipulate that an institution's foreign exchange balance (whether long or short) must always be within 15 per cent. of its capital base, in each currency and for all currencies combined.

Uncertainty regarding currency denomination in the Issuer's loan portfolio has not been fully resolved in the period from 1 January to 30 September 2014. As explained in *About the Issuer – Litigation*, there is litigation pending concerning these currency denominations that the Icelandic courts have not passed judgment on yet.

Due to capital controls, the Issuer's ability to mitigate the risk from ISK related currency fluctuations is limited. However, the Issuer has taken various measures to decrease its overall currency risk and expects future currency risk levels to be within acceptable limits.

- *Imbalance in CPI indexed assets and liabilities.* The Issuer's indexation risks arise from a considerable imbalance in its CPI indexed assets and liabilities. CPI indexation risk is the risk that the fair value or future cash flows of CPI indexed financial instruments may fluctuate due to changes in the Icelandic CPI. The majority of the Issuer's mortgage loans and consumer loans are indexed to the CPI and the Issuer is therefore exposed to inflation risk. In the case of deflation in the CPI, there could be a corresponding impact on the balance sheet and loss to the Issuer.

The Issuer is exposed to liquidity risk. The inability of the Issuer to anticipate and provide for unforeseen decreases or changes in funding sources could have an adverse effect on the Issuer's ability to meet its obligations as and when they fall due

Liquidity risk is the risk that the Issuer 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.

The Issuer's liquidity management policy is built on international standards on liquidity risk measurements developed by the Basel Committee on Banking Supervision e.g. the Liquidity Coverage ratio ("**LCR**") and the Net Stable Funding Ratio ("**NSFR**") and it also applies measurements that best suit the operating environment of the Issuer.

The Issuer is exposed to refinancing risk. The inability of the Issuer to refinance its outstanding debt could have a negative impact on the Issuer's business

The Issuer is predominantly funded by customer deposits, liabilities due to financial institutions, borrowing and share capital. The Issuer aims at diversifying its funding profile by issuing bonds in the domestic and international bond markets. The inability of the Issuer to refinance its outstanding debt in the future, at the right time and at a favourable interest rate could affect the Issuer's business

Operational risks are inherent in the Issuers business activities and are typical of comparable businesses

Operational risk and losses can result from fraud, errors by employees, failure to document transactions properly or to obtain proper internal authorisation, failure to comply with regulatory requirements and business rules, equipment failure, natural disasters or the failure or inadequacy of internal processes or systems or external systems; for example, those of the Issuer's suppliers or counterparties.

The Issuer has in place and maintains necessary rules and working procedures and keeps them accessible to all employees on the Issuer's intranet. It is intended to ensure that key information on work processes is available in one place. However, there is no guarantee that mistakes will not be made which might have a material impact on the Issuer's business.

Both current and former employees of the Issuer can damage the Issuer if they infringe its rules either intentionally or through negligence. While it is difficult to evaluate the damage in each instance, the loss can be financial and/or damage the Issuer's reputation.

The Issuer could suffer a loss as a result of criminal actions, such as a bank robbery, fraud, money laundering or embezzlement. All of these risk factors could cause the Issuer extensive damage and affect its performance.

The Issuer is exposed to the risk of breach of security or functionality of its information systems that could have materially adverse effects on the Issuer's business

The Issuer's information systems ("IT systems") comprise a major operational risk, both with regard to their functioning and accessibility. The Issuer's IT systems are varied and in many instances depend upon co-operating partners. Various kinds of external attacks, viruses, denial of service attacks or other types of attacks on the Issuer's computer systems could disrupt the Issuer's operations. The Issuer has in place specific disaster recovery and business continuity plans, including backup sites. It is not entirely possible, however, to eliminate operational risk arising from unexpected events.

Failure to manage compliance risk could adversely affect the Issuer's business

Compliance is one of the Issuer's support and risk management functions. It is intended to assist in managing the Issuer's compliance risk on a consolidated basis. Compliance risk can be defined as the risk of legal or regulatory sanctions, financial loss or damage to the Issuer's reputation as a result of failure to comply with applicable laws, regulations, codes of conduct and standards of good practice.

Compliance emphasises issues such as market abuse and fraud prevention, anti-money laundering, codes of ethics, avoidance of conflicts of interest and ensuring best practice. The Issuer's Compliance Officer ensures that the Issuer's rules on securities trading and insider dealing are followed, and that the Issuer's operations comply with the Act on Securities Transactions, Act No. 64/2006 on Actions to Combat Money Laundering and Terrorist Financing (the "**Act on Actions to Combat Money Laundering and Terrorist Financing**") and other relevant legislation and regulations.

There is however always the risk that the Issuer could suffer if the above-mentioned rules are not followed.

The Issuer's future success depends, in part, on its ability to attract, retain and motivate qualified and experienced banking and management personnel

Competition for personnel with relevant expertise is significant, due to the relatively small number of available qualified individuals. Failure to attract and retain senior management and key employees could have a material adverse effect on the Issuer's business.

The Issuer's majority owner is the Icelandic government and the Issuer's remuneration policy is determined by the owner. The ability of the Issuer to attract and retain competent personnel could be adversely affected by this.

Damage to the Issuer's image could adversely affect its operation

The image and reputation of financial enterprises are among their most valuable assets. The risk of damage to the Issuer's image or reputation is present whenever it is the subject of discussion. Damage to its image or reputation could prompt the Issuer's customers to direct their business elsewhere. This could have a very negative impact on the Issuer's business. Such damage could result, for instance, from business mistakes, violations of laws or regulations, errors of judgement and poor service or products offered.

Environmental disasters, natural catastrophes and acts of war could have a negative impact on the Issuer's revenues and on-going operation

Although natural catastrophes and environmental disasters could threaten the Issuer's ability to maintain its operations, attempts are made to limit this risk by ensuring the security of critical equipment, its location and distribution between risk areas. The Issuer also has in place specific disaster recovery and business continuity plans.

The Issuer's financial statements are based in part on assumptions and estimates, which, if inaccurate, could lead to future losses

The preparation of financial statements requires the Issuer's 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 on-going basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected. Estimates and assumptions involve a substantial risk which could result in material adjustments to the carrying amounts of assets and liabilities during the next financial year.

The Issuer's insurance coverage may not adequately cover all losses

The Issuer has taken a conscious decision to insure itself against specific risks. The Issuer holds all mandatory insurance coverage, including fire insurance and mandatory vehicle insurance, plus comprehensive vehicle insurance. The Issuer also holds insurance policies provided for in collective bargaining agreements with the Confederation of Icelandic Bank and Finance Employees, such as life and accident insurance, and insurance stipulated by other wage contracts as applicable. In addition, the Issuer has taken out liability insurance against third-party claims, insurance on moveable property and professional liability insurance for its auditors and directors' and officers' liability insurance for the Issuer's directors and senior management. The Issuer also carries insurance against computer crime and professional indemnity coverage. In addition, money transportation is insured in accordance with the interests at stake in each instance. It should be borne in mind, however, that, despite the insurance policies carried by the Issuer, there is no guarantee that it will be fully compensated should it need to lodge claims. If the Issuer did submit claims under its policies, the premiums it pays could be expected to increase in the future. The Issuer's insurance policies are subject to the terms and conditions of the applicable policies.

The Issuer may be exposed to risks that are either not identified or inadequately appraised by present risk management methods

The Issuer has developed and implemented principles, procedures and rating methods for the monitoring and identification of risks. Nevertheless, even with these monitoring systems in place it is not possible to completely eradicate the Issuer's exposure to risks of various kinds which may not be identified or anticipated. Unanticipated or incorrectly quantified risk exposures could have a material adverse effect on the Issuer's operation. Information regarding the Issuer's risk management is further described in "*Description of the Issuer – Risk Management Framework*".

Legal risk

The Issuer's business operations are governed by laws and regulations and are subject to regulatory supervision. The Issuer is regulated by the FME. The Issuer's operating licence is subject to compliance with laws and regulations governing the Issuer and its operations, and any breach of those laws or regulations may result in severe fines, liability for damages and/or the revocation of the Issuer's licence.

The Issuer is subject to a number of laws, regulations, administrative actions and policies governing the provision of financial services in Iceland. Any changes to current legislation might affect the Issuer's operations and its results of operations. Although the Issuer works closely with regulators and continually monitors its legal position, future changes in regulations, fiscal or other policies can be unpredictable and are beyond the Issuer's control.

The Issuer will at any time be involved in a number of court proceedings, which is considered normal due to the nature of the business undertaken. Should any proceedings be determined adversely to the Issuer, this could have a material adverse effect on its results. For further information on litigation see *Description of the Issuer – Litigation*.

Changes to the Capital Requirements Directive could adversely affect the Issuer's results

The new international regulatory framework for banks, Basel III, has been developed and includes requirements regarding regulatory capital, liquidity, leverage ratio and counterparty credit risk measurements. In December 2010, the Basel Committee issued the first version of the Basel III framework and a revised version was issued in June 2012. On 26 June 2013, the European Parliament and Council adopted a legislative package (“**CRD IV**”) for the implementation of the Basel III framework in the European Union (the “**EU**”) and to strengthen the regulation of the banking sector. CRD IV replaces the current Capital Requirements Directives (2006/48/EC and 2006/49/EC) with Directive (2013/36/EU) (the “**CRD IV Directive**”) and Regulation (EU) No. 575/2013) (the “**CRR**”). The global implementation plan of the framework extends throughout 2018. The Ministry of Finance and Economic Affairs has formed a committee to implement CRD IV in Iceland. The timeframe for the implementation has not yet been published.

The introduction of new rules in Iceland reflecting CRD IV and other changes to capital adequacy and liquidity requirements imposed on the Issuer could result in existing tier 1 and tier 2 securities ceasing to count towards the Issuer's regulatory capital, either at the same level as at present or at all. Any failure by the Issuer to maintain any increased regulatory capital requirements or to comply with any other requirements introduced by regulators could result in intervention by regulators or the imposition of sanctions, which may have a material adverse effect on the Issuer's financial condition and results of operations and may also have other effects on the Issuer's financial performance and on the pricing of the Covered Bonds, both with or without the intervention by regulators or the imposition of sanctions. Prospective investors in the Covered Bonds should consult their own advisers as to the consequences of the implementation of CRD IV in Iceland.

Changes in tax laws or in their interpretation could harm the Issuer's business

The Issuer's results of operations could be harmed by changes in tax laws and tax treaties or the interpretation thereof, changes in corporate tax rates and the refusal of tax authorities to issue or extend advanced tax rulings.

In December 2010, the Icelandic Parliament passed Act No. 155/2010 under which certain types of financial institution, including the Issuer, are required to pay an annual levy of the carrying amount of their liabilities as determined for tax purposes. This levy was originally 0.041 per cent. but in December 2011 a transitional provision was introduced under which financial institutions had to pay an additional 0.0875 per cent. of their tax base as assessed for the years 2012 and 2013. In 2013 the levy was increased and set at 0.376 per cent. of the total debt of financial institutions excluding tax liabilities in excess of ISK 50 billion at the end of the year. Non-financial subsidiaries are exempt from this tax. There can be no assurance that the levy will not be further increased. Any such increase could have a material adverse effect on the financial condition of the Issuer.

In June 2009, the Icelandic Parliament adopted an amendment to the Income Tax Act No. 90/2003 (the “**ITA**”) as a result of which payments of Icelandic sourced interest by an Icelandic debtor, such as the Issuer, to a foreign creditor, including holders of bonds, who are not Icelandic is taxable in Iceland and can be subject to withholding tax at the rate of 10 per cent. This withholding is applicable unless the foreign creditor can demonstrate and obtain approval from the Icelandic Inland Revenue that an exemption applies, such as the existence of a relevant double taxation treaty, and in such case the provisions of the double tax treaty will apply. Bonds issued by energy companies and certain financial institutions, including bonds issued by the Issuer, are also subject to exemption. The exemption, subject to certain other requirements, applies to bonds that are held through a clearing system, such as the ISD, Euroclear and Clearstream, Luxembourg, within a member state of the OECD, the EEA, a founding member state of EFTA or the Faroe Islands.

In December 2011, the Icelandic Parliament passed Act No. 165/2011 under which certain types of financial institutions, including the Issuer, were required to pay a special additional tax levied on all remuneration paid to employees, with effect from 1 January 2012. The levy is currently set at 5.5 per cent. of such remuneration. Additionally, Act No. 165/2011 amended Article 71 of the ITA, regarding income tax of legal entities, and imposed a special additional income tax on legal entities liable for taxation according to Article 2 of Act

165/2011, which includes the Issuer. The levy is set at 6 per cent. on income over ISK 1 billion, without consideration to joint taxation and transferable losses.

Abnormal pricing as a consequence of capital controls

The currency controls described in “*Icelandic laws and rules on foreign exchange - currency controls*” have the implication that domestic parties, primarily investors, are prohibited from transferring their funds and investing outside of the Icelandic market. Consequently, they are confined to and must focus their investments on Iceland, which entails various risks, including a risk for abnormal pricing and financial bubbles occurring within several sectors of the Icelandic market. This applies both to investments in shares of listed and unlisted companies, investment funds, various other financial instruments and real-estate (primarily commercial) and may have a negative impact on the Issuer’s business.

Iceland’s national implementation of EEA rules may be inadequate in certain circumstances

Iceland is a member state of the EEA and is therefore obligated to implement certain EU instruments with EEA relevance, including legislation relating to financial markets. Where implementation of such instruments into Icelandic law is inadequate, (i.e. Iceland has failed to adapt national law to conform to EEA rules) citizens may be unable to rely on these instruments and the Icelandic courts barred from applying them, unless Icelandic legislation may be interpreted in accordance with the EEA rules. As a result, holders of Covered Bonds in some circumstances may experience different legal protections than they would expect as holders of securities issued by the Banks in EU member states where EU instruments are directly applicable or have been adequately implemented into national legislation.

FACTORS THAT ARE MATERIAL FOR THE PURPOSE OF ASSESSING THE RISKS ASSOCIATED WITH COVERED BONDS ISSUED UNDER THE PROGRAMME

Risks related to the structure of a particular issue of Covered Bonds

A wide range of Covered Bonds may be issued under the Programme. A number of these Covered Bonds may have features which contain particular risks for potential investors. Set out below is a description of the most common such features:

If the Issuer has the right to redeem any Covered Bonds at its option, this may limit the market value of the Covered Bonds concerned and an investor may not be able to reinvest the redemption proceeds in a manner which achieves a similar effective return

If the optional redemption feature of the Covered Bonds is applicable in the Final Terms, it is likely to limit their market value. During any period when the Issuer may elect to redeem Covered Bonds, the market value of those Covered Bonds generally will not rise substantially above the price at which they can be redeemed. This may also be true prior to any redemption period.

The Issuer may be expected to redeem Covered Bonds when its cost of borrowing is lower than the interest rate on the Covered Bonds. At those times, an investor generally would not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the Covered Bonds being redeemed and may only be able to do so at a significantly lower rate. Potential investors should consider reinvestment risk in light of other investments available at that time.

If the Issuer has the right to convert the interest rate from a fixed rate to a floating rate or vice versa, this may affect the secondary market and the market value of the Covered Bonds concerned

Fixed/Floating Rate Covered Bonds may bear interest at a rate that converts from a fixed rate to a floating rate, or from a floating rate to a fixed rate. Where the Issuer has the right to effect such a conversion, this will affect

the secondary market and the market value of the Covered Bonds since the Issuer may be expected to convert the rate when it is likely to produce a lower overall cost of borrowing. If the Issuer converts from a fixed rate to a floating rate in such circumstances, the spread on the Fixed/Floating Rate Covered Bonds may be less favourable than the prevailing spreads on comparable Floating Rate Covered Bonds tied to the same Reference Rate. In addition, the new Floating Rate at any time may be lower than the rates on other Covered Bonds. If the Issuer converts from a Floating Rate to a fixed rate in such circumstances, the fixed rate may be lower than then prevailing rates on its Covered Bonds.

Covered Bonds which are issued at a substantial discount or premium may experience price volatility in response to changes in market interest rates

The market values of securities issued at a substantial discount or premium from their principal amount tend to fluctuate more in relation to general changes in interest rates than do prices for conventional interest-bearing securities. Generally, the longer the remaining term of such securities, the greater the price volatility as compared to conventional interest-bearing securities with comparable maturities.

The Covered Bonds may be subject to extendable obligations that may change the Maturity Date, Interest Payment Dates and Interest Periods for the Covered Bonds concerned

Following the failure by the Issuer to pay the Final Redemption Amount of a Series of Covered Bonds on their Maturity Date, payment of such amounts shall be automatically deferred. This will occur if the Final Terms for a relevant Series of Covered Bonds provides that such Covered Bonds are subject to an Extended Maturity Date on which the payment of all or (as applicable) part of the Final Redemption Amount payable on the Maturity Date will be deferred in the event that the Final Redemption Amount is not paid in full on the Maturity Date.

To the extent that the Issuer has sufficient funds available to pay in part the relevant Final Redemption Amount in respect of the relevant Series of Covered Bonds, the Issuer shall make partial payment of the relevant Final Redemption Amount as described in Condition 8.12(f). Payment of all unpaid amounts shall be deferred automatically until the applicable Extended Maturity Date, provided that any amount representing the Final Redemption Amount due and remaining unpaid on the Maturity Date may be paid by the Issuer on any Interest Payment Date thereafter up to (and including) the relevant Extended Maturity Date.

The Issuer is not required to notify the Covered Bondholders of such automatic deferral. The Extended Maturity Date and the applicable interest rate will be specified in the relevant Final Terms. Interest will continue to accrue on any unpaid amount and be payable on each Interest Payment Date falling after the Maturity Date up to (and including) the Extended Maturity Date. In these circumstances, failure by the Issuer to make payment in respect of the Final Redemption Amount on the Maturity Date shall not constitute a default in payment by the Issuer. However, failure by the Issuer to pay the Final Redemption Amount or the balance thereof on the Extended Final Maturity Date and/or interest on such amount on any Interest Payment Date falling after the Maturity Date up to (and including) the Extended Maturity Date shall constitute a default in payment by the Issuer.

Furthermore, in relation to all amounts constituting accrued interest due and payable on each Interest Payment Date falling after the Maturity Date up to (and including) the Extended Maturity Date, as provided in the applicable Final Terms, the Issuer may pay such interest pursuant to the Floating Rate set out in the applicable Final Terms notwithstanding that the relevant Covered Bond was a Fixed Rate Covered Bond as at its relevant Issue Date.

In addition, following deferral of the Maturity Date, the Interest Payment Dates and Interest Periods may change as set out in the applicable Final Terms.

Risks relating to the Covered Bonds issued by the Issuer

Changes to the current legislation on covered bonds might affect the value of the Covered Bonds issued by the Issuer

The Covered Bonds are governed by law and regulations. The Act on Covered Bonds provides that the FME may issue rules providing for the types of assets in a cover pool, methods for appraisal of collateral of bonds, terms and conditions for derivative agreements and conditions for the calculation of risk and interest payments. FME has issued such rules, i.e. Rules No. 528/2008, on Covered Bonds (the “**Rules on Covered Bonds**”) that concern, among other things, the conditions for being granted a licence to issue Covered Bonds, appraisal and revaluation of the assets in the cover pool, matching rules, derivative agreements, the covered bonds register and the eligibility and reporting of the cover pool monitor. Any changes to the Act on Covered Bonds and/or the Rules on Covered Bonds as well as other current legislation might affect the legal and regulatory risks relating to the Covered Bonds.

The Act on Covered Bonds entered into force on 4 March 2008. To date only a few licenses to issue covered bonds have been granted under the Act on Covered Bonds and there are no precedents on how its provisions will be interpreted or applied by Icelandic courts or administrative authorities. The preparatory works to the Act on Covered Bonds give limited guidance and the system of covered bonds secured by the cover pool lacks any clear analogues in Icelandic law that would allow for clear conclusions in respect of the Act on Covered Bonds, the covered bonds or the cover pool.

A decline in the price of real estate and the housing market could affect the Issuer’s ability to perform its obligations under the Covered Bonds.

The Cover Pool which will secure the Covered Bonds is comprised of mortgage loans secured on residential property which, at the date of this Base Prospectus, are located in Iceland. These residential mortgage loans may be loans originally made to a borrower for the purpose of buying, constructing, altering or refinancing a residential property in which that borrower then or subsequently resides or may be mortgage loans made to a borrower for the purchase of that residential property for investment, rental or other purposes.

A borrower under a residential loan may default on its obligation under that residential loan. The credit risk relating to the Cover Pool is partly driven by the performance of the real estate and housing market in Iceland. There can be no assurance on the future development of the value of assets in the Cover Pool. Several circumstances may affect the level of credit loss such as changes in the economic climate, both nationally and internationally, changes in market rates, increases in taxation, inflation and changes on political policies etc. Borrowers may default and their financial standing may deteriorate as a result of, for example, changes in their own personal circumstances such as unemployment, death, illness or relationship status. Defaults in respect of the Issuer’s assets in the Cover Pool under residential mortgage loans could jeopardise the Issuer’s ability to make payment in full or on a timely basis on the Covered Bonds. If a substantial part of the assets in the Cover Pool were to default, there is no guarantee that the required level of assets in the Cover Pool could be maintained or that the Issuer would be able to replace the defaulting assets with non-defaulting assets. Any such failures could adversely affect the Issuer’s results of operation, financial condition and business prospects and its ability to perform its obligations under the Covered Bonds.

The Covered Bonds may be subject to withholding taxes in circumstances where the Issuer is not obliged to make gross-up payments and this would result in holders receiving less interest than expected and could significantly adversely affect their return on the Covered Bonds.

U.S. Foreign Account Tax Compliance Withholding

The Issuer and other non-U.S. financial institutions through which payments on the Covered Bonds are made may be required to withhold U.S. tax at a rate of 30 per cent. on all, or a portion of, payments made after 31 December 2014 in respect of (i) any Covered Bonds issued after 18 March 2012 and (ii) any Covered Bonds

which are treated as equity for U.S. federal tax purposes, whenever issued, pursuant to the U.S. Foreign Account Tax Compliance Act (“**FATCA**”). This withholding tax may be triggered if (i) the Issuer is a foreign financial institution (“**FFI**”) (as defined in FATCA) which enters into and complies with an agreement with the U.S. Internal Revenue Service (“**IRS**”) to provide certain information on its account holders (a term which includes the holders of its debt or equity interests that are not regularly traded on an established securities market) (making the Issuer a “**Participating FFI**”), (ii) the Issuer has a positive “pass-through percentage” (as defined in FATCA), and (iii)(a) an investor does not provide information sufficient for the Participating FFI to determine whether the investor is a U.S. person or should otherwise be treated as holding a “United States Account” of the Issuer, or (b) any FFI through which payment on such Covered Bonds is made is not a Participating FFI.

The application of FATCA to interest, principal or other amounts paid with respect to the Covered Bonds is not clear. If an amount in respect of U.S. withholding tax were to be deducted or withheld from interest, principal or other payments on the Covered Bonds as a result of a holder’s failure to comply with these rules or as a result of the presence in the payment chain of a non-Participating FFI, neither the Issuer nor any paying agent nor any other person would, pursuant to the Conditions of the Covered Bonds be required to pay additional amounts as a result of the deduction or withholding of such tax other than in respect of payments as to which the withholding would not have been required had the Issuer’s Agent receiving the payment been a Participating FFI. As a result, investors may, if FATCA is implemented as currently proposed by the IRS, receive less interest or principal than expected. Holders of Covered Bonds should consult their own tax advisors on how these rules may apply to payments they receive under the Covered Bonds.

The application of FATCA to Covered Bonds issued after 18 March 2012 (or whenever issued, in the case of Covered Bonds treated as equity for U.S. federal tax purposes) may be addressed in the relevant Final Terms or a Supplement to the Base Prospectus, as applicable.

No gross-up

Under the Terms and Conditions of the Covered Bonds, all payments in respect of the Covered Bonds will be made without deduction for or on account of withholding taxes imposed by the Republic of Iceland (“**Iceland**”) or any political subdivision or any authority thereof or therein having power to tax unless such withholding or deduction is required by law, in which case such deduction will be made by the Issuer.

In the event that any such withholding or deduction is required by law, the Terms and Conditions require the Issuer to pay additional amounts in respect of such withholding or deduction subject to customary exceptions see Condition 9. If withholding or deduction arises as a result of one of the circumstances described in paragraphs (a) to (d) of Condition 9, the Issuer will not be required to pay such additional amounts and affected investors will receive interest payments net of such withholding. If, however, the Issuer is required to pay additional amounts, it will have the option under Condition 8.13 to redeem the relevant Covered Bonds early.

The last paragraph of Condition 9 deals with Article 3 of ITA (as amended by Act No. 70/2009), which imposes withholding tax on payments of Icelandic sourced interest to foreign bondholders at a rate of 10 per cent., unless exemptions are available to the relevant bondholders in their home countries or under a double taxation treaty with Iceland.

No events of default

The Terms and Conditions of the Covered Bonds contain no contractual events of default or right to accelerate the Covered Bonds on a failure to pay, insolvency of the Issuer or otherwise. If the Issuer fails to make a payment when due or becomes insolvent, then the Covered Bonds remain outstanding in accordance with the Terms and Conditions of the Covered Bonds.

Maintenance of the Register

The Issuer must maintain a register (the “**Register**”) in respect of the Covered Bonds, the Cover Pool and any derivative agreements. If the Register or the value of the Cover Pool is not maintained in accordance with the

Act on Covered Bonds, the FME may revoke the Issuer's license to issue Covered Bonds. Assets in a cover pool must be endorsed showing they are part of a cover pool and have been entered in a register as provided for in the Act on Covered Bonds. The endorsement must also indicate that the debt instrument is to secure priority rights of a specific class of covered bonds.

If the Issuer fails to enter the assets in the Cover Pool and payments received therefrom ("**Cover Pool Revenue**") in the Register, the Covered Bondholders and Swap Providers will not have priority claims to the Cover Pool and the Cover Pool Revenue and will rank with the Issuer's unsecured creditors in the event of winding-up of the Issuer.

Conflicting interests of other creditors

The rights of the Covered Bondholders rank junior to counterparties to derivative agreements included in the Cover Pool, though they have preferential right with respect to other creditors against the Cover Pool. Further, in the event of the winding-up of the Issuer, they will rank junior to costs incurred in connection with the operation, management, collection and realisation of the Cover Pool, as well as the claims due to derivative agreements concluded in accordance with the provisions of the Act on Covered Bonds, which will be covered before the claims of the Covered Bondholders.

To the extent that Covered Bondholders are not fully paid from the proceeds of the liquidation of the assets comprising the Cover Pool, they will be able to apply for the balance of their claims as unsecured creditors of the Issuer and will be entitled to receive payment from the proceeds of the liquidation of the other assets of the Issuer not comprising the Cover Pool. The Covered Bondholders would in such case rank *pari passu* with the other unsecured, unsubordinated creditors of the Issuer and, as a result, may not receive all amounts owed by the Issuer to such Covered Bondholders. Please note that as a result of the enactment of the Emergency Act, should the Issuer enter into winding-up proceedings, such claims of Covered Bondholders would be subordinated to claims of the Issuer's depositors.

Restriction on ability to petition for bankruptcy

If distributions on realisation of the assets in the Cover Pool are insufficient to make payments on the Covered Bonds, none of the Covered Bondholders, any Swap Provider, any Paying Agent shall be entitled at any time to institute against the Issuer, or join in any institution against the Issuer of any winding-up, bankruptcy, reorganisation, arrangement, insolvency or liquidation proceedings or other proceedings under any applicable bankruptcy or similar law in connection with any obligations of the Issuer relating to the issuance of the Covered Bonds, save for lodging a claim in the liquidation of the Issuer which is initiated by another party or taking proceedings to obtain a declaration or judgment as to the obligations of the Issuer in relation thereto.

Liquidity

If the Issuer is wound up, neither the Issuer nor its estate would be authorised to issue further Covered Bonds. It would therefore not be possible for a winding-up committee to fund the estate in the market through the issuance of further Covered Bonds following the winding-up of the Issuer. Further, neither the Act on Covered Bonds nor the Rules on Covered Bonds stipulate that the winding-up committee or the Issuer's estate may contract debt obligations of any kind in order to service timely payment under the terms of the Covered Bonds. There is no legislation in effect which states that the winding-up committee managing the Issuer's estate can raise loans or enter into any such agreements in order to service the timely payment of interest and principal on the Covered Bonds. Article 17(1) of the Act on Covered Bonds states that the winding-up committee shall fulfil an issuer's commitments under covered bonds and derivative agreements using the mortgage bonds and other assets in the cover pool and payments received on such assets, provided that the assets are listed in the register. However, neither the Act on Covered Bonds nor the Rules on Covered Bonds provide any guidelines as to whether liquidity can be raised by selling the mortgage bonds and other assets registered to the cover pool in the market. The Issuer is subject to liquidity requirements in its capacity as a commercial bank supervised by the FME, including a statutory requirement to maintain sufficient liquidity to enable it to discharge its obligations as they fall due. The Issuer is subject to the Central Bank's Rules no. 782/2012, on Liquidity Ratios. The FME has

issued guidelines on liquidity, which are not binding on the Issuer. However, any serious or systematic deviations from such guidelines may lead to the FME determining that the Issuer's business does not fulfil the statutory soundness requirement for commercial banks and result in the FME imposing sanctions against the Issuer.

Risk related to the Cover Pool

Non-compliance with matching rules

The Act on Covered Bonds contains matching rules which, *inter alia*, require that the total current value of the assets registered to the cover pool as collateral for a specific class of covered bonds must always exceed the total current value of the principal of the covered bonds of that same class. The Act on Covered Bonds also requires that the instalments and other payment flows accruing on assets in the cover pool and from derivative agreements are in such a manner that all commitments towards the covered bondholders and derivative agreements can be met.

A breach of the matching requirements prior to the winding-up of the Issuer in the circumstances where no additional assets are available to the Issuer or the Issuer lacks the ability to acquire additional assets could cause the FME to revoke the Issuer's license to issue Covered Bonds.

If the matching requirements are breached following the winding-up of the Issuer, the winding-up committee would not be permitted to add more assets to the Cover Pool. The Act on Covered Bonds does not provide any further guidance as to the consequences of a breach of the matching rules following the winding-up of the Issuer.

To the extent that the Covered Bondholders are not fully paid from the proceeds of the liquidation of the assets comprising the Cover Pool, the Covered Bondholders will not be able to institute against the Issuer, or join in any institution against the Issuer of any winding-up proceedings, bankruptcy, reorganisation, arrangement, insolvency or liquidation proceedings see above "*Restrictions on ability to petition for bankruptcy*". The explanatory memorandum for the Act on Covered Bonds provides that assets can be removed from the cover pool and replaced with same kind of assets without limitations. If assets are replaced with substitute collateral there are limitations in the Act on Covered Bonds as to how much can be replaced with such collateral. Neither the Act on Covered Bonds nor the Rules on Covered Bonds provide clear guidance in this respect. This can, however, be subject to contract.

Over-collateralisation

The Act on Covered Bonds requires the value of the assets in the cover pool at all times to exceed the value of the claims against the cover pool. However, the Act on Covered Bonds does not require that the value of such assets exceeds the value of such claims by any specific amount. Failure to maintain sufficient assets in the Cover Pool could result in the Issuer being unable to issue further Covered Bonds or refinance existing Covered Bonds.

The Issuer intends to over-collateralise the Cover Pool at all times by at least 120 per cent. The licence from FME to issue the Covered Bonds is in addition subject to a 30 per cent. maximum over-collateralization, see the sections "*Cover Pool Assets*" and "*The Issuer's licence to issue Covered Bonds*" in the chapter "*Summary of Icelandic legislation in consideration of Covered Bonds*".

The Cover Pool consists of limited assets.

The Cover Pool consists of loans which are secured on interests in residential property, claims which the Issuer holds, or may acquire, against Covered Bond Swap Providers and certain substitute assets. All assets in the Cover Pool must comply with the Act on Covered Bonds and the Rules on Covered Bonds. See the sections "*Cover Pool Assets*" and "*The Issuer's licence to issue Covered Bonds*" in the chapter "*Summary of Icelandic legislations in consideration of Covered Bonds*" for a description of the assets that can constitute the Cover

Pool. At the date of this Base Prospectus, all of the properties over which mortgages are created are located in Iceland. The value of the Cover Pool may therefore decline in the event of a general downturn in the value of property in Iceland, which could adversely affect the Issuer's operating results, financial condition and business prospects and its ability to perform its obligations under the Covered Bonds.

Limited description of the Cover Pool

Save as stipulated in each applicable Final Terms, Covered Bondholders will not receive detailed statistics or information in relation to the assets contained or to be contained in the Issuer's Cover Pool. It is expected that the constitution of the Cover Pool may change from time to time due, for example, to the purchase or origination of further residential mortgages by the Issuer from time to time. Although an independent inspector ("**Independent Inspector**") appointed under the Act on Covered Bonds will monitor the Issuer's compliance with some of the requirements of the Act on Covered Bonds, the Independent Inspector's report will not be made public. A regular report on the Cover Pool will however be published quarterly, no later than 30 days from the end of each quarter, on the Issuer's website, www.landsbankinn.is/sertryggd-skuldabref.

Geographic concentration risks /location of the properties in the Cover Pool

Certain geographic regions of Iceland may from time to time experience weaker regional economic conditions and housing markets or be directly or indirectly affected by natural disasters or civil disturbances. Mortgage loans in such areas will experience higher rates of loss and delinquency than mortgage loans in general.

The ability of borrowers to make payments on mortgage loans may also be affected by factors which do not necessarily affect property values, such as adverse economic conditions generally, in particular geographic areas or industries, or affecting particular segments of the borrowing community (such as borrowers relying on commission income and self-employed borrowers). Such occurrences may accordingly affect the actual rate of delinquency and loss with respect to the mortgage loans in the Cover Pool.

The mortgage loans underlying certain series of Covered Bonds may be concentrated in certain regions. Such concentration may present the risk considerations described above in addition to those generally present for similar securities without such concentration.

The Cover Pool consists of mortgage loans which are secured in residential property. As at the date of the Base Prospectus all of the properties over which the mortgages are created are located in Iceland. The residential properties in the Cover Pool may, however, be concentrated in certain locations in Iceland. The value of the Cover Pool may decline in the event of a general or location-specific deterioration in prices of residential properties or general deterioration or location-specific deterioration in economic conditions. This could adversely affect the Issuer's operating results, financial condition and business prospects as well as its ability to perform its obligations under the Covered Bonds.

Appraisals

In accordance with the Act on Covered Bonds, appraisals or valuation of the properties securing the mortgage loans may be undertaken by the Issuer, and take account of the following: (a) The selling price of a property on the day the transaction is made; or (b) an independent appraisal conducted by a licensed realtor; or (c) an acquisition offer, signed on behalf of both the seller and the buyer; or (d) the rateable value of the property, made by Registers Iceland (*Ice. "Þjóðskrá Íslands"*). Appraisals based on the selling price of a property shall be valid for a period of 3 months from the day the transaction was made.

Such appraisal undertaken by the Issuer will be verified by the Independent Inspector as being based on an accepted methodology.

No assurance can be given that values of the properties underlying the mortgage loans have remained or will remain at the levels which existed on the dates of appraisal (or, where applicable, on the dates of appraisal updates) of the related mortgage loans.

The appraisal relates both to the land and to the structure; in fact, a significant portion of the appraised value of a property may be attributable to the value of the land rather than to the residence. Because of the unique locations and special features of certain properties, identifying comparable properties in nearby locations may be difficult. The appraised values of such properties will be based to a greater extent on adjustments made by the appraisers to the appraised values of reasonably similar properties rather than on objectively verifiable sales data. As a result, such appraisals could be more likely to overvalue certain properties and therefore overstate the value of the collateral underlying the Cover Pool.

Audit of the Cover Pool – no due diligence

Other than any reviewed interim financial statements or audited annual financial statements the Issuer does not publish any separate review or audits of the Cover Pool. However the Issuer is subject to surveillance by an Independent Inspector in accordance with the requirements of the Act on Covered Bonds and FME; this Independent Inspector monitors that the register is maintained in a correct manner. See the section “*Independent Inspector*” in the chapter “*Summary of the Icelandic legislation in consideration of covered bonds*” for a description of the Independent Inspector.

The Issuer will not undertake any investigations, searches or other actions in respect of the assets in the Cover Pool. The Covered Bondholders will not have the ability to investigate the Cover Pool but will instead rely on the obligations of the Issuer under the Act on Covered Bonds and the supervision of the Independent Inspector.

Factors that may affect the realisable value of the Cover Pool

The Cover Pool revenue or the realisable value of Cover Pool, in the event of the winding-up of the Issuer, may be reduced, which may affect the ability of the Issuer (or the winding-up committee in the event of the winding-up of the Issuer) to make payments on the Covered Bonds as a result of:

- Borrowers defaulting payments of amounts due on their mortgage loans;
- changes to the lending criteria of the Issuer;
- no representations or warranties being given by the Issuer;
- set-off risks in relation to some types of mortgage loans in the Cover Pool; and
- possible regulatory changes by regulatory authorities in Iceland.

It should be noted that the matching rules under the Act on Covered Bonds are intended to ensure that the value of the Cover Pool will be sufficient to enable the Issuer to meet its obligations under the Covered Bonds and any derivative agreements.

Court proceedings regarding the legal basis for the price indexation of loans

A related issue concerns the validity of Icelandic loans indexed to the CPI. A borrower has brought legal proceedings against the Issuer claiming that CPI indexation should be found illegal based on a number of arguments, including that the increase in loan amounts is unjust and can be challenged on the basis of Article 36 of the Act on Contracts etc. Another argument is that indexation is a form of derivative and should therefore not have been offered to consumers without extensive consulting in accordance with Act on Securities Transactions, which has implemented the requirements of the MiFID.

Default by borrowers in paying amounts due on their loans.

Borrowers may default on their obligations under the mortgage loans in the Cover Pool. Defaults may occur for a variety of reasons. The mortgage loans are affected by credit, liquidity and interest rate risks. Various factors influence mortgage delinquency rates, prepayment rates, repossession frequency and the ultimate payment of interest and principal, such as changes in the national or international economic climate, regional economic or housing conditions, changes in tax laws or other laws, interest rates, inflation, the availability of financing, yields on alternative investments, political developments and government policies. Other factors in borrowers’

individual, personal or financial circumstances may affect the ability of borrowers to repay the mortgage loans. Loss of earnings, illness, divorce and other similar factors may lead to an increase in delinquencies by and bankruptcies of borrowers, and could ultimately have an adverse impact on the ability of borrowers to repay the mortgage loans. In addition, the ability of a borrower to sell a property pledged as security for a mortgage loan at a price sufficient to repay the amounts outstanding under that mortgage loan will depend upon a number of factors, including the availability of buyers for that property, the value of that property and property values in general at the time.

The Act on Covered Bonds provides that no mortgage loan may be registered in the Cover Pool if payment on it is 90 days or more in arrears.

Changes to the lending criteria of the Issuer

Each of the mortgage loans originated by the Issuer will have been granted in accordance with its lending criteria at the time of origination. It is expected that the Issuer's lending criteria will generally consider type of property, term of loan, age of applicant, the loan-to-value ("LTV") ratio, status of applicants and credit history. The Issuer retains the right to revise its lending criteria from time to time but would do so only to the extent that such a change would be acceptable to a reasonable, prudent mortgage lender. If the lending criteria changes in a manner that affects the creditworthiness of the mortgage loans, that may lead to increased defaults by borrowers and may affect the Cover Pool revenue or the realisable value of the Cover Pool.

In accordance with the Act on Covered Bonds the Issuer may only include in the Cover Pool mortgage loans issued against mortgages secured by real property if the LTV ratio does not exceed 80 per cent. for residential property, 60 per cent. for industrial, office or commercial property, and 70 per cent. for agricultural property. Moreover, as noted above, mortgage loans 90 days or more in arrears may not be registered in the Cover Pool.

Set-off risks in relation to some types of loans may adversely affect the value of the Cover Pool or any part thereof

Registration of assets in the Cover Pool will not affect the rights of borrowers. Borrowers will therefore continue to have independent set-off rights against the Issuer (such as, for example, set-off rights associated with borrowers' holding deposits with the Issuer).

The exercise of set-off rights by borrowers may adversely affect the realisable value of the Cover Pool and/or the ability of the winding-up committee to meet in full the Issuer's obligation under the Covered Bonds.

No representations or warranties to be given by the Issuer if Cover Pool to be sold

In the event of the bankruptcy of the Issuer, the winding-up committee shall fulfil the Issuer's obligations under the Covered Bonds and any Swap Agreements using the assets in the Cover Pool and the Cover Pool Revenue. In respect of any sale of assets in the Cover Pool to third parties, the Issuer may not be permitted to give representations and warranties or indemnities in respect of the assets in the Cover Pool. Accordingly, there is a risk that the realisable value of the Cover Pool could be adversely affected by the lack of representations and warranties or indemnities which in turn could adversely affect the ability of the administrator to meet in full all the Issuer's obligations under the Covered Bonds.

Reliance on Swap Providers

A brief description of certain risks relating to swaps is set out below. The Issuer is however not permitted to enter into Currency Swaps under the Issuer's current licence to issue Covered Bonds.

Reliance on Currency Swaps

Subject to currency restrictions in place at each time, the Issuer may rely on the Currency Swap Providers under the Currency Swaps to provide payments on Covered Bonds denominated in currencies other than ISK. If the Issuer fails to make timely payments of amounts due or certain other events occur in relation to the Issuer under

a Currency Swap and any applicable grace period has expired, then the Issuer will have defaulted under that Currency Swap. If the Issuer defaults under a Currency Swap due to non-payment or otherwise, the relevant Currency Swap Provider will not be obliged to make further payments under that Currency Swap and may terminate that Currency Swap. If a Currency Swap Provider is not obliged to make payments, or if it exercises any right of termination it may have under the relevant Currency Swap Agreement, or if it defaults in its obligations to make payments under a Currency Swap, the Issuer will be exposed to changes in currency exchange rates and in the associated interest rates on the currencies. Unless a replacement swap is entered into, the Issuer may have insufficient funds to make payments due on the Covered Bonds.

Reliance on Interest Rate Swaps

Subject to currency restrictions in place at each time, in order to hedge the Issuer's interest rate risks in ISK and/or other currencies to the extent that these have not already been hedged by the Cover Pool Swap or a Currency Swap, the Issuer may enter into Interest Rate Swaps. If the Issuer fails to make timely payments of amounts due or certain other events occur in relation to the Issuer under an Interest Rate Swap and any applicable grace period has expired, then the Issuer will have defaulted under that Interest Rate Swap. If the substitute assets available to the Issuer on a payment date are insufficient to make the payment ordinarily required in full, the payment obligations of both the Issuer and the swap counterparty on that payment date may be reduced accordingly and may be deferred should the Issuer introduce deferral of payment mechanics into the interest rate swaps. If the Issuer defaults under an Interest Rate Swap due to non-payment or otherwise, the relevant Interest Rate Swap Provider will not be obliged to make further payments under that Interest Rate Swap and may terminate that Interest Rate Swap. If an Interest Rate Swap Provider is not obliged to make payments, or if it exercises any right of termination it may have under the relevant Interest Rate Swap Agreement, or if it defaults on its obligation to make payment under an Interest Rate Swap, the Issuer will be exposed to changes in interest rates. Unless a replacement swap is entered into, the Issuer may have insufficient funds to make payments due on the Covered Bonds.

Reliance on Indexed Currency Swaps

Subject to currency restrictions in place at each time, the Issuer may rely on the Indexed Currency Swap Providers under the Currency Swaps to provide payments on Covered Bonds denominated in currencies other than ISK and not pegged to an index. If the Issuer fails to make timely payment of amounts due or certain other events occur in relation to the Issuer under an Indexed Currency Swap and any applicable grace period has expired, then the Issuer will have defaulted under that Currency Swap. If the Issuer defaults under an Indexed Currency Swap due to non-payment or otherwise, the relevant Indexed Currency Swap Provider will not be obliged to make further payments under that Indexed Currency Swap and may terminate that Indexed Currency Swap. If an Indexed Currency Swap Provider is not obliged to make payments, or if it exercises any right of termination it may have under the relevant Indexed Currency Swap Agreement, or if it defaults in its obligations to make payments under an Indexed Currency Swap, the Issuer will be exposed to changes in currency exchange rates, the associated interest rates on the currencies and inflation. Unless a replacement swap is entered into, the Issuer may have insufficient funds to make payments due on the Covered Bonds.

Reliance on Cover Pool Swap

In order to hedge the possible variance between the rates of interest payable on the Covered Bonds and the various rates of interest payable in respect of certain assets registered to the Cover Pool, the Issuer may enter into the Cover Pool Swap. If the Issuer fails to make timely payments of amounts due or certain other events occur in relation to the Issuer under the Cover Pool Swap and any applicable grace period has expired, then the Issuer will have defaulted under that Cover Pool Swap. If the Issuer defaults under the Cover Pool Swap due to non-payment or otherwise, the Cover Pool Swap Provider will not be obliged to make further payments under the Cover Pool Swap and may terminate the Cover Pool Swap. If the Cover Pool Swap Provider is not obliged to make payments, or if it exercises any right of termination it may have under the Cover Pool Swap Agreement, or if it defaults in its obligation to make payment under the Cover Pool Swap, the Issuer will be exposed to

changes in interest rates. Unless a replacement swap is entered into, the Issuer may have insufficient funds to make payment due on the Covered Bonds.

Termination payments for Swaps

If any of the Interest Rate Swaps, Currency Swaps or Cover Pool Swap is terminated, the Issuer may as a result be obliged to make a termination payment to the relevant Swap Provider. The amount of the termination payment will be based on the cost of entering into a replacement Interest Rate Swap, Currency Swap or Cover Pool Swap, as the case may be. Any termination payment to be made by the Issuer to a Swap Provider will rank *pari passu* with payments due to the Covered Bondholders.

Potential amendments to Swap Agreements

If and when the Issuer enters into a swap agreement in the context of an issue of Covered Bonds, the terms of the swap agreement will be negotiated with the relevant swap provider. As a result of such negotiations, the terms of a swap agreement may contain terms that adversely affect the Issuer's operating results, financial condition and business prospects and its ability to perform its obligations under the Covered Bonds.

Risks relating to covered bonds generally

Set out below is a brief description of certain risks relating to covered bonds generally:

Covered Bonds issued under the Programme

Covered Bonds issued under the Programme (save in respect of the first issue of Covered Bonds) will either be fungible with an existing Series of Covered Bonds or have different terms to an existing Series of Covered Bonds (in which case they will constitute a new Series). All Covered Bonds issued from time to time will rank *pari passu* with each other in all respects and will rank *pari passu* with any other Covered Bonds which may be issued by the Issuer in accordance with the Act on Covered Bonds.

Covered Bonds are obligations of the Issuer only

The Covered Bonds will constitute obligations of the Issuer only and have the benefit of a statutory preference under the Act on Covered Bonds on the Cover Pool maintained by the Issuer. An investment in the Covered Bonds involves a reliance on the creditworthiness of the Issuer. The Covered Bonds are not guaranteed by any other person.

In addition, an investment in the Covered Bonds involves the risk that subsequent changes in the actual or perceived creditworthiness of the Issuer may adversely affect the market value of the relevant Covered Bonds. There can be no assurance that the Cover Pool will be sufficient to pay in full the amounts payable under the Covered Bonds.

Withholding under the EU Savings Directive

Under Council Directive 2003/48/EC on the taxation of savings income (the “**Savings Directive**”), EU Member States are required to provide to the tax authorities of other EU Member States details of payments of interest and other similar income paid by a person established within its jurisdiction to (or for the benefit of) an individual resident in another EU Member State or certain other types of entities established in another EU Member State, except that Austria and Luxembourg will instead impose a withholding system for a transitional period unless during such period they elect otherwise. The Luxembourg government has announced its intention to elect out of the withholding system in favour of an automatic exchange of information with effect from 1 January 2015.

The Council of the EU has adopted Council Directive 2014/48/EU (the “**Amending Directive**”) which will, when implemented, amend and broaden the scope of the requirements described above. The Amending Directive will expand the range of payments covered by the Savings Directive, in particular, to include additional types of income payable on securities and the circumstances in which payments must be reported or

paid subject to withholding. For example, payments made to (or for the benefit of) (i) an entity or legal arrangement effectively managed in an EU Member State that is not subject to effective taxation or (ii) a person, entity or legal arrangement established or effectively managed outside of the EU (and outside any third country or territory that has adopted similar measures to the Savings Directive) which indirectly benefit an individual resident in an EU Member State, may fall within the scope of the Savings Directive, as amended. The Amending Directive requires EU Member States to adopt national legislation necessary to comply with it by 1 January 2016, which legislation must apply from 1 January 2017.

If a payment were to be made or collected through an EU Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment pursuant to the Savings Directive or any other Directive implementing the conclusions of the Economic and Financial Affairs Council (the “**ECOFIN Council**”) meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to such directive, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Covered Bonds as a result of the imposition of such withholding tax. Furthermore, once the Amending Directive is implemented and takes effect in EU Member States, such withholding may occur in a wider range of circumstances than at present, as explained above.

The Issuer is required to maintain a Paying Agent with a specified office in an EU Member State that is not obliged to withhold or deduct tax pursuant to any law implementing the Savings Directive or any other directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000, which may mitigate an element of this risk if the holder of Covered Bonds is able to arrange for payment through such a Paying Agent. However, investors should choose their custodians and intermediaries with care, and provide each custodian and intermediary with any information that may be necessary to enable such persons to make payments free from withholding and in compliance with the Savings Directive.

Investors who are in any doubt as to their position should consult their professional advisers.

Change of law and establishment of case law

The Covered Bonds (except for the ISD System Covered Bonds), the Receipts, the Coupons are governed by and shall be construed in accordance with, English law except for Condition 3, which is governed by, and construed in accordance with Icelandic law, in each case as in effect as at the date of this Base Prospectus. The ISD System Covered Bonds are governed by, and construed in accordance with Icelandic law. No assurance can be given as to the impact of any possible judicial decision or change to English law, Icelandic law and/or administrative practice after the date of this Base Prospectus.

Covered Bonds where denominations involve integral multiples: Definitive Covered Bonds

In relation to any issue of Covered Bonds which have denominations consisting of a minimum Specified Denomination plus one or more higher integral multiples of another smaller amount, it is possible that such Covered Bonds may be traded in amounts that are not integral multiples of such minimum Specified Denomination. In such a case a holder who, as a result of trading such amounts, holds an amount which is less than the minimum Specified Denomination in his account with the relevant clearing system at the relevant time may not receive a definitive Covered Bond in respect of such holding (should definitive Covered Bonds be printed) and, in order to receive a definitive Covered Bond, would need to purchase a principal amount of Covered Bonds such that its holding amounts to a Specified Denomination.

If definitive Covered Bonds are issued, holders should be aware that definitive Covered Bonds which have a denomination that is not an integral multiple of the minimum Specified Denomination may be illiquid and difficult to trade.

Reliance on Euroclear and Clearstream, Luxembourg procedures

Covered Bonds (other than the ISD System Covered Bonds) issued under the Programme will be represented on issue by one or more Global Covered Bonds that may be deposited with a common depository (in the case of

Bearer Covered Bonds) or common safekeeper (in the case of registered Global Covered Bonds) for Euroclear and Clearstream, Luxembourg (each as defined under Condition 2). Except in the circumstances described in each Global Covered Bond, investors will not be entitled to receive Covered Bonds in definitive form. Each of Euroclear and Clearstream, Luxembourg and their respective direct and indirect participants will maintain records of the beneficial interests in each Global Covered Bond held through it. While the Covered Bonds (other than the VS System Covered Bonds) are represented by Global Covered Bonds, investors will be able to trade their beneficial interests only through the relevant clearing systems and their respective participants.

While the Covered Bonds (other than the ISD System Covered Bonds) are represented by Global Covered Bonds, the Issuer will discharge its payment obligation under the Covered Bonds by making payments through the relevant clearing systems. A holder of a beneficial interest in Global Covered Bonds must rely on the procedures of the relevant clearing system and its participants to receive payments under the Covered Bonds. The Issuer has no responsibility or liability for the records relating to, or payments made in respect of, beneficial interests in any Global Covered Bond.

Holders of beneficial interests in a Global Covered Bonds will not have a direct right to vote in respect of the Covered Bonds so represented. Instead, such holders will be permitted to act only to the extent that they are enabled by the relevant clearing system and its participants to appoint appropriate proxies.

Risks related to the market generally

Set out below is a brief description of the principal market risks, including liquidity risk, exchange rate risk, interest rate risk and credit risk:

The secondary market generally

Covered Bonds may have no established trading market when issued, and one may never develop. If a market does develop, it may not be very liquid. Additionally, the market places concerned may be closed, or temporary restrictions may be imposed. Therefore, investors may not be able to sell their Covered Bonds easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. This is particularly the case for Covered Bonds that are especially sensitive to interest rate, currency or market risks, are designed for specific investment objectives or strategies or have been structured to meet the investment requirements of limited categories of investors. These types of Covered Bonds generally would have a more limited secondary market and more price volatility than conventional debt securities.

Lack of liquidity in the secondary market may adversely affect the market value of the Covered Bonds

Generally weak global credit market conditions could contribute to a lack of liquidity in the secondary market for instruments similar to the Covered Bonds. In addition, the difficult market conditions which have prevailed since mid-September 2008 have limited the primary market for a number of financial products including instruments such as the Covered Bonds. While some measures have been taken by governments, there can be no assurance that the market for securities similar to the Covered Bonds will recover at the same time or to the same degree as such other recovering global credit market sectors. Any of these fluctuations may be significant and could result in significant losses to an investor.

Exchange rate risks and exchange controls

The Issuer will pay principal and interest on the Covered Bonds in the Specified Currency, subject to currency restrictions in place at each time, if the Covered Bonds are issued in currencies other than ISK. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "**Investor's Currency**") other than the Specified Currency. These include the risk that exchange rates may significantly change (including changes due to devaluation of the Specified Currency or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's

Currency relative to the Specified Currency would decrease (1) the Investor's Currency-equivalent yield on the Covered Bonds, (2) the Investor's Currency-equivalent value of the principal payable on the Covered Bonds and (3) the Investor's Currency-equivalent market value of the Covered Bonds.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

Exchange rate risk is mitigated by the use of the Currency Swaps and by matching interest rate flow with the maturity of loan and other assets of the Issuer.

Interest rate risks

Interest rate risks occur when fixed interest periods or interest basis for assets and liabilities do not coincide. Investment in Fixed Rate Covered Bonds involves the risk that subsequent changes in market interest rates may adversely affect the value of the Fixed Rate Covered Bonds. Investments in Floating Rate Covered Bonds will involve a risk of interest rate changes.

The Issuer may enter into Cover Pool Swaps and Interest Rate Swaps to ensure that the risks do not exceed the limit values approved by its Board of Directors and to ensure that matching is maintained in accordance with the Act on Covered Bonds.

Trading in the clearing systems

In relation to any issue of Covered Bonds which have a minimum denomination and are tradable in the clearing systems in amounts above such minimum denomination, should definitive Covered Bonds be required to be issued, a holder who does not have an integral multiple of the minimum denomination in his account with the relevant clearing system at the relevant time may not receive all of his entitlement in the form of definitive Covered Bonds unless and until such time as his holding becomes an integral multiple of the minimum denomination.

Judicial considerations may restrict certain investments

The investment activities of certain investors are subject to rules and regulations and/or review or regulation by certain authorities. Each potential investor should consult his legal advisers or responsible supervisory authority in order to determine whether and to what extent the investor has the opportunity to invest in Covered Bonds.

Credit ratings may not reflect all risks

One or more independent credit rating agencies may assign credit ratings to the Covered Bonds. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Covered Bonds. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time. A credit rating may not reflect all risks associated with an investment in the Covered Bonds.

In general, European regulated investors are restricted under Regulation (EC) No. 1060/2009 (as amended) (the “**CRA Regulation**”) from using credit ratings for regulatory purposes, unless such ratings are issued by a credit rating agency established in the EU and registered under the CRA Regulation (and such registration has not been withdrawn or suspended), subject to transitional provisions that apply in certain circumstances whilst the registration application is pending. Such general restriction will also apply in the case of credit ratings issued by non-EU credit rating agencies, unless the relevant credit ratings are endorsed by an EU-registered credit rating agency or the relevant non-EU rating agency is certified in accordance with the CRA Regulation (and such endorsement action or certification, as the case may be, has not been withdrawn or suspended). The list of registered and certified rating agencies published by the European Securities and Markets Authority (“**ESMA**”), on its website in accordance with the CRA Regulation, is not conclusive evidence of the status of the relevant rating agency included in such list, as there may be delays between certain supervisory measures being taken

against a relevant rating agency and the publication of the updated ESMA list. Certain information with respect to the credit rating agencies and ratings will be disclosed in the Final Terms.

Legal investment considerations may restrict certain investments

The investment activities of certain investors are subject to investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisors to determine whether and to what extent (1) Covered Bonds are legal investments for it, (2) Covered Bonds can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of any Covered Bonds. Financial institutions should consult their legal advisors or the appropriate regulators to determine the appropriate treatment of Covered Bonds under any applicable risk-based capital or similar rules.

IMPORTANT INFORMATION

NOTICE TO INVESTORS

This Base Prospectus, dated 9 December 2014, constitutes a base prospectus for the purposes of Article 5 of Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 (the “**Prospectus Directive**”) and Article 45 of the Act on Securities Transactions and relevant regulations thereto.

This Base Prospectus and copies of Final Terms relating to the Covered Bonds which are admitted to trading on a regulated market will be available on the website of the Issuer, www.landsbankinn.is (<http://www.landsbankinn.is/sertryggd-skuldabref>). Investors can request printed copies of the Base Prospectus free of charge at the Issuer’s registered office at Austurstræti 11, 155 Reykjavík, Iceland.

This Base Prospectus has been prepared to provide clear and thorough information on the Issuer. Investors are encouraged to acquaint themselves thoroughly with this Base Prospectus. They are advised to pay particular attention to the chapter on Risk Factors. This Base Prospectus should by no means be viewed or construed as a promise by the Issuer or other parties of future success either in operations or return on investments. Investors are reminded that investing in securities entails risk, as the decision to invest is based on expectations and not promises. Investors must rely primarily on their own judgement regarding any decision to invest in the Issuer’s securities, bearing in mind, *inter alia*, the business environment in which it operates in, anticipated profits, external conditions and the risk inherent in the investment itself. Prospective investors are advised to contact experts, such as licensed financial institutions, to assist them in their assessment of the securities issued by the Issuer as an investment option. Investors are advised to consider their legal status, including taxation issues that may concern the purchase or sale of the Issuer’s securities and seek external and independent advice in that respect.

Neither this Base Prospectus nor any other information supplied in connection with the Programme or any Covered Bonds (i) is intended to provide the basis of any credit or other evaluation or (ii) should be considered as a recommendation by the Issuer that any recipient of this Base Prospectus or any other information supplied in connection with the Programme or any Covered Bonds should purchase any Covered Bonds. Each investor contemplating purchasing any Covered Bonds should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness of the Issuer. Neither the Base Prospectus nor any other information supplied in connection with the Programme or the issue of any Covered Bonds constitutes an offer or invitation by or on behalf of the Issuer to any person to subscribe for or to purchase any Covered Bonds.

This Base Prospectus does not constitute an offer to sell or the solicitation of an offer to buy any Covered Bonds in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Base Prospectus and the offer or sale of Covered Bonds may be restricted by law in certain jurisdictions. The Issuer does not represent that this Base Prospectus may be lawfully distributed, or that any Covered Bonds may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer which would permit a public offering of any Covered Bonds or distribution of this Base Prospectus in any jurisdiction where action for that purpose is required. Accordingly, no Covered Bonds may be offered or sold, directly or indirectly, and neither this Base Prospectus nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Base Prospectus or any Covered Bonds may come must inform themselves about, and observe any such restrictions on the distribution of this Base Prospectus and the offering and sale of Covered Bonds. The Issuer accepts no liability to any person in relation to the distribution of this Base Prospectus in any jurisdiction. In particular, there are restrictions on the distribution of this Base Prospectus and the offer or sale of Covered Bonds in the United States, the EEA and Japan.

This Base Prospectus may be passported in accordance with the provisions of the Prospectus Directive into other jurisdictions within the EEA.

No person is or has been authorised by the Issuer to give any information or to make any representation of information not contained in or not consistent with this Base Prospectus or any other information supplied in connection with the Programme or the Covered Bonds and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer.

Neither the delivery of this Base Prospectus nor the offering, sale or delivery of any Covered Bonds shall in any circumstances imply that the information contained herein concerning the Issuer is correct at any time subsequent to the date hereof or that any other information supplied in connection with the Programme is correct as of any time subsequent to the date indicated in the document containing the same.

The language of this Base Prospectus is English. Certain legislative references and technical terms have been cited in their original language in order that the correct technical meaning may be ascribed to them under the applicable law. Capitalised terms used in this Base Prospectus have been defined in the Terms and Conditions (“1. Definitions”), in the chapter Important Information (“Abbreviations and definitions”) or throughout this Base Prospectus.

The Covered Bonds may not be a suitable investment for all investors

Each potential investor in the Covered Bonds must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- have sufficient knowledge and experience to make a meaningful evaluation of the Covered Bonds, the merits and risks of investing in the Covered Bonds and the information contained or incorporated by reference in this Base Prospectus or any applicable supplement;
- have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Covered Bonds and the impact the Covered Bonds will have on its overall investment portfolio;
- have sufficient financial resources and liquidity to bear all of the risks of an investment in the Covered Bonds, including Covered Bonds with principal or interest payable in one or more currencies, or where the currency for principal or interest payments is different from the potential investor’s currency;
- understand thoroughly the terms of the Covered Bonds and be familiar with the behaviour of any relevant indices and financial markets; and
- be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for legislative, economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

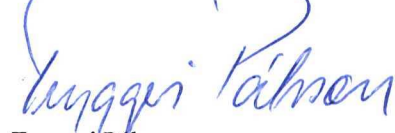
The Covered Bonds are complex financial instruments. Institutional investors generally do not purchase complex financial instruments as stand-alone investments. They purchase complex financial instruments as a way to reduce risk or enhance yield with an understood, measured, appropriate addition of risk to their overall portfolios. A potential investor should not invest in Covered Bonds which are complex financial instruments unless it has the expertise (either alone or with a financial adviser) to evaluate how the Covered Bonds will perform under changing conditions, the resulting effects on the value of the Covered Bonds and the impact this investment will have on the potential investor’s overall investment portfolio.

ISSUER'S STATEMENT

The Board of Directors and CEO of Landsbankinn hf., Reg. No. 471008-0280, registered office at Austurstræti 11, 155 Reykjavík, Iceland., on behalf of the Issuer hereby declare that, having taken all reasonable care to ensure that such is the case, the information contained in this Base Prospectus is, to the best of their knowledge, in accordance with the facts and contains no omission likely to affect its import.

Reykjavík, 9 December 2014

On behalf of the Board of Directors,



Tryggvi Pálsson,

Chairman of the Board of Directors

On behalf of Landsbankinn hf.,



Steinþór Pálsson,

Chief Executive Officer

STATUTORY AUDITOR

The National Audit Office, Skúlagata 57, 105 Reykjavík, Iceland, has been the Issuer's statutory auditor for the financial years 2012 and 2013 and for the first nine months of 2014. The National Audit Office is authorized to outsource part of its assignments and has outsourced the audit of Landsbankinn hf. to KPMG ehf., registered office at Borgartún 27, 105 Reykjavík, Iceland for the financial years 2012 and 2013 and for the first nine months of 2014. The Issuer's statutory auditor has not resigned, been removed or not re-appointed during that period. Helgi F. Arnarson and Sigríður Helga Sveinsdóttir were the auditors on behalf of KPMG ehf. for the financial years 2012 and 2013 and for the first nine months of 2014. They are members of the Institute of State Authorized Public Accountants in Iceland.

DOCUMENTS INCORPORATED BY REFERENCE

This Base Prospectus should be read and construed in conjunction with the following information which has been previously filed with Nasdaq Iceland and published on the Issuer's website.

- The reviewed Condensed Consolidated Interim Financial Statements of the Issuer for the nine months ended 30 September 2014, with the review report thereon;
<http://www.landsbankinn.com/uploads/documents/arsskyrsluroguppjor/Interim-Report-9M-2014.pdf>
- The audited Consolidated Financial Statements of the Issuer for the financial year ended 31 December 2013, together with the audit report thereon;
<http://www.landsbankinn.com/uploads/documents/arsskyrsluroguppjor/Consolidated-Financial-Statements-2012.pdf>

- The audited Consolidated Financial Statements of the Issuer for the financial year ended 31 December 2012, together with the audit report thereon;

<http://www.landsbankinn.com/uploads/documents/arsskyrsluroguppjor/Consolidated-Financial-Report-2013-EN.pdf>

DOCUMENTS ON DISPLAY

For the period of 12 months following the date of this Base Prospectus copies of the following documents are available for viewing on the Issuer's website, www.landsbankinn.is (www.landsbankinn.is/sertryggd-skuldabref) and at the Issuer's registered office at Austurstræti 11, 155 Reykjavík, Iceland:

- The Issuer's Articles of Association.
- This Base Prospectus, dated 9 December 2014.
- The Audited Consolidated Financial Statements of the Issuer for the years 2012 and 2013 together with the audit reports prepared therewith and the Reviewed Condensed Consolidated Interim Financial Statements for nine months ended 30 September 2014 together with the review report therewith.
- The most recently published audited annual financial statements of the Issuer and the most recently published reviewed interim financial statements of the Issuer, in each case together with any audit or review reports prepared in connection therewith.
- All issued Final Terms and any future Final Terms, supplements to this Base Prospectus and any other documents incorporated into this Base Prospectus by reference.

THIRD PARTY INFORMATION

Information in this Base Prospectus is not based on the statements of external specialists or third party other than publicly available information published by governmental entities. In such instances the information has been accurately reproduced and as far as the Issuer is aware and is able to ascertain, no facts have been omitted which would render the reproduced information inaccurate or misleading.

VALIDITY OF THIS BASE PROSPECTUS

This Base Prospectus is valid until no more of the Covered Bonds concerned are issued in a continued or repeated manner.

Applications may be made for new series of Covered Bonds issued under the Programme to be admitted to trading on a regulated market, for the purposes of Directive 2004/39/EC ("**MiFID**") which has been implemented in Iceland through the Act on Securities Transactions and Act on Stock Exchanges No. 110/2007, within 12 months of the date of this Base Prospectus.

SUPPLEMENTS TO THIS BASE PROSPECTUS

Following the publication of this Base Prospectus one or more supplements may be prepared by the Issuer and approved by the FME in accordance with Article 16 of the Prospectus Directive and Article 46 of the Act on Securities Transactions. Statements contained in any such supplements (or contained in any document incorporated by reference therein) shall, to the extent applicable (whether expressly, by implication or

otherwise), be deemed to modify or supersede statements contained in this Base Prospectus. Any statement so modified or superseded shall not, except as so modified or superseded, constitute a part of this Base Prospectus.

In the event of any significant factor arising or any material mistake or accuracy relating to the information included in this Base Prospectus which is capable of affecting the assessment of any Covered Bonds or any change in the condition of the Issuer which is material in the context of the Programme or the issue of Covered Bonds, the Issuer will prepare and publish a supplement to this Base Prospectus or publish a new prospectus for use in connection with any subsequent issue of Covered Bonds.

ABBREVIATIONS AND DEFINITIONS

Act on Actions to Combat Money Laundering and Terrorist Financing	Act No. 64/2006 on Actions to Combat Money Laundering and Terrorist Financing
Act on Financial Undertakings	Act No. 161/2002 on Financial Undertakings
Amending Act	Act No. 134/2008 amending the Act on Foreign Exchange No. 87/1992
Amending Directive	Directive (2014/48/EU) amending Directive on taxation of savings income in the form of interest payments (2003/48/EC)
Bankruptcy Act	Bankruptcy Act No. 21/1991
Base Prospectus	This Base Prospectus dated 9 December 2014 and issued by Landsbankinn.
Basel III	Amendments to the Basel Committee's Framework
Basel Committee	The Basel Committee on Banking Supervision
CA	Current Account
Capacent	Capacent ehf., Reg. No. 550910-0630, Borgartún 27, 105 Reykjavík, Iceland.
CAR	Capital Adequacy Requirement
Central Bank	The Central Bank of Iceland
CEO	Chief Executive Officer
CFO	Chief Financial Officer
Competition Authority	The Icelandic Competition Authority
Cover Pool Revenue	Assets in the Cover Pool and payments received therefrom
CRA Regulation	Regulation (EC) No. 1060/2009 (as amended)
CRD	EU Capital Requirements Directive
CSR	Corporate Social Responsibility
DTC	Depository Trust Company
EAD	Exposures of Default
ECOFIN	Economic and Financial Affairs
EEA	European Economic Area

EEA Agreement	The Agreement on the European Economic Area (EEA) which entered into force in 1 January 1994.
EFTA	European Free Trade Association; the International free trade organization of Iceland, Norway, Switzerland and Lichtenstein
Emergency Act	Act No. 125/2008, on the Authority for Treasury Disbursements Due to Special Financial Market Circumstances etc.
Employee Shareholders	Current and former employees of the Issuer that are shareholders in the Issuer
ESMA	The European Securities and Markets Authority
FATCA	The U.S. Foreign Account Tax Compliance Act
FFI	A foreign financial institution as defined in FATCA
Foreign Exchange Act	The Act on Foreign Exchange No. 87/1992
Framework	A revised framework of the Basel Committee's Capital Accord published in June 2006; "International Convergence of Capital Measurements and Capital Standards: A Revised Framework (Comprehensive Version)"
FSÍ	Framtakssjóður Íslands
FX	Foreign exchange
GDP	Gross domestic product
HFF	Icelandic Housing Financing Fund
HR	Human resources
ICAAP	Internal Capital Adequacy Assessment Process
Ice	Icelandic
Iceland	Republic of Iceland
Independent Inspector	Independent inspector as provided for in Chapter VIII of the Act on Covered Bonds
IRS	The U.S. Internal Revenue Service
ISFI	The Icelandic State Financial Investments
IT	Information Technology
ITA	The Income Tax Act No. 90/2003
LBI hf.	LBI hf., formerly Landsbanki Íslands hf., Reg. No. 540291-2259, Álfheimar 74, 104 Reykjavík Iceland.
LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
LTV	Loan-to-value
MiFID	Markets in Financial Instruments Directive (2004/39/EC)
NSFR	Net Stable Funding Ratio

OECD	Organisation for Economic Co-operation and Development
PD	Probability of Default
PPP	Purchasing power parity
PwC	PricewaterhouseCoopers ehf., Reg.No. 690681-0139, Skógarhlíð 12, 105 Reykjavík, Iceland.
Rules on Foreign Exchange	The Central Bank's Rules on Foreign Exchange, No. 565/2014
Rules on Foreign Exchange Balances	The Central Bank's Rules on Foreign Exchange Balances No. 950/2010
RWA	Risk-Weighted Assets
S&P	International rating agency Standard & Poor's.
Savings Directive	Directive on the taxation of savings income (2003/48/EC)
SME	Small and medium sized enterprises
SREP	Supervisory Review and Evaluation Process
Supreme Court	The Supreme Court of Iceland
UCITS	Undertakings for Collective Investments in Transferable Securities
Q	Quarter

APPLICABLE FINAL TERMS

Set out below is the form of Final Terms which will be completed for each Tranche of Covered Bonds issued under the Programme.

[Date]

LANDSBANKINN HF.

Issue of [Aggregate Nominal Amount of Tranche] [Title of Covered Bonds]
under the ISK 100,000,000,000 Covered Bond Programme

PART A – CONTRACTUAL TERMS

Terms used herein shall be deemed to be defined as such for the purposes of the Terms and Conditions of the Covered Bonds (the “**Terms and Conditions**”) set forth in the Base Prospectus dated 9 December 2014. This document constitutes the Final Terms of the Covered Bonds described herein for the purposes of Article 5(4) of the Prospectus Directive, as amended (which includes the amendments made by Directive 2010/73/EU) and Article 45 of Act on Securities Transactions and must be read in conjunction with the Base Prospectus and any supplements if applicable which constitute a base prospectus for the purposes of the Prospectus Directive. Full information on the Issuer and the offer of the Covered Bonds is only available on the basis of the combination of these Final Terms and the Base Prospectus and any supplements, if applicable. A copy of said Base Prospectus is available for viewing at the issuer’s website, www.landsbankinn.is/sertryggd-skuldabref.

[Include whichever of the following apply or specify as “Not Applicable” (N/A). Note that the numbering should remain as set out below, even if “Not Applicable” is indicated for individual paragraphs or subparagraphs. Italics denote directions for completing the Final Terms.]

[When adding any other final terms or information consideration should be given as to whether such terms or information constitutes “significant new factors” and consequently triggers the need for a supplement to the Base Prospectus under Article 16 of the Prospectus Directive.]

1. Issuer: Landsbankinn hf.

2.

i. Series Number: []

ii. Tranche Number: []

(If fungible with an existing Series, details of that Series, including the date on which the Covered Bonds become fungible)

3. Specified Currency or Currencies: []

4. Aggregate Nominal Amount:

i. Series: []

ii. Tranche: []

5. Issue Price: [] per cent. of the Aggregate Nominal Amount [plus accrued interest from [insert date] (if applicable)]

6. Specified Denominations:

i. Specified Denominations: []

(in the case of Registered Covered Bonds this means the minimum integral amount in which transfers can be made)

(N.B. Following the entry into force of the 2010 PD Amending Directive on 31 December 2010, Covered Bonds to be admitted to trading on a regulated market within the European Economic Area with a maturity

date which will fall after the implementation date of the 2010 PD Amending Directive in the relevant European Economic Area Member State (which was due to be no later than 1 July 2012) must have a minimum denomination of EUR 100,000 (or equivalent) in order to benefit from Transparency Directive exemptions in respect of wholesale securities. Similarly, Covered Bonds issued after the implementation of the 2010 PD Amending Directive in a Member State must have a minimum denomination of EUR 100,000 (or equivalent) in order to benefit from the wholesale exemption set out in Article 3.2(d) of the Prospectus Directive in that Member State.)

(Note – where Bearer Covered Bonds with multiple denominations above €100,000 or equivalent are being used the following sample wording should be followed:

"€100,000 and integral multiples of [€1,000] in excess thereof up to and including €199,000. No Covered Bonds in definitive form will be issued with a denomination above €199,000.")

(N.B. If an issue of Covered Bonds is (i) NOT admitted to trading on an European Economic Area exchange; and (ii) only offered in the European Economic Area in circumstances where a prospectus is not required to be published under the Prospectus Directive, the €100,000 minimum denomination is not required.)

ii. Calculation Amount:

[]

(If only one Specified Denomination, insert the Specified Denomination. If more than one Specified Denomination, insert the highest common factor. Covered Bond: There must be a common factor in the case of two or more Specified Denominations.)

7.

i. Issue Date:

[]

ii. Interest Commencement Date:

[]

8.

i. Maturity Date:

[Specify date]

ii. Extended Maturity Date:

[Applicable/Not Applicable]

(If not applicable, delete the remaining sections of this subparagraph)

The Extended Maturity Date is [specify date or Interest Payment Date falling in or nearest to the relevant month and year; in each case falling one year after the Maturity Date].

[If applicable, complete relevant sections regarding interest, etc.]

9.

i. Interest Basis to Maturity Date:

[Inflation Linked Interest]

- [] per cent. Fixed Rate]
 [[LIBOR/EURIBOR/REIBOR] +/- [] per cent.
 Floating
 [Zero Coupon]
[specify other]
- ii. Interest Basis from Maturity Date
 to Extended Maturity Date: [Inflation Linked Interest]
 [] per. cent. Fixed Rate]
 [[LIBOR/EURIBOR/REIBOR] +/- [] per cent.
 Floating
 [Zero Coupon]
[specify other]
- 10. Redemption/Payment Basis:** [Annuity]
 [Redemption at par]
 [Equal principal payments]
 [Instalment]
[specify other]
- (N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value, the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive, and the requirements of Annex XII to the Prospectus Directive Regulation will apply.)*
- 11. Change of Interest Basis or Redemption/Payment Basis:** *[Specify details of any provision for change of Covered Bonds into another Interest Basis or Redemption/Payment Basis/Not Applicable]*
- 12. Investor Put/Issuer Call:** [Investor Put/Not Applicable]
 [Issuer Call/ Not Applicable]
[(further particulars specified below)]
- 13. Status of the Covered Bonds:** Senior/*[specify other]*
- 14. Approval for Issuance of the Covered Bonds:** Date of [Board] approval for issuance of Covered Bonds obtained]:
 [Date/ Not Applicable]
(N.B. Only relevant where Board (or similar) authorization is required for the particular Tranche of Covered Bonds)
- 15. Method of Distribution:** [Syndicated/Non-syndicated]
- 16. Calculation Agent:** [Issuer/(specify other)]

PROVISIONS RELATING TO INFLATION LINKED ANNUITY COVERED BONDS

- 17. Inflation Linked Annuity Covered Bonds:** [Applicable/Not Applicable]
(if not applicable, delete the remaining subparagraphs of this paragraph)
(N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value, the Covered Bonds will be derivative securities for the purposes of the

Prospectus Directive, and the requirements of Annex XII to the Prospectus Directive Regulation will apply.)

- i. Rate(s) of Interest to Maturity Date: [] per cent. per annum [payable [annually/semi-annually/quarterly/monthly] in arrears]
- ii. Rate(s) of Interest from Maturity Date to Extended Maturity Date: [] per cent. per annum [payable [annually/semi-annually/quarterly/monthly] in arrears]
- iii. Number of Interest Payment Dates: []
- iv. Interest Payment Date(s): [The [] day in the months of [] and [] in each year up to and including the Maturity Date]. First Interest Payment Date being []
- v. Day Count Fraction: [30/360] [*specify other*]
- vi. Principal Repayment(s): An amount calculated by the Issuer on each Interest Payment Date by multiplying the nominal amount on the Issue Date with the Index Ratio and with the factor A, which is calculated according to the following formula:

$$A = \frac{r * (1 + r)^{k-1}}{(1 + r)^n - 1}$$

where,

A = Principal repayment factor

$$r = \frac{c}{f}$$

c = The rate of interest of the relevant bond

f = The number of interest payments per year

n = Number of Interest Payment Dates

k = the number of payments that have already been made (k=0 on the Issue Date, k=1 on the first Interest Payment Date, k=n on the last Interest Payment Date, etc.)

- vii. Interest Payment(s): Interest is calculated on each Interest Payment Date as the nominal amount on the Issue Date multiplied with the Index Ratio and with the factor I, which is calculated according to the formula:

$$I_k = \frac{r * \left[(1 + r)^n - (1 + r)^{k-1} \right]}{(1 + r)^n - 1}$$

where,

I_k = Interest repayment factor for period k

$$r = \frac{c}{f}$$

c = The rate of interest of the relevant bond

f = The number of interest payments per year

n = Number of Interest Payment Dates

k = the number of payments that have already been made
(k=0 on the Issue Date, k=1 on the first Interest Payment Date, k=n on the last Interest Payment Date, etc.)

viii. Payment(s):

On each Interest Payment Date the sum of the relevant Principal Repayment and the Interest Payment.

ix. Index Ratio:

The value of the Index Ratio (**IR**) on the relevant Interest Payment Date shall be the value of the Reference Index (**RI**) applicable to the relevant Interest Payment Date divided by the value of the Base Index (**BI**) as calculated by the Issuer:

$$IR = \frac{RI_t}{BI}$$

where,

Reference Index or **RI_t** means on each Interest Payment Date:

For each day in the calendar month and number RI rounded to 5 decimals:

$$RI = CP_{M-2} + \left[\frac{d-1}{D} * (CP_{M-1} - CP_{M-2}) \right]$$

where,

CP_{M-1} = CPI value published by Statistic Iceland in the month preceding month M

CP_{M-2} = CPI value published by Statistic Iceland 2 months prior to month M

d = the relevant calendar date

D = number of calendar days in the relevant calendar month

Provided that if the Reference Index in i) or ii) is lower than the Base Index, the Reference Index shall equal the Base Index.

And

Base Index means [*to be inserted*], being the value of the CPI on [*to be inserted*].

If at any time a new index is substituted for the CPI, as of the calendar month from and including that in which such substitution takes effect:

- (i) the Reference Index shall be deemed to refer to the new index; and
- (ii) the new Base Index shall be the product of the existing Base Index and the Reference Index immediately following such substitution,

divided by the Reference Index immediately prior to such substitution.

PROVISIONS RELATING TO INFLATION LINKED EQUAL PRINCIPAL PAYMENT COVERED BONDS INCLUDING COVERED BONDS WITH ONE PAYMENT OF PRINCIPAL ON MATURITY DATE

18. Inflation Linked Equal Principal Payment Covered Bonds:

[Applicable/Not Applicable]
(if not applicable, delete the remaining subparagraphs of this paragraph)

(N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value, the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive, and the requirements of Annex XII to the Prospectus Directive Regulation will apply.)

- i. Rate(s) of Interest to Maturity Date: [] per cent. per annum [payable [annually/semi-annually/quarterly/monthly] in arrears]
- ii. Rate(s) of Interest from Maturity Date to Extended Maturity Date: [] per cent. per annum [payable [annually/semi-annually/quarterly/monthly] in arrears]
- iii. Number of Interest Payment Dates: []
- iv. Interest Payment Date(s): [The [] day in [month] up to and including the Maturity Date]
- v. Number of Interest Payment Dates: [Number of Interest Payment Dates]
- vi. Principal Payment Date(s): [On each Interest Payment Date/Maturity Date]
- vii. Day Count Fraction: [30/360 /Actual/Actual (ISMA)/[specify other]]
- viii. Principal Repayment(s): An amount calculated by the Calculation Agent on each Principal Payment Date by multiplying the Principal Amount Outstanding on the Issue Date with the Index Ratio and dividing with the number of principal Payment Dates.
- ix. Interest Payment(s): Interest is calculated on each Interest Payment date as the Principal Amount Outstanding on each Interest Payment Date multiplied with the Rate of Interest and, the appropriate Day Count Fraction.
- x. Payment(s): On each Interest Payment Date the sum of the relevant Principal Repayment and the Interest Payment.
- xi. Principal Amount Outstanding: On the relevant Interest Payment Date, the Principal Amount Outstanding is calculated based on the following formula:

$$PAO_t = (PAO_{t-1} - PR_{t-1}) \frac{IR_t}{IR_{t-1}}$$

where,

PAO_t means the Principal Amount Outstanding on the relevant Interest Payment Date.

PAO_{t-1} means the Principal Amount Outstanding on the preceding Interest Payment Date.

PR_{t-1} means the Principal Repayment on the preceding Interest Payment Date.

IR_t means the Index Ratio on the relevant Interest Payment Date.

IR_{t-1} means the Index Ratio on the preceding Interest Payment Date (Issue Date for the first Interest Payment Date).

xii. Index Ratio:

The value of the Index Ratio (**IR**) on the relevant Interest Payment Date shall be the value of the Reference Index (**RI**) applicable to the relevant Interest Payment Date divided by the value of the Base Index (**BI**) as calculated by the Issuer:

$$IR = \frac{RI_t}{BI}$$

where,

Reference Index or **RI_t** means on each Interest Payment Date:

For each day in the calendar month and number **RI** rounded to 5 decimals:

$$RI = CP_{M-2} + \left[\frac{d-1}{D} * (CP_{M-1} - CP_{M-2}) \right]$$

where,

CP_{M-1} = CPI value published by Statistics Iceland in the month preceding month **M**

CP_{M-2} = CPI value published by Statistics Iceland 2 months prior to month **M**

d = the relevant calendar date

D = number of calendar days in the relevant calendar month Provided that if the Reference Index is lower than the Base Index, the Reference Index shall equal the Base Index.

And

Base Index means [*to be inserted*], being the value of the CPI on [*to be inserted*]. If at any time a new index is substituted for the CPI, as of the calendar month from and including that in which such substitution takes effect:

- i. the Reference Index shall be deemed to refer to the new index; and
- ii. the new Base Index shall be the product of the existing Base Index and the Reference Index immediately following such substitution, divided by Reference Index immediately prior to such substitution.

PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE

19. Fixed Rate Covered Bond Provisions:

[Applicable/Not Applicable]
(If not applicable, delete the remaining subparagraphs of this paragraph)

- i. Rate(s) of Interest to Maturity Date: [] per cent. per annum [payable[annually/semi-annually/quarterly] in arrears]
- ii. Rate(s) of Interest from Maturity Date to Extended Maturity Date: [] per cent. per annum [payable [annually/semi-annually/quarterly] in arrears]
- iii. Interest Payment Date(s): [[] in each year up to and including the Maturity Date]/
[specify other]
(N.B. This will need to be amended in the case of long or short coupons.)
- iv. Day Count Fraction: [30/360 /Actual/Actual (ISMA)/*[specify other]*]
- v. Other terms relating to the method of calculating interest for Fixed Rate Covered Bonds: [None/*give details*]

20. Floating Rate Covered Bond Provisions:

[Applicable/Not Applicable]
(If not applicable, delete the remaining subparagraphs of this paragraph)

- i. Specified Period(s)/Specified Interest Payment Dates: []
[NB: Specify the Specified Period(s)/Specified Interest Payment Date(s) up to and including the Extended Maturity Date, if applicable]
- ii. Business Day Convention: [Floating Rate Convention/Following Business. Day Convention/Modified Following Business. Day Convention/Preceding Business Day Convention/
[specify other]]
- iii. Additional Business Centre(s): [*Specify*/None]
- iv. Manner in which the Rate of Interest and Interest Amount is to be determined: [Screen Rate Determination/ISDA Determination/*specify other*]
- v. Screen Rate Determination - Reference Rate: []

(Either LIBOR, EURIBOR, REIBOR or other, although additional information is required if other)

- Interest Determination Date(s): []

(Second London Business day prior to the start of each Interest Period if LIBOR (other than Sterling or euro LIBOR), first day of each Interest Period if Sterling LIBOR and the second day on which the TARGET System if EURIBOR or euro LIBOR) and second Reykjavík Business Day of each interest period if REIBOR

[NB: Specify the Interest Determination Date(s) up to and including the Extended Maturity Date, if applicable]

- Relevant Screen Page: []

(In the case of EURIBOR, if not Telerate Page 248 ensure it is a page which shows a composite rate or amend the fallback provisions appropriately)

vi. ISDA Determination:

- Floating Rate Option: []
- Designated Maturity: []
- Reset Date: []

vii. Margin(s) to Maturity Date: [+/-] [] per cent. per annum

viii. Margin(s) from Maturity Date to Extended Maturity Date: [+/-] [] per cent. per annum

ix. Minimum Rate of Interest: [[] per cent. per annum/Not Applicable]

x. Maximum Rate of Interest: [[] per cent. per annum/Not Applicable]

xi. Day Count Fraction: [Actual/Actual
Actual/365
Actual/365 (Fixed)
Actual/365 (Sterling)
Actual/360
30/360
30E/360
Other]

xii. Fallback provisions, rounding provisions and any other terms relating to the method of calculating interest on Floating Rate Covered Bonds, if different from those set out in the Terms and Conditions: [Applicable/Not Applicable]

xiii. Maximum Interest Amount: [Applicable/Not Applicable]

21. Zero Coupon Covered Bond Provisions:

[Applicable/Not Applicable]
(If not applicable, delete the remaining subparagraphs of this paragraph)

i. Accrual Yield: [] per cent. per annum

ii. Reference Price: []

- iii. Any other formula/basis of determining amount payable: ☐
- iv. Day Count Fraction in relation to Early Redemption Amounts and late payment: ☐ [Conditions 8.7.b) and 8.11 apply/*specify other*]

PROVISIONS RELATING TO REDEMPTION

- 22. Issuer Call:** ☐ [Applicable/Not Applicable]
(If not applicable, delete the remaining Subparagraphs of this paragraph)
- i. Optional Redemption Date(s): ☐
 - ii. Optional Redemption Amount of each Covered Bond and method, if any, of calculation of such amount(s): ☐ per Covered Bond of ☐ Specified Denomination] *[specify formula]* ☐ [Condition 8.7 applies]
 - iii. Early Redemption Amount: ☐ [As set out in Condition 8.7]
 - iv. If redeemable in part:
 - (i) Minimum Redemption Amount: ☐
 - (ii) Maximum Redemption Amount: ☐
 - v. Notice period (if other than as set out in the Terms and Conditions): ☐
- 23. Investor Put:** ☐ [Applicable/Not Applicable] *(If applicable specify details.)*

- 24. Final Redemption Amount of each Covered Bond:** ☐ per Covered Bond of ☐ Specified Denomination/*specify other/see Appendix* ☐ [Not Applicable]

- 25. Early Redemption Amount of each Covered Bond payable on redemption and/or the method of calculating the same (if required or if different from that set out in Condition 8.7 (a):** ☐

GENERAL PROVISIONS APPLICABLE TO THE COVERED BONDS

- 26. New Global Covered Bond:** ☐ [Yes/No]
- 27. Form of Covered Bonds:** ☐ [VS System Covered Bonds/ISD System Covered Bonds]
☐ [Bearer Covered Bonds]

Temporary Bearer Global Covered Bond exchangeable for a Permanent Bearer Global Covered Bond which is exchangeable for definitive Covered Bonds [on 60 days' notice given at any time/only after an Exchange Event]]

[Temporary Bearer Global Covered Bond exchangeable for definitive Covered Bonds on and after the Exchange Date]

[Permanent Bearer Global Covered Bond exchangeable for definitive Covered Bonds [on 60 days' notice given at any time/only after an Exchange Event]]¹

[Registered Covered Bond]

Regulation S Global Covered Bonds (U.S.\$ [] nominal amount) registered in the name of a common depository for Euroclear and Clearstream, Luxembourg/a common safekeeper for Euroclear and Clearstream, Luxembourg]

28. Additional Financial Centre(s) or other special provisions relating to Payment Days:

[Not Applicable/give details]
(Note that this item relates to the place of payment and not Interest Period end dates)

29. Talons for future Coupons or Receipts to be Attached to definitive Covered Bonds (and dates on which such Talons mature):

[Yes/No. (If yes, give details)]

30. Details relating to Partly Paid Covered Bonds:

amount of each payment comprising the Issue Price and date on which each payment is to be made and consequence of failure to pay, including any right of the Issuer to forfeit the Covered Bonds and interest due on late Payment:

[Not Applicable/give details. N.B. a new form of Temporary Global Covered Bond and/or Permanent Global Covered Bond may be required for Partly Paid issues]

31. Details relating to Instalment Covered Bonds:

- i. Instalment Amount(s):
- ii. Instalment Date(s):

[Not Applicable/give details]

[Not Applicable/give details]

Maximum Instalment Amount means, with respect to an Interest Period and a Series of Covered Bonds, the Relevant Percentage of the aggregate of principal receipts received by the Issuer in respect of assets in the Cover Pool plus amounts in respect of notional principal received from any Swap Provider less amounts payable by the Issuer to any Swap Provider, in each case, converted where applicable into the

¹ The option to exchange a Temporary or Permanent Global Covered Bond for a Definitive Covered Bond on 60 days' written notice which may be given at any time will only be available to Bondholders where (a) drawdowns are issued in denominations that are a multiple of the minimum denomination traded by Euroclear and Clearstream, Luxembourg or (b) in circumstances where the Bondholder's share is an integral of the minimum denomination traded by Euroclear and Clearstream, Luxembourg

- Specified Currency at the applicable swap rate of exchange;
- 32. Redenomination applicable:** Redenomination [not] applicable
(if Redenomination is applicable, specify the applicable Day Count Fraction and any provisions necessary to deal with floating rate interest calculation (including alternative reference rates))
- 33.** i. Swap Provider [Not applicable/give details]
ii. Nature of Swap [Not applicable/give details]
- 34. Other final terms:** [Not Applicable/give details]
(When adding any other final terms consideration should be given as to whether such terms constitute “significant new factors” according to the Commission Delegated Regulation (EU) no. 486/2012 and consequently trigger the need for supplements to the Base Prospectus under Article 16 of the Prospectus Directive.)

DISTRIBUTION

- 35.** i. If syndicated, names of Managers: [Not Applicable/give names]
ii. Stabilizing Manager (if any): [Not Applicable/give names]
- 36. If non-syndicated, name of relevant Dealer** []
- 37. Additional selling restrictions:** [Not Applicable/give details]

LISTING AND ADMISSION TO TRADING APPLICATION

These Final Terms comprise the final terms required for the Covered Bonds described herein **to be admitted to trading** pursuant to the ISK 100,000,000,000 Covered Bond Programme of Landsbankinn hf. [Specify other]

RESPONSIBILITY

The Issuer accepts responsibility for the information contained in these Final Terms. [[Relevant third party information, for example in compliance with Annex XII to the Prospectus Directive in relation to an index or its components] has been extracted from [specify source]. The Issuer confirms that such information has been accurately reproduced and that, so far as it is aware and is able to ascertain from information published by [specify source], no facts have been omitted which would render the reproduced information inaccurate or misleading].

Signed on behalf of the Issuer:

By:
Duly authorized

PART B – OTHER INFORMATION

1. LISTING

- i. Listing: [Nasdaq Iceland/other (*specify*)/None]
- ii. Admission to trading: [Application has been made for the Covered Bonds to be admitted to trading on [].] [Not Applicable.] [*specify other.*]

2. RATING

[Not Applicable/The Covered Bonds to be issued have been rated:

[S & P: [•]]
[Moody's: [•]]
[Fitch: [•]]
[Other: [•]]

[Need to include here a brief explanation of the meaning of the ratings if this has previously been published by the rating provider.](The above disclosure should reflect the rating allocated to Covered Bonds of the type being issued under the Programme generally or, where the issue has been specifically rated, that rating.)

3. NOTIFICATION

[The [*name of competent authority in home Member State*] [has been requested to provide/has provided – include first alternative for an issue which is contemporaneous with the establishment or update of the Programme and the second alternative for subsequent issues] the [*names of competent authorities of host Member States*] with a certificate of approval attesting that the Base Prospectus has been drawn up in accordance with the Prospectus Directive.]

4. INTERESTS OF NATURAL AND LEGAL PERSONS INVOLVED IN THE ISSUE

[Save for any fees payable to the [Managers/Dealer/Advisor], so far as the Issuer is aware, no person involved in the issue of the Covered Bonds has an interest material to the issue. – *Amend as appropriate if there are other interests*]

(When adding any other description, consideration should be given as to whether such matters described constitute “significant new factors” and consequently trigger the need for a supplement to the Base Prospectus under Article 16 of the Prospectus Directive regulation.)

5. USE OF PROCEEDS, ESTIMATED NET PROCEEDS AND TOTAL EXPENSES

- i. Use of proceeds: [For general funding purposes of the Issuer/*specify other*]
- ii. Estimated net proceeds: []
- iii. Estimated total expenses: []

6. YIELD (*Fixed Rate Covered Bonds Only*)

Indication of yield: [Not Applicable/*specify*]
[Note: The yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.]

7. HISTORIC INTEREST RATES (*Floating Rate Covered Bonds Only*)

[Not Applicable/Details of historic [LIBOR/EURIBOR/REIBOR/other] rates can be obtained from [Telerate].]

8. PERFORMANCE OF CPI, EXPLANATION OF EFFECT ON VALUE OF INVESTMENT AND ASSOCIATED RISKS AND OTHER INFORMATION CONCERNING THE UNDERLYING *(Inflation Linked Annuity Covered Bonds and Inflation Linked Equal Principal Payment Covered Bonds Only)*

[Need to include details of where past and future performance and volatility of the index/formula can be obtained.]

[Where the underlying is an index need to include the name of the index and a description if composed by the Issuer and if the index is not composed by the Issuer need to include details of where the information about the index can be obtained.]

[(When completing the above paragraphs, consideration should be given as to whether such matters described constitute “significant new factors” and consequently trigger the need for a supplement to the Base Prospectus under Article 16 of the Prospectus Directive.)]

The Issuer [intends to provide post-issuance information [specify what information will be reported and where it can be obtained]] [does not intend to provide post-issuance information]

(N.B. This paragraph only applies if the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies.)

9. OPERATIONAL INFORMATION

i. ISIN Code: []

ii. Common Code: []

iii. Any Clearing system(s) other than Euroclear Bank S.A./N.V. or Clearstream Banking, société anonyme (together with the address of each such clearing system) and the relevant identification number(s):

[Not Applicable/give name(s) and number(s)/ISD. The Issuer shall be entitled to obtain certain information from the register maintained by the ISD for the purpose of performing its obligations under the issue of ISD System Covered Bonds. The ISD Agent shall be entitled to obtain such information as is required to perform its duties under the Terms and Conditions of the Covered Bonds and rules and regulations of, and applicable to, the ISD.]

iv. Delivery: Delivery [against/free of] payment

v. Names and addresses of additional Paying Agent(s) (if any): []

vi. Intended to be held in a manner which would allow Eurosystem eligibility: [Yes][No]

Note that the designation “yes” simply means that the Covered Bonds are intended upon issue to be deposited

*with one of the ICSDs as common safekeeper and does not necessarily mean that the Covered Bonds will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria.]]**[Include this text if “yes” selected in which case the Covered Bonds must be issued in/NGCBform)]*

TERMS AND CONDITIONS OF THE COVERED BONDS

The following are the Terms and Conditions of the Covered Bonds which will be incorporated by reference into each Covered Bond (as defined below). The applicable Final Terms in relation to any Tranche of Covered Bonds may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the following Terms and Conditions, replace or modify the following Terms and Conditions for the purpose of such Covered Bonds. Reference should be made to “Form of the Covered Bonds” for a description of the content of Final Terms which will specify which of such terms are to apply in relation to the relevant Covered Bonds.

The Covered Bonds are bonds issued by Landsbankinn hf. (the “**Issuer**”) in accordance with the Icelandic Act on Covered Bonds no. 11/2008 (the “**Act on Covered Bonds**”) and Rules No. 528/2008 on covered bonds (the “**Rules on Covered Bonds**”). The Covered Bonds will be issued in compliance with any applicable legal or regulatory restrictions including the rules on foreign exchange issued by the Central Bank of Iceland, and any reference to currencies other than ISK and related expressions shall be construed as taking effect subject to such restrictions being lifted.

This covered bond is one of a Series (as defined below) of Covered Bonds issued by the Issuer.

References herein to the **Covered Bonds** shall be references to the Covered Bonds of this Series and shall include:

- (a) in relation to any Covered Bonds represented by a global Covered Bond (a “**Global Covered Bond**”), units of the lowest denomination specified in the relevant Final Terms (the “**Specified Denomination**”) in the currency specified in the relevant Final Terms (the “**Specified Currency**”);
- (b) any definitive Covered Bonds in bearer form (“**Bearer Covered Bonds**”) issued in exchange for a Global Covered Bond in bearer form; and
- (c) any definitive Covered Bonds in registered form (“**Registered Covered Bonds**”) (whether or not issued in exchange for a Global Covered Bond in registered form); and
- (d) any Covered Bonds issued in uncertificated book entry form cleared through the Icelandic Securities Depository or VP Lux (the “**VS System Covered Bonds**”). VS System Covered Bonds are in dematerialised form. Any references in these Terms and Conditions (the “**Conditions**”) to Receipts, Coupons and Talons shall not apply to VS System Covered Bonds and no global or definitive Covered Bonds will be issued in respect of VS System Covered Bonds.

Interest bearing definitive Covered Bonds have interest coupons (“**Coupons**”) and, if indicated in the applicable Final Terms, talons for further Coupons (“**Talons**”) attached on issue. Any reference herein to Coupons or coupons shall, unless the context otherwise requires, be deemed to include a reference to Talons or talons. Definitive Covered Bonds repayable in instalments have receipts (“**Receipts**”) for the payment of the instalments of principal (other than the final instalment) attached on issue. Global Covered Bonds do not have Receipts, Coupons or Talons attached on issue.

The Final Terms for this Covered Bond (or the relevant provisions thereof), as set out in Part A of the Final Terms which are (except in the case of VS System Covered Bonds) attached to or endorsed on this Covered Bond, supplement these Conditions and may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the Conditions, replace or modify the Conditions for the purposes of this Covered Bond. References to the **applicable Final Terms** are to Part A of the Final Terms (or the relevant provisions thereof) which are (except in the case of VS System Covered Bonds) attached to or endorsed on this Covered Bond and (in the case of the VS System Covered Bonds) which are deposited with the ISD or VP Lux.

Any reference to **Covered Bondholders** or to **holders** or to **Investor(s)** in relation to any Covered Bonds shall mean (in the case of Bearer Covered Bonds) the holders of the Covered Bonds, (in the case of Registered Covered Bonds) the persons in whose name the Covered Bonds are registered and (in the case of VS Covered

Bonds) the persons who are for the time being shown in the records of the ISD or VP Lux as the holders of the Covered Bonds, and shall, in relation to any Covered Bonds represented by a Global Covered Bond and any VS Covered Bonds, be construed as provided below. Any reference herein to **Receiptholders** shall mean the holders of the Receipts and any reference herein to **Couponholders** shall mean the holders of the Coupons and shall, unless the context otherwise requires, include the holders of the Talons.

As used herein, **Tranche** means Covered Bonds which are identical in all respects (including as to listing and admission to trading on a Regulated Market) and **Series** means a Tranche of Covered Bonds together with any further Tranche or Tranches of Covered Bonds which are (i) expressed to be consolidated and form a single series and (ii) identical in all respects (including as to listing and admission to trading on a Regulated Market) except for their respective Issue Dates, Interest Commencement Dates and/or Issue Prices.

Copies of the applicable Final Terms are available for viewing on the Issuer's website, www.landsbankinn.is/sertryggd-skuldabref.

Except where the context otherwise requires, capitalised terms used and not otherwise defined in these Terms and Conditions (including the preceding paragraphs) shall bear the meanings given to them in the applicable Final Terms.

1. DEFINITIONS

Interpretation: In these Conditions:

- Covered Bonds and Covered Bondholder shall be deemed to include references to Coupons and Coupon-holders, respectively, where relevant;
- If Talons are specified in the relevant Final Terms as being attached to the Covered Bonds at the time of issue, references to Coupons shall be deemed to include references to Talons;
- If Talons are not specified in the relevant Final Terms as being attached to the Covered Bonds at the time of issue, references to Talons are not applicable;
- Any reference to principal shall be deemed to include Final Redemption Amount, any additional amounts in respect of principal which may be payable under Condition 9, any premium payable in respect of a Covered Bond and any other amount in the nature of principal payable pursuant to these Conditions;
- Any reference to interest shall be deemed to include any additional amounts in respect of interest which may be payable under Condition 9 and any other amount in the nature of interest payable pursuant to these Conditions;
- If an expression is stated in this Condition (1 Definitions) to have the meaning given in the relevant Final Terms, but the relevant Final Terms gives no such meaning or specifies that such expression is "not applicable" then such expression is not applicable to Covered Bonds;
- VS System Covered Bonds are in dematerialised form, and any references in these Terms and Conditions to Coupons and Talons shall not apply to VS System Covered Bonds and no global or definitive Covered Bonds will be issued in respect thereof;
- If the Covered Bonds are Zero Coupon Covered Bonds, references to Coupons and Couponholders are not applicable; and
- Where the word "including" appears in these Conditions the words "without limitation" shall be deemed to be inserted immediately afterwards.

Accrual Period	In accordance with Condition 6.7(c)(i), the relevant period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date.
Accrual Yield	In relation to a Zero Coupon Covered Bond, the meaning given in the applicable Final Terms.
Act on Covered Bonds	The Icelandic Act on Covered Bonds No. 11/2008 which came into effect 4 March 2008, as amended (<i>Ice. "Lög um sértryggð skuldabréf nr. 11/2008"</i>).
Act on Securities Transactions	The Icelandic Act on Securities Transactions No. 108/2007 which came into effect 1 November 2007, as amended (<i>Ice. "Lög um verðbréfavíðskipti 108/2007"</i>).
Additional Business Centre	The meaning (if any) given in the applicable Final Terms.
Additional Financial Centre	The meaning (if any) given in the applicable Final Terms.
Agency Agreement	Shall mean the agency agreement (if any) to be entered into between the Issuer, Fiscal Agent and other agents.
Amortised Face Amount	The meaning given in Condition 8.7(b).
Annuity Amount	The meaning given in Condition 7.1(a).
Annuity Covered Bonds	Covered Bonds which will be redeemed in Annuity Amounts (subject to adjustment for indexation in accordance with the provisions specified in the applicable Final Terms) on one or more Interest Payment Dates as specified in the applicable Final Terms.
Automatic Extension	The meaning given in Condition 8.12(b).
Bearer Covered Bond	Means Cover Bonds issued in bearer form.
Business Day	As defined in Condition 6.7(a).
Business Day Convention	In respect of a Tranche of Covered Bonds and either the Specified Periods or the Interest Payments Dates, the business day convention specified in the applicable Final Terms and determined in accordance with Conditions 6.7(b).
Calculation Agent	The meaning (if any) given in the applicable Final Terms.
Clearstream, Luxembourg	Clearstream Banking, société anonyme, 42 Avenue JF Kennedy L-1855, Luxembourg, or its successors.
Common Safekeeper	The common safekeeper for Euroclear and Clearstream Luxembourg.
CPI	The consumer price indexation, as calculated by Statistics Iceland in accordance with the Act on Price Indexation No. 12/1995 (<i>Ice. "Lög um vísitölu neysluverðs nr. 12/1995"</i>) and published monthly in the

Legal Gazette (*Ice. "Lögbirtingablaðið"*) in Iceland.

Couponholders	The holders of the Coupons (which expression shall, unless the context otherwise requires, include the holders of the Talons).
Coupons	Interest coupons expressing the amount payable by way of interest in respect of definitive Covered Bonds.
Cover Pool	A collection of bonds, substitute collateral and other assets listed in the Register, as provided for in Chapter VI of the Act on Covered Bonds, over which the Covered Bondholders and Issuer's counterparties have rights of priority pursuant to the provisions of the Act on Covered Bonds.
Cover Pool Member States	A state which is a party to the Agreement on the European Economic Area or the European Free Trade Association Treaty, or the Faroe Islands.
Covered Bond	The covered bonds issued or to be issued by the Issuer under the Programme in accordance with the Act on Covered Bonds.
Covered Bondholders	The holders for the time being of the Covered Bonds.
Covered Bond Legislation	Act on Securities Transactions, Act on Covered Bonds, any relevant executive orders and appurtenant regulations as may be supplemented, amended, modified or varied from time to time (as well as any judicial decisions and administrative pronouncements, all of which are subject to change, including with retroactive effect).
Cover Pool Swap Agreement	Means the ISDA Master Agreement, schedule and confirmation(s) (as amended and supplemented from time to time) relating to the Cover Pool Swap entered into from time to time between the Issuer and the Cover Pool Swap Provider.
Cover Pool Swap Provider	Means the third party counterparties in their respective capacities as cover pool swap provider under a Cover Pool Swap Agreement.
Cover Pool Swap	Means the Cover Pool Swap which enables the Issuer to convert ISK interest payments (less a client margin) received by the Issuer in respect of assets (other than Swaps) registered to the Cover Pool into floating or fixed payments (as the case may be) payments linked to the interest rate payable on the Covered Bonds.
Currency Swap Agreement	Means the ISDA Master Agreement, schedule and confirmation(s) (as amended and supplemented from time to time) relating to the Currency Swap(s) entered into from time to time between the Issuer and each Currency Swap Provider.
Currency Swap Provider	Means the third party counterparties in their respective capacities as currency swap provider under a Currency Swap Agreement.
Currency Swap	Means each currency swap which enables the Issuer to hedge currency risks arising from (a) Covered Bonds which are issued in currencies other than ISK and (b) assets (other than Mortgage Bonds) which are registered to the Cover Pool and are denominated

	in currencies other than ISK.
Dealer	Any dealer appointed by the Issuer (if any).
Designated Account	Means the account maintained by a holder with a Designated Bank and identified as such in the Registered Covered Bond Register.
Designated Bank	Means (in the case of payment in a Specified Currency other than euro) a bank in the principal financial centre of the country of such Specified Currency and (in the case of a payment in euro) any bank which processes payments in euro.
Designated Maturity	The meaning given in the ISDA Definitions.
Determination Date	The meaning given in the applicable Final Terms.
Determination Period	The meaning given in Condition 6.7(d).
Directors	The directors for the time being of the Issuer as defined in the Icelandic Act No. 2/1995, on Limited Liability Companies (<i>Ice. "Lög um hlutafélög nr. 2/1995"</i>).
Distribution Compliance Period	The period that ends 40 days after completion of the distribution of each Tranche of Covered Bonds, as certified by the relevant Dealer.
Early Redemption Amount	The amount calculated in accordance with Condition 8.7.
Equal Payment Amount	The meaning given in Condition 7.1(b).
EU	The European Union.
EURIBOR	Euro-zone Inter Bank Offered Rate.
Euroclear	Euroclear Bank S.A./N.V., 1, Boulevard du Roi Albert II B - 1210 Brussels, or its successor.
Extended Maturity Date	Means the date to which the payment of the Final Redemption Amount is deferred if not paid at the Maturity Date as further outlined in Condition 8.12.
Final Redemption Amount	The meaning given in the applicable Final Terms.
Final Terms	In relation to listing, each Tranche will be the subject to the Final Terms which, for the purposes of that Tranche only, completes the Terms and Conditions of the Covered Bonds and this Base Prospectus and must be read in conjunction with this Base Prospectus. The terms and conditions applicable to any particular Tranche of Covered Bonds are the Terms and Conditions of the Covered Bonds as completed, amended and/or replaced by the relevant Final Terms.
Fiscal Agent	Landsbankinn hf., or any successor agent appointed as such.

Fixed Rate Covered Bonds	Covered Bonds that pay a fixed rate of interest on such date or dates as may be agreed between the Issuer and the relevant Dealer as specified in the applicable Final Terms and on redemption calculated on the basis of such Day Count Fraction as may be agreed between the Issuer and the relevant Dealer.
Floating Rate	The meaning given in the ISDA Definitions.
Floating Rate Convention	The meaning given in Condition 6.7(b)(i).
Floating Rate Covered Bonds	<p>Covered Bonds which bear interest at a rate determined:</p> <ul style="list-style-type: none"> (i) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the ISDA Definitions; or (ii) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or (iii) on such other basis as may be agreed between the Issuer and the relevant Dealer, or as set out in the applicable Final Terms.
FME	The Financial Supervisory Authority, Iceland (<i>Ice. "Fjármálaeftirlitið"</i>).
Following Business Day Convention	The meaning given in Condition 6.7(b)(ii).
Global Covered Bonds	Global Covered Bonds comprising Temporary Global Covered Bonds and Permanent Global Covered Bonds.
Government Bond	Bonds granted to or guaranteed by certain governmental bodies, in accordance with Article 5 of the Act on Covered Bonds.
Group	The Issuer and its subsidiaries.
IFRS	International Financial Reporting Standards.
Indexed Currency Swap Agreement	Means the ISDA Master Agreement, schedule and confirmation(s) (as amended and supplemented from time to time) relating to the Indexed Currency Swap(s) entered into from time to time between the Issuer and each Indexed Currency Swap Provider.
Indexed Currency Swap Provider	Means the third party counterparties in their respective capacities as indexed currency swap provider under an Indexed Currency Swap Agreement.
Indexed Currency Swap	Means each currency swap which enables the Issuer to hedge currency and inflation risks arising from (i) Covered Bonds which are issued in currencies other than ISK and not indexed linked and (ii) assets which are registered to the Cover Pool and are denominated in ISK and indexed linked.
Inflation Linked Annuity Covered	Covered Bonds that pay an Annuity Amount on such date or dates as

Bonds	decided by the Issuer and set out in the Final Terms.
Inflation Linked Equal Principal Payment Covered Bonds	Covered Bonds that pay an Equal Payment Amount on such date or dates as decided by the Issuer and set out in the Final Terms.
Instalment Amounts	In respect of Instalment Covered Bonds, each amount specified as such in the applicable Final Terms.
Instalment Covered Bonds	Covered Bonds which will be redeemed in Instalment Amounts and on the Instalment Dates specified in the applicable Final Terms.
Instalment Dates	In respect of Instalment Covered Bonds, each date specified as such in the applicable Final Terms.
Interest Amount	The amount of interest payable on the Floating Rate Covered Bonds in respect of each Specified Denomination for the relevant Interest Period, as calculated in accordance with Condition 6.4(d) or the amount of interest payable on Inflation Linked Annuity Covered Bonds or Inflation Linked Equal Payment Covered Bonds in respect of each Specified Denomination for the relevant Interest Period, as calculated in accordance with Conditions 6.1 and 6.2 respectively.
Interest Commencement Date	In the case of interest-bearing Covered Bonds, the date specified in the applicable Final Terms from (and including) which interest will accrue in respect of the relevant Covered Bonds.
Interest Determination Date	In respect of Floating Rate Covered Bonds to which Screen Rate Determination is applicable, the meaning given in the applicable Final Terms.
Interest Payment Date	In respect of Fixed Rate Covered Bonds, Inflation Linked Annuity Covered Bonds and Inflation Linked Equal Payment Covered Bonds, the meaning given in the applicable Final Terms and in respect of Floating Rate Covered Bonds the meaning given in Condition 6.4(a).
Interest Rate Swap Agreement	Means the ISDA Master Agreement, schedule and confirmation(s) (as amended and supplemented from time to time) relating to the Interest Rate Swap(s) entered into from time to time between the Issuer and each Interest Rate Swap Provider.
Interest Period	In accordance with Condition 6.7(e) the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.
Investor	The holders for the time being of the Covered Bonds.
Investor's Currency	The currency or currency unit that an investor's financial activities are denominated in, other than the Specified Currency.
Investor Put	If specified as applicable in the applicable Final Terms, the provision by which the Investor may redeem a Series of Covered Bonds in accordance with Condition 8.4.

ISD	The Icelandic Securities Depository hf. Reg.No. 500797-3209, with its registered office at Laugavegur 182, 105 Reykjavík (<i>Icelandic “Verðbréðaskráning Íslands”</i>).
ISD system account operator	Landsbankinn hf. in its capacity as ISD system account operator.
ISD System Covered Bonds	Shall mean Covered Bonds issued in a dematerialised, uncertified book entry form cleared through ISD.
ISDA	International Swaps and Derivatives Association, Inc.
ISDA Definitions	The meaning given in Condition 6.4(b).
ISDA Determination	If specified as applicable in the applicable Final Terms Document, the manner in which the Rate of Interest on Floating Rate Covered Bonds is to be determined in accordance with Condition 6.4(b).
ISDA Rate	The meaning given in Condition 6.4(b).
ISK or Icelandic Krona or krónur	The lawful currency of the Republic of Iceland.
Issue Date	Each date on which the Issuer issues a Tranche of Covered Bonds under the Programme, as specified in the applicable Final Terms.
Issue Price	The price, generally expressed as a percentage of the nominal amount of the Covered Bonds, at which a Tranche of Covered Bonds will be issued.
Issuer	Landsbankinn hf., Reg.No. 471008-0280, having its registered office at Austurstræti 11, 155 Reykjavík, Iceland.
Issuer Call	If specified as applicable in the applicable Final Terms, the provision by which the Issuer may redeem a Series of Covered Bonds in accordance with Condition 8.3.
Landsbankinn	Landsbankinn hf., Reg.No. 471008-0280, having its registered office at Austurstræti 11, 155 Reykjavík, Iceland.
LIBOR	London inter-bank offered rate
Margin	As specified in the applicable Final Terms (if any).
Maturity Date	As specified in the applicable Final Terms.
Maximum Rate of Interest	In respect of a Floating Rate Covered Bond, the percentage rate per annum (if any) specified in the applicable Final Terms.
Maximum Redemption Amount	The amount specified as such in the applicable Final Terms.
Member State	A state which is a member of the European Economic Area.
Minimum Rate of Interest	In respect of Floating Rate Covered Bonds, the percentage rate per annum (if any) specified in the applicable Final Terms.

Minimum Redemption Amount	The amount specified as such in the applicable Final Terms.
Modified Following Business Day Convention	The meaning given in Condition 6.7(b)(iii).
Mortgage	Each mortgage loan referenced by its mortgage loan identifier number and comprising the aggregate of all principal sums, interest, costs, charges, expenses and other moneys due or owing with respect to that mortgage loan under the relevant mortgage terms by a borrower to the Issuer on the security of a Mortgage from time to time outstanding or, as the context may require, the borrower's obligations in respect of the same, and eligible to be added to the Cover Pool.
Nasdaq Iceland	The main market of NASDAQ OMX Iceland hf., Reg.No. 681298-2829, with its registered office at Laugavegur 182, 105 Reykjavík.
Optional Redemption Amount	The meaning (if any) given in the applicable Final Terms.
Optional Redemption Date	The meaning (if any) given in the applicable Final Terms.
Overcollateralization	The percentage by which the Value will exceed the nominal value of the liabilities, relating to the issued Covered Bonds, along with all accrued interests.
Partial Redemption	The meaning given in Condition 8.12(f).
Paying Agents	The Principal Paying Agent and any other paying agent appointed (if any).
Payment Day	The meaning given in Condition 7.8.
Preceding Business Day Convention	The meaning given in Condition 6.7(b)(iv).
Principal Amount Outstanding	In accordance with Condition 6.7(f) means in respect of a Covered Bond, except an Inflation Linked Annuity Covered Bond and an Inflation Linked Equal Principal Payment Covered Bond on any day, the principal amount of that Covered Bond on the relevant Issue Date thereof less principal amounts received by the relevant Covered Bondholder in respect thereof on or prior to that day and in respect of an Inflation Linked Annuity Covered Bond and an Inflation Linked Equal Payment Covered Bond, the meaning given in the applicable Final Terms.
Principal Paying Agent	The Issuer, Landsbankinn hf.
Programme	ISK 100,000,000,000 (or its equivalence in other currencies calculated as described herein) covered bond programme established by the Issuer on the Issue Date which shall in the beginning not exceed a limit of ISK 10,000,000,000. Any increases of the Programme shall be subject to the FME approval.

Prospectus Directive and PD	Directive 2003/71/EC (<i>Ice. “Tilskipun Evrópuþingsins og Ráðsins 2003/71/EB”</i>) as amended (which includes the amendments made by Directive 2010/73/EU).
Rate of Interest	In respect of a Series of interest-bearing Covered Bonds, the rate of interest payable from time to time in respect of such Covered Bonds determined in accordance with the Terms and Conditions and the applicable Final Terms.
Receiptholders	The holders of Receipts (which expression shall, unless the context otherwise requires, include the holders of the Talons).
Redeemed Covered Bonds	The meaning given in Condition 8.3.
Reference Price	In respect of a Zero Coupon Covered Bond, the meaning given in the applicable Final Terms.
Reference Rate	In respect of Floating Rate Covered Bonds to which Screen Rate Determination applies, the meaning given in the applicable Final Terms.
Registrar	Any registrar to be appointed in accordance with an Agency Agreement.
Register	A special register in respect of Covered Bonds and the Cover Pool, together with any derivative agreements that an issuer must maintain in accordance with Chapter VI of the Act on Covered Bonds and Chapter VI of the Rules on Covered Bonds.
Registered Covered Bond Register	Register of holders of the Registered Covered Bonds maintained by the Registrar.
Registered Covered Bond	Means Covered Bonds issued in registered form.
Regulated Market	Means a medium for the exchange of goods or services over which a government body exerts a level of control.
Regulation S	Regulation S under the US Securities Act.
Regulation S Global Covered Bonds	Global covered bonds offered and sold in reliance on Regulation S.
REIBOR	Reykjavík Inter Bank Offered Rate.
Relevant Screen Page	In respect of Floating Rate Covered Bonds to which Screen Rate Determination applies, the meaning given in the Final Terms.
Relevant Subsidiary	Means any Subsidiary other than (i) a Subsidiary acquired, formed or operated in relation to the merger and acquisitions services provided to a customer of the Issuer for the purpose of completing a transaction or restructuring a company or (ii) any Subsidiary acquired or formed as a result of the Issuer’s foreclosure activities in relation to its general banking business.

Reset Date	The Meaning given in the ISDA Definitions.
Rules on Covered Bonds	The rules of 3 June 2008 No. 528/2008 on Covered Bonds issued by the FME under the authority conferred on it by Article 25 of the Act on Covered Bonds, which came into effect 3 June 2008, as amended.
Screen Rate Determination	If specified as applicable in the applicable Final Terms, the manner in which the Rate of Interest on Floating Rate Covered Bonds is to be determined in accordance with Condition 6.4(b).
Security Interest	The meaning given in Condition 4.1.
Selection Date	The meaning given in Condition 8.3.
Senior Debt	Means loans that may be taken out to purchase assets which are in turn added to the Cover Pool in the event that the Issuer is required to post additional collateral.
Series	A Tranche of Covered Bonds together with any further Tranche or Tranches of Covered Bonds which are (i) expressed to be consolidated and form a single series and (ii) identical in all respects (including as to listing and admission to trading) except for their respective Issue Dates, Interest Commencement Dates and/or Issue Prices.
Specified Currency	Subject to any applicable legal or regulatory restrictions, euro, Sterling, U.S. Dollars and such other currency or currencies as may be agreed from time to time by the Issuer, the relevant Dealer and the Principal Paying Agent and specified in the applicable Final Terms.
Specified Denomination	In respect of a Series of Covered Bonds, the denomination or denominations of such Covered Bonds at the minimum amount of EUR 100,000 as specified in the applicable Final Terms.
Specified Interest Payment Date	In respect of Floating Rate Covered Bonds, the meaning (if any) given in the applicable Final Terms.
Subsidiary	Means an entity from time to time of which the Issuer (i) has direct or indirect control or (ii) owns directly or indirectly more than 50 per cent. of the share capital or similar ownership; “control” for this purpose means the power to direct the management and the policies of the entity, whether through the ownership of voting capital, by contract or otherwise.
Sub-Unit	The meaning given in Condition 6.7(g).
Swap Provider	Means the Cover Pool Swap Provider, each Currency Swap Provider and each Interest Rate Swap Provider.
Talons	Talons for further Coupons in respect of interest-bearing definitive Covered Bonds.
TARGET System	The meaning given in Condition 6.7(a).

Temporary Bearer Global Covered Bond	The temporary global Covered Bond in bearer form which will initially represent the Bearer Covered Bond of each Tranche.
Terms and Conditions or Conditions	The terms and conditions of the Covered Bonds.
Tranche	An issue of Covered Bonds which are identical in all respects (including as to listing and admission to trading).
Transfer Agent	Landsbankinn hf., or any successor agent appointed as such.
US Securities Act	U.S. Securities Act of 1933, as amended.
Value	The nominal par value of the Cover Pool along with all accrued interest (but excluding the nominal par value of each Mortgage within the Cover Pool which is in arrears for 90 days or longer at the relevant time).
VS System Covered Bonds	Means Covered Bonds issued in uncertificated book entry form cleared through the ISD or VP Lux and/or, in relation to any Tranche of Covered Bonds, any other clearing system as may be specified in the relevant Final Terms (as the case may be).
VP LUX	Means VP Lux S.à.r.l., 32, Boulevard Royal, L-2449 Luxembourg, or its successors.
Zero Coupon Covered Bonds	Covered Bonds which will be offered and sold at a discount to their nominal amount and which will not bear interest.
€, Euro, EUR or euro	The currency of the European economic monetary union.
£ or Sterling	The lawful currency for the time being of the United Kingdom of Great Britain and Northern Ireland.
\$, U.S.\$, U.S. Dollars, US Dollars or USD	The lawful currency for the time being of the United States of America.

2. FORM, DENOMINATION AND TITLE

The Covered Bonds will be issued in bearer form (the Bearer Covered Bonds), registered form (the Registered Covered Bonds), or, in the case of VS System Covered Bonds, uncertificated book entry form, as specified in the applicable Final Terms and, in the case of definitive Covered Bonds, serially numbered, in the Specified Currency and the Specified Denomination(s). The Covered Bonds will be in the Specified Currency and the Specified Denomination(s). Covered Bonds of one Specified Denomination may not be exchanged for Covered Bonds of another Specified Denomination.

The Covered Bonds may take the form of an Inflation Linked Annuity Covered Bond, an Inflation Linked Equal Principal Payment Covered Bond, a Fixed Rate Covered Bond, a Floating Rate Covered Bond, a Zero Coupon Covered Bond or a combination of any of the foregoing, depending upon the Interest Basis and Redemption/Payment Basis shown in the applicable Final Terms.

Bearer Covered Bonds

Each Tranche of Covered Bonds issued in the form of Bearer Covered Bonds will initially be represented by a Temporary Bearer Global Covered Bond or, if so specified in the applicable Final Terms, a Permanent Bearer Global Covered Bond without Coupons, Receipts or Talons which will:

- (i) if the Global Covered Bonds are intended to be issued in a new global covered bond form (“**NGCB**”), as specified in the applicable Final Terms, be delivered on or prior to the original issue date of the Tranche to a Common Safekeeper; and
- (ii) if the global Covered Bonds are not intended to be issued in NGCB form, be delivered on or prior to the original issue date of the Tranche to a Common Depositary.

Interests in the Temporary Bearer Global Covered Bond will be exchanged either for interests in a Permanent Bearer Global Covered Bond or, where specified in the applicable Final Terms (subject to such notice period as is specified in the Final Terms), for definitive Bearer Covered Bonds on or after the date (the “**Exchange Date**”) which is the later of (i) 60 days after the Temporary Bearer Global Covered Bond is issued and (ii) 60 days after completion of the distribution of the relevant Tranche, as certified by the relevant Dealer (in the case of a non-syndicated issue) or the relevant lead manager (in the case of a syndicated issue). Such exchange will be made only upon delivery of written certification to Euroclear and/or Clearstream, Luxembourg, as the case may be, to the effect that the beneficial owner of such Covered Bonds is not a U.S. person or other person who has purchased such Covered Bonds for resale to, or on behalf of, U.S. persons and Euroclear and/or Clearstream, Luxembourg, as the case may be, and has given a like certification (based on the certification it has received) to the Fiscal Agent.

If an interest or principal payment date for any Covered Bonds occurs whilst such Covered Bonds are represented by a Temporary Bearer Global Covered Bond, the related interest or principal payment will be made only to the extent that certification of non-U.S. beneficial ownership has been received as described in the last sentence of the immediately preceding paragraph unless such certification has already been given. The holder of a Temporary Bearer Global Covered Bond will not be entitled to collect any payment of interest or principal due on or after the Exchange Date unless, upon due certification, exchange of the Temporary Bearer Global Covered Bond is improperly withheld or refused. Payment of principal or interest (if any) on a Permanent Bearer Global Covered Bond will be made through Euroclear or Clearstream, Luxembourg (against presentation or surrender, as the case may be, of the Permanent Bearer Global Covered Bond if the Permanent Bearer Global Covered Bond is not intended to be issued in NGCB form) without any further requirement for certification. Pursuant to the Agency Agreement the Fiscal Agent shall arrange that, where a further Tranche of Covered Bonds is issued, the Covered Bonds of such Tranche shall be assigned a common code and ISIN by Euroclear and Clearstream, Luxembourg which are different from the common code and ISIN assigned to Covered Bonds of any other Tranche of the same Series until at least expiry of the Distribution Compliance Period applicable to the Covered Bonds of such Tranche.

The applicable Final Terms will specify that either (i) a Permanent Bearer Global Covered Bond will be exchangeable (free of charge), in whole but not in part, for definitive Bearer Covered Bonds with, where applicable, Receipts, Coupons and Talons attached upon not less than 60 days’ written notice from Euroclear and (or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Bearer Global Covered Bond) to the Fiscal Agent as described therein or (ii) a Permanent Bearer Global Covered Bond will be exchangeable (free of charge), in whole but not in part, for definitive Bearer Covered Bonds with, where applicable, Receipts, Coupons and Talons attached only upon the occurrence of an Exchange Event as described therein. “**Exchange Event**” means (i) the Issuer has been notified that either Euroclear or Clearstream, Luxembourg has been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or has announced an intention permanently to cease business or has in fact done so and no alternative clearing system satisfactory to the Issuer, the Fiscal Agent, the other Paying Agents and the Covered Bondholders is available or, unless otherwise specified in the applicable Final Terms, (ii) the Issuer has or will become obliged to pay additional amounts as provided for or referred to in Condition 9 which

would not be required were the Covered Bonds represented by the Permanent Bearer Global Covered Bond in definitive bearer form and a certificate to such effect signed by two Directors has been given to the Fiscal Agent. The Issuer will promptly give notice to Covered Bondholders in accordance with Condition 11 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Bearer Global Covered Bond) or the Covered Bondholders may give notice to the Fiscal Agent requesting exchange and in the event of the occurrence of an Exchange Event as described in (ii) above, the Issuer may also give notice to the Fiscal Agent and the Covered Bondholders requesting exchange. Any such exchange shall occur not later than 30 days after the date of receipt of the first relevant notice by the Fiscal Agent.

The following legend will appear on all Bearer Covered Bonds, Coupons, Receipts and Talons which have an original maturity of more than 365 days:

“ANY UNITED STATES PERSON WHO HOLDS THIS OBLIGATION WILL BE SUBJECT TO LIMITATIONS UNDER THE UNITED STATES INCOME TAX LAWS INCLUDING THE LIMITATIONS PROVIDED IN SECTIONS 165(j) AND 1287 (a) OF THE INTERNAL REVENUE CODE.”

The sections referred to provide that United States holders, with certain exceptions, will not be entitled to deduct any loss on bearer Covered Bonds, receipts or interest coupons and will not be entitled to capital gains treatment of any gain on any sale, disposition, redemption or payment of principal in respect of Bearer Covered Bonds, Receipts or Coupons.

Registered Covered Bonds

Unless otherwise provided with respect to a particular Series of Registered Covered Bonds, the Registered Covered Bonds of each Tranche of such Series offered and sold in reliance on Regulation S, which will be sold to non-U.S. persons outside the United States, will initially be represented by a Regulation S Global Covered Bond which will be deposited with a custodian for, and registered in the name of a nominee of, a Depository Trust Company (the “**DTC**”) or Common Safekeeper as the case may be for the accounts of Euroclear and Clearstream, Luxembourg. Prior to expiry of the Distribution compliance Period applicable to each Tranche of Covered Bond, beneficial interests in a Regulation S Global Covered Bond may not be offered or sold to, or for the account or benefit of, a U.S. person save as otherwise provided in Condition 2 and may not be held otherwise than through Euroclear or Clearstream, Luxembourg and such Regulation S Global Covered Bond will bear a legend regarding such restrictions on transfer.

Registered Covered Bonds of each Tranche of such Series may only be offered and sold in the United States or to U.S. persons in private transactions to Qualified Institutional Buyers (“**QIB**”). The Registered Covered Bonds of each Tranche sold to QIBs will be represented by a Restricted Global Covered Bond which will be deposited with a custodian for, and registered in the name of a nominee of, DTC.

Persons holding beneficial interests in Registered Global Covered Bonds will be entitled or required, as the case may be, under the circumstances described below, to receive physical delivery of definitive Covered Bonds in fully registered form.

Payments of principal on the Registered Covered Bonds will be made on the relevant payment date to the persons shown on the Registered Covered Bond Register at the close of business on the business day (being for this purpose a day on which banks are open for business in Brussels) immediately prior to the relevant payment date. Payments of interest on the Registered Covered Bonds will be made on the relevant payment date to the person in whose name such Covered Bonds, Receipts and Coupons immediately preceding such payment date.

Payments of the principal of, and interest (if any) on, the Registered Global Covered Bonds will be made to the nominee of DTC as the registered holder of the Registered Global Covered Bonds. None of the Issuer, any Paying Agent and the Registrar will have any responsibility or liability for any aspect of the records relating to

or payments made on account of beneficial ownership interests in the Registered Global Covered Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Interests in a Registered Global Covered Bonds will be exchangeable (free of charge), in whole but not in part, for definitive Registered Covered Bonds without receipts, coupons or talons attached only upon the occurrence of an Exchange Event. For these purposes, Exchange Event means that (i) in the case of Covered Bonds registered in the name of a nominee for a Common Depositary the Issuer has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or such case, no successor clearing system is available) or (ii) has or will become subject to adverse conditions for the trading of Global Covered Bonds in definitive form. The Issuer will promptly give notice to Covered Bondholders in accordance with Condition 11 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg or any person acting on their behalf (acting on the instructions of any holder of an interest in such Registered Global Covered Bond) may give notice to the Registrar requesting such exchange and, in the event of the occurrence of an Exchange Event as described in (ii) above, the Issuer may also give notice to the Registrar requesting exchange. Any such exchange shall occur not later than 10 days after the date of receipt of the first relevant notice by the Registrar.

Transfer of interest

For so long as any of the Covered Bonds are represented by a Bearer Global Covered Bond held by Euroclear and/or Clearstream, Luxembourg, or so long as DTC or its nominee is the registered holder of a Registered Global Covered Bond or so long as the Covered Bond is a VS Systems Covered Bond, each person who is for the time being shown in the records of Euroclear and/or Clearstream, Luxembourg, DTC, the ISD or VP Lux, as the case may be, as the holder of a particular nominal amount of such Covered Bonds (in which regard any certificate or other document issued by Euroclear, Clearstream, Luxembourg, DTC or its nominee, the ISD or VP Lux as to the nominal amount of such Covered Bonds standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Issuer, the Fiscal Agent and any other Paying Agent as the holder of such nominal amount of such Covered Bonds for all purposes other than (in the case only of Covered Bonds not being VS System Covered Bonds) with respect to the payment of principal or interest on the Covered Bonds, for which purpose, in the case of Covered Bonds represented by a Bearer Global Covered Bond, the bearer of the relevant Global Bearer Covered Bond, or in the case of Covered Bonds where DTC or its nominee is the registered holder of a Registered Global Covered Bond, DTC or its nominee shall be treated by the Issuer, the Fiscal Agent and any other Paying Agent as the holder of such Covered Bonds in accordance with and subject to the terms of the relevant global Covered Bond (and the expressions “Covered Bondholder” and “holder of Covered Bonds” and related expressions shall be construed accordingly).

Covered Bonds which are represented by a Bearer Global Covered Bond will only be transferable in accordance with the rules and procedures for the time being of Euroclear or Clearstream, Luxembourg.

Interests in a Registered Global Covered Bond may, subject to compliance with all applicable restrictions, be transferred to a person who wishes to hold such interest in another Registered Global Covered Bonds. No beneficial owner of an interest in a Registered Global Covered Bond will be able to exchange or transfer such interest, except in accordance with the applicable procedures of DTC, Euroclear and Clearstream, Luxembourg, in each case to the extent applicable. Transfers of beneficial interests in Registered Global Covered Bonds will be effected by Euroclear or Clearstream, Luxembourg, as the case may be, and, in turn, by other participants and, if appropriate, indirect participants in such clearing systems acting on behalf of transferors and transferees of such interests. A beneficial interest in a Registered Global Covered Bond will, subject to compliance with all applicable legal and regulatory restrictions, be transferable for Covered Bonds in definitive form or for a beneficial interest in another Registered Global Covered Bond only in the authorised denominations set out in the applicable Final Terms and only in accordance with the rules and operating procedures for the time being of

Euroclear or Clearstream, Luxembourg, as the case may be, and in accordance with the terms and conditions specified in the Agency Agreement. Registered Covered Bonds are also subject to the restrictions on transfer set forth therein and will bear a legend regarding such restrictions.

A Registered Covered Bond in definitive form may be transferred in whole or in part (in the authorised denominations set out in the applicable Final Terms). In order to effect any such transfer (a) the holder or holders thereof must (i) surrender the Registered Covered Bond for registration of the transfer of the Registered Covered Bond (or the relevant part of the Registered Covered Bond) at the specified office of any Transfer Agent, with the form of transfer thereof in writing and (ii) complete and deposit such other certification as may be required by the relevant Transfer Agent (if any) and (b) the relevant Transfer Agent (if any) must, after due and careful enquiry, be satisfied with the documents of title and the identity of the person making the request. Subject as provided above, the relevant Transfer Agent (if any) has agreed within three business days (being for this purpose a day on which banks are open for business in the city where the specified office of the relevant Transfer Agent (if any) is located) of the request (or such longer period as may be required to comply with any applicable fiscal or other laws or regulations), authenticate and deliver, or procure the authentication and delivery of, at its specified office as the relevant transferee may request, a new Registered Covered Bond in definitive form in respect of the balance of the Registered Covered Bond not transferred will be so authenticated and delivered or (at the risk of the transferor) sent to the transferor.

Prior to expiry of the applicable Distribution Compliance Period, transfers by the holder of, or of a beneficial interest in, a Regulation S Global Covered Bond to a transferee in the United States or who is a U.S. person will only be made upon receipt by the Registrar of a written certification substantially in the form set out in the Agency Agreement, amended as appropriate, copies of which are available from the specified office of any Transfer Agent (if any), from the transferor of the Covered Bond or beneficial interest therein to the effect that such transfer is being made pursuant to the Securities Act or an exemption therefrom, subject to receipt by the Issuer of such satisfactory evidence as the Issuer may reasonably require, which may include an opinion of U.S. counsel, that such transfer is in compliance with any applicable securities laws of any State of the United States, and, in each case, in accordance with any applicable securities laws of any State of the United States or any other jurisdiction.

Each Tranche of VS System Covered Bonds will be issued in uncertificated and dematerialised book entry form. Legal title to the VS Systems Covered Bonds will be evidenced by book entries in the records of ISD or VP LUX. Title to the VS System Covered Bonds will pass by registration in the register between the direct accountholders at the ISD or VP Lux in accordance with the rules and procedures of the ISD and VP LUX. The person evidenced (including any nominee) as a holder of the VS System Covered Bonds shall be treated as the holder of such VS System Covered Bonds for the purposes of payment of principal and interest on such VS System Covered Bonds. Settlement of sale and purchase transactions in respect of VS System Covered Bonds in the ISD or VP LUX will take place in accordance with market practice at the time of the relevant transaction.

Title to the VS System Covered Bonds will pass by registration in the registers between the direct accountholders at the ISD or VP LUX.

Covered Bonds that are represented by a Global Covered Bond and VS System Covered Bonds will be transferable only in accordance with the rules and procedures for the time being of Euroclear, Clearstream, VP LUX and/or ISD, (as the case may be). References to Euroclear, Clearstream, VP LUX and/or the ISD, (as the case may be) shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system approved by the Issuer.

Title to the Bearer Covered Bonds, Receipts and Coupons will pass by delivery. The Issuer may deem and treat the bearer of any Bearer Bond, Receipt of Coupon as the absolute owner thereof (whether or not overdue and notwithstanding any notice of ownership or writing thereon or notice of any previous loss or theft thereof) for all purposes.

3. STATUS OF THE COVERED BONDS

The Covered Bonds constitute direct, unconditional, unsubordinated and secured obligations of the Issuer issued in accordance with the Act on Covered Bonds and appurtenant regulations and rank *pari passu* among themselves and with all other obligations of the Issuer that have been provided the same priority as debt instruments issued pursuant to the Act on Covered Bonds (save for certain obligations required to be preferred by law) (other than subordinated obligations, if any), from time to time outstanding. Senior Debt (if any) ranks thereafter. To the extent that claims in relation to the Covered Bonds, related derivative contracts and Senior Debt (if any) are not met out of the assets of the Cover Pool or the proceeds arising from it, the residual claims will rank *pari passu* with the claims of all other unsubordinated creditors of the Issuer (other than those preferred by law) in all other respects. The cost of bankruptcy administration, to such extent as the cost is incurred due to efforts of the bankruptcy administrator concerning the Covered Bonds and the Cover Pool, will rank ahead of claims for payments of the Covered Bonds, of related derivative contracts and of the relevant Senior Debt (if any). Other cost of bankruptcy administration shall not be paid from the assets of the Cover Pool.

4. ISSUER COVENANTS

4.1 Negative pledge

In accordance with the Act on Covered Bonds, cf. Article 12(4), the Issuer undertakes, so long as any of the Covered Bonds, Receipts or Coupons remain outstanding, that it will not, and that it will procure that none of its Relevant Subsidiaries will, create or have outstanding any mortgage, charge, pledge, lien or other security interest (each a Security Interest) over the assets in the Cover Pool, other than any lien arising by operation of law (if any).

4.2 Maintenance of the Issuer's Cover Pool

For so long as the Covered Bonds are outstanding, the value of the Cover Pool will not at any time be less than the total aggregate outstanding principal amount of all Covered Bonds issued under the Programme plus an Overcollateralization of 20 per cent.

For the avoidance of doubt, the Issuer shall not at any time reduce the Overcollateralization which applies to the Programme if to do so would result in any credit rating then applying to the Covered Bonds by any rating agency appointed by the Issuer in respect of the Covered Bonds being reduced, removed, suspended or placed on credit watch.

4.3 Composition of the Issuer's Cover Pool

For so long as any of the Covered Bonds are outstanding the Issuer shall ensure that the Cover Pool maintained or to be maintained by the Issuer shall at all times comply with the requirements of the Act on Covered Bonds.

4.4 Interest cover

The amounts of interest received by the Issuer in respect of the Cover Pool and under the related derivative contracts entered into by the Issuer shall be at least equal to or exceed the amounts payable by the Issuer under the Covered Bonds and the related derivative contracts entered into by the Issuer.

5. REDENOMINATION

Where redenomination is specified in the applicable Final Terms as being applicable, the Issuer may, without the consent of the Covered Bondholders, the Receiptholders and the Couponholders, but after at least 30 days' prior notice to the Covered Bondholders in accordance with Condition 11, elect that, with effect from the

Redenomination Date specified in the notice, the Covered Bonds shall be redenominated in euro or other Specified Currency.

The election will have effect as follows:

- (i) the Covered Bonds shall be deemed to be redenominated into euro or other Specified Currency in the denomination of euro 0.01 or as applicable to other Specified Currency with a principal amount for each Covered Bond equal to the principal amount of that Covered Bond in the Specified Currency, converted into euro or other Specified Currency at the spot rate for such conversion on the day that the relevant redenomination occurs, provided that, if the Issuer determines, that the then market practice in respect of the redenomination into euro or other Specified Currency of internationally offered securities is different from the provisions specified above, such provisions shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Covered Bondholders, the stock exchange (if any) on which the Covered Bonds may be listed of such deemed amendments;
- (ii) save to the extent that an Exchange Notice has been given in accordance with paragraph 5(iv) below, the amount of interest due in respect of the Covered Bonds will be calculated by reference to the aggregate principal amount of Covered Bonds presented for payment by the relevant holder and the amount of such payment shall be rounded down to the nearest euro 0.01 or as applicable in the relevant Specified Currency;
- (iii) if definitive Covered Bonds are required to be issued after the Redenomination Date, they shall be issued at the expense of the Issuer in the denominations as the Issuer shall determine and notify to the Covered Bondholders;
- (iv) if issued prior to the Redenomination Date, all unmatured Coupons denominated in the Specified Currency (whether or not attached to the Covered Bonds) will become void with effect from the date on which the Issuer gives notice (the Exchange Notice) that replacement euro-denominated Covered Bonds, Receipts and Coupons are available for exchange (provided that such securities are so available) and no payments will be made in respect of them. The payment obligations contained in any Covered Bonds and Receipts so issued will also become void on that date although those Covered Bonds and Receipts will continue to constitute valid exchange obligations of the Issuer. New redenominated Covered Bonds, Receipts and Coupons will be issued in exchange for Covered Bonds, Receipts and Coupons denominated in the Specified Currency in such manner as the Principal Paying Agent may specify and as shall be notified to the Covered Bondholders in the Exchange Notice. No Exchange Notice may be given less than 15 days prior to any date for payment of principal or interest on the Covered Bonds;
- (v) after the Redenomination Date, all payments in respect of the Covered Bonds, other than payments of interest in respect of periods commencing before the Redenomination Date, will be made solely in the redenomination currency;
- (vi) if the Covered Bonds are Fixed Rate Covered Bonds, Inflation Linked Annuity Covered Bonds or Inflation Linked Equal Principal Payment Covered Bonds, and interest for any period ending on or after the Redenomination Date is required to be calculated for a period ending other than on an Interest Payment Date, it will be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest Sub-Unit of the relevant Specified Currency, half of any such Sub-Unit being rounded upwards or otherwise in accordance with applicable market convention; and
- (vii) if the Covered Bonds are Floating Rate Covered Bonds, the applicable Final Terms will specify any relevant changes to the provisions relating to interest.

6. INTEREST

6.1 Interest on Inflation Linked Annuity Covered Bonds

Each Inflation Linked Annuity Covered Bond bears interest from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest. Interest shall be calculated as defined under Interest Payment(s) in the applicable Final Terms and rounding the resultant figure to the nearest ISK. Interest will be payable in arrears on the Interest Payment Date(s) in each year up to (and including) the Maturity Date.

If interest is required to be calculated for a period other than an Interest Period, such interest shall be calculated by using the same methodology as described for Interest Payment(s) in the applicable Final Terms.

6.2 Interest on Inflation Linked Equal Principal Payment Covered Bonds including Covered Bonds with one payment of Principal on Maturity Date

Each Inflation Linked Equal Principal Payment Covered Bond, including Covered Bonds with one payment of principal on Maturity Date, bears interest from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest. Interest shall be calculated as defined under Interest Payment(s) in the applicable Final Terms and rounding the resultant figure to the nearest ISK. Interest will be payable in arrears on the Interest Payment Date(s) in each year up to (and including) the Maturity Date.

If interest is required to be calculated for a period other than an Interest Period, such interest shall be calculated by using the same methodology as described for Interest Payment(s) in the applicable Final Terms.

6.3 Interest on Fixed Rate Covered Bonds

Each Fixed Rate Covered Bond bears interest from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest.

Interest shall be calculated as defined under Interest Payment(s) in the applicable Final Terms and rounding the resultant figure to the nearest ISK. Interest will be payable in arrears on the Interest Payment Date(s) in each year up to (and including) the Maturity Date.

If interest is required to be calculated for a period other than an Interest Period, such interest shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest Sub-Unit of the relevant Specified Currency, half of any such Sub-Unit being rounded upwards or otherwise in accordance with applicable market convention.

6.4 Interest on Floating Rate Covered Bonds

a) Interest Payment Dates

Each Floating Rate Covered Bond bears interest from (and including) the Interest Commencement Date and such interest will be payable in arrears on either:

the Specified Interest Payment Date(s) in each year specified in the applicable Final Terms; or

if no Specified Interest Payment Date(s) is/are specified in the applicable Final Terms, each date (each such date, together with each Specified Interest Payment Date, an Interest Payment Date) which falls the number of months, or other period specified as the Specified Period in the applicable Final Terms, after the preceding Interest Payment Date or, in the case of the first Interest Payment Date, after the Interest Commencement Date.

Such interest will be payable in respect of each Interest Period (which expression shall, in these Terms and Conditions, mean the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.

b) Rate of Interest

The Rate of Interest payable from time to time in respect of Floating Rate Covered Bonds will be determined in the manner specified in the applicable Final Terms.

ISDA Determination for Floating Rate Covered Bonds

Where ISDA Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will be the relevant ISDA Rate plus or minus (as indicated in the applicable Final Terms) the Margin (if any). For the purposes of this subparagraph (i), ISDA Rate for an Interest Period means a rate equal to the Floating Rate that would be determined by the Principal Paying Agent or other person specified in the applicable Final Terms under any interest rate swap transaction if the Principal Paying Agent or that other person were acting as Calculation Agent for that swap transaction under the terms of an agreement incorporating the 2000 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc. and as amended and updated as at the Issue Date of the first Tranche of the Covered Bonds (the ISDA Definitions), and under which:

- (i) the Floating Rate Option is as specified in the applicable Final Terms;
- (ii) the Designated Maturity is the period specified in the applicable Final Terms; and
- (iii) unless otherwise stated in the applicable Final Terms, the relevant Reset Date is the first day of that Interest Period.

For the purposes of this subparagraph (i), Floating Rate, Calculation Agent, Floating Rate Option, Designated Maturity and Reset Date have the meanings given to those terms in the ISDA Definitions.

Screen Rate Determination for Floating Rate Covered Bonds

Where Screen Rate Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will, subject as provided below, be either:

- (i) the offered quotation (if there is only one quotation on the Relevant Screen Page); or
- (ii) the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) of the offered quotations, (expressed as a percentage rate per annum) for the Reference Rate which appears or appear, as the case may be, on the Relevant Screen Page as at 11.00 a.m. (Iceland time, in the case of REIBOR, London time, in the case of LIBOR, or Brussels time, in the case of EURIBOR) on the Interest Determination Date in question plus or minus (as indicated in the applicable Final Terms) the Margin (if any), all as determined by the Issuer. If five or more of such offered quotations are available on the Relevant Screen Page, the highest (or, if there is more than one such highest quotation, one only of such quotations) and the lowest (or, if there is more than one such lowest quotation, one only of such quotations) shall be disregarded by the Issuer for the purpose of determining the arithmetic mean (rounded as provided above) of such offered quotations.

If the Reference Rate from time to time in respect of Floating Rate Covered Bonds is specified in the applicable Final Terms as being other than REIBOR, LIBOR or EURIBOR, the Rate of Interest in respect of such Covered Bonds will be determined as provided in the applicable Final Terms.

c) Minimum Rate of Interest and/or Maximum Rate of Interest

If the applicable Final Terms for a Floating Rate Covered Bond specifies a Minimum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (b) above is less than such Minimum Rate of Interest, the Rate of Interest for such Interest Period shall be such Minimum Rate of Interest.

If the applicable Final Terms for a Floating Rate Covered Bond specifies a Maximum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (b) above is greater than such Maximum Rate of Interest, the Rate of Interest for such Interest Period shall be such Maximum Rate of Interest.

d) Determination of Rate of Interest and calculation of Interest Amounts

The Calculation Agent will at, or as soon as practicable after, each time at which the Rate of Interest is to be determined, determine the Rate of Interest for the relevant Interest Period.

The Calculation Agent will calculate the amount of interest (each an Interest Amount) payable on the Floating Rate Covered Bonds in respect of each Specified Denomination for the relevant Interest Period. Each Interest Amount shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest Sub-Unit of the relevant Specified Currency, half of any such Sub-Unit being rounded upwards or otherwise in accordance with applicable market convention.

e) Maximum Interest Amounts

If the applicable Final Terms specifies a Maximum Interest Amount for any Interest Period, in the event that the Interest Amount in respect of such Interest Period determined in accordance with the provisions of paragraph (d) above is greater than such Maximum Interest Amount, the Interest Amount for such Interest Period shall be such Maximum Interest Amount.

f) Certificates to be final

All certificates, communications, opinions, determinations, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition (6.4), shall (in the absence of wilful default, bad faith or manifest error as aforesaid) be binding on the Issuer and all Covered Bondholders, Receiptholders and Couponholders.

6.5 Accrual of interest

Each Covered Bond (or in the case of the redemption of part only of a Covered Bond, that part only of such Covered Bond) will cease to bear interest (if any) from the date of its redemption unless, upon due presentation thereof, payment of principal is improperly withheld or refused. In such event, interest will continue to accrue in accordance with these Terms and Conditions. In the event of non-payment of a Zero Coupon Covered Bond, interest will accrue as provided in Condition 8.11.

- a) The Covered Bonds shall bear interest from (and including) the Maturity Date to (but excluding) the earlier of the relevant Interest Payment Date after the Maturity Date on which the Covered Bonds are redeemed or the Extended Maturity Date, subject to Condition 8.12. In that event, interest shall be payable on those Covered Bonds at the rate determined in accordance with Condition 6.6 (b) on the Principal Amount Outstanding of the Covered Bonds on each Interest Payment Date after the Maturity Date in respect of the Interest Period ending immediately prior to the relevant Interest Payment Date, subject as otherwise provided in the applicable Final Terms. The final Interest Payment Date shall fall no later than the Extended Maturity Date;
- b) The rate of interest payable from time to time under Condition 6.6(a) will be as specified in the applicable Final Terms and, where applicable, determined by the Calculation Agent so specified, three Business Days after the Maturity Date in respect of the first such Interest Period and thereafter as specified in the applicable Final Terms; and
- c) In the case of Covered Bonds which are Zero Coupon Covered Bonds, for the purposes of this Condition (6.5) the Principal Amount Outstanding shall be the total amount otherwise payable by the Issuer on the Maturity Date less any payments made by the Issuer in respect of such amount in accordance with these Conditions.

6.6 Interest Payments up to the Extended Maturity Date

If an Extended Maturity Date is specified in the applicable Final Terms as applying to a Series of Covered Bonds and the maturity of those Covered Bonds is extended beyond the Maturity Date in accordance with Condition 8.12:

- a) the Covered Bonds shall bear interest from (and including) the Maturity Date to (but excluding) the earlier of the relevant Interest Payment Date after the Maturity Date on which the Covered Bonds are redeemed or the Extended Maturity Date. In that event, interest shall be payable on those Covered Bonds at the rate determined in accordance with Condition 6.6(b) on the Principal Amount Outstanding of the Covered Bonds on each Interest Payment Date after the Maturity Date in respect of the Interest Period ending immediately prior to the relevant Interest Payment Date, subject as otherwise provided in the applicable Final Terms. The final Interest Payment Date shall fall no later than the Extended Maturity Date;
- b) the rate of interest payable from time to time under Condition 6.6(a) will be as specified in the applicable Final Terms and, where applicable, determined by the Issuer so specified, three Business Days after the Maturity Date in respect of the first such Interest Period and thereafter as specified in the applicable Final Terms; and
- c) in the case of Covered Bonds which are Zero Coupon Covered Bonds, for the purposes of this Condition (6.6) the Principal Amount Outstanding shall be the total amount otherwise payable by the Issuer on the Maturity Date less any payments made by the Issuer in respect of such amount in accordance with these Conditions.

6.7 Business Day, Business Day Convention, Day Count Fraction and other adjustments

- a) In these Terms and Conditions, Business Day means:
 - (i) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in Reykjavík and any Additional Business Centre specified in the applicable Final Terms; and
 - (ii) either (A) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency as specified in applicable Final Terms (if other than Reykjavík and any Additional Business Centre and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney and Auckland, respectively) or (B) in relation to any sum payable in euro, a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System (the TARGET System) is open.
- b) If a Business Day Convention is specified in the applicable Final Terms and (x) if there is no numerically corresponding day in the calendar month in which an Interest Payment Date should occur or (y) if any Interest Payment Date would otherwise fall on a day which is not a Business Day, then, if the Business Day Convention specified is:
 - (i) in any case where Specified Periods are specified in accordance with Condition 6.4(a), the Floating Rate Convention, such Interest Payment Date (1) in the case of (x) above, shall be the last day that is a Business Day in the relevant month and the provisions of (ii) below shall apply mutatis mutandis, or (2) in the case of (y) above, shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event (I) such Interest Payment Date shall be brought forward to the immediately preceding Business Day, and (II) each subsequent Interest Payment Date shall be the last Business Day

in the month which falls the Specified Period after the preceding applicable Interest Payment Date occurred; or

- (ii) the Following Business Day Convention, such Interest Payment Date shall be postponed to the next day which is a Business Day; or
- (iii) the Modified Following Business Day Convention, such Interest Payment Date shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event such Interest Payment Date shall be brought forward to the immediately preceding Business Day; or
- (iv) the Preceding Business Day Convention, such Interest Payment Date shall be brought forward to the immediately preceding Business Day.

c) Day Count Fraction means, in respect of the calculation of an amount of interest for any Interest Period:

if *Actual/Actual (ISMA)* is specified in the applicable Final Terms:

- (i) in the case of Covered Bonds where the number of days in the relevant period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (the “**Accrual Period**”) is equal to or shorter than the Determination Period (as defined in Condition 6.7(d)) during which the Accrual Period ends, the number of days in such Accrual Period divided by the product of (I) the number of days in such Determination Period and (II) the number of Determination Dates (as specified in the applicable Final Terms) that would occur in one calendar year assuming that interest was to be payable in respect of the whole of that year; or
- (ii) in the case of Covered Bonds where the Accrual Period is longer than the Determination Period during which the Accrual Period ends, the sum of (I) the number of days in such Accrual Period falling in the Determination Period in which the Accrual Period begins divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and (II) the number of days in such Accrual Period falling in the next Determination Period divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year;

if *Actual/365* is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (i) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366, and (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365);

if *Actual/365 (Fixed)* is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365;

if *Actual/365 (Sterling)* is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 or, in the case of an Interest Payment Date falling in a leap year, 366;

if *Actual/360* is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 360;

if *30/360, 360/360 or Bond Basis* is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months (unless, in the case of Floating Rate Covered Bonds only, (i) the last day of the Interest Period is the 31st day of a month but the first day of the Interest Period is a day other than the 30th or 31st day of a month, in which case the month that includes that last day shall not be considered to be shortened to a 30-day month, or (ii) the last day of the Interest Period is the last day of the month

of February, in which case the month of February shall not be considered to be lengthened to a 30-day month));

if *30E/360 or Eurobond Basis* is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months, without regard to the date of the first day or last day of the Interest Period unless, in the case of the final Interest Period, the Maturity Date is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month); or such other Day Count Fraction as may be specified in the applicable Final Terms.

- d) Determination Period means each period from (and including) a Determination Date to (but excluding) the next Determination Date (including, where either the Interest Commencement Date or the final Interest Payment Date is not a Determination Date, the period commencing on the first Determination Date prior to, and ending on the first Determination Date falling after, such date).
- e) Interest Period means the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.
- f) Principal Amount Outstanding means, in respect of a Covered Bond except an Inflation Linked Annuity Covered Bond and an Inflation Linked Equal Payment Covered Bond, on any day the principal amount of that Covered Bond on the Issue Date less principal amounts (if any) received by the holder of such Covered Bond in respect thereof on or prior to that day. In respect of an Inflation Linked Annuity Covered Bond and an Inflation Linked Equal Payment Covered Bond, the meaning given in the applicable Final Terms.
- g) Sub-Unit means, with respect to any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, with respect to euro, euro 0.01.

7. PAYMENTS

7.1 Payments in respect of Inflation Linked Covered Bonds

- a) Payments in respect of Inflation Linked Annuity Covered Bonds

In case of an Inflation Linked Annuity Covered Bond, the Issuer shall, on each relevant Interest Payment Date, make a combined payment of principal, and interest due (together, the Annuity Amount) as calculated by the Calculation Agent in accordance with the formula specified in the applicable Final Terms.

- b) Payments in respect of Inflation Linked Equal Principal Payment Covered Bond, including Covered Bonds with one payment of Principal on Maturity Date

In case of an Inflation Linked Equal Payment Covered Bond, including Covered Bonds with one payment of Principal on Maturity Date, the Issuer shall, on each relevant Interest Payment Date, make a combined payment of principal, and interest due (together, the Equal Payment Amount) as calculated by the Calculation Agent in accordance with the formula specified in the applicable Final Terms.

7.2 Method of payment

Subject as provided below payments in a Specified Currency will be made:

- a) by credit or transfer to an account in the relevant Specified Currency maintained by the payee with a bank in the principal financial centre of the country of such Specified Currency, or
- b) by credit or transfer to an account in any other Specified Currency maintained by the payee with a bank in the principal financial centre of the country of such Specified Currency which shall be converted into such Specified Currency at the date of payment using the spot rate of exchange for the purchase of such currency against payment of ISK being quoted by the Fiscal Agent.

Payments will be subject in all cases to any fiscal or other laws and regulations applicable thereto in the place of payment but without prejudice to the provisions of Condition 7.

7.3 Presentation of Definitive Covered Bonds, Receipts and Coupons

Payments of principal in respect of definitive Bearer Covered Bonds will (subject as provided below) be made in the manner provided in Condition 7.2 (Method of payment) only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of definitive Covered Bonds, and payments of interest in respect of definitive Covered Bonds will (subject as provided below) be made as aforesaid only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of Coupons, in each case at the specified office of any Paying Agent outside the United States (which expression, as used herein, means the United States of America (including the States and the District of Columbia and its possessions)).

Payments of instalments of principal (if any) in respect of definitive Bearer Covered Bonds, other than the final instalment, will (subject as provided below) be made in the manner provided in Condition 7.2 only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Receipt in accordance with the preceding paragraph. Payment of the final instalment will be made in the manner provided in Condition 7.2 only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Covered Bond in accordance with the preceding paragraph. Each Receipt must be presented for payment of the relevant instalment together with the definitive Bearer Covered Bond presented for payment of the relevant instalment together with the definitive Bearer Covered Bond to which they appertain do not constitute valid obligations of the Issuer. Upon the date on which any definitive Bearer Covered Bond becomes due and repayable, unmatured Receipts (if any) relating thereto (whether or not attached) shall become void and no payment shall be made in respect thereof.

Fixed Rate Covered Bonds in definitive bearer form should be presented for payment together with all unmatured Coupons appertaining thereto (which expression shall for this purpose include Coupons falling to be issued on exchange of matured Talons), failing which the amount of any missing unmatured Coupon (or, in the case of payment not being made in full, the same proportion of the amount of such missing unmatured Coupon as the sum so paid bears to the sum due) will be deducted from the sum due for payment. Each amount of principal so deducted will be paid in the manner mentioned above against surrender of the relative missing Coupon at any time before the expiry of 10 years after the Relevant Date (as defined in Condition 10) in respect of such principal or, if later, five years from the date on which such Coupon would otherwise have become due, but in no event thereafter.

Upon any Fixed Rate Covered Bond in definitive bearer form becoming due and repayable prior to its Maturity Date, all unmatured Talons (if any) appertaining thereto will become void and no further Coupons will be issued in respect thereof.

Upon the date on which any Floating Rate Covered Bond in definitive form becomes due and repayable, unmatured Coupons and Talons (if any) relating thereto (whether or not attached) shall become void and no payment or, as the case may be, exchange for further Coupons shall be made in respect thereof.

If the due date for redemption of any definitive Bearer Covered Bond is not an Interest Payment Date, interest (if any) accrued in respect of such Bearer Covered Bond from (and including) the preceding Interest Payment Date or, as the case may be, the Interest Commencement Date shall be payable only against surrender of the relevant definitive Bearer Covered Bonds.

7.4 Payments in respect of Bearer Global Covered Bond

Payments of principal and interest (if any) in respect of Covered Bonds represented by any Bearer Global Covered Bond will (subject as provided below) be made in the manner specified above in relation to definitive Bearer Covered Bonds and otherwise in the manner specified in the relevant Bearer Global Covered Bond, where applicable, against presentation or surrender, as the case may be, of such Bearer Global Covered Bond at the specified office of any Paying Agent outside the United States. A record of each payment, distinguishing

between any payment of principal and any payment of interest, will be made on such Bearer Global Covered Bond either by the Paying Agent to which it was presented or in the records of Euroclear and Clearstream, Luxembourg, as applicable.

7.5 Payments in respect of Registered Covered Bonds

Payments of principal (other than instalments of principal prior to the final instalment) in respect of each Registered Covered Bond (whether or not in global form) will be made against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the Registered Covered Bond at the specified office of the Registrar or any of the Paying Agents. Such payments will be made by transfer to the Designated Account of the holder (or the first named of joint holders) of the Registered Covered Bond appearing in the register of holders of the Registered Covered Bonds maintained by the Registrar (i) where in global form, at the close of the business day (being for this purpose a day on which Euroclear and Clearstream, Luxembourg are open for business) before the relevant due date, and (ii) where in definitive form at the close of business at the close of business on the third business day (being for this purpose a day on which banks are open for business in the city where the specified office of the Registrar is located) before the relevant due date. Notwithstanding the previous sentence, if (a) holder does not have a Designated Account or (b) the principal amount of the Covered Bonds held by a holder is less than U.S. \$250,000 (or its approximate equivalent in any other Specified Currency), payment will instead be made by a cheque in the Specified Currency drawn on a Designated Bank. For these purposes, Designated Account means the account (which, in the case of a payment in Japanese yen to a non-resident of Japan, shall be a non-resident account) maintained by a holder with a Designated Bank and identified as such in the Registered Covered Bond Register and Designated Bank means (in the case of payment in a Specified Currency other than euro) a bank in the principal financial centre of the country of such Specified Currency (which, if the Specified Currency is Australian dollars or New Zealand dollars, shall be Sydney and Auckland, respectively) and (in the case of a payment in euro) any bank which processes payments in euro.

Payments of interest and payments of instalments of principal (other than the final instalment) in respect of each Registered Covered Bond (whether or not in global form) will be made by a cheque in the Specified Currency drawn on a Designated Bank and mailed by uninsured mail on the Business Day in the city where the specified office of the registrar is located immediately preceding the relevant due date to the holder (or the first named of joint holders) of the Registered Covered Bond appearing in the Registered Covered Bond Register (i) where in global form, at the close of the business day (being for this purpose a day on which Euroclear and Clearstream, Luxembourg are open for business) before the relevant due date, and (ii) where in definitive form, at the close of business on the fifteenth day (whether or not such fifteenth day is a business day) before the relevant due date (the Record Date) at his address shown in the Registered Covered Bond Register on the Record Date and at his risk. Upon application of the holder to the specified office of the Registrar not less than three Business Days in the city where the specified office of the Registrar is located before the due date for any payment of interest in respect of a Registered Covered Bond, the payment may be made by transfer on the due date in the manner provided in the preceding paragraph. Any such application for transfer shall be deemed to relate to all future payments of interest (other than interest due on redemption) and instalments of principal (other than the final instalment) in respect of the Registered Covered Bonds which become payable to the holder who has made the initial application until such time as the Registrar is notified in writing to the contrary by such holder. Payment of the interest due in respect of each Registered Covered Bond on redemption and the final instalment of principal will be made in the same manner as payment of the principal amount of such Registered Covered Bond.

Holders of Registered Covered Bonds will not be entitled to any interest or other payment for any delay in receiving any amount due in respect of any Registered Covered Bond as a result of a cheque posted in accordance with this Condition arriving after the due date for payment or being lost in the post. No commissions or expenses shall be charged to such holders by the Registrar in respect of any payments of principal or interest in respect of the Registered Covered Bonds.

None of the Issuer or the Paying Agents will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interest in the Registered Global Covered Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

7.6 General provisions applicable to payments

The holder of a Global Covered Bond shall be the only person entitled to receive payments in respect of Covered Bonds represented by such Global Covered Bond and the Issuer will be discharged by payment to, or to the order of, the holder of such Global Covered Bond in respect of each amount so paid. Each of the persons shown in the records of Euroclear or Clearstream, Luxembourg as the beneficial holder of a particular nominal amount of Covered Bonds represented by such Global Covered Bond must look solely to Euroclear or Clearstream, Luxembourg, as the case may be, for his share of each payment so made by the Issuer to, or to the order of, the holder of such Global Covered Bond.

7.7 Payments in respect of VS System Covered Bonds

VS System Covered Bonds: Payments of principal and interest in respect of VS System Covered Bonds will be made to the Covered Bondholders shown in the relevant records of the ISD, VP LUX or Clearstream/Euroclear (as the case may be) in accordance with and subject to the rules and regulations from time to time governing the ISD, VP LUX or Euroclear/Clearstream (as the case may be).

7.8 Payment Day

If the date for payment of any amount in respect of any Covered Bond, Receipt or Coupon is not a Payment Day, the holder thereof shall not be entitled to payment of the relevant amount due until the next following Payment Day and shall not be entitled to any interest or other sum in respect of any such delay. For these purposes, Payment Day means any day which (subject to Condition 10) is:

- a) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in:
 - the relevant place of presentation;
 - Reykjavík; and
 - any Additional Financial Centre specified in the applicable Final Terms.
- b) either (i) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than the place of presentation, Reykjavík and any Additional Financial Centre) or (ii) in relation to any sum payable in euro, a day on which the TARGET System is open.
- c) Interpretation of principal
 - Any reference in these Terms and Conditions to principal in respect of the Covered Bonds shall be deemed to include, as applicable:
 - the Final Redemption Amount of the Covered Bonds;
 - the Early Redemption Amount of the Covered Bonds;
 - the Optional Redemption Amount(s) (if any) of the Covered Bonds;
 - in relation to Covered Bonds (other than Inflation Linked Annuity Covered Bonds or Inflation Linked Equal Principal Payment Covered Bonds) redeemable in instalments, the Instalment Amounts;
 - in relation to Zero Coupon Covered Bonds, the Amortised Face Amount (as defined in Condition 8.7); and

any premium and any other amounts (other than interest) which may be payable under or in respect of the Covered Bonds.

8. REDEMPTION AND PURCHASE

8.1 Redemption of Inflation Linked Annuity Covered Bonds and Inflation Linked Equal Payment Covered Bonds, including Covered Bonds with one payment of Principal on Maturity Date

Unless previously redeemed or purchased and cancelled, each Inflation Linked Annuity Covered Bond and each Inflation Linked Equal Payment Covered Bond, including Covered Bonds with one payment of Principal on Maturity Date, will, subject to Condition 7.1(a) or (b) (as applicable), be redeemed in one or more amounts, calculated in accordance with the formula specified in the applicable Final Terms, in the relevant Specified Currency on the relevant Interest Payment Dates.

8.2 Final Redemption

Unless previously redeemed or purchased and cancelled, each Covered Bond will be redeemed by the Issuer at its Final Redemption Amount specified in, or determined in the manner specified in, the applicable Final Terms in the relevant Specified Currency on the Maturity Date.

8.3 Redemption at the option of the Issuer (Issuer Call)

If an Issuer Call is specified in the applicable Final Terms, the Issuer may, having given not less than 15 nor more than 30 days' notice to the Covered Bondholders in accordance with Condition 11 (which notices shall be irrevocable and shall specify the date fixed for redemption), redeem all or some only of the Covered Bonds then outstanding on any Optional Redemption Date and at the Optional Redemption Amount(s) specified in, or determined in the manner specified in, the applicable Final Terms together, if appropriate, with interest accrued to (but excluding) the relevant Optional Redemption Date. Any such redemption must be of a nominal amount not less than the Minimum Redemption Amount and not more than the Maximum Redemption Amount, in each case as may be specified in the applicable Final Terms. In the case of a partial redemption of Covered Bonds, the Covered Bonds to be redeemed (Redeemed Covered Bonds) will be selected individually without involving any part only of a Bearer Covered Bond, in the case of Redeemed Covered Bonds represented by definitive Covered Bonds, and in accordance with the rules of Euroclear and/or Clearstream, (to be reflected in the records of Euroclear and Clearstream as either a pool factor or a reduction in nominal amount, at their discretion) and in accordance with the rules of the ISD or any other relevant clearing system (as the case may be) in the case of VS System Covered Bonds in each case not more than 30 days prior to the date fixed for redemption (such date of selection being hereinafter called the Selection Date). In the Case of Redeemed Covered Bonds represented by definite Covered Bonds, a list of the serial numbers of such Redeemed Covered Bonds will be published in accordance with Condition 11 not less than 15 days prior to the date fixed for redemption. The aggregate nominal amount of Redeemed Covered Bonds represented by definitive Covered Bonds shall bear the same portion to the aggregate nominal amount of all Redeemed Covered Bonds as the aggregate nominal amount of definite Covered Bond outstanding bears to the aggregate nominal amount of the Covered Bonds outstanding, in each case on the Selection Date. No exchange of the relevant Covered Bond will be permitted during the period from (and including) the Selection Date to (and including) the date fixed for redemption pursuant to this Condition (8.3) and notice to that effect shall be given by the Issuer to the Covered Bondholders in accordance with Condition 11 at least five days prior to the Selection Date.

8.4 Redemption at the option of the Covered Bondholders (Investor Put)

If Investor Put is specified in the applicable Final Terms, upon the holder of any Covered Bond giving the Issuer in accordance with Condition 11 not less than 15 nor more than 30 days' notice the Issuer will, upon the expiry of such notice, redeem, subject to, and in accordance with, the terms specified in the applicable Final Terms,

such Covered Bond on the Optional Redemption Date and at the Optional Redemption Amount together, if appropriate, with interest accrued to (but excluding) the Optional Redemption Date. Registered Covered Bonds may be redeemed under this Condition in any multiple of their lowest Specified Denomination. It may be that before an Investor Put can be exercised, certain conditions and/or circumstances will need to be satisfied. Where relevant, the provisions will be set out in the applicable Final Terms.

To exercise the right to require redemption of this Covered Bond the holder of this Covered Bond must, if this Covered Bond is in definitive form and held outside Euroclear and Clearstream, Luxembourg, deliver, at the specified office of any Paying Agent (in the case of Bearer Covered Bonds) or the Registrar (in the case of Registered Covered Bonds) at any time during normal business hours of such Paying Agent or, as the case may be, the Registrar falling within the notice period, a duly completed and signed notice of exercise in the form (for the time being current) obtainable from any specified office of any Paying Agent or, as the case may be, the Registrar (a “**Put Notice**”) and in which the holder must specify a bank account (or, if payment is required to be made by cheque, an address) to which payment is to be made under this Condition and, in the case of Registered Covered Bonds, the nominal amount thereof to be redeemed and, if less than the full nominal amount of the Registered Covered Bonds so surrendered is to be redeemed, an address to which a new Registered Covered Bond in respect of the balance of such Registered Covered Bonds is to be sent subject to and in accordance with the provisions of Condition 2. If this Covered Bond is in definitive bearer form, the Put Notice must be accompanied by this Covered Bond or evidence satisfactory to the Paying Agent concerned that this Covered Bond will, following delivery of the Put Notice, be held to its order or under its control.

If the Covered Bond is represented by a Global Covered Bond or is in definitive form and held through Euroclear or Clearstream, Luxembourg, to exercise the right to require redemption of this Covered Bond the holder of this Covered Bond must, within the notice period, give notice to the Fiscal Agent of such exercise in accordance with the standard procedures of Euroclear and Clearstream, Luxembourg (which may include notice being given on his instruction by Euroclear or Clearstream, Luxembourg or any Common Depositary for them to the Fiscal Agent by electronic means) in a form acceptable to Euroclear and Clearstream, Luxembourg from time to time and, if this Covered Bond is represented by a Global Covered Bond, at the same time present or procure the presentation of the relevant Global Covered Bond to the Agent for notation accordingly.

If the Covered Bond is an ISD System Covered Bond, to exercise the right to require redemption of this Covered Bond the holder of this Covered Bond must, within the notice period, give notice to the Principal Paying Agent of such exercise in accordance with the standard procedures of the ISD from time to time. Any Put Notice or other notice given in accordance with the standard procedures of Euroclear and Clearstream, Luxembourg or, in the case of ISD System Covered Bonds, the ISD given by a holder of any Covered Bond pursuant to this paragraph shall be irrevocable.

8.5 Redemption due to illegality or invalidity

If the Covered Bonds become illegal and/or invalid, the Covered Bonds of all Series may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 or more than 60 days’ notice to all Covered Bondholders (which notice shall be irrevocable).

Covered Bonds redeemed pursuant to this Condition (8.5) will be redeemed at their Early Redemption Amount referred to in Condition 8.7 together (if appropriate) with interest accrued (and, if this is an Inflation Linked Annuity Covered Bond or an Inflation Linked Equal Principal Payment Covered Bond, including Covered Bonds with one payment of Principal on Maturity Date, adjusted for indexation in accordance with the provisions set out in the applicable Final Terms) to (but excluding) the date of redemption.

8.6 Certification

The publication of any notice of redemption pursuant to Condition 8.7 shall include a certificate signed by authorised personnel of the Issuer stating that the Issuer is entitled or required to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred and the certificate shall be sufficient evidence of the satisfaction of the conditions precedent set

out above, in which event it shall be conclusive and binding on all Covered Bondholders, Receiptholders and Couponholders.

8.7 Early Redemption Amounts

For the purpose of Condition 8.5, each Covered Bond will be redeemed at its Early Redemption Amount calculated as follows:

- a) in the case of a Covered Bond (other than a Zero Coupon Covered Bond but including an Instalment Covered Bond), at the amount specified in, or determined in the manner specified in, the applicable Final Terms or, if no such amount or manner is so specified in the applicable Final Terms, at its Principal Amount Outstanding (and, in the case of an Inflation Linked Annuity Covered Bond or an Inflation Linked Equal Principal Payment Covered Bond, including Covered Bonds with one payment of Principal on Maturity Date, adjusted for indexation in accordance with the provisions set out in the applicable Final Terms); or
- b) in the case of a Zero Coupon Covered Bond, at an amount (the Amortised Face Amount) calculated in accordance with the following formula:

$$\text{Early Redemption Amount} = \text{RP} \times (1 + \text{AY})^y$$

where:

RP means the Reference Price;

AY means the Accrual Yield expressed as a decimal; and

y is a fraction the numerator of which is equal to the number of days (calculated on the basis of a 360-day year consisting of 12 months of 30 days each) from (and including) the Issue Date of the first Tranche of the Covered Bonds to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Covered Bond becomes due and repayable and the denominator of which is 360, or on such other calculation basis as may be specified in the applicable Final Terms.

8.8 Instalments

Instalment Covered Bonds will be redeemed in the Instalment Amounts and on the Instalment Dates. In the case of early redemption, the Early Redemption Amount will be determined pursuant to Condition 8.7.

8.9 Purchases

The Issuer or any of its Subsidiaries may at any time purchase Covered Bonds at any price in the open market or otherwise. If purchases are made by tender, tenders must be available to all Covered Bondholders alike. Subject to the provision below, such Covered Bonds may be held, reissued, resold or, at the option of the Issuer, surrendered to the Issuer for cancellation.

8.10 Cancellation

All Covered Bonds which are redeemed will forthwith be cancelled (together with all unmaturing Receipts and Coupons attached thereto or surrendered therewith at the time of redemption). All Covered Bonds so cancelled and any Covered Bonds purchased and surrendered for cancellation pursuant to Condition 8.9 and cancelled (together with all unmaturing Receipts and Coupons cancelled therewith) shall be forwarded to the Issuer and in the case of VS System Covered Bonds shall be deleted from the records of the ISD, VP LUX or any other relevant clearing system (as the case may be) and cannot be reissued or resold.

8.11 Late Payment on Zero Coupon Covered Bonds

If the amount payable in respect of any Zero Coupon Covered Bond upon redemption of such Zero Coupon Covered Bond pursuant to Conditions 8.2, 8.3 or 8.5, the amount due and repayable in respect of such Zero

Coupon Covered Bond shall be the amount calculated as provided in Condition 8.7 (b) as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon Covered Bond becomes due and payable were replaced by references to the date which is the earlier of:

- a) the date on which all amounts due in respect of such Zero Coupon Covered Bond have been paid; and
- b) five days after the date on which the full amount of the moneys payable in respect of such Zero Coupon Covered Bonds has been received by the Issuer and notice to that effect has been given to the Covered Bondholders in accordance with Condition 11.

8.12 Extension of Maturity Date

- a) Extended Maturity Date:

An Extended Maturity Date shall be specified in the applicable Final Terms as applying to each Series of Covered Bonds unless to do so would result in the Issuer being unable to obtain if applicable the relevant credit rating from the relevant rating agencies appointed by the Issuer at the relevant time in respect of a Series of Covered Bonds.

- b) Automatic Extension:

If an Extended Maturity Date is specified in the applicable Final Terms as applying to a Series of Covered Bonds and the Issuer fails to redeem the relevant Covered Bonds in full on the Maturity Date or within three Business Days thereafter, the maturity of the outstanding Covered Bonds and the date on which such Covered Bonds will be due and repayable for the purposes of these Terms and Conditions will be automatically extended up to but no later than the Extended Maturity Date, subject as otherwise provided for in the applicable Final Terms. In that event, the Issuer may redeem all or any part of the Principal Amount Outstanding of the Covered Bonds on any Interest Payment Date falling in any month after the Maturity Date up to and including the Extended Maturity Date or as otherwise provided for in the applicable Final Terms. The Issuer shall give notice to the Covered Bondholders (in accordance with Condition 11) of its intention to redeem all or any of the Principal Amount Outstanding of the Covered Bonds at least five Business Days prior to the relevant Interest Payment Date. Any failure by the Issuer to notify such persons shall not affect the validity or effectiveness of any redemption by the Issuer on the relevant Interest Payment Date, or give rise to rights to any such person.

The Issuer is not required to notify the Covered Bondholders of such automatic deferral.

- c) Zero Coupon Bonds:

In the case of Covered Bonds which are Zero Coupon Covered Bonds to which an Extended Maturity Date is specified under the applicable Final Terms, for the purposes of this Condition (8.12) the Principal Amount Outstanding shall be the total amount otherwise payable by the Issuer on the Maturity Date less any payments made by the Issuer in respect of such amount in accordance with these Terms and Conditions.

- d) Extension Irrevocable:

Any extension of the Maturity Date under this Condition (8.12) shall be irrevocable. Where this Condition (8.12) applies, any failure to redeem the Covered Bonds on the Maturity Date or any extension of the Maturity Date under this Condition (8.12) shall not constitute an event of default or acceleration of payment for any purpose or give any Covered Bondholder any right to receive any payment of interest, principal or otherwise on the relevant Covered Bonds other than as expressly set out in these Terms and Conditions.

- e) Payments:

In the event of the extension of the maturity of Covered Bonds under this Condition (8.12) Interest Rates, Interest Periods and Interest Payment Dates on the Covered Bonds from (and including) the Maturity Date to (but excluding) the Extended Maturity Date shall be determined and made in accordance with the applicable Final Terms.

Interest will continue to accrue on any unpaid amount and be payable on each Interest Payment Date falling after the Maturity Date up to (and including) the Extended Maturity Date.

Furthermore, in relation to all amounts constituting accrued interest due and payable on each Interest Payment Date falling after the Maturity Date up to (and including) the Extended Maturity Date, as provided in the applicable Final Terms, the Issuer may pay such interest pursuant to the Floating Rate set out in the applicable Final Terms notwithstanding that the relevant Covered Bond was a Fixed Rate Covered Bond as at its relevant Issue Date.

f) Partial Redemption after Maturity Date:

If the Issuer redeems part and not all of the Principal Amount Outstanding of Covered Bonds on any Interest Payment Date falling after the Maturity Date, the redemption proceeds shall be applied rateably across the Covered Bonds and the Principal Amount Outstanding on the Covered Bonds shall be reduced by the level of that redemption. If any partial redemption after the Maturity Date is not sufficient to redeem all outstanding Interest Payments, then the remainder of any Interest Payment shall be added to the principal amount of the Covered Bonds.

g) Restriction on Further Issues:

If the maturity of any Covered Bonds is extended up to the Extended Maturity Date in accordance with this Condition (8.12) subject as otherwise provided for in the applicable Final Terms, for so long as any of those Covered Bonds remains outstanding, the Issuer shall not issue any further Covered Bonds, unless the proceeds of issue of such further Covered Bonds are applied by the Issuer on issue to redeem in whole or in part the relevant Covered Bonds in accordance with the terms hereof.

8.13 Redemption for Tax Reasons

The Covered Bonds may be redeemed at the option of the Issuer in whole, but not in part, at any time or on any Interest Payment Date, on giving not less than 30 nor more than 60 days' notice to the ISD and, in accordance with Condition 11, the Covered Bondholders (which notice shall be irrevocable), if:

- a) on the occasion of the next payment due under the Covered Bonds, the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 9 as a result of any change in, or amendment to, the laws or regulations in Iceland or any political subdivision or any authority thereof or any authority or agency therein having power to tax, or any change in the application or official interpretation of such laws or regulation, which change or amendment becomes effective on or after the Issue Date of the first Tranche of the Covered Bonds; and
- b) such obligation cannot be avoided by the Issuer taking reasonable measures available to it.

Covered Bonds redeemed pursuant to this Condition (8.13) will be redeemed at their Early Redemption Amount together (if appropriate) with interest accrued to (but excluding) the date of redemption.

9. TAXATION

All payments of principal and interest in respect of the Covered Bonds and Coupons by the Issuer will be made without, or deduction for or on account of, any present or future taxes, duties assessments or governmental charges of whatever nature imposed or levied by or on behalf of Iceland or any political subdivision or any authority or agency thereof or therein having power to tax unless such withholding or deduction is required by law. In such event, the Issuer will pay such additional amount as shall be necessary in order that the net amounts received by the holders of the Covered Bonds and Coupons after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Covered Bonds or Coupons, as the case may be, in the absence of such withholding or deduction, except that no such additional amounts shall be payable with respect to any Covered Bond or Coupon:

- a) in respect of any demand made for payment in Iceland; or
- b) in respect of any demand made for payment by or on behalf of a holder who is liable for such taxes, duties, assessments or governmental charges in respect of such Covered Bond or Coupon by reason of it having some connection with Iceland other than the mere holding of such Covered Bond or Coupon; or
- c) in respect of any demand made for payment more than thirty days after the Relevant Date (as defined below) except to the extent that the holder thereof would have been entitled to an additional amount on making such demand for payment on or before the expiry of such period of thirty days; or
- d) in respect of any demand made for payment by or on behalf of a holder who would be able to avoid such withholding or deduction by making a demand in respect of the Covered Bond or Coupon to another Paying Agent in a Member State of the EU.

Where such withholding or deduction is required to be made based on provisions of the Act on Withholding of Public Levies at Source No. 45/1987, as amended, the Act on Withholding of Tax on Financial Income No. 94/1996, as amended, and Article 3 of the ITA, and any other legislation, laws or regulations, replacing or supplementing the same.

10. PRESCRIPTION

The Covered Bonds, Receipts and Coupons will become void in accordance with Act on the Expiration of Debt and other Obligations No. 150/2007 unless presented for payment within 10 years (in the case of principal) and four years (in the case of interest or any other amount) after the Relevant Date (as defined below).

There shall not be included in any Coupon sheet issued on exchange of a Talon, any Coupon the claim for payment in respect of which would be void pursuant to this Condition (10) or Condition 7.3 or any Talon which would be void pursuant to Condition 7.3.

For the purposes of these Terms and Conditions, Relevant Date means the date on which such payment first becomes due, except that, if the full amount of the moneys payable has not been duly received by the Principal Paying Agent on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Covered Bondholders in accordance with Condition 11.

11. NOTICES

All notices regarding the Covered Bonds will be valid if published in a manner which complies with the rules and regulations of the relevant act which apply to publicly listed securities, and/or any stock exchange and/or any other relevant authority on which the Covered Bonds are for the time being listed or by which they have been admitted to trading. Any such notice will be deemed to have been given on the date of the first publication. The Issuer can additionally at its own discretion obtain information from the ISD or VP Lux on the Covered Bondholders in order to send notices to each Covered Bondholder directly.

Notices to be given by any Covered Bondholder shall be in writing and given by lodging the same, together with the relevant Covered Bond or Covered Bonds.

12. FURTHER ISSUES

The Issuer shall be at liberty from time to time without the consent of the Covered Bondholders, the Receiptholders or the Couponholders to create and issue further covered bonds having terms and conditions the same as the Covered Bonds or the same in all respects save for the amount and date of the first payment of

interest thereon and so that the same shall be consolidated and form a single Series with the outstanding Covered Bonds.

13. GOVERNING LAW AND JURISDICTION

The Covered Bonds (except for the ISD System Covered Bonds), the Receipts, the Coupons are governed by, and shall be construed in accordance with, English law except for Condition 3, which will be governed by, and construed in accordance with Icelandic Law.

The Issuer irrevocably agrees that any dispute arising out of the Programme, the Covered Bonds, the Coupons, the Receipts shall be subject to the exclusive jurisdiction of the Courts of England.

The ISD System Covered Bonds will be governed by, and construed in accordance with Icelandic law.

The Issuer irrevocably agrees that any dispute arising out of the ISD System Covered Bonds shall be subject to the exclusive jurisdiction of the District Court of Reykjavík (*Ice. "Héraðsdómur Reykjavíkur"*).

Legal action taken under this Condition (13) may be proceeded with in accordance with the Act on Civil Procedure No. 91/1991 (*Ice. "Lög um meðferð einkamála"*), Chapter 17.

SUMMARY OF ICELANDIC LEGISLATION IN CONSIDERATION OF COVERED BONDS

The Act on Covered Bonds was adopted by the Icelandic Parliament on 4 March 2008. This legislation enables Icelandic commercial banks, savings banks and credit undertakings which have been duly licensed to issue covered bonds as defined therein.

The Issuer is licensed by the FME under the Act on Covered Bonds which enables it to issue the Covered Bonds. The following constitutes a general summary of the Icelandic legislation governing the issuance of covered bonds in Iceland, at the date and pursuant to this Base Prospectus, which law may be supplemented, amended, modified or varied by legislative enactment or by way of judicial decisions and administrative pronouncements, including possibly, with retroactive effect. The summary does not purport nor shall be construed as being an exhaustive description or presentation of all aspects of the Covered Bond Legislation. The original language of the Act on Covered Bonds is Icelandic. The relevant legislation, executive orders and or regulations in the original Icelandic version should be consulted in the event of any doubt.

COVERED BONDS

The Act on Covered Bonds defines “covered bonds” as bonds and other unilateral, unconditional, written debt obligations which enjoy a right of priority over the cover pool (as defined below) of an issuer and which are issued in compliance with the Act on Covered Bonds.

COVER POOL

The Act on Covered Bonds defines a cover pool as the collection of bonds, substitute collateral and other assets that have been registered in a register in accordance with Chapter VI of the Act on Covered Bonds. Covered bondholders and counterparties of the issuer under derivative agreements have a priority claim to seek enforcement in respect of such assets in accordance with the Act on Covered Bonds.

A cover pool consist of certain assets, which include bonds secured by various types of mortgages, of other registered assets, bonds granted to or guaranteed by certain governmental bodies (“**Government Bonds**”), receivables in the form of certain derivative agreements and substitute collateral.

The real property and the registered assets which serve as security for the bonds included in the cover pool must be located in a member state of the EEA, EFTA or the Faroe Islands (each a “**Cover Pool Member State**” and collectively the “**Cover Pool Member States**”). A cover pool will consist primarily of mortgage bonds secured against residential property; industrial, office or commercial property; agricultural property; debt instruments including those issued by the Icelandic state or another member state, municipality in Iceland or in another member state, or guaranteed by such member state within the EEA, and certain collateral up to a specific limit of the value of the relevant cover pool.

Substitute collateral are assets that may be included in the cover pool and are intended to ensure that the interests of covered bondholders are not prejudiced despite changes which may occur to the assets of the cover pool. The cover pool may include the following substitute collateral; (1) Demand deposits with a financial undertaking; (2) Deposits with or claims against a Cover Pool Member State or central bank in a Cover Pool Member State; (3) Claims against other legal entities which in FME’s evaluation, do not involve greater risk than those in points (1) and (2) above. Substitute collateral may not comprise more than 20 per cent. of the value of the cover pool. The FME may however authorise an increase in the proportion of substitute collateral in the cover pool to as much as 30 per cent. of its value.

Assets in the cover pool are to be kept separate from other business operations of the issuer, as further defined below in the section *The Register*.

COVER POOL ASSETS

Eligible cover pool assets consist primarily of mortgage bonds issued by borrowers against collateral in the form of real property or public credit (i.e. loans to creditors with high credit worthiness, such as the State of Iceland, Icelandic municipalities and foreign central banks). Collateral for mortgage bonds shall consist of:

- (i) Pledged real property designated for residential purposes;
- (ii) Pledged real property designated for industrial, office or business purposes; and,
- (iii) Pledged real property designated for agricultural purposes.

The collateral may form part of the cover pool only to the extent that on the date of registration the ratio of the principal balance of the mortgage bond compared to the market value (LTV) in relation to the collateral does not exceed:

- (i) 80 per cent. of the market value for real property designated for residential purposes;
- (ii) 70 per cent. of the market value for real property designated for agricultural purposes; and,
- (iii) 60 per cent. of the market value for real property designated for industrial, office or commercial purposes.

Furthermore, the mortgage bonds issued against mortgages in residential, industrial, office, commercial or agricultural purposes may not be registered in the cover pool if payment is in arrears of 90 days or more.

The market value of real properties is assessed by an appraisal which must be based on the selling price in recent transactions with comparable properties. The issuer shall regularly monitor the development of such selling prices. If the market value of collateral in the cover pool (i.e. the underlying mortgaged real estate) substantially decreases, the amount of the value of the assets in the cover pool shall be decreased to ensure that the LTV lies within the limits described above. If the market value or selling price in recent transactions with comparable properties is not available it shall be determined by a specific valuation. The valuation shall be based on generally accepted principles for market valuation of real estate. Data on real estate price developments from the Registers Iceland (*Ice. "Þjóðskrá Íslands"*), for instance, may be used as a basis, together with other systematic collection of real estate price data.

If an issuer assesses the market value of real estate in accordance with the foregoing, the Independent Inspector provided for in Chapter VIII of the Act on Covered Bonds, must verify that the appraisal is based on an accepted methodology. The Independent Inspector may re-assess the market price of one or more properties if it is believed to be valued incorrectly. An appraisal of the market value of real estate must be in writing and specify what methodology is used, who has carried out the appraisal and when it was made.

MATCHING RULES

An issuer of covered bonds must ensure that the total current value of a cover pool which is to serve as collateral for a specific class of covered bonds always exceeds the aggregate total current value of that class of covered bonds. Moreover, instalments and other cash flows accruing on the assets in the cover pool and from derivative agreements shall be in such a manner that at any given time the issuer can meet all its financial obligations to covered bondholders and counterparties to derivative agreements.

In order to maintain a suitable balance between the cover pool and the corresponding class of covered bonds, the issuer (a) must ensure that the assets in the cover pool (including substitute collateral) are valued having proper

regard to currency exchange rates, interest rates, maturity dates, and other relevant factors; and (b) may enter into derivative agreements for the purpose of achieving this balance.

FME SUPERVISION

The issue of covered bonds requires a licence from the FME, which monitors compliance with the Act on Covered Bonds as well as being the supervisory authority for the business operations of an issuer conducted in connection with the issue of covered bonds. A license from the FME requires, *inter alia*, that the issuance comply with the Act on Covered Bonds and that a certified public accountant certifies that the issuer's budget and accounts demonstrate that its financial situation is stable enough not to jeopardise the interests of other creditors. Furthermore, the FME may grant the licence subject to specified conditions.

The FME may revoke an issuer's license to issue covered bonds if (a) the issuer no longer fulfils the requirements to issue covered bonds; (b) the issuer's budget, as attested to by a certified public accountant, demonstrates that its financial situation is no longer sufficiently sound so that the issuance of covered bonds will jeopardise the interests of other creditors; or (c) the issuer violates provisions of the Act on Covered Bonds or rules adopted by virtue of it. If the FME revokes the issuer's license to issue covered bonds it shall decide how to terminate the activities of the issuer.

The FME may authorise that previously issued bonds and other comparable debt instruments which were issued for the purposes of financing the assets in a cover pool may be converted to covered bonds under the Act on Covered Bonds.

THE REGISTER

The issuer of covered bonds must maintain a Register of the issued covered bonds, and the cover pool, together with related derivative agreements in accordance with the Act on Covered Bonds. The Register must, among other things include the following information; (1) the nominal value, interest terms, and final maturity of the covered bonds; (2) the types of assets in the cover pool; and (3) in respect of each mortgage bond in the cover pool, the name of the underlying borrower, their ID./Reg. No., the nominal value of the loan, date of issue, maturity, terms of instalments and interest. Furthermore, the Register shall show the appraisal of the collateral security in the cover pool, when the appraisal was carried out and the premises used. Bonds in a cover pool must be endorsed showing they are part of a cover pool and have been entered into the Register as provided for in Chapter VI of the Act on Covered Bonds. The endorsement shall also indicate that the debt instrument is to secure priority rights of a specific class of covered bonds.

INDEPENDENT INSPECTOR

The issuer shall appoint an independent inspector (the “**Independent Inspector**”) to supervise the issuance of covered bonds licensed by the FME and the FME must approve his appointment in accordance with the Act on Covered Bonds. In seeking FME's approval for the Independent Inspector's appointment, an issuer must disclose possible interrelation between the Independent Inspector and the issuer. The Independent Inspector must fulfil the eligibility criteria prescribed in the Act on Covered Bonds and is assigned the task of monitoring that the Register is maintained in accordance with the provisions of the Act on Covered Bonds and to verify that the valuation of collateral for bonds in the cover pool is based on proper methodology. The Independent Inspector shall report regularly to the FME on his observations and immediately inform the FME of any circumstances he becomes aware of, that could affect the FME's assessment of the issuer, as frequently and in such format as the FME decides, or above and beyond this if exceptional circumstances so warrant.

RIGHTS OF PRIORITY

In the event of bankruptcy of an issuer of covered bonds, covered bondholders and derivative agreement counterparties are entitled to rights of priority to the assets in the cover pool that are registered in the Register, as well as over the funds that originate from those assets.

HANDLING OF ASSETS IN THE EVENT OF WINDING-UP OF AN ISSUER

If an issuer enters into winding-up proceedings, any issued covered bonds do not fall due unless it was specifically agreed otherwise. Furthermore, any derivative agreements entered into by the issuer in relation thereto shall not accelerate upon the winding-up of the issuer and such agreements may not include provisions on automatic termination of contracts under such circumstances. In case of the winding-up of an issuer, the winding-up committee shall keep the covered bonds, substitute collateral and other assets in the cover pool segregated from other assets of the issuer's estate. The same shall apply to funds and other assets substituted for the covered bonds, substitute collateral and other assets in the cover pool, or paid in respect of such assets. Such separation shall be maintained until claims arising from the covered bonds have been paid in full.

The winding-up committee shall also keep derivative agreements, and funds returned by such assets or which must be paid from the cover pool to the counterparties to those derivative agreements, separate from other assets of the issuer's estate.

Payments received by the issuer after the date of a winding-up order in respect of funds and other assets substituted for the covered bonds, substitute collateral and other assets in the cover pool intended for payment of claims, including fulfilment of derivative agreements, shall be entered in the Register by the winding-up committee.

Article 17(1) of the Act on Covered Bonds states that the winding-up committee shall fulfil the issuer's commitments under the covered bonds and derivative agreements using mortgage bonds and other assets in the cover pool and payments received on such assets provided that these assets are listed in the Register.

The separation of the cover pool shall be maintained until claims arising from the covered bonds have been paid in full. The general rule is that to the extent that a cover pool is not sufficient to cover the covered bonds and derivative agreements, the covered bondholders may continue to file claims as non-preferential creditors of the issuer and to receive dividends from the other assets of the issuer and be ranked *pari passu* with other, general non-prioritised non-preferential creditors of the issuer.

According to the Bankruptcy Act No. 21/1991 (the "**Bankruptcy Act**") the covered bondholders' priority rights to the cover pool rank third after; (a) third party's assets held by an issuer, provided that the third party can prove his entitlement to the asset (no such third party's assets should be a part of the cover pool); (b)(i) certain bankruptcy (winding-up) costs; (ii) third party claims incurred after the date of the winding-up order due to agreements made on behalf of the bankruptcy estate by the winding-up committee or to liability for losses incurred by third parties as a result of any negligent act of the bankruptcy estate; and (iii) lawful third party claims, including claims due to derivative agreements concluded in accordance with the provisions of the Act on Covered Bonds, incurred by the estate after the date of a moratorium order or a composition proceedings order, if applicable.

If an issuer seeks composition with creditors, the composition arrangement will not affect claims which benefit from security (such as the claims of covered bondholders), to the extent the security is sufficient to settle the claim and the security interest will not cease to exist as a result of the composition agreement. However, according to Article 60(4) of the Bankruptcy Act, if the creditor values the collateral as being insufficient to

meet his claim, he may (in order to increase the chances of recovery) partly waive his right to a secured claim and thereby partly obtain a contractual claim on the debtor, to the extent of such waiver.

The part of the winding-up costs that concerns the covered bonds, the cover pool, and payments with respect to the covered bonds, cover pool or derivative agreements, shall be paid from the cover pool. Payments received by the issuer after the date of the winding-up order in accordance with the terms and conditions governing the cover pool should be entered into the Register.

Notwithstanding the provisions of Chapter XX of the Bankruptcy Act, actions taken by an issuer in accordance with the Act on Covered Bonds, including the delivery of funds or substitute collateral to the cover pool, payments on the cover pool, or disposal of funds from the cover pool to fulfil obligations under a covered bond or a derivative agreement concluded in accordance with the Act on Covered Bonds and in connection with the cover pool, shall not be subject to annulment or claw-back.

In relation to specific risk factors of the Act on Covered Bonds that have been identified, please refer to the section on *Risk Factors* in this Base Prospectus.

THE RULES ON COVERED BONDS

FME has issued Rules No. 528/2008 on Covered Bonds (the “**Rules on Covered Bonds**”) that concern among other things, the conditions for being granted licence to issue covered bonds, appraisal and revaluation of the assets in the cover pool, matching rules, derivative agreements, the Register and the eligibility and reporting of the Independent Inspector. The Rules on Covered Bonds are issued with reference to the Act on Covered Bonds and elaborate on the provisions of said Act.

The Rules on Covered Bonds list the documents to be provided to the FME by an issuer who applies for FME’s licence to issue covered bonds. Such documents include, among other things, approvals, descriptions of the proposed programme, the issuer’s budget, information on data systems, etc. The Rules on Covered Bonds describe the assets which are eligible to be registered to the cover pool and how the eligibility of such assets shall be evaluated.

The Rules on Covered Bonds provide further clarification with respect to matching requirements and provide a method of calculating the present value of assets/liabilities in relation thereto. The Rules on Covered Bonds prescribe that an issuer shall complete such calculations as often as deemed necessary and at least on a weekly basis.

The Rules on Covered Bonds provide for certain restrictions to the provisions and counterparties of derivative agreements. Such agreements may not include provisions on automatic termination of contracts upon the winding-up of the issuer. Furthermore, counterparties to derivative agreements must have a financial strength rating from a fully accredited rating agency and such a rating may not fall below the limits listed in the table below. If another rating agency has given the respective counterparty a lower rating, it has to receive ratings from at least two accredited rating agencies giving it equal or higher rating than listed in the following table:

	Minimum rating	
Rating Agency	Long Term	Short Term
Moody’s	A3	P2
Standard & Poor’s	A-	A2
Fitch	A-	F2

The Rules on Covered Bonds provide further detail on the Register. The Register shall be kept in a secure manner and updated on a daily basis. The FME shall have access to the Register.

The Rules on Covered Bonds provide further detail on the obligations of the Independent Inspector to be appointed by the issuer. The Independent Inspector shall ensure that the Register is properly maintained and updated and shall therefore verify that bonds and derivative agreements are correctly registered; only eligible assets and substitute collateral are included in the cover pool; the value of the assets registered in the cover pool and the valuation thereof is in accordance with the Act on Covered Bonds and the Rules on Covered Bonds; that LTV calculations are correctly updated upon significant decrease in the market value of mortgaged assets; and that the matching rules are complied with.

The Independent Inspector shall once a year provide the FME with a written report regarding his/her surveillance. Furthermore, the Independent Inspector shall as soon as possible notify the FME should he/she become aware of any matters which could affect the FME's assessment of the issuer's position in general. The Issuer has appointed an Independent Inspector pursuant to an agreement with PricewaterhouseCoopers ehf. ("PwC").

THE ISSUER'S LICENCE TO ISSUE COVERED BONDS

On 29 April 2013 the FME granted the Issuer a licence to issue Covered Bonds under the Act on Covered Bonds. Pursuant to the terms of such a licence, the Issuer is able, from time to time, to issue Covered Bonds that entitle the holder to the benefit of a statutory preferred creditor status in respect of the assets contained in the Issuer's Cover Pool in the event of the insolvency of the Issuer.

The licence was granted on 29 April 2013 and is subject to the requirements specified below:

- (a) The Programme shall initially not exceed a limit of ISK 10,000,000,000. Any further increase of the Programme is subject to the approval of the FME.
- (b) The Programme and the Cover Pool shall be in ISK. The Cover Pool shall only consist of bonds in accordance with item 1 of Paragraph 1 of Article 5 of the Act on Covered Bonds and replacement collateral in accordance with Paragraph 1 of Article 6 of the Act on Covered Bonds.
- (c) The aggregated total amount of bonds and other assets in the Cover Pool shall not exceed a level of 30 per cent. above the issued Covered Bonds at any time unless increased demand has developed due to other provisions of the Act on Covered Bonds, such as due to stress tests or present value calculations. If the Cover Pool exceeds the aforementioned limit the Issuer shall notify the FME and the Independent Inspector immediately. The Issuer shall remedy the level within 14 days.
- (d) The Independent Inspector shall on a quarterly basis file a report to the FME regarding his supervision duties. The report shall be filed every three months from the Issue Date and shall contain information stipulated in Paragraph 3 of Article 16 of the Rules on Covered Bonds. This requirement shall be revised twelve months from the Issue Date of the Covered Bonds. FME revised this requirement on 11 June 2014 and the Independent Inspector shall, according to the revision, file its report to the FME every six months.
- (e) The Independent Inspector shall at any Issue Date verify that the provisions of Chapters II and III of the Act on Covered Bonds, with regards to assets of the Cover Pool and Mortgages, are fulfilled.
- (f) The Issuer shall at least weekly execute stress tests and calculate the present value of the Cover Pool.

The Issuer shall at least quarterly disclose information to the Covered Bondholders about key figures regarding the Programme, e.g. outcome of any stress tests and the calculation of the present value of the Cover Pool. Furthermore, the Issuer shall allow the Independent Inspector to submit its remarks, if any, regarding this disclosure of information obligation of the Issuer.

ICELANDIC TAXATION

The comments below are of a general nature based on the Issuer's understanding of current law and practice in Iceland. They relate only to the position of persons who are the absolute beneficial owners of the Covered Bonds to be issued under the Programme. They may not apply to certain classes of person such as dealers. Prospective holders of the Covered Bonds to be issued under this Base Prospectus who are in any doubt as to their personal tax position or who may be subject to tax in any other jurisdiction should consult their professional advisers.

NON- ICELANDIC TAX RESIDENTS

Natural and legal persons that are not residents in Iceland and receive interest payments from Iceland are as a general principle considered to have limited tax liability in Iceland according to Article 3(8) of the ITA and are as such subject to 10 per cent. income tax on interest payments. The tax liability applies both to interest payment as such but also to capital gains on the bonds, since such gains are taxed in Iceland as interest payments. The abovementioned Article 3(8) of the ITA provides nevertheless for certain tax exemptions.

Article 3 (8) of the ITA states:

“All entities who receive interest income in this country from bank deposits, securities- or investment funds, debentures or other claims or financial contracts, as noted in item 3, section C of Article 7, shall pay income tax on such income. This provision neither applies to interest paid by the Central Bank of Iceland in its own name or on behalf of the Treasury nor to interest paid to foreign states, international institutions or other public entities that are exempt from taxation in their country of domicile.

This provision does not apply to interest income from bonds issued by Financial Undertakings as defined in point 1. of the 1st. Paragraph of Article 4 of Act No. 161/2002, On Financial Undertakings, and Energy Undertakings as defined in Act No. 50/2005, on Taxation on Energy Undertakings. Under the conditions that the bonds must be issued by a Securities Depository in a member state of the Organization for Economic Co-operation and Development (OECD), a member state of the European Economic Area or a founding member of EFTA or in the Faroe Islands and the trading must not be covered by the provisions of Article 13. b – 13. n of the Act No. 87/1992, On Foreign Exchange. This provision does not apply if a double-taxation agreement that Iceland has concluded with a foreign country states that a withholding tax on interest shall not be retained. The Minister of Finance is authorised to issue a regulation that further specifies the implementation of this provision.

See also Regulation No. 630/2013.

Individuals are not subject to taxation on interest income up to ISK 100,000 or lower per year. Additionally, a non-Icelandic tax resident may be exempt from such taxation of interest, by virtue of a Double Taxation Treaty that the Government of Iceland has concluded with the Government of the home state of the non-Icelandic tax resident, which provides for relief from double taxation. In such circumstances, the taxable person (the recipient of the interest payments) must apply for such exemption to the Directorate of Internal Revenue by filing an application (form RSK 5.42) for exemption from such withholding. If an application is not made prior to such withholding, a tax refund for the withholding tax can be claimed through the same channels (form RSK 5.43).

There are no estate or inheritance taxes, succession duties or gift taxes imposed by Iceland or any authority of or in Iceland in respect of the Covered Bonds if, at any time of the death of the holder or the transferee of the Covered Bonds, such holder or transferor is not a resident of Iceland.

Non-resident individuals are subject to net wealth tax according to Temporary Provision XLVII to the Income Tax Act No. 90/2003 on net value of Icelandic assets that are more than ISK 75 million for individuals. The tax

brackets and tax rates (1.5-2.0 per cent.) for net wealth tax vary depending on marital status and the value of Icelandic assets.

ICELANDIC TAX RESIDENTS

Beneficial owners of the Covered Bonds residing in Iceland for tax purposes are subject to income tax in Iceland on their interest income in accordance with Icelandic tax law. The rate depends on their tax status. Subject to certain exemptions, applicable to e.g. most banks and pension funds, the Issuer is required to withhold a 20 per cent. tax on the interest paid to the holders of Covered Bonds which is considered a preliminary tax payment but does not necessarily constitute the final tax liability of the holder. As with non-Icelandic tax residents, Icelandic tax residents do not pay tax on interest payments of up to ISK 100,000 per year. Individuals are subject to net wealth tax according to Temporary Provision XLVII to the ITA on net value of Icelandic assets of 75 million ISK or more for individuals. The tax brackets and tax rates (1.5-2.0 per cent.) for net wealth tax vary depending on marital status and the value of Icelandic assets.

THE ICELANDIC ECONOMY²

The Icelandic economy is small. In terms of GDP, it is the smallest economy within the OECD with a total GDP of ISK 1,873 billion in 2013. The population is also small, numbering just under 326 thousand. According to World Bank data, gross national income per capita, measured in terms of purchasing power parities (“PPP”), amounted to nearly 39 thousand USD in 2013, the twenty-second highest in the world and the thirteenth highest among the OECD countries.

Historically, economic prosperity in Iceland has been built largely on abundant marine and energy resources, with investment and services as the main drivers of economic growth. Exports of services, driven by a booming tourist sector, are an increasingly important source of export revenues. Services now account for roughly 37 per cent. of total export revenues, while exports of marine products account for 27 per cent. and exports of aluminium and aluminium products account for 22 per cent.

In 2008, the Icelandic economy entered into a deep recession after a five-year period of robust but unsustainable economic growth. The growth was initially spurred by investments in the aluminium and power sectors, followed by a phenomenal growth of the banking sector accompanied by a credit boom, sustained by easy access to global credit. The growth soon became increasingly imbalanced which was reflected in a rapidly growing current account (“CA”) deficit and mounting inflationary pressures. The recession was triggered by a twin currency and banking crisis in autumn 2008. Domestic demand contracted by nearly 30 per cent. from its peak in 2006 to its trough in 2010.

After a period of austerity measures and restructuring of the financial sector, growth resumed in 2011 as GDP grew by 2.1 per cent.; in 2012, growth continued at 1.1 per cent. Unemployment peaked at 11.9 per cent. in early 2010 but was down to 4.1 per cent. in September 2014, well below the EU average. The exchange rate of the ISK has stabilised significantly after losing almost 50 per cent. of its value against the euro from January 2008 to November 2009. At the end of October 2014, the ISK had appreciated by 17 per cent. since its lowest level November 2009.

Despite a significant trade account surplus, 8.3 per cent. of GDP in 2013, the CA balance was only positive by 5.6 per cent. of GDP that year. Following adjustments for calculated income and expenses of deposit money banks in winding-up the underlying CA surplus is estimated at 7.3 per cent. of GDP in 2013.

Statistics Iceland forecasts an average annual GDP growth of 2.9 per cent. in 2014 to 2018, driven by growing investment and private consumption. Annual CPI inflation in October 2014 measured 1.9 per cent., well below the 2.5 per cent. inflation target of the Central Bank.

THE RESIDENTIAL HOUSING MARKET IN ICELAND

Developments in the housing market in Iceland for the last 10 years are closely intertwined with the economic upswing that began in 2003 and ended abruptly in October 2008 with the collapse of the banking sector. The upswing began when construction commenced on a large foreign-owned aluminium smelter and an associated state-owned power plant. In combination, these investments were equivalent to more than one-third of 2003 GDP. These projects were accompanied by a credit boom resulting from a combination of favourable global financial conditions and sweeping changes in Iceland’s financial system, including the full privatisation of major banks in 2003 and their subsequent expansion abroad, as well as changes in the domestic mortgage market.

In the summer of 2004, substantial changes were introduced to the Icelandic housing market. The state-owned mortgage lender, the HFF, changed its system for backing residential mortgages. Following these changes the newly privatized commercial banks entered the market and engaged the HFF in direct competition. HFF had

² Sources: This chapter was compiled by Landsbankinn’s Economic Research Department based on data and information obtained from Statistics Iceland and the Central Bank of Iceland, 6 November 2014.

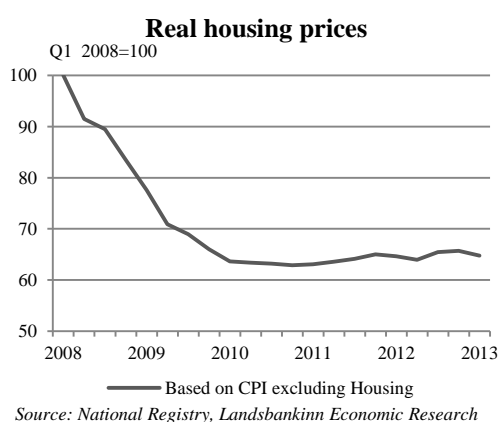
traditionally been the main provider of mortgage loans to households. The commercial banks offered new products in the consumer loan market, including mortgage loans with longer maturities, lower interest rates, higher loan-to-value ratio, and later foreign currency indexed loans. Housing purchases were no longer a precondition for a loan, which facilitated refinancing and mortgage equity withdrawal. These changes had a profound impact on the housing and construction sector. Demand for housing increased significantly, followed by dramatic price increases and a boom in housing construction. A lot of land was developed and sold for residential and commercial housing. Housing construction rose steadily during this period, partly due to the fact that building costs rose much slower than property prices.

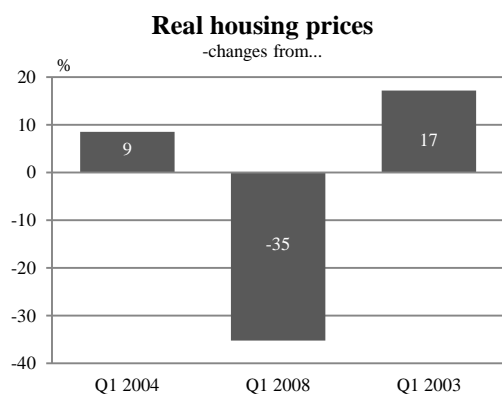
Traditionally most mortgage loans in Iceland have been CPI-indexed but during the boom years an increasing number of mortgage loans were linked to foreign currencies. Thus, mortgage borrowers were vulnerable to extreme fluctuations in inflation and the exchange rate, as well as to a fall in house prices. In the autumn of 2008, households were hit by all of these factors. The exchange rate fell drastically, inflation rose, the housing market froze and mortgage payments became increasingly difficult for a significant share of households.

The banks and the central government have undertaken various measures focused at aiding the restructuring of household debt through other means than bankruptcy. This includes for example an agreement on a formal process for writing down mortgages to 110 per cent. of the value of mortgaged assets. The road to recovery has been long and bumpy but signs of a return to normality in the housing market have begun to emerge.

Housing prices peaked in Q1 2008 after an almost continuous rise since 1996. There was a sharp turn upwards in 1999 and then again in 2004. Historically the nominal value of residential housing in Iceland is sticky downwards. The index was at its lowest point in Q1 2010, and based on the highest value before the crises, prices fell by 15 per cent. in approximately 2 years. The nominal price changed insignificantly in 2010 but has since then risen steadily. The nominal prices as of September 2014 are 12 per cent. higher than at the peak in 2008. The number of transactions on the property market is still much lower than during the boom years but the turnover and number of transactions has increased steadily since 2009.

The most significant part of the adjustment to the property market after the collapse took place through inflation and changes in real prices. The nominal value of housing prices decreased by 1 per cent. from Q1 2008 when it peaked until Q1 2013 while general consumer prices (excluding housing) increased by around 53 per cent. This means that the real decline in housing prices has been 35 per cent. In comparison with other periods the real housing prices September 2014 were 24 per cent. higher than in the beginning of 2004 and 31 per cent. higher than in the first quarter in 2003. Taking the recent positive development of the economy into consideration, it is not unreasonable to assume that nominal housing prices reached bottom already in 2010.





Source: National Registry, Landsbankinn Economic Research

FINANCIAL MARKETS IN ICELAND

Size of the banking system

Total assets of Icelandic credit institutions, i.e. commercial banks, savings banks and credit undertakings, amounted to ISK 3,076 billion as at 31 December 2013 according to the Central Bank, of which foreign assets were ISK 445 billion, or 14 per cent. The Icelandic financial market is therefore highly exposed to the Icelandic economy.

The total assets of the three largest commercial banks, the Issuer, Íslandsbanki hf. and Arion Bank hf., comprised around 76 per cent. of the total assets of the Icelandic banking system as at 31 December 2013 according to the Central Bank. The proportion of the HFF was 22 per cent.

Market participants and supervision

Icelandic credit institutions are comprised of four commercial banks, eight savings banks and six credit institutions. The financial market also includes eleven securities companies, two securities brokerages and nine management companies of Undertakings for Collective Investment in Transferable Securities (“UCITS”). The HFF, a fully state-owned institution, operates in Iceland and offers financing for residential housing in Iceland.

One stock exchange is operated in Iceland, Nasdaq Iceland, and one securities depository, Verðbréfaskráning Íslands. Nasdaq Iceland operates under Act No. 110/2007, on Stock Exchanges. In 2000, the Iceland Stock Exchange joined NOREX and in 2006, the Iceland Stock Exchange joined the OMX Nordic Exchange.

Icelandic financial markets are supervised by the FME. Entities engaging in financial activities which are subject to licence are regulated by FME, including credit institutions, insurance companies and pension funds. The activities of FME are largely governed by Act No. 87/1998, on the Official Supervision of Financial Operations, and Act No. 98/1999, on the Payment of Cost Due to the Official Supervision of Financial Activities.

The Central Bank is in charge of monetary policy implementation in Iceland and performs a wide range of functions to this end. The main objective of monetary policy is price stability. The activities of the Central Bank are largely governed by Act No. 36/2001, on the Central Bank. The Central Bank imposes a reserve requirement on all the commercial and savings banks. The purpose of this limitation is to ensure that credit institutions have sufficient margin to the reserve requirement account to meet fluctuations in their liquidity positions. Foreign exchange transactions have been subject to capital controls since the banking system collapse in 2008. The Central Bank oversees surveillance of the Rules on Foreign Exchange.

Other relevant institutions in the financial market

Seven other credit institutions are currently operating in Iceland, one investment bank, two payment card companies, two investment funds and an asset financing company and the state-owned mortgage lender the HFF.

The establishment of the mortgage lender HFF was approved at the beginning of 1999. The fund is based on legislation approved by the Icelandic Parliament in June 1998, which was aimed at rationalising the existing state financing system for housing. The HFF was the largest provider of financing for residential housing until the year 2004 when the three major banks in Iceland entered the financing sector for residential housing. Pension funds are an important source of long-term finance in the country and are active in the financial market through their investments activities. These funds invest in domestic bonds, equity capital and in some foreign securities. Membership in a pension fund is obligatory for wage earners and self-employed individuals, in accordance with Act No. 129/1997, on Mandatory Pension Insurance and on the Activities of Pension Funds.

Security houses are operating domestically but their operations were limited after the recession in 2008. Many of them operated mutual funds of various kinds.

Three major insurance companies, Tryggingamiðstöðin hf., Sjóvá-Almennar tryggingar hf. and Vátryggingafélag Íslands hf., which are licensed to operate in Iceland have been active in the financial market through their investment activities in Iceland.

DESCRIPTION OF THE ISSUER

OVERVIEW

The Issuer is a leading Icelandic financial institution, offering a full range of financial services in the Icelandic financial service sector with a total of 32 branches and outlets across the country. The Issuer was established on 7 October 2008 as a limited liability company, but the history of its predecessor, LBI hf., dates back to 1886.

The Issuer operates pursuant to the provisions of the Act on Financial Undertakings, No. 161/2002, the Act on Public Limited Companies, No. 2/1995 and the Act on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc., No. 125/2008. The Issuer is supervised by the FME.

The Issuer is registered with the Register of Enterprises in Iceland with registration number 471008-0280. The Issuer's registered office is located at Austurstræti 11, 155 Reykjavík, Iceland and its telephone number is: +354 410 4000.

In January 2014, the international rating agency Standard & Poor's ("S&P") assigned its BB+ long-term counterparty credit rating to the Issuer with stable outlook. In October 2014 S&P revised the outlook for the Issuer from stable to positive and affirmed its previous rating. The Issuer's rating is one notch below the sovereign credit rating for Iceland.

In the first nine months of 2014, the Issuer's net interest income was ISK 22.3 billion (compared to ISK 34.3 billion in 2013 and ISK 35.6 billion in 2012), its operating income was ISK 44.7 billion (compared to ISK 65.6 billion in 2013 and ISK 49.1 billion in 2012) and profit for the first nine months of 2014 was ISK 20.0 billion (compared to ISK 28.8 billion in 2013 and ISK 25.5 billion in 2012). As at 30 September 2014, the Issuer's total assets were ISK 1,201 billion (compared to ISK 1,152 billion at year-end 2013 and ISK 1,085 at year-end 2012).

Historical financial information in this Base Prospectus is for the period 1 January 2012 to 30 September 2014. Audited Consolidated Financial Statements for the Issuer for the years 2012 and 2013, together with the audit reports thereon and the reviewed Interim Condensed Financial Statements for the first nine months of 2014, together with the review report thereon, are incorporated by reference into this Base Prospectus.

No material adverse changes in the prospects of the Issuer have occurred since the date of its last published audited financial statements on 31 December 2013.

No significant changes in the financial or trading position of the Issuer have occurred since the end of the last financial period on 30 September 2014 other than the entry into force of the agreement described in the chapter Recent Developments below.

RECENT DEVELOPMENTS

On 8 May 2014 the Issuer and the Winding-up Board of LBI hf. reached an agreement on extension of the repayment schedule of the secured bonds, issued to LBI hf. The Winding-up Board of LBI hf. made the agreement conditional on receiving certain exemptions, in accordance with the Foreign Exchange Act. On 4 December 2014 the Winding-up Board of LBI hf. notified the Issuer that the authorities have approved the necessary exemptions and that the agreement has as a result entered into force.

The final payment from the Issuer to LBI hf. will now take place in October 2026 instead of October 2018. The outstanding amount is paid in ten bonds maturing every second year, issued in GBP, USD and EUR. The Issuer is authorised to make full or partial prepayment, without cost, at any time during the term.

The Issuer and the Winding-up Board of LBI hf. have also agreed on amendments that allow the Issuer, under certain circumstances, to postpone payment of the amounts maturing in 2018 and 2020. Furthermore, the minimum collateral requirement has been lowered from 125 per cent. to 115 per cent. of the outstanding amount at each time.

Interest rates will remain unchanged at a 2.9 per cent. margin until October 2018, stepping up to a 3.50 per cent. margin for the 2020 tranche to end at a 4.05 per cent. margin for the final maturity in 2026.

Each tranche maturing in 2016 to 2026 will amount to the equivalent of ISK 30 billion, with the exception of the 2018 tranche in the equivalent amount of ISK 40 billion. Upon entry into force of the agreement, the Issuer will pay the equivalent of ISK 30 billion and the outstanding amount of the bonds will subsequently equal 196 billion.

On 25 November 2014 the Issuer announced the signing of an agreement to sell its 31.2 per cent. shareholding in Borgun hf., for ISK 2,184 million. Borgun hf. is a leader in the development and practical application of solutions in the field of electronic payments. The sale is subject to the approval of regulators.

HISTORICAL BACKGROUND

LBI hf., the Issuer's predecessor, was established by the Icelandic Parliament on 1 July 1886. In establishing LBI hf., the Icelandic Parliament hoped to boost monetary transactions and encourage the country's nascent industries. LBI hf.'s first decades of operation were restricted by its limited financial capacity and it was little more than a building society.

Following the turn of the 20th century, however, Icelandic society progressed and prospered as industrialisation finally made inroads, and LBI hf. grew and developed in parallel to the nation. In the 1920s, LBI hf. became Iceland's largest bank and was made responsible for issuing Iceland's bank bonds. Issuing of bank bonds was transferred to the then newly established Central Bank of Iceland in 1961 and LBI hf. continued to develop as a commercial bank, expanding its branch network in the ensuing decades.

Liberalisation of financial services in Iceland, beginning in 1986, opened up new opportunities which LBI hf. managed to take advantage of, despite some economic adversity. In 1997, LBI hf. was incorporated as a limited liability company, and the ensuing privatisation was concluded in 2003. From 2003 to 2008, LBI hf. operated as a private bank with substantial international activities in addition to its traditional Icelandic operations.

Following the continuous deterioration of the financial markets and the collapse of the Icelandic banking system, the FME took control of LBI hf. on 7 October 2008. The Issuer, wholly owned by the Icelandic State, was established around the domestic deposits and the majority of the Icelandic assets of the old bank. All liabilities and assets not transferred to the Issuer were retained in LBI hf. and a Resolution Committee was appointed to supersede the board of directors of LBI hf.

SHAREHOLDERS

The Issuer's total share capital is ISK 24,000,000,000. Each share is of the nominal value of one ISK and entitles the owner to one vote at shareholders' meetings.

The Issuer has 1,403 shareholders. The largest shareholder is the ISFI, which manages 23,500,000,000 (97.9 per cent.) shares and voting rights of the National Treasury. The second largest shareholder is the Issuer, which holds 312,930,963 (1.30 per cent.) of its own shares after the delivery of shares to current and former employees of the Issuer. Shares are held by the Issuer to meet income taxes, financial services tax and other salary related expenses as described below. The allocation of shares to current and former employees of the Issuer took place in September 2013 and in February 2014. 1,401 other shareholders that are current and former employees of the Issuer hold 187,069,037 (0.78 per cent.) shares and voting rights in the Issuer.

The Issuer's holding of its own shares is a result of a settlement agreement, between the Issuer, LBI hf. and the Icelandic State dated 15 December 2009. The settlement agreement stipulated that 500,000,000 shares be distributed to the Issuer's employees ("**Employee Shareholders**"). After the allocation of shares, the Issuer holds 1.30 per cent. of its own shares because employees are required to pay income tax on the value of the

shares as per normal salary payments. The Issuer retained shares in the amount of the income tax payment required from employees, financial services tax levied on financial undertakings, pension and other salary-linked expenses and paid this amount to the Icelandic State, and pension funds.

Employee Shareholders are required, according to the terms on which the shares were allocated to them, to retain the shares in the Issuer for at least three years, following allocation. Should the Issuer list its shares on a stock exchange, 60 per cent. of the shares held by each Employee Shareholder may be sold one month following listing. The remaining shares (40 per cent.) may not be sold until three years have elapsed from the date of allocation. During that time, the shares may not be mortgaged or assigned.

The Issuer is not directly or indirectly owned or controlled by others than those listed above.

The Issuer does not know of any arrangements, the operation of which may at a subsequent date result in a change in control of the Issuer.

ORGANISATIONAL STRUCTURE

The Issuer is the parent company of a group and its principal subsidiaries include the following as at the date of this Base Prospectus:

Principal subsidiaries	Principal area of activity	Ownership interest
Eignarhaldsfélag Landsbankans ehf.	Holding company	100%
Horn Fjárfestingarfélag ehf.	Investment company	100%
Landsbréf ehf.	Fund management company	100%
Hömlur ehf.	Holding company for appropriated assets	100%

STRATEGY

The Issuer's strategy is "Landsbankinn – your financial partner". The Issuer's strategy, which was introduced in 2010, rests on four main pillars, all of equal importance. These pillars are:

- A unified team, referring to the Issuer's human resources and employees' positive attitude;
- A solid infrastructure, referring to procedures, financial strength, risk management and operational discipline;
- Satisfied customers, referring to the Issuer's service to customers and the mutual benefit of a long-term business relationship; and,
- Benefits to society and owners, which refers to the Issuer's role in Icelandic society.

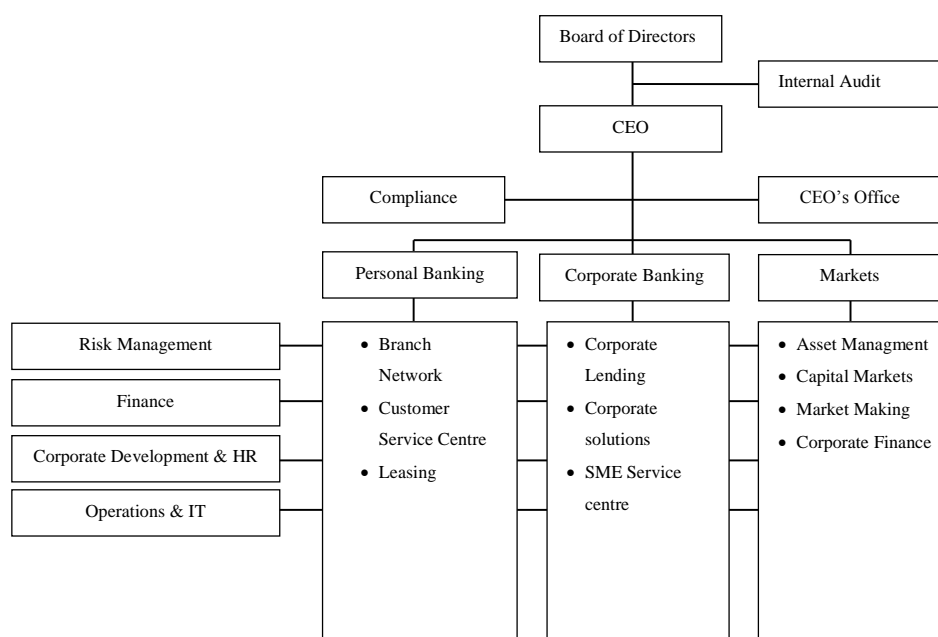
The strategy outlines the Issuer's vision to become an exemplary company and to be among the best banks in the Nordic region by 2015. To achieve these goals, the focus is set on efficient operations, sound management, a unified team and a responsible marketing strategy. The Issuer wants to be a force for change with the aim of creating value for customers, society, owners and employees.

In September 2012, the Issuer introduced new emphases leading up to 2015 based on its strategy introduced in 2010. The new emphases entail increasing operational efficiency by reducing cost, strengthening management and team unity, while also pursuing a responsible market strategy. At the same time, the Issuer made significant changes to its organisational structure, which came into effect on 1 October 2012.

Emphasis is placed on increased co-operation between all of the Issuer's divisions that communicate with customers, in order to offer better and more effective services for the mutual benefit of customers and the Issuer. The aim is to promote the objective of efficient and profitable operations while simultaneously strengthening the branches and providing employees with a greater mandate to act.

BUSINESS

The organisational chart below illustrates the Issuer's principal operating and support functions as at the date of this Base Prospectus:



Personal Banking

The Personal Banking division (“**Personal Banking**”) comprises three departments: the Branch Network, the Customer Service Centre and Leasing (vehicle and equipment financing). Personal Banking has two support units: the Debt Management Advisory Centre and Business Solutions.

Personal Banking provides individuals and small and medium-sized enterprises (“**SMEs**”) in rural areas with general and specialised banking services. Financing of vehicles, equipment and machinery is provided through the Leasing department.

From the beginning of 2014, all services to corporate customers, including SMEs, in the capital region are provided in a Corporate Service Centre, located in the Corporate Banking division of the Issuer's organisational structure. Nevertheless, most branches still provide basic SME services to ensure customer comfort.

The Issuer operates 32 branches and outlets around Iceland. Its distribution channel strategy is to ensure the provision of personal, economical and value-added banking services to its customers.

Emphasis is placed on providing customers with a diverse range of products. Each branch offers general services and personal advice to individuals. In rural areas, branches provide further service and advice to SMEs. Various self-service options are available throughout the country. In addition, the Issuer's customers have access to financial services through its Customer Service Centre and online banking system.

At Leifsstöð, Iceland's international airport, travellers are provided with a certain range of targeted financial services.

Among the Issuer's customers are over 100,000 individuals and around 6,000 SMEs. Its market share is around 34 per cent. with respect to retail customers and 33 per cent. with respect to SMEs, according to a survey conducted by Capacent in March 2014.

Corporate Banking

Corporate Banking ("**Corporate Banking**") provides comprehensive financial services to large, small and medium size corporate clients and municipalities, as well as tailored services to meet customer specific needs. Corporate Banking also handles corporate and SME's services in the capital region through a SME's Center, established in April 2014. Corporate Banking holds a strong position among the largest companies and institutions in Iceland. As at March 2014, according to an annual survey conducted by Capacent, the Issuer's share of the market in Corporate Banking was around 33.6 per cent.

Corporate Banking comprises five business units and three support units. The business units are split based on sector segmentation; one unit manages relations with contractors, real estate companies, travel service companies and municipalities; the second unit manages relations with industrial companies and companies in trade and service; the third unit manages relations with the Issuer's larger customers in fisheries and agriculture; the fourth unit manages relations with around 7,000 SMEs in the capital region and the fifth unit, Corporate Restructuring, handles the resolution and restructuring of the debt of viable companies. Corporate Banking has three support units: Business Support, Credit Assessment and Legal Services.

Business Support is a support unit designed to assist the business units by providing in-depth data analysis and business development solutions.

Credit Assessment is responsible for the preparation of credit rating reports and supervising business cases, which are submitted for credit decisions.

Legal Services, within Corporate Banking, provides legal advice regarding corporate lending and restructuring and is responsible for drafting more complex loan contracts and collateral agreements.

Markets

Markets ("**Markets**") provides brokerage services in securities, foreign currencies and derivatives, sale of securities issues, money market lending and corporate finance services. The division provides a range of wealth and asset management products and services for individuals, corporations and institutional investors. Landsbréf ehf. and Horn fjárfestingarfélag ehf., subsidiaries of the Issuer, are a part of Markets. The Markets Division comprises four departments: Asset Management, Capital Markets, Market Making and Corporate Finance. The Markets Division has one support unit: Business Solutions.

Asset Management offers comprehensive asset management services, including advice in selecting appropriate savings options, and development and management of asset portfolios. The customers of Asset Management are diverse and include individuals, pension funds, institutions, municipalities and companies.

A part of the product offering provided by Asset Management is securities and investment funds run by Landsbréf ehf., an independent subsidiary of the Issuer. In addition, Asset Management has three pension funds under full management, which involves the asset management of securities portfolios, supervising the funds' accounting, registration of pension rights and pension payments.

Asset Management's services also entail the management of asset portfolios by Private Banking Services along with customised management for companies, pension funds, insurance companies, municipalities and charities. Private Banking Services are customised to meet the needs of the Issuer's wealthiest customers. Activities

involve the management of customer's asset portfolios in addition to general banking services. Customers can choose between active management of an asset portfolio where the advisers of Private Banking Services manage the assets in accordance with a predetermined investment strategy, or advice on management where the customer manages its own portfolio with the assistance of an adviser.

An Investment Council operates within Asset Management. Its purpose is to form an investment policy for customers' asset portfolios, assess risk and identify risk-mitigating measures, in addition to being a forum for professional discussions on the best rate of return, opportunities on the market and best practice.

Asset Management's incorporates Fund & Pension Advisory Services, which provide the Issuer's customers with advice and services in matters relating to savings, investments and pensions. The department's main customers are general investors involved in securities trading and individuals and companies in relation to pension issues.

Capital Markets handles market transactions in financial instruments, such as bonds, equities, derivatives and foreign currencies for professional clients. Capital Markets also handles the issue and sale of corporate, municipal and national government bonds.

Market Making acts as a market maker for a number of listed securities, as well as the ISK on the interbank market. The role of a market maker is to promote normal price formation and liquidity on the market by submitting offers to buy or sell the asset to which the market making agreement applies at any time, for its own account within a maximum price range.

Corporate Finance provides advisory services to companies and investors, and is focused on services in relation to the restructuring of companies, among other things, through mergers and acquisitions, purchase and sale of companies and advice on project financing. It also advises on and co-ordinates public offerings and listings on stock exchanges, as well as providing services to companies listed on a stock exchange.

Business Solutions is a support unit designed to assist the business units on daily basis and to provide support in business development.

Support divisions

The Issuer has four support divisions: Risk Management, Finance, Corporate Development & Human Resources and Operations & IT.

Risk Management

The role of the Risk Management Division is to assess and control the Issuer's credit risk, to assess market risk, liquidity risk and operational risk, and monitor these risk factors in the Issuer's operations. The Risk Management Division is responsible for maintenance and analysis of the Issuer's risk assessment systems. The Division comprises four departments: Credit Management, Market Risk, Operational Risk and Credit Risk & Economic Capital.

The Credit Management department is responsible for risk assessment and veto rights on credit applications from customers with exposures exceeding the credit limits of individual business units and customers who have been classified yellow, orange or red as further described below under "*Description of the Issuer - Risk Management Framework – Credit risk control and monitoring*". Secondary voting on decisions exceeding the authorisation of the Risk Management Division is referred to the Issuer's Credit Committee.

The Market Risk Department is responsible for measuring and monitoring market risk, liquidity risk and interest rate risk in the Issuer's banking book. The Issuer's banking book is the portfolio of assets, primarily loans the Issuer expects to hold until maturity when the loan is repaid fully; the banking book typically refers to the loans the Issuer underwrites. The Market Risk Department is also responsible for (i) monitoring all derivatives trading the Issuer enters into, both for hedging and trading purposes, (ii) Foreign Exchange ("**FX**") balance monitoring

for the Issuer and (iii) providing limit monitoring for pension funds under management by the Issuer. The Market Risk Department is also responsible for comprehensive risk reporting to various departments and committees.

The Operational Risk Department is responsible for ensuring that the Issuer's operational risks are monitored and that the Issuer implements and maintains an effective operational risk management framework. The department assists the Issuer's managers with operational risk assessment incidents related to normal operations and operational loss incidents analysis, and oversees continuity plans. The Operational Risk Department leads the work on the Issuer's certification under the ISO 2701 standard for information security.

The Credit Risk & Economic Capital Department is responsible for providing the Issuer with internal models 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 Issuer. In addition, the Department is responsible for credit risk, economic capital and impairment analysis and reporting within the Issuer.

Finance

Finance is a division that incorporates both support and profit functions. The division comprises five departments: Treasury, Accounting & Financial Reporting, Budgeting, Legal and Recalculation.

Treasury is primarily concerned with liquidity management and financing for the Issuer, Asset and Liability Management, market-making in the money market and controlling internal pricing of capital. Treasury also handles communications with the Central Bank, domestic and overseas financial institutions, as well as rating agencies. Treasury proposes changes to the Issuer's tariff and determines special terms for accounts in collaboration with the branch network. Treasury also manages the Issuer's price list.

Accounting & Financial Reporting is responsible for financial accounting and prepares the Issuer's monthly, quarterly and annual financial statements. Accounting & Financial Reporting registers and discharges cost accounting.

Budgeting manages the Issuer's budgets. Compilation and dissemination of management information is a key part of the department's responsibilities. Budgeting also handles analysis and control; it project manages and edits the Issuer's Internal Capital Adequacy Assessment Process ("ICAAP").

The Issuer's Legal Department handles legal aspects of the Issuer's operations. The Legal Department provides the Issuer and its subsidiaries with legal advice, representation in district courts, preparation of cases reviewed by the Complaints Committee on Transactions with Financial Undertakings and preparation of documents and communication with regulators, especially the FME and the Icelandic Competition Authority. The Issuer's Legal Department handles collection of all payments in arrears owed to the Issuer.

Following ruling No. 155/2011 of the Supreme Court of Iceland (the "**Supreme Court**"), the Issuer created the Recalculation department. Its role is to handle recalculation of exchange rate indexed loans and the correction thereof in the Issuer's systems. Currently, its main tasks involve correction of recalculations of car loans with shorter maturity in accordance with the Supreme Court rulings No. 60/2011 and 464/2012. In addition, Recalculation works with Legal on various court proceedings that concern disputes on classification and recalculation of loans and queries on FX-denominated loans.

Corporate Development & Human Resources

Corporate Development & Human Resources comprises seven departments: Strategic Project Management Office ("**Strategic PMO**"), Human Resources ("**HR**"), the Marketing Department, the Web Department, Sales & Services, Business Development and Corporate Social Responsibility ("**CSR**").

The role of the Strategic PMO is to ensure that the Issuer's activities progress effectively and professionally, guided by the Issuer's strategy. In addition, Strategic PMO oversees the Issuer's strategy, which involves conducting reviews, audits and implementation thereof.

HR is responsible for all employee-related issues, such as salary and benefits, recruitment and job development. The Education and Training Department is located within HR.

The Marketing Department is responsible for formulating and implementing the Issuer's marketing strategy and planning.

The Web Department is responsible for mobile banking and the development and technical maintenance of the intranet and external Internet services, as well as special solutions for the Issuer's various divisions.

The Sales & Services Department is project-driven and is responsible for development in areas relating to the Issuer's sales and service quality. The Department provides advice, education and support to the development and implementation of improvement measures in sales and services.

The role of Business Development is to drive innovation in banking services, product development and the Issuer's distribution channels. Business Development closely monitors market developments, changes in consumer behaviour and distribution channels.

CSR is responsible for defining and forming the Issuer's CSR policy and works towards the implementation of CSR in the Issuer's daily operations and in its departments and divisions.

Operations & IT

Operations & IT comprises six departments: Property, IT, Appropriated Assets, Transaction Services, Loan Administration and Records and Information Management.

The Property Department oversees the Issuer's internal operations, i.e. the operation and maintenance of all its properties, including sale or purchase. The Department is also responsible for employees' working facilities, purchase of equipment for the Issuer's operations, internal security and relations with external security facilities and custodial operations.

The IT Department is responsible for developing, operating and advising on the Issuer's information systems and solutions. The Department oversees all internally developed and third-party software, as well as hardware such as data centres, telephone systems, Automated Teller Machines (ATMs), etc.

Appropriated Assets handles assets which the Issuer comes to possess through foreclosure or other debt settlement and is responsible for their sale.

Transaction Services provides services to the income divisions of the Issuer and to the Issuer's customers. Its activities include international transfers, settlement of securities and FX transactions, fund administration for securities and pension funds and back-office functions for pension savings.

Loan Administration takes care of all administration of loans, such as documentation of loan agreements between the Issuer and its customers and payments of loans. It is also responsible for the registration and storage of original loan documents.

Records and Information Management provides document management consulting, information searching, printing services and administration of the archives.

Other divisions

CEO's Office

The CEO's Office works closely with the CEO and aids him in his duties. The CEO Office's main responsibilities are to implement the Issuer's strategy, handle internal and external communication, including with institutions, public enterprises and various stakeholders. The CEO's Office manages the activities and decisions of the Issuer's Board of Directors and executive board and provides follow-up.

Compliance

Compliance is an independent unit which reports directly to the CEO. Compliance's main responsibilities are to:

- Monitor and regularly assess the functionality of measures established to maintain relevant policies and procedures designed to detect any risk that the Issuer might fail to fulfil its obligations pursuant to legislation on securities transactions.
- Assist, support and advice management in the fulfilment of their duties. Provide those employees of the Issuer, who are responsible for securities transactions, with the training, advice and assistance necessary to enable them to fulfil the Issuer's obligations in accordance with legislation on securities transactions.
- Enforce provisions of Act on Actions to Combat Money Laundering and Terrorist Financing and make sure that co-ordinated procedures are developed to ensure the correct execution of the above referenced Act.
- Identify, assess and monitor the compliance risks faced by the Issuer.

Internal Audit

The internal audit function is a part of the Issuer's organisational structure and constitutes one aspect of its internal oversight system. The role of the internal audit function is to provide independent and objective assurance and advice, which is intended to add value and improve the Issuer's operations.

The internal audit function evaluates the functionality of the Issuer's governance, risk management and internal controls, and thus supports the Issuer in achieving its goals. The internal audit function covers all of the Issuer's business units, including its subsidiaries, and pension funds managed and operated by the Issuer.

The Internal Auditor is appointed by the Issuer's Board of Directors and is responsible to the Board and its Audit Committee. The Internal Auditor reports functionally and administratively to the Chairman of the Board of Directors. Strong emphasis is placed on employees of internal audit function being independent and objective in their work. The internal audit function is certified according to international standards and guidelines on internal auditing (IPPF).

LOAN PORTFOLIO

The table below sets out details of the Issuer's loans and advances to customers as at 30 September 2014, classified by type of loan. During the first nine months of 2014 the Issuer was not permitted to sell or re-pledge any collateral in absence of default by the owner of the collateral.

	30 September 2014
	<i>(millions ISK)</i>
Public entities	10,161
Individuals	249,252
Corporations	505,095
Less: Allowance for impairment.....	(44,881)
Total	719,627

The table below sets out details of the Issuer's loans and advances to financial institutions as at 30 September 2014, classified by type of loan.

	30 September 2014
	<i>(millions ISK)</i>
Bank accounts with financial institutions	19,492
Money market loans	36,502
Overdrafts	5,508
Other loans.....	6,690
Total	68,192

The following tables show the Issuer's maximum credit risk exposure at 30 September 2014. For on-balance sheet assets, the exposures set out below are based on net carrying amounts as reported in the statement of financial position. Off-balance sheet amounts in the tables below are the maximum amounts the Issuer might have to pay for guarantees, loan commitments in their full amount, and undrawn overdraft and credit card facilities.

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

	Corporations												
At 30 September 2014	Financial institutions	Public entities ⁽¹⁾	Individuals	Fisheries	Construction and real estate companies	Services	Retail	Holding companies	Manufacturing	Agriculture	ITC ⁽²⁾	Other	Carrying amount
<i>(millions of ISK except %)</i>													
Cash and balances with Central Bank	–	38,820	–	–	–	–	–	–	–	–	–	–	38,820
Bonds and debt instruments.....	143	271,021	–	–	13,658	–	–	8,200	–	–	–	774	293,796
Derivative instruments	42	--	2	–	–	–	--	6	–	–	–	32	82
Loans and advances to financial institutions	68,192	–	–	–	–	–	–	–	–	–	–	–	68,192
Loans and advances to customers.....	–	10,067	232,236	153,772	127,839	54,726	38,014	44,509	29,082	7,848	20,644	890	719,627
Other financial assets	4,012	304	593	12	1,105	501	114	51	16	76	2	3	6,789
Total on-balance sheet exposure	72,389	320,212	232,831	153,784	142,602	55,227	38,128	52,766	29,098	7,924	20,646	1,699	1,127,306
Off-balance sheet exposure	4,630	15,883	22,125	26,238	33,919	12,686	10,644	4,552	8,999	2,631	2,822	784	145,913
Financial guarantees and underwriting commitments.....	45	608	533	8,056	2,016	1,960	2,441	3,525	691	27	675	223	20,800
Undrawn loan commitments.....	600	9,564	–	15,641	29,736	1,283	3,791	839	6,311	2,220	1,068	--	71,053
Undrawn overdraft/credit card facilities	3,985	5,711	21,592	2,541	2,167	9,443	4,412	188	1,997	384	1,079	561	54,060
Maximum exposure to credit risk.....	77,019	336,095	254,956	180,022	176,521	67,913	48,772	57,318	38,097	10,555	23,468	2,483	1,273,219
Percentage of carrying amount ..	6.0%	26.4%	20.0%	14.1%	13.9%	5.3%	3.8%	4.5%	3.0%	0.8%	1.8%	0.2%	100%

Notes:

- (1) Public entities consist of central government, state-owned enterprises, Central Bank and municipalities.
- (2) ITC consists of corporations in the information, technology and communication industry sectors.

The table below shows the credit exposure, allowances and impairment by industry and customer segments as at 30 September 2014.

At 30 September 2014	Individually impaired							Carrying amount
	Gross carrying amount	Gross not individually impaired	Collective allowance	Of which performing		Of which non-performing ⁽¹⁾		
				Gross carrying amount	Individual allowance	Gross carrying amount	Individual allowance	
			(millions of ISK)					
Financial institutions	68,192	68,192	-	-	-	-	-	68,192
Public entities	10,161	10,043	12	59	57	59	25	10,067
Individuals	249,252	222,292	2,476	10,687	5,536	16,273	9,004	232,236
Corporations								
Fisheries	161,246	140,666	932	18,890	5,231	1,691	1,312	153,772
Construction and real estate companies	135,281	124,158	1,852	6,868	3,049	4,255	2,541	127,839
Holding companies	47,130	33,579	688	12,811	1,413	739	519	44,509
Retail	41,959	36,930	559	3,066	2,041	1,963	1,345	38,014
Services	57,421	54,591	1,070	1,121	662	1,709	963	54,726
Information, technology and communication	21,287	20,910	361	270	211	108	72	20,644
Manufacturing	31,498	24,796	328	5,294	1,396	1,408	692	29,082
Agriculture.....	8,376	7,731	96	267	127	377	304	7,848
Other.....	897	897	7	-	-	-	-	890
Total.....	832,700	744,785	8,381	59,333	19,723	28,582	16,777	787,819

The table below shows the credit quality of the Issuer's financial assets, including its loans and advances as at 30 September 2014. The allowance for impairment includes both the allowance for individual impairment and the allowance for collective impairment.

	Gross carrying amount					
	Neither past due not individually impaired	Past due but not individually impaired	Individually impaired	Total	Allowance for impairment 1)	Carrying amount
	(millions of ISK)					
At 30 September 2014						
Cash and balances with Central Bank.....	38,820	-	-	38,820	-	38,820
Bonds and debt instruments.....	285,635	8,161	-	293,796	-	293,796
Derivative instruments	82	-	-	82	-	82
Loans and advances to financial institutions..	68,192	-	-	68,192	-	68,192
Loans and advances to customers.....	638,930	37,663	87,915	764,508	(44,881)	719,627
Other financial assets	6,789	-	-	6,789	-	6,789
Total	1,038,448	45,824	87,915	1,172,187	(44,881)	1,127,306

Note:

(1) The allowance for impairment includes both the allowance for individual impairment and the allowance for collective impairment.

The table below shows the gross carrying amount of loans and advances to financial institutions and customers that have failed to make payments which had become the ageing of the Issuer's past due but not impaired loans and advances.

The table below shows large exposures as at 30 September 2014, including subsidiaries of the Issuer classified as held for sale. Clients are rated as large exposures if their total obligation or those of financially connected parties, exceed 10 per cent. of the Issuer's capital base. The large exposures amount is calculated after taking account of collateral held, in accordance with the FME's Rules on Large Exposures incurred by Financial Undertakings No. 216/2007. According to these rules, no exposure may attain the equivalent of 25 per cent. of the capital base. All of the Issuer's large exposures were within these limits as at 30 September 2014.

FUNDING

Deposits from customers are the Issuer's single largest financing item accounting for around 52 per cent. of the Issuer's liabilities as at 30 September 2014. The Issuer offers various types of deposits to its customers, both fixed rates and variable rates, non-indexed as well as indexed to the Icelandic CPI index. Deposits are predominately non-indexed and available on demand.

The Issuer's borrowing is predominantly in the form of bonds issued to LBI hf. The bonds which the Issuer issued to LBI hf. consist of the secured bonds issued in October 2010 as part of the acquisition price for the Icelandic operations of LBI hf. and the secured bonds issued in April 2013 as the additional consideration for the assets and liabilities transferred from LBI hf. to the Issuer in October 2008. Both of these secured bonds issued are denominated in EUR, USD and GBP. The carrying amount of the bonds as at 30 September 2014 and December 2013 assumes the effective interest of EURIBOR/LIBOR + 2.90 per cent. to maturity.

On 8 May 2014, the Issuer and the Winding-up Board of LBI hf. reached an agreement on extension of the repayment schedule of the secured bonds, which the Issuer issued to LBI hf. The agreement was conditional upon the Winding-up Board of LBI hf. obtaining certain exemptions from capital controls from the Central Bank.

On 4 December 2014 the Winding-up Board of LBI hf. notified the Issuer that the authorities have approved the necessary exemptions and that the agreement has as a result entered into force.

The final payment from the Issuer to LBI hf. will now take place in October 2026 instead of October 2018. The outstanding amount is paid in ten bonds maturing every second year, issued in GBP, USD and EUR. The Issuer is authorised to make full or partial prepayment, without cost, at any time during the term.

The Issuer and the Winding-up Board of LBI hf. have also agreed on amendments that allow the Issuer, under certain circumstances, to postpone payment of the amounts maturing in 2018 and 2020. Furthermore, the minimum collateral requirement has been lowered from 125 per cent. to 115 per cent. of the outstanding amount at each time.

Interest rates will remain unchanged at a 2.9 per cent. margin until October 2018, stepping up to a 3.50 per cent. margin for the 2020 tranche to end at a 4.05 per cent. margin for the final maturity in 2026.

Each tranche maturing in 2016 to 2026 will amount to the equivalent of ISK 30 billion, with the exception of the 2018 tranche in the equivalent amount of ISK 40 billion. Upon entry into force of the agreement, the Issuer will pay the equivalent of ISK 30 billion and the outstanding amount of the bonds will subsequently equal 196 billion.

In addition to bonds issued to LBI hf., the Issuer has in place a ISK 100 billion Covered Bond Programme described in this Base Prospectus and an €1,000,000,000 Euro Medium Term Note Programme (the “**EMTN Programme**”). Notes issued under the EMTN Programme will be listed on the Irish Stock Exchange.

Deposits are expected to continue to form a significant part of the Issuer’s funding in the future. External factors might however affect the Issuer’s deposit base in the short and medium term, such as the lifting of capital controls and the increased availability of other investment opportunities for investors who currently hold deposits with the Issuer. To reduce the risk of these external factors, the Issuer will continue to diversify its funding profile when conditions permit by issuing bonds in the domestic and international bond markets.

RISK MANAGEMENT FRAMEWORK

Risk is inherent in the Issuer’s activities and is managed through a process of ongoing 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 Issuer’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 compliance with the Issuer’s risk appetite.

The objective of the Issuer’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 Issuer will comply with regulatory requirements. In order to ensure that fluctuations that might affect the Issuer’s equity and performance are kept limited and manageable, the Issuer has adopted several policies regarding the risk structure of its asset portfolio.

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

The Board of Directors has overall responsibility for the establishment and oversight of the Issuer’s risk management framework and risk appetite setting. The Issuer’s CEO is responsible for the effective

implementation of the framework and risk appetite through the Issuer's corporate governance structure and committees. The Issuer's CEO is a member of the Credit Committee, Risk and Finance Committee and the Executive Management Committee.

The Credit Committee deals with credit risk, both credit limits on individual customers, as well as policy issues regarding credit risk. The Risk & Finance Committee covers primarily market risk, liquidity risk, operational risk and legal risk. The Risk & Finance Committee monitors all the Issuer's risks. It is also responsible for enforcing the Issuer's risk appetite and risk limits, and reviews and approves changes to risk models before being presented to the Board of Directors. The Executive Management Committee serves as a forum for consultation and communication between the CEO and managing directors, addressing the main current issues in each division. This committee makes all major decisions that are not being considered in other standing committees. The Security Committee is a forum for discussions and decisions on information safety, personnel security, responsibilities in specific security areas and the Issuer's safety procedures.

Risk appetite is defined as the level and nature of risk that the Issuer is willing to take in order to pursue its articulated strategy, and is defined by constraints reflecting the views of the Board of Directors and the Issuer's CEO and Executive Management. The Issuer's risk appetite is reviewed and revised at least annually.

The material risks which the Issuer is exposed to and that arise from financial instruments are credit risk, liquidity risk and market risk.

Credit Risk

Credit risk is mainly managed through the credit process and the Issuer's credit risk models which include Probability of Default ("PD"), Loss Given Default ("LGD") and Exposure of Default ("EAD"). These three models are used for various purposes, e.g. in management reporting.

Credit risk identification

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

The Issuer'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 Issuer 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.

Credit risk assessment

Credit risk is measured in three main dimensions: PD, LGD and exposure. For the purpose of measuring PD, the Issuer 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. Internal ratings and associated PD play an essential role 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, i.e. credit quality. The obligor rating scale has 10 rating grades for non-defaulted obligors going from 1 to 10, where 10 indicates the highest credit quality, and the grade 0 is provided for defaulted obligors. The rating assignment is supported by rating models, which take information such as industry classification, financial accounts and payment behaviour into account.

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

In 2013, the Issuer implemented a new credit rating model for individuals which substantially amended the former model. The new model's discriminatory power significantly exceeds the Basel II regulatory minimum requirement of 0.5. Furthermore, the new model is well calibrated, i.e. the weighted probability of default for each rating grade is equal to the actual default rate with respect to reasonable error limits.

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

Exposure is calculated using the credit conversion factors of the Basel framework.

Credit risk management

The Issuer'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 Risk Management Division and the business units. The Issuer 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 statement 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 Issuer's internal framework of regulation and guidelines. The Issuer's executives are responsible for the appropriate execution of the risk policy by the Issuer's business units and the CEO is responsible for the oversight of the process as a whole.

Incremental credit authorisation levels are defined based on size of units, types of customers and lending experience of credit officers. Credit decisions exceeding authorisation 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 Issuer'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 Issuer.

Credit risk mitigation

Mitigating risks in the credit portfolio is a key element of the Issuer's credit policy and is an inherent part of the credit decision process. Securing loans with collateral is the main method of mitigating credit risk whereas for many 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, ships and financial assets (shares or bonds).

The Issuer regularly assesses the market value of collateral received. The Issuer has developed models to estimate the value of the most common types of collateral. For collateral for which no valuation model exists, the Issuer estimates the value manually. It calculates 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 Issuer monitors the market value of mark to market collateral and may require additional collateral in accordance with underlying loan agreements.

Derivative financial instruments

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

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

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

Amounts due to and from the Issuer are offset when the Issuer 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 Issuer uses fair value estimates based on available information and the Issuer's own estimates.

Credit risk control and monitoring

The Issuer employs an internal Early Warning System to monitor exposures in order to identify signs of weakness in customer earnings and liquidity as soon as possible. To monitor customers, the Issuer uses - supplemental to ratings - a credit monitoring classification of four risk groups (green, yellow, orange and red). The colour classification is the following:

Green customers are considered as performing without signs of repayment problems;

Yellow customers are on *Watch list 1*, they have temporary difficulties and may need some instalments postponed or modification to terms or loan covenants;

Orange customers are on *Watch list 2*, they are still under the supervision of the relevant business unit but are likely to go through debt restructuring or postponement of instalments; and

Red customers are under supervision by Corporate Solutions and need restructuring or are in legal collection. Management of the customer's operations will possibly be taken over by the Issuer. In some cases, collateral or guarantees will be collected and/or the operations sold.

The Credit Risk Monitoring Department within Risk Management is, together with the business units, responsible for the verification of colour of the customer and the transfer of customers from the business units to Corporate Solutions if necessary.

Impairment process

The Issuer's 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 as profit or loss. The impact of financial restructuring of the Issuer's customers is reflected in loan impairment, or net adjustments to loans and advances, as the expected cash flow of customers has changed.

After the financial crisis and recession in October 2008, the Issuer has significantly reduced granting loans in foreign currency unless the customer's income is in the same currency or a comparable currency. This also applies to granting CPI indexed loans to corporate customers.

The total allowance for impairment was ISK 44.9 billion on 30 September 2014, compared to ISK 50.9 billion in 2013. Allowances thus decreased during the first nine months of 2014 while the overall carrying amount increased. The decrease in allowances is mainly due to reduction in past due loans and adjustments to loan valuations. As at 30 September 2014 89 per cent. of the loan portfolio consisted of claims that were neither past due nor impaired and the accumulated impairment loss amounted to ISK 0.5 billion (*for further information, see the Financial Statements for the nine months ended 30 September 2014, note 35 - Allowance for impairment on loans and advances to financial institutions and customers and other financial assets*).

Liquidity Risk

Liquidity risk is identified as one of the Issuer's key risk factors, in light of the Issuer's current operating environment. Accordingly, great emphasis is put on liquidity risk management within the Issuer, which is both reflected in the risk appetite of the Issuer as well as in internal liquidity management policies and rules.

A liquidity policy for the Issuer and its subsidiaries is in place and is formulated by the Risk and Finance Committee. The objective of the liquidity management policy is to ensure that sufficient liquid assets and funding capacity are available to meet financial obligations and sustain withdrawals of confidence sensitive deposits in a timely manner and at a reasonable cost, even in times of stress.

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

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

The Issuer monitors intraday liquidity risk, short-term 30 day liquidity risk, liquidity risk for one year horizon and risk arising from mismatches of longer term assets and liabilities.

The Issuer's liquidity management process includes:

- Projecting expected cash flows in a maturity profile rather than relying merely on contractual maturities and 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.
- Maintaining liquidity and contingency plans which outline measures to take in the event of difficulties arising from a liquidity crisis.

The liquidity management policy is built on international standards on liquidity risk measurements developed by the Basel Committee on Banking Supervision e.g. the Liquidity Coverage ratio ("LCR") and the Net Stable Funding Ratio ("NSFR") and it also applies measurements that best suit the operating environment of the Issuer.

It is the intent of the Issuer to utilise the framework published by the Basel Committee on Banking Supervision e.g. the LCR and the NSFR to further ensure the Issuer's ability to measure and withstand liquidity needs in the short term, as well as to promote more medium and long-term funding of the assets and activities of the Issuer.

As stated earlier, LCR is a short-term liquidity ratio whereas NSFR has a time horizon of one year 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.

Implementation on LCR is already in place within the Issuer in line with the regulatory changes made by the Central Bank in December 2013. Implementation on NSFR is in place as of 1 December 2014.

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

The Central Bank issued new Rules on Liquidity Ratio, no. 1055/2013, and the rules took effect on 1 December 2013. The Central Bank Rules on liquidity are based on international standards developed by the Basel Committee on Banking Supervision but are adapted to Icelandic conditions e.g. including special requirements on foreign currency liquidity and treatment of risk related to the winding-up of the Old Banks.

The rules require the Issuer to maintain a LCR minimum of 70 per cent. for total LCR and 100 per cent. for FX in the year 2014. According to the implementation schedule, the total LCR minimum will gradually increase to 100 per cent. from 2014 to 2019, whereas the FX ratio is constant. The Issuer's LCR as at 30 September 2014 was 108 per cent. and 222 per cent. for foreign currencies (*for further information, see the 2014 Interim Financial Statement for the first nine months ended 30 September 2014, note 37 - Liquidity risk management*).

Another key measure used by the Issuer for monitoring liquidity risk is the ratio of core liquid assets to deposits, which shows the ratio of deposits that the Issuer could deliver on demand without incurring any significant losses due to forced assets sales or other costly actions. Core liquid assets are comprised of cash at hand, balances with the Central Bank, loans to financial institutions (maturity within seven days) and assets eligible for repo transactions with the Central Bank. In addition, the Issuer monitors liquidity risk by its cash ratio, which shows the ratio of on demand deposits that the Issuer could deliver with cash and cash equivalents such as cash at hand, balances with the Central Bank and loans to financial institutions (maturity within seven days).

The table below shows various values of the core liquidity ratio and cash ratio at the end of September 2014 and the end of 2013 and 2012

	Core liquidity ratio			Cash ratio		
	30.9.2014	31.12.2013	31.12.2012	30.9.2014	31.12.2013	31.12.2012
Period-end	49%	50%	48%	13%	13%	12%
Maximum	53%	53%	51%	21%	22%	32%
Minimum	46%	41%	36%	11%	10%	12%
Average	49%	47%	45%	15%	16%	20%

The Issuer submits monthly reports on its liquidity position to the Central Bank and the FME.

Market Risk

Market risk is the risk that changes in market prices will have an adverse impact on the fair value or future cash flows of financial instruments. 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.

Most of the Issuer's products and exposures that entail market risk consist mainly of equities, government bonds and open currency positions.

The Board of Directors is responsible for determining the Issuer's overall risk appetite, including market risk. The CEO of the Issuer 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 the Market Risk unit within Risk Management. The objective of market risk management is to identify, locate and monitor market risk exposures and analyse and report to appropriate parties. Together, the risk appetite of the Issuer and the market risk policies set the overall limits that govern market risk management within the Issuer.

Market risk monitoring and reporting is governed by the Risk & Finance Committee and implemented by the Market Risk Department.

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

Market risks arising from trading and non-trading activities are measured, monitored and reported on a daily, weekly and monthly basis, and the detailed limits set by the Risk & Finance Committee are monitored by Market Risk.

Interest rate risk

Interest rate risk is managed principally by monitoring interest rate gaps. Interest rate risk is managed centrally within the Issuer by the Treasury of the Issuer, and is monitored by the Market Risk Department. In the current economic environment, the Issuer has limited access to derivative instruments and other tools for managing interest rate risk.

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.

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 Issuer employs a quarterly stress test of the interest rate risk in the Issuer's banking book by measuring the impact on profit of shifting the interest rate curves for every currency. The Issuer is now applying more severe interest rate shocks to the relevant rate curves. The magnitudes of the shifts are based on guidelines from the European Banking Authority and the FME, taking historical interest rate volatility into account.

CPI indexation risk (all portfolios)

To mitigate the Issuer's imbalance in its CPI-indexed assets and liabilities, which the Issuer is in a limited position to do, the Issuer offers non-CPI-indexed loans and CPI-indexed deposits. CPI indexation risk is managed centrally within the Issuer by the Treasury of the Issuer, and is monitored by the Market Risk Department.

Management of the Issuer's CPI indexation risk is supplemented by monitoring the sensitivity of the Issuer's overall position in CPI-indexed financial assets and liabilities net on-balance sheet to various inflation/deflation scenarios.

Currency risk (all portfolios)

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

Operational risk management

Whereas the executive managing director of each division is responsible for that division's operational risk, the daily management of operational risk is in the hands of general managers of each department. The Issuer establishes, maintains and co-ordinates its operational risk management framework at a group level. This framework complies with the Basel Committee's 2011 publication "Principles for the Sound Management of Operational Risk". The Issuer ensures that operational risk management stays consistent throughout the Issuer 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 Department. By managing operational risk in this manner, the Issuer intends to ensure that all of the Issuer'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.

Capital Adequacy

The Issuer's capital management policies and practices ensure that the Issuer has sufficient capital to cover the risk associated with its activities. The capital management framework of the Issuer comprises four interdependent activities: Capital Assessment, Risk Appetite/Capital Target, Capital Planning and Reporting/Monitoring. The Issuer regularly monitors and assesses its current risk profile in the most important business areas and for the most important risk types. Risk appetite sets out the level of risk the Issuer is willing to take in pursuit of its business objectives.

Capital requirements are defined by two external bodies: the European Council and the FME. The basis of the requirements of both bodies is the CRD IV. The regulatory minimum capital requirement under the CRD IV is 8 per cent. of Risk Weighted Assets ("**RWA**") for credit risk, market risk and operational risk. The Capital Adequacy Requirement ("**CAR**") is reviewed by the FME in the Supervisory Review and Evaluation Process ("**SREP**"). The FME also requires the Issuer to maintain a minimum core Tier 1 capital ratio of 12 per cent.

The Issuer uses the standardised approach in measuring Pillar I risks. The ICAAP under Pillar II is the Issuer's calculation of its solvency need (as a percentage of RWA) and is based on economic capital calculations, stress tests and results of the SREP. The economic capital requirement at end of 2013 was 13.7 per cent. Including capital buffers the Issuer's internal assessment was 15.1 per cent. as at 31 December 2013. In the latest SREP process, based on year-end 2013, the FME determined the CAR to be 15.8 per cent. (which replaces the 16.7 per cent. requirement determined by the FME in the previous SREP process, based on year-end 2012).

The Issuer's equity at 30 September 2014 amounted to ISK 241 billion (compared to ISK 241 billion at year-end 2013), equivalent to 20.1 per cent. (compared to 21.0 per cent. as at 31 December 2013) of total assets, according to the Consolidated Statement of Financial Position. The Capital Adequacy ratio calculated in accordance with Article 84 of Act No. 161/2002 on Financial Undertakings, was 27.1 per cent. as at 30 September 2014. According to the Act, this ratio may not fall below 8 per cent.

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

The new CRD IV framework has not been incorporated into the EEA Agreement and is therefore, not yet at least, binding on Iceland under international public law. At present, it is not clear when it will be implemented, if at all.

Currently, the Issuer does not have information on proposals for the implementation of the aforementioned provisions of CRD IV into Icelandic law. The Issuer does not expect the implementation of the provisions to lead, overall, to an increase in capital requirements for the Issuer. This view is based on the Issuer's strong capital and liquidity position and the already far reaching capital requirements imposed by the FME under Pillar II.

LITIGATION

The Issuer is party to litigation cases, which arise due to the nature of its business and are not expected to have material effect on the Issuer's financial position. However, since the establishment of the Issuer, the Issuer has engaged in various material litigation cases, most of them related to financial assets and liabilities transferred from LBI hf. to the Issuer. The Issuer has formal controls and policies for managing legal claims. After professional advice has been obtained and estimations on any possible amount have been made, the Issuer takes the necessary steps to mitigate any adverse effects which the claims may have on its financial standing.

Below is a description of pending or threatened proceedings against the Issuer which may have a significant effect on the Issuer's financial position or profitability if not ruled in favour of the Issuer.

Disputes regarding loans indexed to foreign currencies

In 2010 and 2011 the Supreme Court ruled that the principal of a loan agreement denominated in ISK could not be indexed to foreign currencies. Such indexation was deemed contrary to the provisions of the Act on Interest and Price Indexation No. 38/2001. The rulings had the effect that a number of such loans had to be recalculated by the Issuer. In accordance with the rulings and applicable law, loans indexed to foreign currencies should bear the lowest interest rates of non-indexed loans denominated in ISK as determined by the Central Bank. An impact of these rulings on the Issuer was recognised in the consolidated financial statements of the Issuer as of 31 December 2010.

Following further Supreme Court rulings in cases No. 600/2011 and No. 464/2012, there still remains some legal uncertainty regarding the recalculation of loans indexed to foreign currencies and further clarification is expected during the course of 2014. The Issuer has accounted for the potential impact of the rulings in cases No. 600/2011 and No. 464/2012 and recognised, respectively, expenses in the amount of ISK 38 billion and ISK 2.1 billion in its consolidated income statement as at 31 December 2012. These expenses are recorded in the income statements under line item "Loss from foreign currency linkage of loans and advances to customers". The precedents set by these rulings are not entirely clear and further court rulings are needed to clarify the issues regarding loans indexed to foreign currencies. The total amount of the estimated impact may change accordingly.

The specific material litigation in relation to loans indexed to foreign currencies at the date of this Base Prospectus is as follows:

- In December 2012, a company commenced litigation against the Issuer demanding, *inter alia*, that a court acknowledge that a loan agreement dating from June 2006 constitutes a loan in ISK, illegally indexed to foreign currencies, and should as such be recalculated in accordance with Act No. 38/2001. The Issuer's view is that the loan agreement is in fact a loan in foreign currencies and should therefore not be recalculated, *inter alia*, due to the fact the loan was repaid in foreign currencies. The Issuer's view is that it is of no relevance that the repayment currencies were not the same as the foreign currencies stipulated in the loan agreement. The case was heard by the District Court of Reykjavík which in its judgment concluded

that the loan was in ISK, indexed to foreign currencies. The case has been appealed to the Supreme Court and it is expected that the Court will hear the case in early winter 2014.

- In December 2013, a company commenced litigation against the Issuer claiming that previous recalculations of a foreign currency indexed loan should be recalculated in accordance with Supreme Court decisions No. 600/2011 and No. 464/2012 whereby interest rates determined by the Central Bank were considered by the Supreme Court as not being applicable in specified circumstances, *inter alia*, as the lender had issued final receipts for interest payments. One of the conditions established by the Supreme Court for rejecting Central Bank interest rates is that the additional claim, in other words, the difference between the Central Bank's interest amount and the interest amount appearing on the final receipts, would cause a serious disruption of a company's financial position. In this case the Issuer takes the view that this condition is not met. On 7 November 2014 the District Court of Reykjavik acquitted the Issuer of the company's claims. The appeal period has not yet expired.

The results of these cases involving the Issuer will clarify matters further and enable the Issuer to make an informed decision on which loans should be recalculated and the main issues to be considered as regards the methodology of such recalculations.

Disputes regarding loans indexed to the CPI

A related issue concerns the validity of Icelandic loans indexed to the CPI. In January 2013, an individual commenced litigation against the Issuer claiming acknowledgement by the court that he is not legally bound by a clause on consumer price indexation in a bond issued by him to the Issuer; alternatively, that the court confirms that the Issuer is not entitled to revalue the principal amount of the bond on a monthly basis according to changes in the CPI. Furthermore, the individual is seeking confirmation from the court that he is not legally bound by a clause in the same bond regarding the Issuer's obligation to pay a settlement fee. The individual claims that the bond's clauses are illegal according to the Securities Transaction Act, No. 108/2007, and EU Directive No. 2004/39/EC. In a ruling of 31 October 2013, the District Court of Reykjavik found the Securities Transaction Act No. 108/2007 irrelevant to the case. The court did, however, find that Directive 87/102/EEC, concerning consumer credit, and Directive 93/13/EEC, on unfair terms in consumer contracts, might be of relevance to the case and decided to request an advisory opinion from the EFTA Court on the interpretation of certain provisions of these directives. The EFTA Court delivered its advisory opinion on 24 November 2014. As regards Directive 87/102/EEC on consumer credit, the EFTA Court finds that when a credit agreement is linked to a CPI, it is not compatible with the Directive to calculate the total cost of the credit and the annual percentage rate of charge on the basis of 0% inflation if the known rate of inflation at the time of the credit agreement is not 0%. It is for the national court to assess, taking account of all the circumstances of the case, the legal consequences of and the remedies for such incorrect information, provided that the level of protection established by the Directive, as interpreted by the EFTA Court, is not compromised. The Reykjavik District Court will now consider the EFTA Court's advisory opinion and establish, based on Icelandic law, whether and to what extent it impacts judgment in the aforementioned case. It is not possible, at this stage, to determine the final conclusions of the District Court in the case. The Act on Interest and Price Indexation, No. 38/2001, clearly authorises the price indexation of loans. The Issuer is of the opinion that the inflation indexation provisions of loans in its portfolio comply with that Act and other rules of law that apply to the indexation of loans. The Issuer further considers information provided in connection with the granting of indexed loans to have been in compliance with Icelandic laws on consumer credit. The Issuer has reviewed the potential impact of a ruling holding the Issuer responsible for the illegitimacy of provisions on inflation-indexation or of it being established that information provided in connection with the granting of indexed loans was insufficient. Such a verdict could negatively impact the value of the affected portion of the Issuer's inflation-indexed loan portfolio. The Issuer's equity ratio is, however, very strong and would remain well above the FME's minimum capital requirement despite such an outcome. Such a verdict would not impact the Issuer's capacity to repay Covered Bonds issued under this Base Prospectus.

Disputes concerning the transfer of assets from LBI hf. to the Issuer

A few pending cases relate to the transfer of assets from LBI hf. to the Issuer in 2008. One case involves funds received by a foreign bank which acted as a correspondent bank of LBI hf. for international payments. The account had also been used by customers of LBI hf. for international payments. After the establishment of the Issuer, the foreign bank was repeatedly notified of the transfer of the business from LBI hf. to the Issuer and was instructed not to receive payments into the account as the transferred payments were in fact owned by customers of the Issuer. The foreign bank did not act on the instructions and continued to receive payments and crediting the account of LBI hf. The Issuer's customers who did not receive their payments due to the actions of the foreign bank were reimbursed by the Issuer. Of those customers, 10 individual account holders were selected to commence litigation against the foreign bank. On 23 May 2012 the court ruled in favour of the account holders, ordering the foreign bank to pay the total amount of EUR 2.2 million. The foreign bank has now appealed the court's decision to a higher court. It is foreseeable that the proceedings will be ongoing at least until 2015. Litigation has now been initiated regarding the remaining account holders to prevent the expiration of the limitation period for the claims. The total claim for those account holders is approximately EUR 0.9 million.

Investigations regarding alleged breaches of competition law

In March 2013, the Icelandic Competition Authority (the "**Competition Authority**") submitted to the Issuer its preliminary assessment and conclusions in two cases. The first case concerns certain preferential terms and conditions offered during the period from 2004 to 2010 by LBI hf. and, subsequently, by the Issuer to clients for retail banking services, in particular for household mortgage loans. The Issuer has refuted allegations of a breach of competition rules. The Issuer does not have information as to whether the Competition Authority will take further action in the case, but has expressed willingness to discuss the matter. The second case concerns, in particular, an alleged involvement of LBI hf. and, subsequently, of the Issuer during the period from 2007 to 2009 in the way in which decisions were taken on payment card interchange fees. The Issuer has refuted allegations of a breach of competition rules. The Issuer and the Competition Authority have entered into discussions regarding the settlement of the case.

Other legal proceedings

In June 2013, a payment card acquirer commenced litigation against the Issuer, as well as certain other financial undertakings claiming liability in tort of an amount of around ISK 1.2 billion plus interest. The plaintiff argues that the defendants, including the Issuer, are liable in tort for an alleged violation of competition rules. The Issuer refutes the allegations and the claims.

In November 2012, Landsbankinn Guernsey Ltd. commenced litigation against the Issuer, the FME and the Icelandic government. The plaintiff claims that the Issuer should pay approximately GBP 12.8 million, EUR 0.6 million and USD 3.1 million plus interest, based on money market loans between the plaintiff and LBI hf. which the plaintiff claims were transferred to the Issuer with the FME's decision on 9 October 2008. The Issuer's view is that money market loans were not transferred to the Issuer on 9 October 2008 in accordance with the FME's decision. It is foreseeable that the case will be heard by the District Court in early winter 2014.

COMPETITION

The Icelandic competitive landscape is comprised of four commercial banks, eight savings banks and six credit institutions. The financials market also includes eleven securities companies, two securities brokerages and nine management companies of UCITS. The HFF, a fully state-owned mortgage lender, offers financing for

residential housing in Iceland (see “*Financial Markets in Iceland - Other Relevant Institutions in the financial market*”). There is substantial competition for the types of banking and other products and services the Issuer provides. The Issuer’s main competitors are the other large commercial banks in Iceland, Íslandsbanki and Arion Bank. Competition has been limited in recent years as all three banks have focused on restructuring their loan portfolio and improving internal operations in response to the tightened regulatory framework implemented under Basel II and Basel III. While competition has been limited it can still be affected by different needs, consumer demand, technological changes and the impact of consolidation, as well as regulatory actions. The Issuer expects competition from the other commercial banks and smaller specialised institutions to intensify in the coming years. Possible mergers in the financial services industry and the possible entry into the market of foreign banks able to offer a wider array of products and services could complicate the competitive environment further.

The Issuer will continue to offer a full range of specialised financial services to individuals, corporate entities and institutions, as well as work on further product developments to meet different consumer demands.

ADMINISTRATIVE, MANAGEMENT, AND SUPERVISORY BODIES

Name	Function	Principal Outside Activities
Senior Management		
Mr. Steinþór Pálsson	CEO	Chairman of the Icelandic Financial Services Association and vice board member of the Iceland Chamber of Commerce.
Mr. Árni Þór Þorbjörnsson	Managing Director of Corporate Banking	N/A
Mr. Helgi Teitur Helgason	Managing Director of Personal Banking	Board member of Motus ehf. and Greiðslumiðlun Íslands ehf. Advisory board member of Framtakssjóður Íslands GP hf. (“FSÍ”).
Ms. Hrefna Ösp Sigfinnsdóttir	Managing Director of Markets	N/A
Mr. Hreiðar Bjarnason	Managing Director of Finance, CFO	Represents Landsbankinn on the Board of FSÍ GP hf.
Ms. Jensína Kristín Böðvarsdóttir	Managing Director of Corporate Development & Human Resources	Board member of Frumtak GP ehf. and alternate board member of FSÍ.
Ms. Perla Ösp Ásgeirsdóttir	Managing Director of Risk Management	N/A

Name	Function	Principal Outside Activities
Ms. Ragnhildur Geirsdóttir	Managing Director of Operations & IT	N/A
Board of Directors		
Mr. Tryggvi Pálsson	Chairman	Chairman and CEO of Banker Consult slf.
Ms. Eva Sóley Guðbjörnsdóttir	Vice-chairman	Vice President of Corporate Finance at Össur hf., Board Member of Skeljungur hf.
Ms. Danielle Pamela Neben	Board Member	Alternate Board Member of GLS ehf.
Ms. Helga Björk Eiríksdóttir	Board Member	Chairman of the Board of Directors of Firkir ehf. General Manager and Board Member of Integrum ehf. Alternate Board Member of Fösull ehf. and Fenlogi ehf.
Mr. Jón Sigurðsson	Board Member	Senior Vice President of Procurement at Promens hf. and Managing Director in Promens Group A.S. a subsidiary of Promens hf. Eignarhaldsfelag Landsbankans ehf., a subsidiary of Landsbankinn holds 49.9 per cent. of shares in Promens hf. and FSÍ, holds the remaining shares in Promens hf. Landsbankinn owns a 17.7 per cent. shareholding in FSÍ.
Mr. Kristján Þ. Davíðsson	Board Member	Chairman of the Board of Directors of Valka hf., Board Member of Vaki fiskeldiskerfi hf. Board Member of Icelandic seafood industry technology companies; Viðskiptaþróun ehf. and ISDER ehf. Board Member of the Norwegian health supplements company OliVita A.S.
Mr. Jóhann Hjartarson	Board Member	Chairman of Íslensk erfðagreining ehf., General Council of Íslensk erfðagreining ehf. Board Member of UVS-Urður, verðandi Skuld ehf. Alternate Board

Name	Function	Principal Outside Activities
		Member of Skipti hf.
Dr. Tinna Laufey Ásgeirsdóttir	Alternate	N/A

The business address of each of the Senior Management and Directors above is Austurstræti 11, 155 Reykjavík, Iceland.

There are no potential conflicts of interests between any duties of the Senior Management and Directors above and their private interests and/or other duties.