

**Landsbankinn hf.**  
**(incorporated in Iceland as a limited liability company)**  
**ISK 120,000,000,000**  
**Covered Bond Programme**

Under this ISK 120,000,000,000 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 Nasdaq Central Securities Depository Iceland hf. (the “**NCS**”) 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 120,000,000,000 (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. Any increase of the Programme is subject to the FME approval.

This Base Prospectus dated 8 December 2017 (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, as amended (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) (<https://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 (see *Selling Restrictions*). Interests in a Temporary Bearer Global Covered Bond will be exchangeable, in whole or in part, for interests in a Permanent Bearer Global Covered Bond on or after the Exchange Date (as defined in the section *Terms and Conditions of the Covered Bonds*), upon certification as to non-U.S. beneficial ownership. Until the expiration of 40 days after the later of the commencement of the offering of Registered Bonds and the issue date thereof, beneficial interests in a Global Certificate may be held only through Euroclear Bank S.A./N.V. (“**Euroclear**”) or Clearstream Banking (“**Clearstream, Luxembourg**”).

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 8 December 2017.**

This Base Prospectus, dated 8 December 2017, 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, as amended (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) (<https://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.

*The Covered Bonds have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state or other jurisdiction of the United States and the Covered Bonds may include Bearer Covered Bonds that are subject to U.S. tax law requirements. Subject to certain exceptions, the Covered Bonds may not be offered or sold or, in the case of Bearer Covered Bonds, delivered within the United States or*

to, or for the account of benefit of, U.S. persons (as defined in Regulations S under the Securities Act („**Regulations S**“)).

*The Covered Bonds are being offered and sold outside the United States to Non- U.S. persons in reliance on Regulations S. For a description of these and certain further restrictions on offers, sales and transfers of bonds and distribution of this Base Prospectus see chapter Selling Restrictions.*

*The Covered Bonds have not been approved or disapproved by the U.S. Securities and Exchange Commission, any state securities commission in the United States or any other U.S. regulatory authority, nor has any of the foregoing authorities passed upon or endorsed the merits of the offering of Covered Bonds or the accuracy or the adequacy of this Base Prospectus. Any representation to the contrary is a criminal offence in the United States.*

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.

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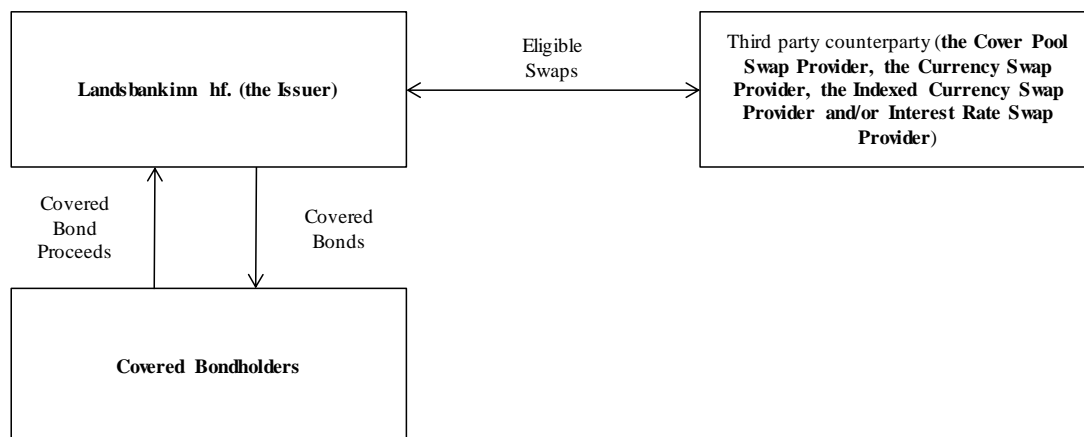
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## OVERVIEW OF THE PROGRAMME

The following is a brief overview (the “**Overview**”) and it should be read in conjunction with the rest of this Base Prospectus, 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 120,000,000,000 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 1,198 billion at the end of September 2017. 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 37 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. Any increases of the Programme shall be subject to the FME approval. On 1.November 2017, FME authorised the Issuer to increase the size limit to ISK 120,000,000,000.

**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 Terms and Conditions.

**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 Terms and Conditions.

**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 Condition 7.1(a) or (b) , 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 (or its equivalent in any other currency) 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) 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.

<b>Insolvency of the Issuer:</b>	<p>In the event of insolvency of the Issuer, the Covered Bonds remain outstanding in accordance with the Terms and Conditions of the Covered Bonds.</p> <p>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.</p>
<b>Use of Proceeds:</b>	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.
<b>Rating:</b>	Covered Bonds issued under the Programme may or may not have a rating by a rating agency as stated in the applicable Final Terms.
<b>Clearing Systems:</b>	Covered Bonds issued under the Programme will be cleared through the NCSD, Euroclear, Clearstream, Luxembourg and/or any other clearing system as specified in the relevant Final Terms.
<b>Listing:</b>	Covered Bonds may be admitted to trading on a regulated market as specified in the applicable Final Terms. The 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 NCSD 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 NCSD 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.

**Certain Restrictions:**

The offer or sale of the Covered Bonds may be restricted by law in certain jurisdictions. 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. See *Selling Restrictions*. Persons into whose possession this Base Prospectus or any Covered Bonds must inform themselves about, and observe any such restrictions on the distribution of this Base Prospectus and the offering and sale of the Covered Bonds.

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.

The Covered Bonds in bearer form are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. Treasury regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986, as amended and U.S. Treasury regulations promulgated thereunder. The applicable Final Terms will identify whether TEFRA C rules or TEFRA D rules apply or whether TEFRA is not applicable.

The Central Bank of Iceland has published the Rules on Special reserve requirements for new foreign currency inflows in accordance with the new Temporary Provision of the Foreign Exchange Act, no. 87/1992. The main purpose this instrument, a capital flow management measure, is to temper inflows of foreign currency and to affect the composition of such inflows. The Rules contain provisions on the implementation of special reserve requirements for new foreign currency inflows, including the special reserve base, holding period, special reserve ratio, settlement currency, and interest

rates on deposit institutions' capital flow accounts with the Central Bank of Iceland. The special reserve base is defined as new inflows of foreign currency in connection with specified types of capital, particularly to include new investment in electronically registered bonds and bills, and deposits.

## 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. (**“Arion Bank”**), Íslandsbanki hf. (**“Íslandsbanki”**), Kvika bank hf., (**“Kvika Bank”**) 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 (see further *“Description of the Issuer - Competition”*). 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.

In addition to the risk factors above, Iceland’s economy remains vulnerable to other economic external factors such as the effects of the sovereign debt crisis in Europe, the withdrawal of the United Kingdom from the EU and instability or deterioration of the international financial markets. These factors could have a material adverse effect on the Icelandic economy. Although the financial sector in Iceland is still to some extent subject to capital controls and is mostly funded by domestic deposits, a global recession is likely to affect demand and the price of Iceland’s main export sectors such as tourism, fishing and aluminium exports.

***The Icelandic State Treasury is the largest shareholder of the Issuer. This may affect the Issuer and its business***

As at the date of this Base Prospectus, the Icelandic State Financial Investments (the **“ISFI”**) manages a 98.2 per cent. shareholding and the corresponding voting rights on behalf of the largest shareholder, the Icelandic State Treasury. The Icelandic Parliament has authorised the Minister of Finance and Economic Affairs to sell all of the Icelandic State Treasury’s shares in the Issuer which are in excess of 70 per cent. of the Issuer’s total share capital, subject to any proposals that may be put forward by the ISFI. 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 to the Issuer due to the fact that the Icelandic State Treasury has the majority shareholding in the Issuer. These rules do not apply to the Issuer’s main competitors as they are not majority owned by the Icelandic State Treasury, except for Íslandsbanki, which became wholly owned by the Icelandic State Treasury in January 2016. These rules may impose a heavier regulatory burden on the Issuer compared to its competitors and may thus have a negative impact on the Issuer’s competitive position, and could affect the Issuer’s business, financial condition and results of operations. These rules are, Article 6 of the Act on the Icelandic National Audit Office No. 86/1997 (the Issuer’s auditor is the National Audit Office), Article 2 of the Information Act No. 140/2012 (the Issuer is subject to the provision of this Act but can obtain a temporary exemption from falling under the scope of this Act), and Article 14 of the Act on Public Archives No. 77/2014 (the Issuer is subject to provision of the Act).

The Annual General Meeting (**“AGM”**) of the Issuer was held 14 April 2016, approved a motion entrusting the Board of Directors to add to its rules of procedures provisions on the competitive independence of the Issuer towards other state-owned commercial banks. Following the changes in ownership of Íslandsbanki, with the corresponding shares relating to such ownership being administered by the same party as the shares in the Issuer, namely the ISFI.

***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, on the Authority for

Treasury Disbursements due to Unusual Financial Market Circumstances etc. (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 (See further “*The Icelandic Economy*”). The economic upswing and improved private sector financial conditions are reflected in the position of Icelandic banks, with good returns on equity and total assets, declining levels of non-performing loans and high capital ratios. Banking system liquidity has remained strong and capital ratios of the three largest Icelandic commercial banks are strong and well above the required minimum of the FME. The Central Bank of Iceland (the “**Central Bank**”) publishes a Financial Stability Report bi-annually.

In the October 2017 Financial Stability Report, the Central Bank concluded that the financial institutions’ operating environment has been favourable in the recent past, and there are no obvious signs of imminent systemic risk. Direct risk to the domestic financial system is limited at present, however Iceland is now more open than it was under the capital controls and therefore more vulnerable to external changes. The key risks to the domestic financial system as set forth in the report stem from the tourism sector and the housing market. Growth in tourism has eased in recent months, but the large commercial banks’ loans to the industry have increased somewhat over the same period. Rapid growth in tourism has played a part in pushing real estate prices upwards. As a result, the market could become more vulnerable to volatility in tourism.

In the most recent International Monetary Fund (the “**IMF**”) Article IV Consultation Staff Report from June 2017, the IMF stated that “risks center on overheating and capital flows”. If homebuilding continues to lag demand, house price pressures could keep foreign workers away. This could cause tightening of the labour market. Another round of large wage increases could tip the economy into overheating. A vicious and complex interplay could also develop between macroeconomic overheating and a carry trade, with excessive króna appreciation, hurting competitiveness and a credit fueled asset boom (likely centered on real estate) turbocharging domestic demand and hurting bank soundness.

In June 2016, the Central Bank published its Rules on Special Reserve Requirements for New Foreign Currency Inflows, No. 490/2016, as amended (the “**Special Reserve Requirement Rules**”), in accordance with the new Temporary Provision III of the Foreign Exchange Act, no. 87/1992, as amended, (the “**Foreign Exchange Act**”). The main purpose of this new Temporary Provision is to provide the Central Bank with a new policy instrument, generally referred to as a capital flow management measure, to temper inflows of foreign currency and to affect the composition of such inflows. All new investments in bonds, bills, fund units and deposits will be subject to special reserve requirements, i.e. investors have to deposit a specific portion (currently 40 per cent<sup>1</sup>.) in reserve accounts for a certain holding period (currently 12 months<sup>2</sup>). Deposit institutions are required to deposit the special reserve amount that they hold in special reserve accounts to a capital flow account with the Central Bank of Iceland which bears 0 per cent. interest. The settlement currency for capital flow accounts shall be the Icelandic Krona. See further “*Taxation and Capital Inflow Restrictions*”.

The Icelandic Government’s strategy for capital account liberalisation has involved a number of complex transactions which, therefore, leads to a number of risks. These risks include the risk of disorderly unwinding of ISK-denominated assets, legal disputes and a slower than envisaged path toward liberalisation. Such risks related to the liberalisation of capital controls could bring negative consequences for the domestic economy and/or renewed financial volatility, and could also have a detrimental impact on investor confidence, which could have a negative effect on the Issuer. See further “*The Issuer’s operating environment is still to some extent subject to capital controls even though the capital controls have mostly been lifted. If the capital control regime is removed in manner which fails to protect the Icelandic economy from a negative impact of its removal it could have material adverse effect on the Issuer’s business*”. Should Iceland’s economy be adversely affected by

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<sup>1</sup> The Foreign Exchange Act states that the special reserve ratio may range up to 75 per cent.

<sup>2</sup> The Foreign Exchange Act states that the holding period may range up to five years

domestic or external factors, whether as a result of any of the above factors or for other reasons, such as fluctuation in the value of the Icelandic krona, lack of foreign investments or inflation, it could adversely affect the ability of the Issuer's customers to repay their loans which in turn could have a material adverse effect on the Issuer's business, financial conditions, results of operations, cash flows and prospects, and its ability to make payments in respect of the Covered Bonds.

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

The Issuer, Íslandsbanki and Arion Bank (together the “**New Banks**”) are the three largest commercial banks in Iceland and were established after the banking crisis in 2008. The Icelandic banking system is small and the New Banks have had limited opportunities for growth. The New Banks have so far primarily engaged in domestic lending in krona. The majority of the New Banks’ funding comes from deposits by customers ( See. further “*Description of the Issuer- Funding*”).

The Icelandic Government maintained a policy since October 2008 to September 2016 that deposits in banks domiciled in Iceland be guaranteed by the Icelandic Government. The basis of this guarantee was 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 would be fully covered. In September 2016 the Icelandic Government stated that it saw no reason to retain the declaration guaranteeing deposits in effect and stated that previous statements on this topic no longer apply.

In addition, in June 2015, the Icelandic Government announced a comprehensive strategy for capital account liberalisation which entailed a threefold plan towards the removal of capital controls. One of the main objectives of the threefold plan is maintaining economic and financial stability in Iceland, which includes mitigating the risk of capital flight from customers who have not been able to transfer their deposits and/or Offshore Krona Assets due to the capital controls. In March 2017, the Icelandic Government announced that the capital controls would to a large extent be removed. For further information see the risk factor below entitled “*The Issuer’s operating environment is still to some extent subject to capital controls even though the capital controls have mostly been lifted. If the capital control regime is removed in manner which fails to protect the Icelandic economy from a negative impact of its removal it could have material adverse effect on the Issuer’s business*“. There is no assurance that the removal of the capital controls will not affect the funding of Icelandic banks as a result of the withdrawal of deposits by such customers. If the Icelandic Government’s strategy for capital account liberalisation progresses too quickly, or in a manner which fails to protect the Icelandic financial sector from the negative impact of its removal, there is a risk that Icelandic banks could be adversely affected.

The small size of the Icelandic economy and the ongoing restructuring of the Icelandic banking sector have affected and continue to affect the Icelandic banks. The reputation of the Icelandic banking sector has at times been negative due to the financial crisis in 2008 and the subsequent recession in Iceland. This negative reputation can be reflected in political and legislative decisions having material adverse effect on the Issuer. Various ideas have been discussed on how to improve the banking sector in Iceland. One idea is the potential law requiring the separation of commercial banking activities from investment banking activities, which could require the Issuer to divest or otherwise restructure some of its operations. No such requirements has been enacted, but there can be no assurance that such law or similar or related measures will not be proposed and ultimately be enacted, which in turn could have material negative effect on the Issuer’s business.

The New Banks could also be adversely affected if other developments in the Icelandic economy or internationally result in a further decline in Iceland’s economic growth, particularly in countries that constitute Iceland’s main trading partners such as European countries and the United Kingdom. The economic and financial environment for borrowers may affect the Issuer’s levels of non-performing loans, determination of loan values and the level of write-offs.

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.

*The Issuer's operating environment is still to some extent subject to capital controls even though the capital controls have mostly been lifted. If the capital control regime is removed in manner which fails to protect the Icelandic economy from a negative impact of its removal it could have material adverse effect on the Issuer's business*

In response to the financial crisis in 2008, the Icelandic Parliament passed Act No. 134/2008 on 28 November 2008, amending the Foreign Exchange Act, as amended 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. 1082/2008 on Foreign Exchange imposing stringent capital controls on cross-border movement of capital and related foreign exchange transactions. Rules No. 1082/2008, on Foreign Exchange were codified with the adoption of Act No. 127/2011 in 2011, amending the Foreign Exchange Act. The Foreign Exchange Act and rules on foreign exchange have been reviewed and amended several times since then. The Foreign Exchange Act is now supplemented by Rules No. 200/2017 on Foreign Exchange, as amended with Rules No. 568/2017, ("**Rules on Foreign Exchange**").

In general, the capital controls in the Foreign Exchange Act restricted the outflow of capital from Iceland and between resident and non-resident parties except in the case of a payment for goods or services. These capital controls prohibited certain transaction with securities and could adversely affect the ability of investors to invest in and trade with the Covered Bonds.

In June 2015, the Icelandic Government announced a comprehensive strategy for capital account liberalisation, which entailed a threefold plan towards the removal of capital controls. Firstly, the estates of the Old Banks and of other smaller financial undertakings agreed to certain stability conditions, which have since been fulfilled by making contributions to the Central Bank after completion of respective winding-up proceedings reaching composition agreements with respective creditors, (all of which have been confirmed by the District Court); secondly, the Central Bank held a foreign currency auction in June 2016, in which owners of ISK-denominated assets subject to special restrictions pursuant to Act No. 37/2017 were invited to participate, and thirdly, it was intended, when conditions in the domestic market allowed, further capital account liberalisation was to be implemented.

In October 2016, an important step towards removal of the capital controls was made, when the Icelandic Parliament passed Act No. 105/2016, amending the Foreign Exchange Act, which entailed increased authorisation for foreign exchange transactions and cross border movement of capital in addition to the removal of specific restrictions that had previously applied to foreign exchange transactions and cross-border movement of capital.

Further steps towards the removal of the capital controls were made in March 2017, when the Icelandic Government announced that the capital controls would to a large extent be removed and the Central Bank of Iceland published Rules No. 200/2017 on Foreign Exchange that took effect as of 14 March 2017. The rules entail that the restrictions on foreign exchange transactions and cross-border movement of foreign domestic and foreign currency have largely been removed. In general, households and businesses are no longer subject to the restriction the Foreign Exchange Act places on, among other things, foreign exchange transactions, foreign investments, hedging and lending activity, furthermore the requirements that residents of Iceland repatriate foreign currency has been removed. With the introduction of Rules No. 200/2017, foreign investment by pension funds, fund for collective investment, and other investors who were subject to explicit exemption by the Central Bank, is now authorised. Furthermore, cross-border transactions with ISK are now authorised. Foreign financial undertakings are therefore authorised to transfer ISK and financial instruments issued in domestic currency to and from Iceland.

The Rules on Foreign Exchange are set in accordance with the authority contained in the Foreign Exchange Act. It is anticipated that the Icelandic Parliament will amend the Foreign Exchange Act to reflect the changes introduced by the Rules on Foreign Exchange.

When Rules no. 200/2017 took effect, foreign issuance of bonds denominated in ISK became permissible again without restrictions which made it possible to conduct carry trade by issuing bonds in ISK and entering into derivatives contracts with domestic banks. In June 2017 the Rules on Foreign Exchange was amended with Rules No. 568/2017, so as to exclude hedging-related derivatives trading in connection with the issuance of ISK denominated bonds, from the exemption for hedging-related derivatives trading with financial undertakings in Iceland. In addition, several amendments were made to the rules so as to narrow the scope of exemptions granted under Rules No. 200/2017. The objective was to prevent investment in Iceland from becoming a vehicle for carry trade.

The status of ISK-denominated assets subject to special restrictions pursuant to Act No. 37/2016 remain unchanged and special reserve requirements will remain in place for specified investments in connection with new inflows of foreign currency. See further “*Taxation and Capital Inflow Restrictions*”. Restrictions will remain in place on the following: (i) derivatives trading for purposes other than hedging, (ii) foreign exchange transactions carried out between residents and non-residents without the intermediation of a financial undertaking, and (iii) in certain instances, foreign denominated lending by residents to non-residents. Such restrictions are still necessary in order to prevent carry trade on the basis of investments not being subject to special reserve requirements, pursuant to Temporary Provision III of the Foreign Exchange Act and the Special Reserve Requirement Rules. The requirements obliging financial undertakings and other parties engaging in capital transactions to notify the Central Bank of capital movements will remain unchanged for the present. However, various foreign exchange transactions and capital transfers that have previously been subject to confirmation by the Central Bank will only be subject to a disclosure requirement. Concurrent with work on the review of the Foreign Exchange Act, attempts will be made to simplify disclosure requirements, which in the long run are the premise for the Central Bank’s being able to identify risks to the balance of payments and the financial system.

The restrictions on capital movements 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 EEA 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 “**District Court**”), 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.

Work on liberalising the capital account is nearly done according to the comprehensive strategy by the Icelandic Government June 2015, but the date for full and complete liberalisation of capital is unknown. If the capital control regime is removed in a manner which fails to protect the Icelandic economy from a negative impact of its removal, there will be negative consequences for the Government’s fiscal position, the stability and recovery of Iceland’s financial sector, and the Icelandic economy as a whole. This could adversely affect the ability of the Issuer’s customers to repay their loans which in turn could have material adverse effect on the Issuer’s business, and its ability to make payments in respect of the Covered Bonds.

As mentioned, the capital controls have the purpose of limiting the flow of foreign currencies in Iceland and prohibiting certain transactions with securities, which could adversely affect the ability of investors to invest in and trade with the Covered Bonds issued by the Issuer. It is uncertain when and if the remaining restrictions of

the capital controls will be lifted in full, and if economic circumstances in Iceland were to change, there can be no assurance that the Icelandic Central Bank, would no re-impose elements of the capital control which have already been lifted. Prospective investors in Covered Bonds issued under the Programme must consider the risk to further changes to the above capital controls and the special reserve requirements and the impact this may have on the Issuer's business and an investment in the Covered Bonds. Prospective investors who are in any doubt as to their position or would like to know more should consult their professional advisers.

***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 2017 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. See further "*Description of the Issuer-Loan Portfolio*". 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.* A 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 risks***

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. 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. 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.

The Issuer has taken various measures to decrease its overall currency risk and to bring expected future currency risk levels 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 (the "**Basel Committee**") for example 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 follows rules No. 266/2017, on Liquidity Ratios, as set by the Central Bank (the "**Rules on Liquidity Ratios**"). The Rules on Liquidity Ratios are based on the LCR developed by the Basel Committee. Information regarding the Issuer's liquidity risk is further described in "*Description of the Issuer - Risk Management Framework*".

The Central Bank also set rule No. 1032/2014, on Funding Ratios, which the Issuer follows. The rules on funding ratios are based on the NSFR.

***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, borrowing and share capital. The Issuer has diversified its funding profile by issuing bonds, commercial paper and Covered Bonds in the domestic and international 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. Information regarding the Issuer's Funding is further described in "*Description of the Issuer – Funding*".

***Operational risks are inherent in the Issuer's 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 detrimental to 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 has implemented controls designed to detect, monitor and mitigate operational risks. However, these controls cannot completely eliminate such risks, as some can be difficult to detect, recommendations and suggestions of surveillance units of the Issuer (such as the compliance and internal audit functions) could be ignored, misunderstood or misapplied, and mitigation may fail to be effective. Failures in internal controls could subject the Issuer to regulatory scrutiny. Such events could harm the Issuer's reputation and have a material adverse effect on the Issuer's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Covered Bonds.

***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.

***The Issuer relies on third party service providers, which may fail to perform their contractual obligation, which could have materially adverse effects on the Issuer's business***

The Issuer relies on the services, products and knowledge of third party service providers in the operation of its business. No assurance can be given that the third party service providers selected by the Issuer will be able to provide the products and services for which they have been contracted, for example, as a result of failing to have the relevant capabilities, products or services or due to changed regulatory requirements.

The Issuer faces the risk that third party service providers become insolvent, enter into default or fail to perform their contractual obligations in a timely manner or at all or fail to perform at an adequate and acceptable level. Any such failure from third party, such as IT system service provider, could lead to interruptions in the Issuer's operations or result in vulnerability of its IT systems, exposing the Issuer to operational failures, additional costs or cyber-attacks. The Issuer may need to replace a third party service provider on short notice to resolve any potential problems, and the search for and payment to a new third party service provider on short notice or any other measures to remedy such potential problems. Any failure of third party service providers to deliver the contracted products and services in a timely manner or at all or to deliver products and services in compliance with applicable laws and regulations and at an adequate and acceptable level could result in reputational damage, claims, losses and damages and have a material adverse effect on the Issuers business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Covered Bonds.



### ***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, the Act on Actions to Combat Money Laundering and Terrorist Financing, No. 64/2006 ("**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***

The Issuer is dependent on its senior management. The departure of key members of its senior management or staff may significantly delay the Issuer's business objectives and could have material adverse effect on its business, financial condition and results of operations. The Issuer's remuneration policy is determined by the Board of Directors and approved by the AGM.

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

### ***Damage to the Issuer's image and reputation 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 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.

### ***Increase in competition and changes in ownership of the New Banks may affect the Issuer and its business***

As Iceland's economy continues to recover and demand for new lending and other financial products increases, the Issuer expects to face increased competition from other large Icelandic banks, pension funds and smaller specialised institutions (see. "*Description of the Issuer - Competition*"). In addition, as the capital controls continue to be eased and there is sufficient credit demand, the Issuer may potentially face competition from foreign banks seeking to establish operations in Iceland, in particular with respect to Corporate Banking. The Issuer may have to comply with regulatory requirements that may not apply to such foreign competitors, creating an unequal competitive environment. The Issuer is also subject to considerable regulatory scrutiny that can hinder its competitiveness. Due to the small economy of Iceland and the Issuer's lack of scale advantage and high regulatory obligations, as a systematically important financial institution in Iceland, foreign competitors may have more resources and financial means available to them compared to the Issuer allowing foreign competitors to offer banking products at a lower price.

It is likely that competition will intensify even further with the development in digital technology that is often referred to as Fintech. In 2018, the Revised Payment Service Directive No. 2015/2366 ("PSD2") will come into effect in Iceland, which is focused on increasing competition between payment providers. The PSD2 requires the commercial banks to open up their application program interface (the "APIs"), so that third party payment service provider ("TPPs") can directly access and use their client's account data. In essence, PSD2 separates the distribution of banking services from their production, by allowing new entrants to provide almost any kind of

banking products and services under lighter regulation. When PSD2 comes into effect, the distribution of financial services will become open to non-banks and retail banking revenues could decrease. This could have negative effect on the Issuer's business.

To keep up with the rapid development in the financial market, the Issuer replaced its deposit and payment system, with Sopra banking system, which simplifies and updates the Issuer's technological infrastructure. The Sopra banking system opens the way to increased integration of software solutions in the financial system.

The Issuer will continue to offer full range of specialized financial products to individuals, corporate entities and institution as well as work on product development to meet increased competition and keep up with the rapid development in digital technology. If the Issuer is unable to provide attractive financial products and services, at more competitive prices, or implement solutions to keep up with development in digital technology, it may lose market share which could have material adverse effect on the Issuer's business, prospects, financial position, and its ability to make payments in respect of the Covered Bonds.

As at the date of this Base Prospectus, the New Banks, which are three out of the four commercial banks in Iceland, are partially or wholly owned by the Icelandic State Treasury. Íslandsbanki is wholly owned and the Issuer and Arion are partially owned by the Icelandic State Treasury. In March 2017, it was announced that 29 per cent. of shares in Arion had been sold to foreign investment funds in a private placement. Further sales of shares in Arion through initial public offerings or private placements could take place in the coming months. Furthermore, it is also likely that the Icelandic State Treasury will want to sell part of its shares in the Issuer and/or in Íslandsbanki. For further information, see the section entitled "The Icelandic State Treasury is the largest shareholder of the Issuer. This may affect the Issuer and its business". Any changes in ownership of the New Banks can affect the competitive environment and the Issuer's business, financial condition and result of operations.

***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. Comprehensive crime insurance

provides cover for fraud by employees and third parties. It covers financial loss sustained by the Issuer and its subsidiary companies, including those sustained in customer accounts, which are first discovered during the period of the policy, regardless of when the fraudulent acts were committed. 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 the Issuer will be fully compensated should the Issuer 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 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 (known as "**CRD IV**") comprising Directive (2013/36/EU) and Regulation ((EU) No. 575/2013), for the implementation of the Basel III framework in the European Union (the "**EU**") and to strengthen the regulation of the banking sector.

The transposition of the CRD IV into Icelandic law is set to take place in separate amendments. The first amendment was introduced on 9 July 2015 by Act No. 57/2015, which amended the Financial Undertakings Act. This amendment includes CRD IV's provisions on capital buffers and adopts a regulation implementing the provisions of the CRR and related technical standards. The second amendment, which was introduced on 1 September 2016, by Act No. 96/2016, and further amended the Financial Undertakings Act, includes CRD IV's provisions on operating licences, initial capital, information obligations, leverage ratios, supervisory review and evaluation process. The third amendment, which was introduced on 9 May 2017 by Act 23/2017, and further amended the Financial Undertakings Act, includes CRD IV's provision on whistle-blowing.

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.

***The European Union adopted the bank recovery and resolution directive which is intended to enable a range of actions to be taken in relation to credit institutions and investment firms considered to be at risk of failing. The full scope of the directive in Iceland and its impact on the Issuer is currently unclear but the implementation of the directive or the taking of any action under it could materially affect the value of any Covered Bonds***

On 6 May 2014, the Council of the EU adopted a directive providing for the establishment of an EU-wide framework for the recovery and resolution of credit institutions and investment firms, the Bank Recovery and Resolution Directive (the "**BRRD**"). Iceland, Liechtenstein, Norway and Switzerland are members of the EFTA and Iceland, together with Liechtenstein and Norway (the "**EEA EFTA States**"), is also a party to the EEA Agreement by which the EEA EFTA States participate in the internal market of the EU.

The BRRD is marked EEA relevant in the Official Journal of the EU and thus should be incorporated into the EEA Agreement. The BRRD is designed to provide authorities with a credible set of tools to intervene sufficiently early and quickly in an unsound or failing institution's so as to ensure the continuity of the institution's critical financial and economic functions, while minimising the impact of an institution's failure on the economy and financial system.

The BRRD contains four resolution tools and powers which may be used alone or in combination where an institution is considered as failing or likely to fail: (i) sale of business which enables resolution authorities to direct the sale of the firm or the whole or part of its business on commercial terms; (ii) bridge institution – which enables resolution authorities to transfer all or part of the business of the firm to a "bridge institution" (an entity created for this purpose that is wholly or partially in public control); (iii) asset separation – which enables resolution authorities to transfer impaired or problem assets to a bridge institution or one or more asset management vehicles to allow them to be managed with a view to maximising their value through eventual sale or orderly wind-down; and (iv) bail-in – which gives resolution authorities the power to write down the claims of unsecured creditors of a failing institution and to convert unsecured debt claims to equity (subject to certain parameters as to which liabilities would be eligible for the bail-in tool).

An institution will be considered as failing or likely to fail when: (i) it is, or is likely in the near future to be, in breach of its requirements for continuing authorisation; (ii) when its assets are, or are likely in the near future to be, less than its liabilities; (iii) when it is, or is likely in the near future to be, unable to pay its debts as they fall due; or (iv) when it requires extraordinary public financial support (except in limited circumstances).

The BRRD was applied by EU member states from 1 January 2015 and the bail-in tool was applied from 1 January 2016. In November 2016 the European Commission published a proposal to amend and supplement certain provisions the BRRD. A bill regarding the BRRD has not been submitted to the Icelandic Parliament. It is unknown if and when the BRRD would be implemented in Iceland.

The powers set out in the BRRD impact how credit institutions and investment firms are managed, as well as, in certain circumstances, the rights of creditors. There can be no assurance that, if implemented in Iceland, its implementation or the taking of any actions currently contemplated in it would not adversely affect the rights of Bondholders, the price or value of their investment in the Covered Bonds and/or the ability of the Issuer to satisfy its obligations under the Covered Bonds.

### ***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 the Act on Special Tax on Financial Institutions, 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 the Issuer excluding tax liabilities in excess of ISK 50 billion at the end of the year. This levy has remained unchanged for the years 2014, 2015, 2016 and, to date, 2017. 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 are taxable in Iceland and can be subject to withholding tax at the rate of 10.0 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 NCSD, Euroclear and Clearstream, Luxembourg, within a member state of the Organization for Economic Co-operation and Development ("OECD"), the EEA, a founding member state of EFTA or the Faroe Islands.

In December 2011, the Icelandic Parliament passed the Act on Tax on Financial Activities, 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 No. 165/2011, which includes the Issuer. The levy is set at 6 per cent. on income over ISK 1 billion, disregarding joint taxation and transferable losses.

### ***Abnormal pricing as a consequence of capital controls***

Since 2008, the Icelandic economy has been subject to capital controls, as more particularly described in section entitled "*The Issuer's operating environment is still to some extent subject to capital controls even though the capital controls have mostly been lifted. If the capital control regime is removed in manner which fails to protect the Icelandic economy from a negative impact of its removal it could have material adverse effect on the Issuer's business*". These capital controls were set up to result in domestic parties, primarily investors, not being allowed, with certain exemptions to transfer their funds and investments outside of the Icelandic market and consequently to confine them 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.

In 12 March 2017, the Icelandic government, however, announced that these capital controls would be to a large extent be removed and as of 14 March 2017 foreign exchange transactions and cross boarder movement of domestic and foreign currency was largely lifted. It is not yet known what impact the removal of the of capital

controls will have on the Issuer's business or pricing on investment in shares in companies, investment funds, and various other financial instruments.

***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, (for example, 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 may be 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 issuers 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.

***Payments and the principal of the Covered Bonds under the programme can in some cases be determined by reference to an index which could adversely affect the value of the index linked Covered Bonds***

Subject to any applicable legal or regulatory restrictions being lifted, the Issuer may issue Covered Bonds with principal or interest determined by reference to an index or formula, to changes in the prices of securities or commodities, to movements in currency exchange rates or other factors (each, a “**Relevant Factor**”). In addition, the Issuer may issue Covered Bonds with principal or interest payable in one or more currencies which may be different from the currency in which the Covered Bonds are denominated. Potential investor should be aware that:

- (a) The market price for such Covered Bonds may be volatile;
- (b) they may receive no interest;
- (c) payment of principal or interest may occur at a different time or in a different currency than expected;
- (d) they may lose all or a substantial portion of their principal;
- (e) a Relevant Factor may be subject to significant fluctuations that may not correlate with changes in interest rates, currencies or other indices;
- (f) if a Relevant Factor is applied to Covered Bonds in conjunction with a multiplier greater than one or contains some other leverage factor, the effect of changes in the Relevant Factor on principal or interest payable likely will be magnified; and
- (g) the timing of changes in a Relevant Factor may affect the actual yield to investors, even if the average level is consistent with their expectations. In general, the earlier the change in the Relevant Factor, the greater the possible effect on yield.

The historical experience of an index or other Relevant Factor should not be viewed as an indication of the future performance of such Relevant Factor during the term of any Covered Bonds. Accordingly, each potential investor should consult its own financial and legal advisers about the risk entailed by an investment in any Covered Bonds linked to a Relevant Factor and the suitability of such Covered Bonds in light of its particular circumstances

***Covered Bonds which are issued with variable interest rates or which are structured to include a multiplier or other leverage factor, are likely to be more volatile than standard securities***

Covered Bonds with variable interest rates can be volatile investments. If they are structured to include multipliers or other leverage factors, or caps or floors, or any combination of those features or other similar related features, their market values may be even more volatile than those for securities that do not include those features and, as a consequence, could drop further in value.

***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 20 March 2008. To date only a few licenses to issue covered bonds have been granted under the Act on Covered Bonds and there are limited 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 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 in 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.

#### ***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. The Act on Covered Bonds does not stipulate to what extent it is necessary to register a security in respect of other assets in a cover pool.

#### ***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 the Issuer is subject to winding-up proceedings.

#### ***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 file against the Issuer, or join in any filing 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 raise finance in the market by 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 also subject to the Central Bank's Rules no. 266/2017, 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. The same applies in the event that the Issuer does not comply with other requirements prescribed in the Act on 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 file against the Issuer, or join in any filing 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 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**"), the Independent Inspector's report will not be made public. A regular report on the Cover Pool will however be published at least quarterly, no later than 30 days from the end of each quarter, on the Issuer's website, <http://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.

Each of these factors is considered in more detail below. However 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.

### ***Default by borrowers in paying amounts due on their loan***

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 in arrears 90 days or more.

### ***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 Index 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 a 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 natural or legal 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.

### ***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 the ITA which states that any interest received from Iceland (outbond payments), such as the interest payable to bondholders by any person or entity residing outside of Iceland is taxable income in Iceland. According to Article 70 (8) of the ITA, the current tax rate on taxable income under Article 3 (8) is (a) 10 per cent. for individuals (only applicable to interest income exceeding the annual amount of ISK 125,000); and (b) 10 per cent. for legal entities, unless the issue is exempt on the grounds that the Covered Bonds are registered with a securities depository within the EEA or OECD and has been registered as such. Further exemptions are available to the relevant bondholders in their home countries or under a double taxation treaty with Iceland.

In April 2013 the Icelandic Parliament adopted an amendment to Article 3(8) of the ITA exempting from taxation the interest earned on income by non-domestic entities, from certain debt instruments issued by financial institutions. This exemption includes bonds registered with a securities depository within the EEA or OECD such as those issued under this programme. The exemption is subject to general registration of the programme with the Directorate of Internal Revenue (*Ice. Ríkisskattstjóri*). See further “*Taxation- Non Icelandic Tax Residents*”.

### ***U.S. Foreign Account Tax Compliance Withholding***

Whilst the Covered Bonds are in global form and held within Euroclear or Clearstream, in all but the most remote circumstances, it is not expected that the new reporting regime and potential withholding tax imposed by sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986, the Foreign Account Tax Compliance Act (“**FATCA**”), will affect the amount of any payment received by Euroclear or Clearstream (see “*Taxation - Foreign Account Tax Compliance Act*”). However, FATCA may affect payments made to custodians or intermediaries in the subsequent payment chain leading to the ultimate investor if any such custodian or intermediary generally is unable to receive payments free of FATCA withholding. It also may affect payment to any ultimate investor that is a financial institution that is not entitled to receive payments free of withholding under FATCA, or an ultimate investor that fails to provide its broker (or other custodian or intermediary from which it receives payment) with any information, forms, other documentation or consents that may be necessary for the payments to be made free of FATCA withholding. Investors should choose the custodians or



intermediaries with care (to ensure each is compliant with FATCA or other laws or agreements related to FATCA) and provide each custodian or intermediary with any information, forms, other documentation or consents that may be necessary for such custodian or intermediary to make a payment free of FATCA withholding. Covered Bond Holders should consult their own tax adviser to obtain a more detailed explanation of FATCA and how FATCA may affect them. The Issuer's obligations under the Covered Bonds are discharged once it has paid the common depository for Euroclear and Clearstream (the "Common Depository") or common safekeeper for Euroclear or Clearstream (the "Common Safekeeper") (as bearer of the Covered Bonds) and the Issuer has therefore no responsibility for any amount thereafter transmitted through Euroclear and Clearstream and custodians or intermediaries. To the extent any such amount is subject to FATCA withholding an investor may, therefore, receive a lesser amount than would otherwise be the case.

***The value of the Covered Bonds could be adversely affected by a change in law or administrative practice***

The Covered Bonds, the Receipts, and the Coupons (other than NCSD System Covered Bonds), and any non-contractual obligations arising out of or in connection with them 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 NCSD 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 Icelandic or English law, or administrative practice after the date of this Base Prospectus, and any such change could materially adversely impact the value of any Covered Bonds affected by it.

***Investors who purchase Covered Bonds in denominations that are not integral multiple of the Specified Denomination may be adversely affected if definitive Covered Bonds are subsequently required to be issued***

In relation to any issue of Covered Bonds which have denominations consisting of a minimum Specified Denomination, as specified in the applicable Final Terms (the "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 in excess of the minimum Specified Denomination that are not integral multiples of such minimum Specified Denomination. In such a case, a holder of such Covered Bonds 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 Covered Bond in definitive form ("Definitive Covered Bonds"), in respect of such holding (should definitive Covered Bonds be printed) and would need to purchase a principal amount of Covered Bonds such that its holding amounts to a Specified Denomination.

If such Covered Bonds in definitive form are issued, bondholders 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.

***Tax exemptions from withholding may not be available if Definitive Covered Bonds are required to be issued***

The Icelandic statutory exemption from withholding only applies to Covered Bonds held through a securities depository in an OECD state, an EU state, an EFTA state or the Faroe Islands. If Definitive Covered Bonds are issued, bondholders should be aware that the tax exemption may not be available. However, the Issuer will be required to pay the necessary additional amounts under Condition 9 (Taxation) in such circumstances to cover any resulting amounts deducted.

***Reliance on Euroclear and Clearstream, Luxembourg procedures***

Covered Bonds (other than the NCSD System Covered Bonds) issued under the Programme may be represented on issue by one or more Global Covered Bonds that may be delivered to a common depository or common safekeeper for Euroclear and Clearstream, Luxembourg. 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

NCSD System Covered Bonds) are represented by a 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 NCSD 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 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

### AUTHORISATION

The establishment of the Programme and the issue of Covered Bonds have been duly authorised by a resolution of the Board of Directors of the Issuer 10 May 2012 and 23 May 2013. Update of the Programme and the issue of Covered Bonds was duly authorised by a resolution of the Board of Directors of the Issuer on the 26 October 2017.

### 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, 8 December 2017

On behalf of the Board of Directors

Helga Björk Eiríksdóttir

Chairman of the Board of Directors

On behalf of Landsbankinn hf.

Lilja Björk Einarsdóttir

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 2015, 2016 and 2017. The National Audit Office has outsourced the audit of the Issuer for the financial years 2015-2020 to Grant Thornton endurskoðun ehf., Suðurlandsbraut 20, 108 Reykjavík, Iceland. Davíð Arnar Einarsson and Sturla Jónsson are the auditors on behalf of Grant Thornton endurskoðun ehf. They are members of the Institute of State Authorized Public Accountants in Iceland.

In accordance with Art. 90 of the Act on Financial Undertakings, an auditor of a financial undertaking shall be elected for a five year term and the same auditor or audit firm shall not be re-elected until five years have passed from the term previously concluded. KPMG ehf. had audited the Issuer for five years at the end of the financial year 2014.

### DOCUMENTS INCORPORATED BY REFERENCE

This Base Prospectus should be read and construed in conjunction with the following information, which has been published on the Issuer's website and have been filed with the FME and shall be incorporated by reference in, and form a part of this Base Prospectus.

- The reviewed Condensed Consolidated Interim Financial Statements of the Issuer for the nine months ended 30 September 2017, with the review report thereon;
- <https://bankinn.landsbankinn.is/uploads/documents/arsskyrsluguppgerjor/Consolidated-Financial-Report-Q3-2017-IS.pdf>

- The audited Consolidated Financial Statements of the Issuer for the financial year ended 31 December 2016, together with the audit report thereon;
- <https://corporate.landsbankinn.com/Uploads/Documents/ArsskyrslurOgUppgjor/Consolidated-Financial-Report-2016-EN.pdf>
- The audited Consolidated Financial Statements of the Issuer for the financial year ended 31 December 2015, together with the audit report thereon;
- <https://bankinn.landsbankinn.is/uploads/documents/arsskyrsluroguppjor/Consolidated-Financial-Report-2015-IS.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](http://www.landsbankinn.is) (<https://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 8 December 2017.
- The Audited Consolidated Financial Statements of the Issuer for the years 2015 and 2016 together with the audit reports prepared therewith and the Reviewed Condensed Consolidated Interim Financial Statements for the nine months ended 30 September 2017 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.
- Series of Covered Bonds issued under the Programme have been admitted to trading on a regulated market, of Nasdaq Iceland.
- 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.

- The Programme also provides that the Issuer may issue Covered Bonds that will not be admitted to trading on any market.

## **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 Covered Bonds	Act No. 11/2008 on Covered Bonds, as amended with Act No. 35/2008.
Act on Financial Undertakings	Act No. 161/2002 on Financial Undertakings.
Act on Securities Transactions	The Icelandic Act on Securities Transactions No. 107/2008, which came into effect 1 November 2007, as amended (Ice. Lög um verðbréfavíðskipta nr. 108/2007)
Amending Act	Act No. 134/2008 amending the Act on Foreign Exchange No. 87/1992.
AT1	Additional Tier 1
Bankruptcy Act	Bankruptcy Act No. 21/1991 (as amended).
Base Prospectus	This Base Prospectus dated 8 December 2017 and issued by Landsbankinn hf.
Basel III	Amendments to the Basel Committee on Banking supervision'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.
CBR	Combined Buffer Requirement

Central Bank	The Central Bank of Iceland.
CEO	Chief Executive Officer.
CET1	Common Equity Tier 1
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 IV	EU Capital Requirements Directive No.2013/36/EU
CRM	Customer Relationship Management.
CRR	EU regulation No. 575/2013 on prudential requirements for credit institutions and investment firms (amending Regulation (EU) No 648/2012
CSR	Corporate Social Responsibility.
EAD	Exposures at 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.
Foreign Exchange Act	The Act on Foreign Exchange No. 87/1992 (as amended).
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)"
FSC	Financial Stability Counsel.
FX	Foreign exchange.
GDP	Gross domestic product.
Group	Landsbankinn hf., Reg. No. 471008-0280, having its registered office at Austurstræti 11, 155 Reykjavík, Iceland including its subsidiaries.



HFF	Icelandic Housing Financing Fund.
HR	Human resources.
ICAAP	Internal Capital Adequacy Assessment Process.
Ice	Icelandic.
Iceland	Republic of Iceland.
IGA	Jurisdictions (including Iceland) that have entered into, or have agreed in substance to intergovernmental agreements with the United States to improve International Tax Compliance and to implement FATCA.
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 ehf.	LBI ehf., previous names LBI hf. and 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.
PMO	Project Management Office.
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, as amended.
Rules on Liquidity Ratios	The Central Bank's Rules on Liquidity No. 266/2017.
RWA	Risk-Weighted Assets.
S&P	International rating agency Standard & Poor's.
SME	Small and medium sized enterprises.
Special Reserve Requirement Rules	Rules on Special Reserve Requirements for new foreign

	currency inflows, No. 490/2016, (as amended).
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 120,000,000,000 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 8 December 2017 and any supplements if applicable. 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](http://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.]*

- |   |  |
|---|--|
| <b>1. Issuer:</b>                           | <b>Landsbankinn hf.</b>  |
| <b>2.</b>                                   |  |
| i. Series Number:                           | [ ]  |
| ii. Tranche Number:                         | [ ]  |
|   | <i>(If fungible with an existing Series, details of that Series, including the date on which the Covered Bonds become fungible)</i>                                  |
| <b>3. Specified Currency or Currencies:</b> | [ ]  |
| <b>4. Aggregate Nominal Amount:</b>         |  |
| i. Series:                                  | [ ]  |
| ii. Tranche:                                | [ ]  |
| <b>5. Issue Price:</b>                      | [ ] per cent. of the Aggregate Nominal Amount [plus accrued interest from [insert date] (if applicable)]   |
| <b>6. Specified Denominations:</b>          |  |
| i. Specified Denominations:                 | [ ]  |
|   | <i>(Note – where Bearer Covered Bonds with multiple denominations above [€100,000] or equivalent are being used the following sample wording should be followed:</i> |
|   | <i>“[€100,000] and integral multiples of [€1,000] in excess thereof up to and including [€199,000]. No Covered</i>   |

*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. Note: There must be a common factor in the case of two or more Specified Denominations.)*

**7.**

i. Issue Date: [ ]

ii. Interest Commencement Date: [Specify/Issue Date/Not applicable]

**8.**

i. Maturity Date: [Specify date or (for Floating Rate Covered Bonds) Interest Payment Date falling in or nearest to [specify month and year ]]

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 for Floating Rate Covered Bonds Interest Payment Date falling in or nearest to the relevant month and year; in each case falling three years 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 Rate]  
[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 Rate]  
[Zero Coupon]  
[specify other]

**10. Redemption/Payment Basis:**

[Annuity]  
[Redemption at par]  
[Equal principal payments]  
[Instalment]

[specify other]

**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]  
[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)

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. Number of Principal 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. Base Index:

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

**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)*

- 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. Number of Principal 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. Base Index: means [to be inserted], being the value of the CPI on [to be inserted].

#### **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/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. 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: [ ] month [*currency*] [LIBOR, EURIBOR, REIBOR, *specify 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 2 System if EURIBOR or euro LIBOR and second Reykjavik 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: [ ]
- (Give details)*
- 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: [ ]

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):** [ ]/[As 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/NCSD 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]]

[Global Certificate ( [ ] 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):

[Not Applicable/give details]

ii. Instalment Date(s):

[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 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. **U.S. selling restrictions:** Reg. S. Compliance Category [2];  
 [TEFRA C]/[TEFRA D]/[TEFRA Not Applicable]
38. **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 120,000,000,000 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:

[Not Applicable/*give details*]  
[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

[Applicable/Not Applicable]

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

[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 [Reuters].]

## 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)*

[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]

## 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)/NCSD. The Issuer shall be entitled to obtain certain information from the register maintained by the NCSD for the purpose of performing its obligations under the issue of NCSD System Covered Bonds. The NCSD 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 NCSD.]                             |
| iv.  | Delivery:  | Delivery [against/free of] payment  |
| v.   | Names and addresses of additional Paying Agent(s) (if any):  | [Not Applicable/give details]   |
| vi.  | Intended to be held in a manner which would allow Eurosystem eligibility:  | [Yes. 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 the European Central Bank being satisfied that the |

*Eurosystem eligibility criteria have been met.] / [No. Whilst the designation is specified as “no” at the date of these Final Terms, should the Eurosystem eligibility criteria be amended in the future such that the Covered Bonds are capable of meeting them the Covered Bonds may then be deposited with one of the ICSDs as common safekeeper. Note that this does not necessarily mean that the Covered Bonds will then be recognised as eligible collateral for Eurosystem monetary policy and intra day credit operations by the Eurosystem at any time during their life. Such recognition will depend upon the European Central Bank being satisfied that the Eurosystem eligibility criteria have been met.]]*

## 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 Nasdaq CSD Iceland 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 NCSD 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 NCS D 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, <https://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 Couponholders, 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.

<b>Accrual Period</b>	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.
<b>Accrual Yield</b>	In relation to a Zero Coupon Covered Bond, the meaning given in the applicable Final Terms.
<b>Act on Covered Bonds</b>	The Icelandic Act on Covered Bonds No. 11/2008 which came into effect 20 March 2008, as amended ( <i>Ice. Lög um sértryggð skuldabréf nr. 11/2008</i> ).
<b>Act on Securities Transactions</b>	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> ).
<b>Additional Business Centre</b>	The meaning (if any) given in the applicable Final Terms.
<b>Additional Financial Centre</b>	The meaning (if any) given in the applicable Final Terms.
<b>Agency Agreement</b>	Shall mean the agency agreement (if any) to be entered into between the Issuer, Fiscal Agent and other agents.
<b>Amortised Face Amount</b>	The meaning given in Condition 8.7(b).
<b>Annuity Amount</b>	The meaning given in Condition 7.1(a).
<b>Annuity Covered Bonds</b>	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.
<b>Applicable Final Terms</b>	The form of Final Terms (Part A of the Final Terms or the relevant provisions thereof) which will be completed for each Tranche of Covered Bonds issued under the Programme.
<b>Automatic Extension</b>	The meaning given in Condition 8.12(b).
<b>Bearer Covered Bond</b>	Means Cover Bonds issued in bearer form.
<b>Business Day</b>	As defined in Condition 6.7(a).
<b>Business Day Convention</b>	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).
<b>Calculation Agent</b>	The meaning (if any) given in the applicable Final Terms.
<b>Clearstream, Luxembourg</b>	Clearstream Banking, société anonyme, 42 Avenue JF Kennedy L-1855, Luxembourg, or its successors.
<b>Common Depositary</b>	The common depositary for Euroclear and Clearstream or its successors.
<b>Common Safekeeper</b>	The common safekeeper for Euroclear and Clearstream Luxembourg.
<b>Couponholders</b>	The holders of the Coupons (which expression shall, unless the context otherwise requires, include the holders of the Talons).



<b>Coupons</b>	Interest coupons expressing the amount payable by way of interest in respect of definitive Covered Bonds.
<b>Cover Pool</b>	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.
<b>Cover Pool Member States</b>	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.
<b>Covered Bond</b>	The covered bonds issued or to be issued by the Issuer under the Programme in accordance with the Act on Covered Bonds.
<b>Covered Bondholders</b>	The holders for the time being of the Covered Bonds.
<b>Covered Bond Legislation</b>	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).
<b>Cover Pool Swap</b>	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.
<b>Cover Pool Swap Agreement</b>	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.
<b>Cover Pool Swap Provider</b>	Means the third party counterparties in their respective capacities as cover pool swap provider under a Cover Pool Swap Agreement.
<b>CPI</b>	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 ( <i>Ice. Lögbirtingablaðið</i> ) in Iceland.
<b>Currency Swap</b>	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.
<b>Currency Swap Agreement</b>	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.
<b>Currency Swap Provider</b>	Means the third party counterparties in their respective capacities as currency swap provider under a Currency Swap Agreement.
<b>Day Count Fraction</b>	The meaning given in Condition 6.7(c).

<b>Dealer</b>	Any dealer appointed by the Issuer (if any).
<b>Definitive Covered Bonds</b>	A Covered Bond in definitive form issued, or to be issued by the Issuer in accordance with the provisions of the Programme, in either bearer form or registered form.
<b>Designated Account</b>	Means the account maintained by a holder with a Designated Bank and identified as such in the Registered Covered Bond Register.
<b>Designated Bank</b>	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.
<b>Designated Maturity</b>	The meaning given in the ISDA Definitions.
<b>Determination Date</b>	The meaning given in the applicable Final Terms.
<b>Determination Period</b>	The meaning given in Condition 6.7(d).
<b>Directors</b>	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> ).
<b>Distribution Compliance Period</b>	The period that ends 40 days after completion of the distribution of each Tranche of Covered Bonds, as certified by the relevant Dealer.
<b>Early Redemption Amount</b>	The amount calculated in accordance with Condition 8.7.
<b>Equal Payment Amount</b>	The meaning given in Condition 7.1(b).
<b>EU</b>	The European Union.
<b>EURIBOR</b>	Euro-zone Inter Bank Offered Rate.
<b>Euroclear</b>	Euroclear Bank S.A./N.V., 1, Boulevard du Roi Albert II B - 1210 Brussels, or its successor.
<b>Exchange Date</b>	The date when interest in a Temporary Bearer Global Cover Bond will be exchanged either for interest in a Permanent Bearer Global Cover Bond or, where specified in the applicable Final terms, for Definitive Bearer Cover Bonds.
<b>Exchange Event</b>	The meaning given in Condition 2 (Form, Denomination and Title) in the section on Bearer Covered Bonds.
<b>Exchange Notice</b>	The meaning given in Condition 5 (iv).
<b>Extended Maturity Date</b>	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.
<b>Final Redemption Amount</b>	The meaning given in the applicable Final Terms.
<b>Final Terms</b>	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.
<b>Fiscal Agent</b>	Landsbankinn hf., or any successor agent appointed as such.
<b>Fixed Rate Covered Bonds</b>	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.
<b>Floating Rate</b>	The meaning given in the ISDA Definitions.
<b>Floating Rate Convention</b>	The meaning given in Condition 6.7(b)(i).
<b>Floating Rate Covered Bonds</b>	Covered Bonds which bear interest at a rate determined: <ul style="list-style-type: none"> <li>(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</li> <li>(ii) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or</li> <li>(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.</li> <li>(iv)</li> </ul>
<b>FME</b>	The Financial Supervisory Authority, Iceland ( <i>Ice. Fjármálaeftirlitið</i> ).
<b>Following Business Day Convention</b>	The meaning given in Condition 6.7(b)(ii).
<b>Global Covered Bonds</b>	Global Covered Bonds in bearer or registered form comprising Temporary Global Covered Bonds and Permanent Global Covered Bonds.
<b>Global Certificate</b>	Registered Bonds held in a clearing system in the form of a single certificate representing the whole principal amount of the issuance, offered and sold in reliance on Regulation S.
<b>Government Bond</b>	Bonds granted to or guaranteed by certain governmental bodies, in accordance with Article 5 of the Act on Covered Bonds.
<b>Group</b>	The Issuer and its subsidiaries.
<b>IFRS</b>	International Financial Reporting Standards.
<b>Index ratio</b>	The value of the Index Ratio ( <b>IR</b> ) on the relevant Interest Payment Date shall be the value of the Reference Index ( <b>RI</b> ) applicable to the relevant Interest Payment Date divided by the value of the Base Index ( <b>BI</b> ) as calculated the Issuer.
<b>Indexed Currency Swap Agreement</b>	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.
<b>Indexed Currency Swap Provider</b>	Means the third party counterparties in their respective capacities as indexed currency swap provider under an Indexed Currency Swap

Agreement.

<b>Indexed Currency Swap</b>	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.
<b>Inflation Linked Annuity Covered Bonds</b>	Covered Bonds that pay an Annuity Amount on such date or dates as decided by the Issuer and set out in the Final Terms.
<b>Inflation Linked Equal Principal Payment Covered Bonds</b>	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.
<b>Instalment Amounts</b>	In respect of Instalment Covered Bonds, each amount specified as such in the applicable Final Terms.
<b>Instalment Covered Bonds</b>	Covered Bonds which will be redeemed in Instalment Amounts and on the Instalment Dates specified in the applicable Final Terms.
<b>Instalment Dates</b>	In respect of Instalment Covered Bonds, each date specified as such in the applicable Final Terms.
<b>Interest Amount</b>	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.
<b>Interest Commencement Date</b>	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.
<b>Interest Determination Date</b>	In respect of Floating Rate Covered Bonds to which Screen Rate Determination is applicable, the meaning given in the applicable Final Terms.
<b>Interest Payment Date</b>	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).
<b>Interest Period</b>	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.
<b>Interest Rate Swap Agreement</b>	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.
<b>Investor</b>	The holders for the time being of the Covered Bonds.
<b>Investor's Currency</b>	The currency or currency unit that an investor's financial activities are denominated in, other than the Specified Currency.
<b>Investor Put</b>	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.
<b>ISDA</b>	International Swaps and Derivatives Association, Inc.
<b>ISDA Definitions</b>	The meaning given in Condition 6.4(b).
<b>ISDA Determination</b>	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).
<b>ISDA Rate</b>	The meaning given in Condition 6.4(b).
<b>ISK or Icelandic Krona or krónur</b>	The lawful currency of the Republic of Iceland.
<b>Issue Date</b>	Each date on which the Issuer issues a Tranche of Covered Bonds under the Programme, as specified in the applicable Final Terms.
<b>Issue Price</b>	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.
<b>Issuer</b>	Landsbankinn hf., Reg.No. 471008-0280, having its registered office at Austurstræti 11, 155 Reykjavík, Iceland.
<b>Issuer Call</b>	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.
<b>Landsbankinn</b>	Landsbankinn hf., Reg.No. 471008-0280, having its registered office at Austurstræti 11, 155 Reykjavík, Iceland.
<b>LIBOR</b>	London inter-bank offered rate
<b>Margin</b>	As specified in the applicable Final Terms (if any).
<b>Maturity Date</b>	As specified in the applicable Final Terms.
<b>Maximum Rate of Interest</b>	In respect of a Floating Rate Covered Bond, the percentage rate per annum (if any) specified in the applicable Final Terms.
<b>Maximum Redemption Amount</b>	The amount specified as such in the applicable Final Terms.
<b>Member State</b>	A state which is a member of the European Economic Area.
<b>Minimum Rate of Interest</b>	In respect of Floating Rate Covered Bonds, the percentage rate per annum (if any) specified in the applicable Final Terms.
<b>Minimum Redemption Amount</b>	The amount specified as such in the applicable Final Terms.
<b>Modified Following Business Day Convention</b>	The meaning given in Condition 6.7(b)(iii).
<b>Mortgage</b>	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.
<b>Nasdaq Iceland</b>	The main market of Nasdaq Iceland hf., Reg.No. 681298-2829, with its registered office at Laugavegur 182, 105 Reykjavík, Iceland.
<b>NCSD</b>	Nasdaq Central Securities Depository Iceland hf. Reg.No. 500797-3209, with its registered office at Laugavegur 182, 105 Reykjavík ( <i>Ice. Nasdaq verðbréfamiðstöð hf.</i> ).
<b>NCSD system account operator</b>	Landsbankinn hf. In its capacity as NCSD system account operator.
<b>NCSD System Covered Bonds</b>	Shall mean Covered Bonds issued in dematerialised, uncertified book entry form cleared through NCSD.
<b>Optional Redemption Amount</b>	The meaning (if any) given in the applicable Final Terms.
<b>Optional Redemption Date</b>	The meaning (if any) given in the applicable Final Terms.
<b>Overcollateralization</b>	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.
<b>Partial Redemption</b>	The meaning given in Condition 8.12(f).
<b>Paying Agents</b>	The Principal Paying Agent and any other paying agent appointed (if any).
<b>Payment Day</b>	The meaning given in Condition 7.8.
<b>Permanent Bearer Global Covered Bond</b>	A Global Covered Bond in bearer form that can be exchanged for a Temporary Bearer Covered Bond. The bearer of a Permanent Bearer Global Covered Bond is the Common Depository.
<b>Preceding Business Day Convention</b>	The meaning given in Condition 6.7(b)(iv).
<b>Principal Amount Outstanding</b>	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.
<b>Principal Paying Agent</b>	The Issuer, Landsbankinn hf.
<b>Programme</b>	ISK 120,000,000,000 (or its equivalence in other currencies calculated as described herein) covered bond programme established by the Issuer on the Issue Date which shall not exceed a limit of ISK 120,000,000,000. Any increases of the Programme shall be subject to the FME approval.
<b>Prospectus Directive and PD</b>	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).
<b>Put Notice</b>	The meaning given in Condition 8.4.

<b>Rate of Interest</b>	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.
<b>Receipts</b>	Receipts for the payment of instalments other than the final instalment attached on issue to Definitive Bonds repayable in instalments.
<b>Receiptholders</b>	The holders of Receipts (which expression shall, unless the context otherwise requires, include the holders of the Talons).
<b>Record Date</b>	The meaning given in Condition 7.5.
<b>Redeemed Covered Bonds</b>	The meaning given in Condition 8.3.
<b>Redenomination currency</b>	The meaning given in Condition 5 (v).
<b>Redenomination date</b>	The meaning given in Condition 5 (iii).
<b>Reference Price</b>	In respect of a Zero Coupon Covered Bond, the meaning given in the applicable Final Terms.
<b>Reference Rate</b>	In respect of Floating Rate Covered Bonds to which Screen Rate Determination applies, the meaning given in the applicable Final Terms.
<b>Register</b>	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.
<b>Registrar</b>	Any registrar to be appointed in accordance with an Agency Agreement.
<b>Registered Covered Bond</b>	Means Covered Bonds issued in registered form.
<b>Registered Covered Bond Register</b>	Register of holders of the Registered Covered Bonds maintained by the Registrar.
<b>Regulated Market</b>	Means a medium for the exchange of goods or services over which a government body exerts a level of control.
<b>Regulation S</b>	Regulation S under the US Securities Act.
<b>REIBOR</b>	Reykjavík Inter Bank Offered Rate.
<b>Relevant Date</b>	The meaning in Condition 10.
<b>Relevant Screen Page</b>	In respect of Floating Rate Covered Bonds to which Screen Rate Determination applies, the meaning given in the Final Terms.
<b>Relevant Subsidiary</b>	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.

<b>Reset Date</b>	The Meaning given in the ISDA Definitions.
<b>Rules on Covered Bonds</b>	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.
<b>Screen Rate Determination</b>	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).
<b>Securities Act</b>	U.S. Securities Act of 1933, as amended.
<b>Security Interest</b>	The meaning given in Condition 4.1.
<b>Selection Date</b>	The meaning given in Condition 8.3.
<b>Senior Debt</b>	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.
<b>Series</b>	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.
<b>Specified Currency</b>	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.
<b>Specified Denomination</b>	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.
<b>Specified Interest Payment Date</b>	In respect of Floating Rate Covered Bonds, the meaning (if any) given in the applicable Final Terms.
<b>Subsidiary</b>	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.
<b>Sub-Unit</b>	The meaning given in Condition 6.7(g).
<b>Swap Provider</b>	Means the Cover Pool Swap Provider, each Currency Swap Provider and each Interest Rate Swap Provider.
<b>Talons</b>	Talons for further Coupons in respect of interest-bearing definitive Covered Bonds.
<b>TARGET2 System</b>	The meaning given in Condition 6.7(a).
<b>Temporary Bearer Global Covered Bond</b>	The temporary global Covered Bond in bearer form which will initially represent the Bearer Covered Bond of each Tranche.



<b>Terms and Conditions or Conditions</b>	The terms and conditions of the Covered Bonds.
<b>Tranche</b>	An issue of Covered Bonds which are identical in all respects (including as to listing and admission to trading).
<b>Transfer Agent</b>	Landsbankinn hf., or any successor agent appointed as such.
<b>Value</b>	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).
<b>VP LUX</b>	Means VP Lux S.à.r.l., 32, Boulevard Royal, L-2449 Luxembourg, or its successors.
<b>VS System Covered Bonds</b>	Means Covered Bonds issued in uncertificated book entry form cleared through the NCSD 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).
<b>Zero Coupon Covered Bonds</b>	Covered Bonds which will be offered and sold at a discount to their nominal amount and which will not bear interest.
<b>€, Euro, EUR or euro</b>	The currency of the European economic monetary union.
<b>£ or Sterling</b>	The lawful currency for the time being of the United Kingdom of Great Britain and Northern Ireland.
<b>\$, U.S.\$, U.S. Dollars, US Dollars or USD</b>	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.

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.

### **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 (the “**Common Depositary**”) for Euroclear and Clearstream or its successors.

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) 40 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, which have an original maturity of more than 365 days, and Coupons, Receipts and Talons:

**“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 OF 1986, AS AMENDED.”**

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 Global Certificate which will be registered in the name of a nominee of, the 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 Global Certificate 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 Global Certificate will bear a legend regarding such restrictions on transfer.

Persons holding beneficial interests in Global Certificate 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 Global Certificate will be made to the nominee of to the order of the person whose name is entered on the Register. 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 Global Certificate or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Interests in a Global Certificate 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 or Common Safekeeper as applicable, 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 Certificate 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 Global Certificate) 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 the Common Depository or Common Safekeeper, as applicable or its nominee is the registered holder of a Global Certificate 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, the NCSD 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, or its nominee, the NCSD 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 Bearer Global Covered Bond, or in the case of Covered Bonds where the Common Depository or Common Safekeeper, as applicable or its nominee is the registered holder of a Global Certificate Common Depository or Common Safekeeper, as applicable 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 Global Certificate may, subject to compliance with all applicable restrictions, be transferred to a person who wishes to hold such interest in another Global Certificate. No beneficial owner of an interest in a Global Certificate 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 Global Certificate 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 Global Certificate 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 Global Certificate 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.

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 NCSD 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 NCSD 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 NCSD 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 NCSD 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 NCSD, (as the case may be). References to Euroclear, Clearstream, VP LUX and/or the NCSD, (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 Covered 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 is calculated on each Interest Payment Date as the nominal amount on the Issue Date multiplied with the Index Ratio, as defined below and with the factor  $I_k$ , 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.)

The resultant figure shall be rounded 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. Payment(s) on each Interest Payment Date is the sum of the relevant Principal Repayment and the Interest Payment.

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<sub>t</sub>** 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<sub>M-1</sub>** = CPI value published by Statistic Iceland in the month preceding month M

**CP<sub>M-2</sub>** = 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) below is lower than the Base Index, the Reference Index shall equal the Base Index.

And

**Base Index** means the index value defined in the applicable Final Terms, being the value of the CPI on the date defined in the applicable Final Terms.

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.

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.

## **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 is calculated on each Interest Payment date as the Principal Amount Outstanding as defined in Condition 7.1 b) on each Interest Payment Date multiplied with the Rate of Interest and, the appropriate Day Count Fraction 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.

## **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:

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

i. 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 2006 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.

ii. 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 (TARGET2) System (the TARGET2 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 payment that is the sum of the relevant Principal Repayment as defined in this Condition and the Interest Payment as defined in Condition 6.1 (together, the Annuity Amount) as calculated by the Calculation Agent.

Principal Repayment(s) is the 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.)

- 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, as defined in this condition and interest due as defined in Condition 6.2 (together, the Equal Payment Amount) as calculated by the Calculation Agent.

Principal Repayment(s) is 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.

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<sub>t</sub>** means the Principal Amount Outstanding on the relevant Interest Payment Date.

**PAO<sub>t-1</sub>** means the Principal Amount Outstanding on the preceding Interest Payment Date.

**PR<sub>t-1</sub>** means the Principal Repayment on the preceding Interest Payment Date.

**IR<sub>t</sub>** means the Index Ratio on the relevant Interest Payment Date.

**IR<sub>t-1</sub>** means the Index Ratio on the preceding Interest Payment Date (Issue Date for the first Interest Payment Date).

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<sub>t</sub>** 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<sub>M-1</sub>** = CPI value published by Statistic Iceland in the month preceding month M

**CP<sub>M-2</sub>** = 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 is lower than the Base Index, the Reference Index shall equal the Base Index, the Reference Index shall equal the Base Index.

And

**Base Index** means the index value defined in the applicable Final Terms, being the value of the CPI on the date specified in the applicable Final Terms.

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.

## **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 NCSD, 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 NCSD, 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:
  - (i) the relevant place of presentation;
  - (ii) Reykjavík; and
  - (iii) 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.

## **7.9 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:

- a) the Final Redemption Amount of the Covered Bonds;
- b) the Early Redemption Amount of the Covered Bonds
- c) the Optional Redemption Amount(s) (if any) of the Covered Bonds;
- d) 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;
- e) in relation to Zero Coupon Covered Bonds, the Amortised Face Amount (as defined in Condition 8.7); and
- f) 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 NCSD 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 8.4 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 NCSD 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 NCSD 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 NCSD System Covered Bonds, the NCSD 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 unmatured 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 unmatured 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 NCSD, 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 NCSD 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 any Tax Jurisdiction 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 a Tax Jurisdiction 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) 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.

As used herein:

**“Tax Jurisdiction”** means Iceland or any political subdivision or any authority thereof or therein having power to tax

the **“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.

## 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 in Condition 9 (Taxation)).



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.

## **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 NCSD 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**

### **13.1 Governing law**

The Covered Bonds, the Receipts, the Coupons (other than NCSD System Covered Bonds) and any non-contractual obligations arising out of or in connection with them 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 NCSD System Covered Bonds will be governed by, and construed in accordance with Icelandic law.

### **13.2 Jurisdiction**

The Courts of England are to have jurisdiction to settle any disputes that may arise out of or in connection with any of the Covered Bonds, Receipts or Coupons (other than NCSD System Covered Bonds) and accordingly any legal action or proceedings arising out of or in connection with any Covered Bonds, Receipts or Coupons (other than NCSD System Covered Bonds) (“**Proceedings**”) may be brought in such courts. The Issuer irrevocably submits to the jurisdiction of the courts of England and waives any objection to Proceedings in such courts on the ground of venue or on the ground that the Proceedings have been brought in an inconvenient forum. This submission is made for the benefit of each of the holders of the Covered Bonds, Receipts or Coupons (other than NCSD System Covered Bonds) and shall not affect the right of any of them to take Proceedings in any other court of competent jurisdiction nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction (whether concurrently or not).

The Issuer irrevocably agrees that any dispute arising out of the NCSD System Covered Bonds shall be subject to the exclusive jurisdiction of the District Court of Reykjavík (*Ice. Héraðsdómur Reykjavíkur*) and legal action taken may be proceeded with in accordance with the Act on Civil Procedure No. 91/1991 (*Ice. Lög um meðferð einkamála*), Chapter 17.

### **13.3 Service of Process**

The Issuer irrevocably appoints the Embassy of Iceland, London as its agent in England to receive, for it and on its behalf, service of process in any Proceedings in England. Such service shall be deemed completed on delivery to such process agent (whether or not, it is forwarded to and received by the Issuer). If for any reason such process agent ceases to be able to act as such or no longer has an address in London, the Issuer irrevocably agrees to appoint a substitute process agent and shall immediately notify holders of such appointment in accordance with Condition 11 (Notices). Nothing shall affect the right to serve process in any manner permitted by law.

## SELLING RESTRICTIONS

### UNITED STATES

The Covered Bonds have not been and will not be registered under the Securities Act and the Covered Bonds may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons, except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S.

Each Dealer appointed under the Programme will be required to agree that, except as permitted by any dealer agreement entered into, it will not offer, sell or, in the case of Bearer Covered Bonds, deliver (i) as part of their distribution at any time or (ii) otherwise until 40 days after the completion of the distribution of an identifiable tranche of which such Bonds are a part, as determined and certified to the Fiscal Agent by such Dealer (or, in the case of an identifiable tranche of Bonds sold to or through more than one Dealer, by each of such Dealers with respect to Bonds of an identifiable tranche purchased by or through it, in which case the Fiscal Agent shall notify such Dealer when all such Dealers have so certified), within the United States or to, or for the account or benefit of, U.S. persons, and it will have sent to each Dealer to which it sells Bonds during the Distribution Compliance Period a confirmation or other notice setting out the restrictions on offers and sales of the Bonds within the United States or to, or for the account or benefit of, U.S. persons. Terms used in the preceding sentence have the meanings given to them by Regulation S.

The Bonds are being offered and sold outside the United States to non-U.S. persons in reliance on Regulation S. In addition, until 40 days after the commencement of the offering of any identifiable tranche of Bonds, an offer or sale of Bonds within the United States by any dealer (whether or not participating in the offering of such tranche of Bonds) may violate the registration requirements of the Securities Act.

This Base Prospectus has been prepared by the Issuer for use in connection with the offer and sale of the Covered Bonds outside the United States. The Issuer and the Dealers reserve the right to reject any offer to purchase the Covered Bonds, in whole or in part, for any reason. This Base Prospectus does not constitute an offer to any person in the United States. Distribution of this Base Prospectus by any non-U.S. person outside the United States to any U.S. person or to any other person within the United States is unauthorised and any disclosure without the prior written consent of the Issuer of any of its contents to any such U.S. person or other person within the United States, is prohibited.

Covered Bonds in bearer form having a maturity of more than one year are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. Treasury regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986, as amended, and U.S. Treasury regulations promulgated thereunder.

Covered Bonds in bearer form will be issued in compliance with U.S. Treasury Regulations §1.163-5(c)(2)(i)(D) (or any successor rules in substantially the same form that are applicable for purposes of Section 4701 of The United States Internal Revenue Code of 1986, as amended (the “**Code**”)) (“**TEFRA D**”) unless: (i) the applicable Final Terms state that Covered Bonds are issued in compliance with U.S. Treasury Regulations §1.163-5(c)(2)(i)(C) (or any successor rules in substantially the same form that are applicable for purposes of Section 4701 of the Code) (the “**TEFRA C**”); or (ii) the Covered Bonds are issued other than in compliance with TEFRA D or TEFRA C but in circumstances in which the Covered Bonds will not constitute “registration required obligations” under the United States Tax Equity and Fiscal Responsibility Act of 1982 (“**TEFRA**”), which circumstances will be referred to in the applicable Final Terms as a transaction to which TEFRA is not applicable.

## EEA

In relation to each Member State of the EEA which has implemented the Prospectus Directive (each, a “**Relevant Member State**”), each Dealer appointed under the Programme will be required to represent and agree, that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the “**Relevant Implementation Date**”) it has not made and will not make an offer of Covered Bonds which are the subject of the offering contemplated by this Base Prospectus as completed by the final terms in relation thereto to the public in that Relevant Member State except that it may, with effect from and including the Relevant Implementation Date, make an offer of such Covered Bonds to the public in that Relevant Member State:

- (a) if the final terms in relation to the Bonds specify that an offer of those Bonds may be made other than pursuant to Article 3(2) of the Prospectus Directive in that Relevant Member State (a “**Non-exempt Offer**”), following the date of publication of a prospectus in relation to such Bonds which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, provided that any such prospectus has subsequently been completed by the final terms contemplating such Non-exempt Offer, in accordance with the Prospectus Directive, in the period beginning and ending on the dates specified in such prospectus or final terms, as applicable and the Issuer has consented in writing to its use for the purpose of that Non-exempt Offer;
- (b) at any time to any legal entity which is a qualified investor as defined in the Prospectus Directive;
- (c) at any time to fewer than 150 natural or legal persons (other than qualified investors as defined in the Prospectus Directive), subject to obtaining the prior consent of the relevant Dealer or Dealers nominated by the Issuer for any such offer; or
- (d) at any time in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Bonds referred to in (b) to (d) above shall require the Issuer or any Dealer to publish a prospectus pursuant to Article 3 of the Prospectus Directive, or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression an “offer of Bonds to the public” in relation to any Bonds in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Bonds to be offered so as to enable an investor to decide to purchase or subscribe the Bonds, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State, the expression “**Prospectus Directive**” means Directive 2003/71/EC (as amended, including by Directive 2010/73/EU), and includes any relevant implementing measure in the Relevant Member State.

## JAPAN

The Covered Bonds have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (Act No. 25 of 1948, as amended, the “**Financial Instruments and Exchange Act**”). Accordingly, each Dealer appointed under the Programme will be required to agree that it will not, directly or indirectly, offer or sell and will not, directly or indirectly, offer or sell any Covered Bonds in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan) or to others for re-offering or re-sale, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Financial Instruments and Exchange Act and other relevant laws and regulations of Japan.

## **GENERAL**

These selling restrictions may be modified by the agreement of the Issuer and the Dealers following a change in a relevant law, regulation or directive. Any such modification will be set out in the Final Terms issued in respect of the issue of Covered Bonds to which it relates or in a supplement to this Base Prospectus.

No representation is made that any action has been taken in any jurisdiction that would permit a public offering of any of Covered Bonds, or possession or distribution of the Base Prospectus or any other offering material or any Final Terms, in any country or jurisdiction where action for that purpose is required.

Each Dealer appointed under the Programme will be required to agree that it shall, to the best of its knowledge, comply with all relevant laws, regulations and directives in each jurisdiction in which it purchases, offers, sells or delivers Covered Bonds or has in its possession or distributes the Base Prospectus, any other offering material or any Final Terms therefore in all cases at its own expense.

## 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, as amended (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 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 initially granted on 29 April 2013 and is subject to the requirements, as amended at the date of this Base Prospectus specified below:

- (a) The Programme shall not exceed a limit of ISK 120,000,000,000. 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 every six months file a report to the FME regarding his supervision duties. The report shall contain information stipulated in Paragraph 3 of Article 16 of the Rules on Covered Bonds.
- (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. The aforementioned requirements are all subject to review by the FME.

## TAXATION AND CAPITAL INFLOW RESTRICTIONS

The comments below are of a general nature based on the Issuer's understanding of current law and practice. 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 persons 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.

In addition, set out below is a brief description of the policy instrument to temper and affect the composition of capital flows into Iceland. Prospective investor in the Covered Bond is strongly advised to consult their professional advisers, if in any doubt on how the capital inflow restrictions will affect their potential investment.

### 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 Covered 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 125,000 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 (*Ice. Ríkisskattstjóri*) 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.

## 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 125,000 per year.

## FATCA WITHHOLDING

Pursuant to certain provisions of U.S. Internal Revenue Code of 1986, as amended, commonly known as FATCA, a “foreign financial institution” may be required to withhold on certain payments it makes (“**foreign passthru payments**”) to persons that fail to meet certain certification, reporting, or related requirements. The Issuer believes that it is a foreign financial institution for these purposes. A number of jurisdictions (including Iceland) have entered into, or have agreed in substance to, intergovernmental agreements with the United States to implement FATCA (“**IGAs**”), which modify the way in which FATCA applies in their jurisdictions. Certain aspects of the application of these rules to instruments such as the Covered Bonds, including whether withholding would ever be required pursuant to FATCA or an IGA with respect to payments on instruments such as the Covered Bonds, are uncertain and may be subject to change. Even if withholding would be required pursuant to FATCA or an IGA with respect to payments on instruments such as the Covered Bonds, such withholding would not apply prior to 1 January 2019 and Covered Bonds issued on or prior to the date that is six months after the date that is six months after the date on which final regulations defining “foreign passthru payments” are filed with the U.S. Federal Register generally would be “grandfathered” for purposes of FATCA withholding unless such Covered Bonds are (i) materially modified after such date or (ii) treated as equity for U.S. federal income tax purposes. However, if additional Covered Bonds (as described under “Terms and Conditions—Further Issues”) that are not distinguishable from outstanding Covered Bonds in the same Series are issued after the expiration of the grandfathering period and are subject to withholding under FATCA, then withholding agents may treat all Covered Bonds in such Series, including grandfathered Covered Bonds, as subject to withholding under FATCA. Holders should consult their own tax advisors regarding how these rules may apply to their investment in the Covered Bonds.

### *The proposed financial transaction tax (“FTT”)*

On 14 February 2013, the European Commission published a proposal (the “Commission’s Proposal”) for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the “**Participating Member States**”). However, Estonia has since stated that it will not participate.

The Commission’s Proposal has a very broad scope and could, if introduced, apply to certain dealings in the Covered Bonds (including secondary market transactions) in certain circumstances. The issuance and subscription of Covered Bonds should, however, be exempt.

Under the Commission’s Proposal, the FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in the Covered Bonds where at least one party is a financial institution, and at least one party is established in a participating Member State. A financial institution may be, or be deemed to be, “established” in a participating Member State in a broad range of circumstances, including (a) by transacting with a person established in a participating Member State or (b) where the financial instrument which is subject to the dealings is issued in a participating Member State. However, the FTT proposal remains subject to negotiation between participating Member States. It may therefore be altered prior to any implementation, the timing of which remains unclear. Additional EU member states might decide to participate. Prospective holders of the Covered Bonds are advised to seek their own professional advice in relation to the FTT and its potential impact on the Covered Bonds.

Investors who are in any doubt as to their position or would like to know more should consult their professional advisers.

## **RULES ON SPECIAL RESERVE REQUIREMENTS FOR NEW FOREIGN CURRENCY INFLOWS - CAPITAL INFLOW RESTRICTIONS**

In June 2016, the Central Bank published its Rules on Special Reserve Requirements for New Foreign Currency Inflows, No. 490/2016, as amended (the “**Special Reserve Requirement Rules**”), in accordance with the new Temporary Provision III of the Foreign Exchange Act, no. 87/1992, as amended, (the “**Foreign Exchange Act**”). The Special Reserve Requirement rules have since then been amended with rules No. 537/2016, rules No. 892/2016 and rules No. 201/2017. The main purpose of this Temporary Provision III is to provide the Central Bank with a policy instrument, generally referred to as a capital flow management measure, to temper inflows of foreign currency and to affect the composition of such inflows. It is therefore intended to reduce the risk that could accompany excessive capital inflows under the current regulatory framework for foreign exchange, support other aspects of domestic economic policy, and contribute to macroeconomic and financial stability.

The Special Reserve Requirement Rules contain provisions on the implementation of special reserve requirements for new foreign currency inflows, including the special reserve base, holding period, special reserve ratio, settlement currency, and interest rates on deposit institutions’ capital flow accounts with the Central Bank. The special reserve base is defined as new inflows of foreign currency in connection with specified types of capital, particularly to include new investment in electronically registered bonds and bills issued in Icelandic Krona, and deposits in Icelandic Krona, which bear 3.0 per cent. annual interest or more. In addition, new inflows related to loans taken for investment in such instruments can create the special reserve base. Individuals are exempted from the special reserve requirement up to a maximum equivalent to ISK 100,000,000. The aforementioned exemption for individuals is subject to the requirement that the individual is the beneficial owner of the funds in question.

According to the rules the special reserve requirement shall be satisfied by deposit of the special reserve amount to a special reserve account whereas the special reserve amount is the product of the special reserve base and the special reserve ratio. The rules currently set the special reserve ratio at 40 per cent<sup>3</sup>.

The holding period under the current rules is 12 months<sup>4</sup> and begins on the business day that the special reserve amount is deposited to a special reserve account with a deposit institution in Iceland. Deposit institutions are required to deposit the special reserve amount that they hold in special reserve accounts to a capital flow account with the Central Bank of Iceland which bears 0 per cent. interest. The settlement currency for capital flow accounts shall be the Icelandic Krona.

Investors who are in any doubt as to their position or would like to know more should consult their professional advisers.

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<sup>3</sup>The Foreign Exchange Act states that the special reserve ratio may range up to 75 per cent.

<sup>4</sup>The Foreign Exchange Act states that the holding period may range up to five years.

## THE ICELANDIC ECONOMY<sup>5</sup>

The Icelandic economy is small. In terms of GDP, it is the smallest economy within the OECD with a total GDP of ISK 2,449 billion in 2016. The population is also small, numbering just under 338 thousand. According to World Bank data, gross national income per capita, measured in terms of purchasing power parities (“PPP”), amounted to nearly 51.4 thousand USD in 2016 which is in the top twenty of the highest in the world.

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. In 2016 services accounted for roughly 56 per cent. of total export revenues, while exports of marine products accounted for 20 per cent. and exports of aluminium and aluminium products accounted for 15 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 just over 27 per cent. from its peak in 2007 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 2.0 per cent.; in 2012, growth continued at 1.3 per cent. Registered unemployment peaked at 9.3 per cent. in early 2010 but was down to 1.8 per cent. in September 2017, 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 September 2017, the ISK had appreciated by 50 per cent. since its lowest level in November 2009.

The trade account surplus measured 7.3 per cent. of GDP in 2016 and the CA balance was positive by 7.8 per cent. of GDP.

The Central Bank forecasts an average annual GDP growth of 3.7 per cent. in 2017 to 2019, driven by growing investment and private consumption. Annual CPI inflation in September 2017 measured 1.4 per cent., well below the 2.5 per cent. inflation target of the Central Bank. The Central Bank forecast assumes that CPI inflation will accelerate in the coming years to 2.6 per cent. in 2018 and 2.8 per cent. in 2019.

## THE RESIDENTIAL HOUSING MARKET IN ICELAND

Developments in the housing market in Iceland for the last 10-15 years have been closely intertwined with the general economic development; the upswing that began in 2003 and ended abruptly in October 2008 with the collapse of the banking sector and the following recovery. 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 new privatized commercial banks entered the market and engaged the HFF in direct competition by offering mortgage loans with longer maturities, lower interest rates, higher loan-to-value ratio, and at a later state foreign currency indexed loans were also offered. Housing purchases were no longer a precondition for a loan, which facilitated refinancing and mortgage equity

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<sup>5</sup> Sources: This chapter was compiled by Landsbankinn’s Economic Research Department based on data and information obtained from Statistics Iceland, the Central Bank of Iceland and Register Iceland, October 2017.

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 which 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. Mortgage borrowers became more 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 share of indebted households in financial distress grew from around 12 per cent. in early 2007 to 27 per cent. in autumn 2009. Household debt relative to GDP peaked at 125 per cent. in 2009. Various measures undertaken by banks and the central government have since reduced Iceland's household indebtedness down to 78 per cent. of GDP at year-end 2017, or by nearly 41 per cent of GDP. Compared with other countries with high household debt levels, this is a dramatic fall.

Housing prices peaked in Q1 2008 after an almost continuous rise since 1996. The nominal value of residential housing in Iceland has always been sticky downwards. The price was at its lowest point in Q1 2010 after nominal prices had fallen by 15 per cent. in approximately 2 years. The most significant part of the adjustment to the property market after the collapse took place through inflation and changes in real prices. The real decline in housing prices was 35 per cent. at that time.

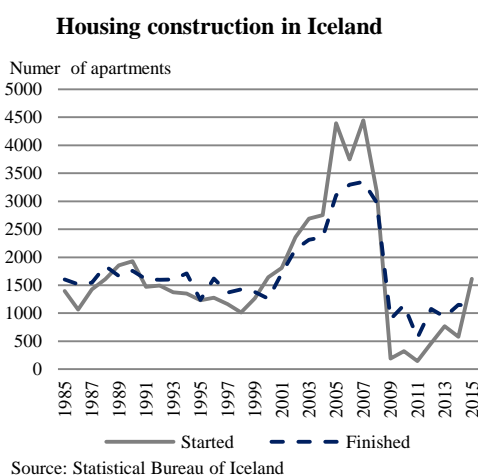
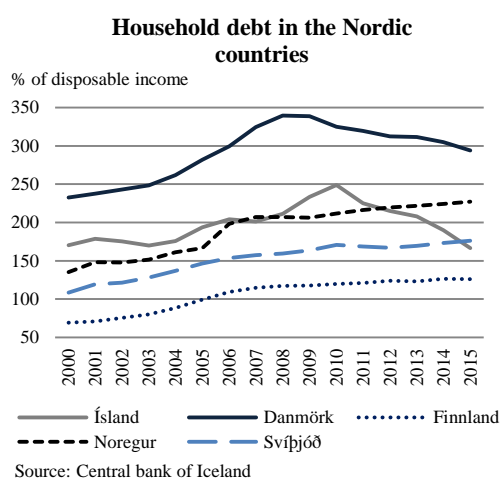
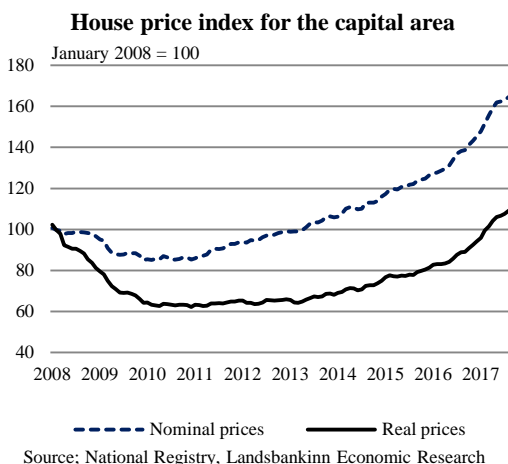
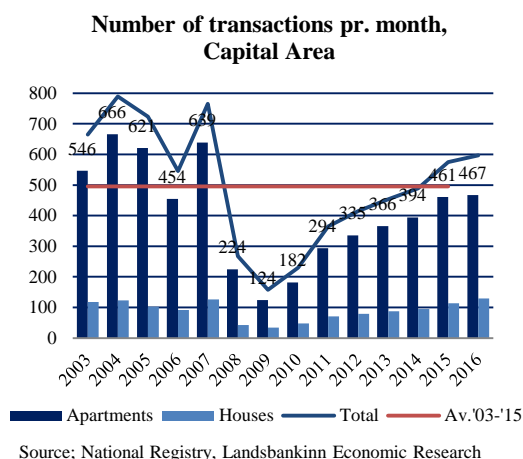
Since 2011 the real estate prices have risen steadily. The nominal prices in September 2017 were 65 per cent. higher than at the peak in 2008 and the prices have risen at similar rates in the Capital area and the larger towns in Iceland. In real terms prices are 7.5 per cent higher than at the peak in the beginning of 2008. The number of transactions on the property market rose steadily from 2010 but is still lower than during the boom years, and was in 2016 higher the average for the last 14 years.

The main drivers for steady rises in house prices in the last years have been higher nominal incomes, large amount of properties rented out to tourists and lack of supply of new housing. After the boom in housing construction in 2004-2008 the building activity almost came to a complete stop. The building plans at that time were completed in a slow pace in the next years but very few new projects went into development. Together with the improved financial situation demand for housing began to rise again, especially for smaller and cheaper apartments. The building activity has been slow to respond to this new demand, which especially comes from young people that can't afford the traditional big apartments that have been most common new constructions in the past. This situation, together with steadily increasing portion of apartments being rent to tourists in certain areas has put an upward pressure on the prices of smaller apartments, especially in central areas. Widespread renting to tourists has also decreased the traditional rental market in Iceland where individual owners let apartments out to students and young people.

The financial position of households has improved considerably in recent years. There has been strong GDP growth, robust employment growth, and a rise in real disposable income by just over 5 per cent. per year between 2011 and 2016. The growth in disposable income has outpaced growth in private consumption in recent years, which means that households have been accumulating savings. Significant increases in asset prices have also led to a stronger household equity position. The net wealth of households relative to disposable income has increased by 155 percentage points between 2008 and year-end 2016. Due to increased income and reduction of debt, the debt-to-income ratio has fallen by 94 percentage points in only five years, to 155 per cent. of disposable income as of year-end 2016.

House prices are expected to rise in tandem with GDP growth, growing real income and increased immigration. The nominal prices have risen by 8-10 per cent. in the last years. Signs of increased supply from new construction are begging to emerge which could dampen the cycle over time. New plans for construction of rental apartments in co-operation between municipals and trade unions are in a starting phase. The activities of traditional housing construction companies are also rising.





## FINANCIAL MARKETS IN ICELAND

### SIZE OF THE BANKING SYSTEM

Total assets of Icelandic deposit money banks which are four commercial banks and four savings banks amounted to ISK 3,4161.9 billion as at 30 September 2017 according to the Central Bank, of which foreign assets were ISK 337.8 billion, or 8.0 per cent. The Icelandic financial market is therefore naturally highly exposed to the Icelandic economy.

The total assets of the three largest commercial banks namely the Issuer, Íslandsbanki and Arion Bank comprised 69 per cent of the total assets of Icelandic credit institutions (excl. the Central Bank, incl. the failed banks' holding companies)<sup>6</sup> as at the end of Q2 2017 according to the Central Bank. The proportion of the HFF was 16 per cent.

<sup>6</sup> The total assets of the three largest commercial banks comprise 60 per cent. of the banking system and other credit institutions incl. the Central Bank. The HFF proportion is 14 per cent.

## MARKET PARTICIPANTS AND SUPERVISION

Icelandic credit institutions are comprised of four commercial banks, four savings banks and five credit undertakings. The financial market also includes ten securities companies and investment funds, one securities brokerage and ten fund management companies of undertakings for collective investment in transferable securities (“UCITS”), as well as three other supervised entities (HFF, Depositors’ and Investors’ Guarantee Fund and Savings Bank Depositors’ Guarantee Fund).

The HFF, a fully state-owned institution, operates in Iceland and offers financing for residential housing in Iceland. The establishment of the mortgage lender HFF was approved at the beginning of 1999. The HFF 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 2004 when the three major banks in Iceland entered the financing sector for residential housing.

One stock exchange is operated in Iceland, Nasdaq Iceland hf., and one securities depository, Nasdaq CSD Iceland. Nasdaq Iceland operates under Act No. 110/2007, on Stock Exchanges.

Icelandic financial markets are supervised by the FME. Entities engaging in financial activities which are subject to licence are regulated by the 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 the 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. In June 2014 the Government of Iceland presented comprehensive strategy for capital account liberalisation. In 2014 a new Act amending the Foreign Exchange Act took effect and in March 2017, the Central Bank announced new rules which provide for general exemptions to most of the restrictions pursuant to the Foreign Exchange Act. The Central Bank oversees surveillance of the rules on Foreign Exchange - see further *“The Issuer’s operating environment is still to some extent subject to capital controls even though the capital controls have mostly been lifted. If the capital control regime is removed in manner which fails to protect the Icelandic economy from a negative impact of its removal it could have material adverse effect on the Issuer’s business”*

## OTHER RELEVANT INSTITUTIONS IN THE FINANCIAL MARKET

There are other relevant financial institutions which participate in the financial markets.

Pension funds, which are independent non-governmental entities, are an important source of long-term finance in Iceland 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. In addition, ten security companies are operating primarily domestically and provide services to professional and institutional investors. Many of them operated mutual funds of various kinds.

Furthermore, there are three major insurance companies, Tryggingamiðstöðin, Sjóvá and Vátryggingafélag Íslands hf., which are licensed to operate in Iceland, and have been active in the financial market through their investment activities in Iceland and are listed on Nasdaq 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 37 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 ehf., 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 October 2017, the international rating agency Standard & Poor's ("S&P") raised the long term rating of the Issuer from BBB-/A-2 to BBB+/A-2 with a stable outlook. Previous rating was from October 2016, where S&P raised both the long and short term rating of the Issuer from BBB-/A-3 to BBB-/A-2 with "positive outlook".

In the first nine months of 2017, the Issuer's net interest income was ISK 27.1 billion (compared to ISK 26.2 billion in 2016 and ISK 25.0 billion in 2015), its operating income was ISK 41.2 billion (compared to ISK 41.2 billion in 2016 and ISK 50.9 billion in 2015) and profit for the first nine months of 2017 was ISK 16.8 billion (compared to ISK 16.4 billion in 2016 and ISK 24.4 billion in 2015). As at 30 September 2017, the Issuer's total assets were ISK 1,198 billion (compared to ISK 1,111 billion at year-end 2016 and ISK 1,119 billion at year-end 2015).

Historical financial information in this Base Prospectus is for the period 1 January 2015 to 30 September 2017. Audited Consolidated Financial Statements for the Issuer for the years 2015 and 2016, together with the audit reports thereon and the reviewed Interim Condensed Financial Statements for the first nine months of 2017, 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 2016.

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 2017.

### RECENT DEVELOPMENTS

On 20 November 2017 the Issuer invited holders of EUR 300,000,000, 3.00 per cent notes due in 2018 to tender their notes for purchase by the Issuer against cash payment. The Issuer received valid tenders of EUR 199,620,000 and offers in the amount of EUR 150,000,000 were accepted, with a pro rata scaling factor of 75.6770 per cent.

On 21 November 2017 the Issuer concluded sale of a new 5.5 year EUR 300,000,000 senior unsecured bonds maturing in May 2023, with a fixed 1.00 per cent coupon. The proceeds of the issuance was used amongst other to pre-pay the Issuer's euro issuance maturing in October 2018, as a result of the tender offer closed in November 2017. The bonds were issued under the Issuer's EMTN programme. The issuance followed a recent upgrade of the Issuer's credit rating from S&P Global rating resulting in better terms and longer tenor than previous issuance.

## HISTORICAL BACKGROUND

LBI ehf., the Issuer's predecessor, was established by the Icelandic Parliament on 1 July 1886. In establishing LBI ehf., the Icelandic Parliament hoped to boost monetary transactions and encourage the country's nascent industries. LBI ehf.'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 ehf. grew and developed in parallel to the nation. In the 1920s, LBI ehf. 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 ehf. 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 ehf. managed to take advantage of, despite some economic adversity. In 1997, LBI ehf. was incorporated as a limited liability company, and the ensuing privatisation was concluded in 2003. From 2003 to 2008, LBI ehf. 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 ehf. 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 ehf. and a Resolution Committee was appointed to supersede the board of directors of LBI ehf.

## SHAREHOLDERS AND SHARE CAPITAL

As at 26 October 2017, the Issuer had 934 shareholders. The ISFI manages 23,567,013,778 (98.2 per cent.) shares and the corresponding voting rights on behalf of the largest shareholder, the Icelandic State Treasury. The ISFI manages its holdings in the Issuer in accordance with its publicly available ownership policy. The second largest shareholder is the Issuer, which holds 360,460,639 (1.50 per cent.) of its own shares after acquisition by the Issuer of own shares under its buy-back Programme (the "**Buy-back programme**"), which was initiated in September 2016. Current and former employees of the Issuer and also former owners of Sparisjóður Vestmannaeyja and Sparisjóður Norðurlands ses hold 72,525,583 (0.30 per cent.) shares and voting rights in the Issuer, after the Issuer exercised an authorisation to purchase shares under the Buy-Back Programme. The shares and voting rights of current and former employees of the Issuer and also former owners of Sparisjóður Vestmannaeyja and Sparisjóður Norðurlands ses are held by each shareholder individually.

	Shares 30.09.2017	% of the Issuer's share capital
Icelandic State Treasury.....	23,567,013,778	98.20
Landsbankinn's own shares .....	360,460,639	1.50
Current and former employees of Landsbankinn and current and former owners of Sparisjóður Vestmannaeyja and Sparisjóður Norðurlands ses. ....	72,525,583	0.30
Total shares.....	24,000,000,000	100.00

The Icelandic Parliament has authorised a sale of all of the Icelandic State Treasury's shares in the Issuer which are in excess of 70 per cent of the Issuer's total share capital – see also "*Risk factors- The Icelandic State Treasury is the largest shareholder of the Issuer. This may affect the Issuer and its business*".

The Issuer is not directly or indirectly owned or controlled by others, other 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.

## Share Capital

The Issuer's total share capital is ISK 24,000,000,000, of which 23,639,539,361 shares are outstanding. Each share is of the nominal value of one ISK and entitles the owner to one vote at shareholders' meetings.

The Issuer's AGM held on 14 April 2016 authorised the Issuer to acquire up to 10 per cent. in nominal value of its share capital, in accordance with Art. 55 of Act No. 2/1995 on Public Limited Liability Companies. The minimum and maximum amounts the Issuer is authorised to pay for each share shall be equivalent to the ratio of equity held by the Issuer's shareholders to share capital as disclosed in the most recent annual or interim financial statements published before any such purchase of own shares take place. This authorisation was valid until the AGM of the Issuer in 2017. On 15 September 2016, the Issuer's Board of Directors decided to exercise an authorisation to purchase the Issuer's own shares. Under the Buy-Back Programme, the acquisition amounted to a total of 480 million shares, or the equivalent of 2 per cent. of its issued share capital. The Issuer offered to repurchase shares from shareholders in three repurchasing periods. The first period was from 19 September to 30 September 2016. The second period was from 31 October to 9 December 2016 and third period was from 13 February to 24 February 2017. The purchase price was determined by the internal value of the Issuer's shares, according to its most recently published financial results prior to the commencement of the repurchase period concerned. The purchase price of the shares therefore changed between repurchase periods, in accordance with the outcome of its quarterly or annual results preceding the respective repurchase period. During the third repurchase period, which was from 13 February to 24 February 2017, 119,524 of the Issuer's own shares were transferred to the Issuer, due to enforcement of pledges. At the conclusion of the third repurchase period, the Issuer held 360,460,639 of its own shares. The Issuer acquired a total of 142,031,497 of its own shares under the Buy-Back Programme, or the equivalent of 0.6 per cent. of all issued shares in the Issuer.

The Issuer's AGM held on 22 March 2017 approved a motion to pay dividends to shareholders amounting to ISK 0.55 per share or around ISK 13 billion, which is equivalent to 78 per cent. of the Issuer's overall profit for the financial year ended 2016. Payment of the dividend was made on 29 March 2017. The AGM also approved a special dividend to shareholders of ISK 0.50 per share, a total of ISK 11.8 billion. The special dividend was paid on 20 September 2017. Total dividends paid by the Issuer in 2017 amounts to ISK 24.8 billion.

Furthermore, the Issuer's AGM, held on 22 March 2017, authorised the Issuer, in accordance with Article 55 of the Act on Public Limited Companies, No. 2/1995, to acquire its own shares, up to 10 per cent. of the nominal value. The minimum and maximum amount the Issuer is authorised to pay for each share shall be the book value of individual shares, i.e. equivalent to the ratio of equity held by the Issuer's shareholders to share capital, as disclosed in the most recent annual or interim financial statement published before the purchase of its own shares takes place. This authorisation is valid until the AGM of the Issuer in 2018. Allocation by the Issuer of its own shares purchased based on this authorisation is subject to shareholder approval.

## 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 (the "Group"):

Principal subsidiaries	Principal area of activity	Ownership interest
Eignarhaldsfélag Landsbankans ehf.	Holding company	100%
Landsbréf hf.	Fund management company	100%

## STRATEGY

The strategy sets the agenda for the next two years until 2020.

*Role:* Trusted financial partner

*Vision:* Landsbankinn is exemplary

### Strategic focal points

The strategic focal points are based on Issuer's core pillars and serve as the Issuer's guide towards a digital future. The Issuer will emphasise initiative in customer relations and provide customers with exemplary service to maintain long-term business relationships.

#### *Accessibility*

Customers can easily tend to all main banking business from anywhere and at anytime. They have easy access to information and a good overview of their finances. The Issuer's main tasks include:

- Creating a banking platform that allows all of the Issuer's customers, both private individuals and corporates, to tend to all main banking business via electronic service solutions
- Facilitating the on boarding of new customers using electronic processes
- Tailoring the Issuer's services to fit the needs of customers

#### *Efficiency*

Customers save time and effort through use of the Issuer's solutions. Their business is tended to expediently and securely using the service platform of the customer's choosing. The Issuer aims include:

- Simplification and digitalisation of those processes that are most important to customers
- Shortening processing time and finalising requests, if possible, at first touch
- Developing models that automate decisions in key processes
- Designing the flow of information to allow customers to review their status in real time
- Creating one system solution that works for both customers and employees
- Co-operation between divisions and departments

#### *Value-adding*

Customers receive personal service tailored to meet their needs. They experience their relationship with the Issuer as valuable and see that their business history is taken into account. The Issuer's challenges include:

- Listening to customers, discerning their needs and identifying solutions that suit each customer
- Leveraging technology and utilising data to tailor service and advice to customers, including needs analysing customer need and the use of preapproved limits
- Developing products and services that are value-adding for both parties
- Being data-driven and utilising information in the Issuer's decision-making processes

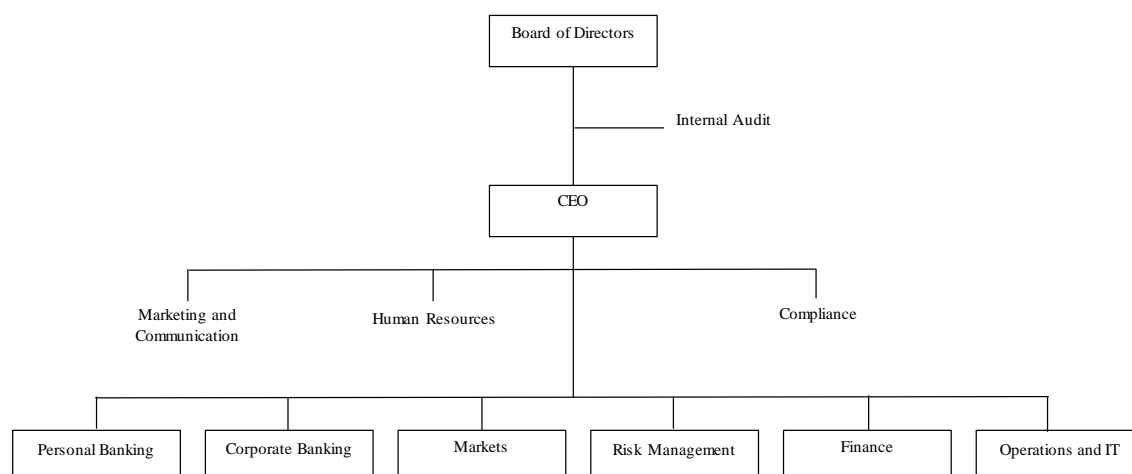
#### *Initiative*

The Issuer's is attentive to customers. Customers notice that the Issuer's employees conduct their work in a professional manner and show initiative. The Issuer's tasks include:

- Building a vibrant and positive corporate culture that is characterised by initiative in communications
- Attracting employees that have the knowledge and capability to take the Issuer towards a digital future
- Emphasising product development and innovation, both in-house and through external collaboration
- Creating a work environment that supports flexible work space where collaboration is key

## 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: Business Solutions and the Business development.

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.

The Issuer operates 37 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 and mobile solutions.

Among the Issuer's customers are over 120,000 individuals and around 11,000 SMEs. Its market share is around 38 per cent. with respect to retail customers and 32 per cent. with respect to SMEs, according to a survey conducted by Gallup in 2017.

### 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. Corporate Banking holds a strong position among the largest companies and institutions in Iceland. The market share in Corporate Banking, according to an annual survey conducted by Gallup in September 2017, is 36.7 per cent.

Corporate Banking comprises four business units and four 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. Corporate Banking has four support units: Business Support, Credit Assessment, Corporate Debt Restructuring 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.

Corporate Debt Restructuring analyses and manages problematic assets in the corporate loan portfolio. The team analyses e.g. the cash flow, debt service capacity, collaterals and assets valuation along with managing negotiations with all stakeholders (shareholders, liquidators, etc.).

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 advisory services. The division provides a range of wealth and asset management products and services for individuals, corporations and institutional investors. Landsbréf hf., a subsidiary of the Issuer, is included in 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 hf. In addition, Asset Management has two 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 accounting 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 advise 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 in the best rate of return, opportunities on the market and best practice.

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.



Capital Markets 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.

Market Making acts as a market maker for a number of issuers 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 in 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 by providing business development.

## **Support divisions**

The Issuer has three support divisions: Risk Management, Finance, 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 five departments: Credit Management, Credit Risk & Economic Capital, Market Risk, and Operational Risk.

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

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 Group.

The Market Risk department is responsible for measuring, monitoring and reporting market risk, liquidity risk and interest rate risk in the Group's banking book. The department develops and maintains the Issuer's market risk models and maintains the Issuer's Market Risk Policy and Liquidity Risk Policy as well as implementing processes to measure and monitor market risk and liquidity risk within the Group. Market Risk department is also responsible for monitoring all derivatives trading the Issuer enters into, both for hedging and trading purposes, as well as FX balance monitoring for the Group.

The Operational Risk department is responsible for ensuring that the Group's operational risks are monitored and that the 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 department is partly responsible for the security system of online banking and leads the work on the Group's certification under the ISO 2701 standard for information security.

### ***Finance***

Finance is a division that incorporates both support and profit functions. The division comprises eight departments: Treasury, Accounting & Financial Reporting, Legal, Budgeting, Legal, Economic Research, Transaction Services, Loan Administration and Operations.

Treasury is responsible for the Issuer's funding, liquidity management and market making in money markets. Treasury manages the Issuer's exchange rate, interest rate and inflation risks, within limits that are set by the Board of Directors. In addition, Treasury handles investor relations, dealings with the Central Bank and communications with domestic and overseas financial institutions, as well as rating agencies. Treasury is also responsible for the Issuer's internal and external interest rate pricing.

The Accounting & Financial Reporting (A&FR) is responsible for the overall financial accounting of the Issuer and maintaining financial controls, which includes inter alia reconciliations of subsystems to the general ledger and transactions control. The A&FR is also responsible for the Group's monthly financial reporting, including the Group's quarterly and annual financial statements. Additionally, the A&FR is responsible for the accounts payable process which involves routing supplier or vendor invoices to accounts payable for processing and paying eventually the invoices.

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.

Budgeting manages the Issuer's budgets and forecasting. 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 Economic Research department monitors financial markets and economic trends of relevance to the Issuer and its clients. The department follows the development in the domestic and global economy and on most import markets. The department publishes research reports on all major domestic macro developments as well as the foreign-exchange, fixed income and equity markets.

Transaction Services provides services to the income divisions of the Issuer and to the Issuer's customers. The main activities include international payments, clearing and settlement of securities and foreign exchange transactions, fund accounting 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.

The Operations division comprises three departments: Properties, Restructuring and Chief Cashier.

The Properties department oversees the Issuer's internal operations and facilities, i.e. the operation and maintenance of all its properties, including sale or purchase. The Properties 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 Restructuring department is responsible for appropriated assets. This includes selling and renting out real estate assets which the Issuer has acquired through foreclosure or as a part of debt restructuring. In addition, the Restructuring department sells vehicles, equipment and other items that the Issuer has acquired through foreclosure.

Chief Cashier is responsible for cash handling in ISK and FX.

## ***Information Technology***

Information Technology (“IT”) division is responsible for developing, operating and advising on the Issuer’s information systems and solutions. The IT division comprises seven departments: Software development, Enterprise Architecture, Operations, Strategic Planning and Project Management (“PMO”), Information Intelligence, IT Service and Web Development,

The Software development department comprises eight different domain units. The department oversees all internally developed and third-party software and is responsible for adjusting the software to the Issuer’s business.

Architecture department comprises several units which are responsible for several different tasks such as providing Solutions, Security and technical architecture, Process improvements role, Procurement – IT Contracts- Licenses management and standards.

Operations department comprises several different units: Operations, System administration. Database administration. Hardware support, Software distribution, Net, Phone, Access control, Batch processing and Security as well as hardware such as data centres, telephone systems, ATMs, etc.

Strategic Planning and PMO is responsible for running all the main strategic projects for the Issuer. The Issuer is implementing a 2020 Strategy and PMO’s key project is its implementation. Furthermore, PMO plays a key role in the Issuer’s project demand management.

Information Intelligence department has Business Intelligence unit (“BI”), and Enterprise Data Warehouse (“EDW”) unit. The department is the driving force in the use of information for decision making and improved customer service. The main tasks is related to the integration of data (in data warehouse), business development and services development.

IT Service department comprises two units: Help desk which provides first and second level service to internal users and ITIL process management.

## **Other divisions**

### ***CEO’s Office***

The CEO’s Office works closely with the CEO and aids him in his duties. Among its primary responsibilities are arranging meetings of the Issuer’s senior management and Board of Directors, and following-up on the implementation of decisions. The support functions Compliance, Human Resources (HR), and Marketing & Communication report directly to the CEO.

HR is responsible for all employee-related issues, such as salary and benefits, recruitment, training and job development.

The Marketing & Communication Department is responsible for formulating and implementing the Issuer’s marketing strategy and planning. It is also responsible for internal and external communication.

Compliance is responsible for identifying, assessing and monitoring the compliance risks faced by the Issuer and to support and advise management and employees in the fulfilment of their duties. 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. This includes providing 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.

### ***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 activity is to provide independent and objective assurance and consulting service, 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 audit activity is accountable both administratively and functionally to the Board of Directors. The Board of Directors employs the chief audit executive, who annually confirms to the board the organizational independence of the internal audit activity. According to an external quality assessment, the internal audit activity of the Issuer generally conforms to the Standards, Definition of Internal Auditing and Code of Ethics, issued by the Institute of Internal Auditors ("IIA").

## **LOAN PORTFOLIO**

The table below sets out details of the Issuer's loans and advances to customers as at 30 September 2017, classified by type of loan. During the first nine months of 2017 the Issuer was not permitted to sell or re-pledge any collateral in absence of default by the owner of the collateral.

	<b>30 September 2017</b>
	<i>(millions ISK)</i>
Public entities .....	12,621
Individuals .....	351,356
Corporations .....	558,781
Less: Allowance for impairment.....	(16,831)
<b>Total</b> .....	<b>905,927</b>

The table below sets out details of the Issuer's loans and advances to financial institutions as at 30 September 2017, classified by type of loan.

	<b>30 September 2017</b>
	<i>(millions ISK)</i>
Bank accounts with financial institutions .....	11,100
Money market loans .....	24,979
Other loans.....	5,406

**30 September  
2017**

**Total .....**

**41,485**

The following tables show the Issuer's maximum credit risk exposure at 30 September 2017. 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 2017	Financial institutions	Public entities <sup>(1)</sup>	Individuals	Fisheries	Construction companies	Real estate companies	Holding Companies	Retail	Services	ITC <sup>(2)</sup>	Manufacturing	Agriculture	Other	Carrying amount
<i>(millions of ISK except %)</i>														
Cash and balances with Central Bank.....	—	33,157	—	—	—	—	—	—	—	—	—	—	—	33,157
Bonds and debt instruments.....	3,353	146,354	—	—	—	8,980	49	—	—	—	—	—	1,487	160,223
Derivative instruments .....	1,603	—	1	2	43	11	79	1	—	—	—	—	47	1,787
Loans and advances to financial institutions.....	41,485	—	—	—	—	—	—	—	—	—	—	—	—	41,485
Loans and advances to customers.....	—	12,404	347,447	115,163	77,203	120,242	39,908	46,549	91,660	26,391	20,713	8,230	17	905,927
Other financial assets .....	6,641	—	217	33	51	32	94	22	1,700	1	1,533	1	—	10,325
<b>Total on-balance sheet exposure .....</b>	<b>53,082</b>	<b>191,915</b>	<b>347,665</b>	<b>115,198</b>	<b>77,297</b>	<b>129,265</b>	<b>40,130</b>	<b>46,571</b>	<b>93,361</b>	<b>26,392</b>	<b>22,246</b>	<b>8,231</b>	<b>1,551</b>	<b>1,152,904</b>
<b>Off-balance sheet exposure .....</b>	<b>5,226</b>	<b>20,314</b>	<b>31,984</b>	<b>11,559</b>	<b>49,456</b>	<b>20,008</b>	<b>5,794</b>	<b>16,173</b>	<b>16,380</b>	<b>5,741</b>	<b>8,633</b>	<b>1,426</b>	<b>104</b>	<b>192,798</b>
Financial guarantees and underwriting commitments..	1,580	636	783	2,326	—	3,402	512	53	2,818	2,937	1,503	770	—	17,403
Undrawn loan commitments .....	—	13,309	8	6,080	42,924	17,978	5,351	8,688	6,111	2,964	5,570	1,004	—	109,987
Undrawn overdraft/credit card facilities .....	3,646	6,369	31,193	3,153	3,130	1,518	390	4,667	7,332	1,274	2,293	422	21	65,408
<b>Maximum exposure to credit risk .....</b>	<b>58,308</b>	<b>212,229</b>	<b>379,649</b>	<b>126,757</b>	<b>126,753</b>	<b>149,273</b>	<b>45,924</b>	<b>62,744</b>	<b>109,741</b>	<b>32,133</b>	<b>30,879</b>	<b>9,657</b>	<b>1,655</b>	<b>1,345,702</b>
Percentage of carrying amount.....	4,3%	15,8%	28,2%	9,4%	9,4%	11,1%	3,4%	4,7%	8,2%	2,4%	2,3%	0,7%	0,1%	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 2017.

At 30 September 2017	Individually impaired							Carrying amount
	Gross carrying amount	Gross not individually impaired	Collective allowance	Of which performing		Of which non-performing <sup>(1)</sup>		
				Gross carrying amount	Individual allowance	Gross carrying amount	Individual allowance	
<i>(millions of ISK)</i>								
Financial institutions.....	41,485	41,485	-	-	-	-	-	41,485
Public entities .....	12,621	12,167	(37)	15	(9)	439	(171)	12,404
Individuals .....	351,356	345,054	(1,269)	1,732	(504)	4,570	(2,136)	347,447
<b>Corporations</b>	<i>558,781</i>	<i>536,004</i>	<i>(2,642)</i>	<i>13,395</i>	<i>(4,270)</i>	<i>9,382</i>	<i>(5,793)</i>	<i>546,076</i>
Fisheries .....	115,816	115,031	(325)	548	(218)	237	(110)	115,163

At 30 September 2017	Individually impaired							Carrying amount
	Gross carrying amount	Gross not individually impaired	Collective allowance	Of which performing		Of which non-performing <sup>(1)</sup>		
				Gross carrying amount	Individual allowance	Gross carrying amount	Individual allowance	
			(millions of ISK)					
Construction companies .....	79,134	77,388	(667)	701	(583)	1,044	(680)	77,203
Real estate companies	122,153	118,115	(486)	2,244	(1,050)	1,795	(376)	120,242
Holding companies .....	40,489	40,094	(266)	119	(67)	276	(248)	39,908
Retail .....	47,365	45,630	(173)	827	(184)	908	(459)	46,549
Services .....	96,721	88,656	(440)	3,502	(1,123)	4,564	(3,499)	91,660
Information, technology and communication .....	26,624	26,552	(189)	46	(31)	25	(12)	26,391
Manufacturing .....	22,146	16,634	(81)	5,014	(969)	498	(383)	20,713
Agriculture.....	8,316	7,887	(15)	394	(45)	35	(26)	8,230
Other.....	17	17	-	-	-	-	-	17
<b>Total.....</b>	<b>964,243</b>	<b>934,710</b>	<b>(3,984)</b>	<b>15,142</b>	<b>(4,783)</b>	<b>14,391</b>	<b>(8,100)</b>	<b>947,412</b>

The table below shows the credit quality of the Issuer's financial assets, including its loans and advances as at 30 September 2017. 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 <sup>1)</sup>	Carrying amount
	<i>(millions of ISK)</i>					
<b>At 30 September 2017</b>						
Cash and balances with Central Bank.....	33,157	-	-	33,157	-	33,157
Bonds and debt instruments.....	160,179	44	-	160,223	-	160,223
Derivative instruments .....	1,787	-	-	1,787	-	1,787
Loans and advances to financial institutions..	41,485	-	-	41,485	-	41,485
Loans and advances to customers.....	869,890	23,335	29,553	922,758	(16,831)	905,927
Other financial assets .....	10,325	-	-	10,325	-	10,325
<b>Total .....</b>	<b>1, 116,823</b>	<b>23,379</b>	<b>29,553</b>	<b>1,169,735</b>	<b>(16,831)</b>	<b>1, 152,904</b>

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.

	Past due 1-5 days	Past due 6-30 days	Past due 31-60 days	Past due 61-90 days	Past due over 90 days	Gross carrying amount
	(millions of ISK)					

At 30 September 2017

	Past due 1–5 days	Past due 6–30 days	Past due 31–60 days	Past due 61–90 days	Past due over 90 days	Gross carrying amount
			<i>(millions of ISK)</i>			
Public entities.....	-	-	-	-	-	-
Individuals .....	2,233	6,518	911	918	938	11,518
Corporations.....	3,751	4,253	897	732	2,184	11,817
<b>Total .....</b>	<b>5,984</b>	<b>10,771</b>	<b>1,808</b>	<b>1,650</b>	<b>3,122</b>	<b>23,335</b>

As at 30 September 2017, two customer groups were rated as large exposure in accordance with rules on large exposures. Customers are rated as large exposures if their total obligations, or those of financially or administratively connected parties, exceed 10 per cent of the Group's eligible capital. No exposure after credit risk mitigation may exceed 25 per cent of the eligible capital. The following table shows the Group's large exposure after credit risk mitigation:

	Number of large exposures	Large exposures <i>(millions ISK, except %)</i>
<b>At 30 September 2017</b>		
Large exposures between 10% and 20% of the Group's capital base.....	1	29,350
Large exposures between 0% and 10% of the Group's capital base.....	1	-
<b>Total .....</b>	<b>2</b>	<b>29,350</b>
Total large exposure to capital base .....		12%

## FUNDING

The Issuer is predominantly funded by three main sources: deposits from customers, borrowing and share capital.

Deposits from customers are the Issuer's single largest funding source and 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 from customers with the Issuer are predominately non-indexed and available on demand.

The Issuer has in place a EUR 2,000,000,000 Euro Medium Term Note Programme ("EMTN"), that is listed on the Irish Stock Exchange. The EMTN programme is utilised to broaden and strengthen the Issuer's funding in foreign currencies, *inter alia* with the purpose of refinancing the Issuer's outstanding bonds secured to LBI ehf.

In addition, the Issuer has in place a ISK 120,000,000,000 Covered Bond Programme that is listed for trading on Nasdaq Iceland. The purpose of the programme is to provide funding for the Issuer's mortgage loan portfolio and hedge the Issuer's fixed interest rate exposure.

Furthermore the Issuer has in place an ISK 50,000,000,000 debt issuance programme that is listed for trading on Nasdaq Iceland. The Issuer will primarily issue Commercial Paper in the domestic market in ISK under the debt issuance programme.

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 further easing 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, subject to market conditions, by issuing bonds in the domestic and international bond markets.

## **RISK MANAGEMENT FRAMEWORK**

Risk is inherent in the Group's activities and is managed through a process of on-going identification, measurement, management and monitoring, subject to risk limits and other controls. Risk identification involves finding the origins and structures of possible risk factors in the Group's operations and undertakings. Risk measurement entails assessing and quantifying 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 Group's risk appetite.

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

Risk policy is implemented through the setting of risk appetite, targets, 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 for setting its risk appetite. The CEO is responsible for the effective implementation of the framework and risk appetite through the corporate governance structure and committees. The CEO has established and is a member of the Executive Management Committee, the Risk & Finance Committee and the Credit Committee.

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

The 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. It is determined by various constraints reflecting the views of the Board of Directors, the CEO and Executive Management Committee. The Group's risk appetite is reviewed and revised at least annually.

The material risks which the Group is exposed to and that arise from financial instruments are credit risk, liquidity risk, market risk and operational 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 the resulting claims.

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

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

### ***Credit risk assessment***

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

The rating system has an obligor rating scale which reflects exclusively quantification of the risk of obligor default 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 used 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.

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

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

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

"Exposure at default" in relation to any particular borrower is an estimate of the amount that would be outstanding (drawn amounts plus likely future drawdowns of yet undrawn lines) in the event that such borrower were to default.

### ***Credit risk management***

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

Incremental credit authorisation levels are defined based on the size of units, type of customers and lending experience of credit officers. The Group has also implemented industry policies relating to the credit decision

process by applying a target share and monitoring limits for specific industries as, for example, a percentage of the loan portfolio, probability of default targets for specific industries and LGD values. 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 Group's Credit Committee. Credit decisions exceeding the limits of the Credit Committee are subject to approval by the Board of Directors, which holds the highest credit authorisation within the Issuer.

### ***Credit risk mitigation***

Mitigating risks in the credit portfolio is a key element of the Group's credit policy as well as an inherent part of the credit decision process. Securing loans with collateral is the main method of mitigating credit risk for many loan products, and in some cases, collateral is mandatory by law (e.g. as in the mortgage finance market), or is standard market practice.

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

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

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

### ***Derivative financial instruments***

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

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

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

### ***Credit risk control and monitoring***

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

- Green customers are considered those whose loans are performing without signs of repayment problems;
- Yellow customers are on Watch list 1. They have temporary difficulties and may need some instalments postponed or modification of terms or loan covenants;

- Orange customers are on Watch list 2. They are still under the supervision of the relevant business unit but are likely to undergo debt restructuring or postponement of instalments; and
- Red customers are under supervision by Corporate Solutions and need restructuring or are in legal collection. Restructuring options may include deferring payments, interest and/or debt forgiveness, collecting collateral or guarantees or the takeover and subsequent sale by the Issuer of the management of the customer's operations.

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

### ***Impairment process***

The Group'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 Group's customers is reflected in loan impairment, or net adjustments to loans and advances, when the expected cash flow of customers has changed.

Total allowance for impairment was ISK 17 billion, as at September 2017, as compared to ISK 21 billion at end of year 2016. Allowances have thus decreased during 2017, while the overall carrying amount has increased considerably. The decrease in allowances is mainly due to written-off loans, lower probability of default and improved collaterals. At 30 September 2017, 95 per cent. of the portfolio consisted of claims that were neither past due nor impaired.

### **Liquidity Risk**

Liquidity risk is identified as one of the Group's key risk factors. Accordingly, great emphasis is put on liquidity risk management within the Issuer, which is both reflected in the risk appetite of the Group as well as in internal liquidity management policies and rules.

A liquidity policy for the Group 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 Group 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 Group 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 Group'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 Group. The Risk & Finance Committee monitors the Group's liquidity risk, while the Internal Audit assesses whether the liquidity management process is designed properly and operating effectively.

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

The Group's liquidity management process includes:

- Projecting expected cash flows in a maturity profile rather than relying merely on contractual maturities 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 LCR and NSFR and it also applies measurements that best suit the operating environment of the Issuer.

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

The Group complies with the liquidity and funding rules set by the Central Bank No. 266/2017 ("**Rule No. 266/2017**"), as well as the guidelines of the FME No. 2/2010 on best practices for managing liquidity in banking organisations. Rule No. 266/2017 requires the Group to maintain a LCR minimum of 100 per cent total and 100 per cent for foreign currencies in the year 2017 and Rule No. 1032/2014 sets requirements for a minimum of 100 per cent NSFR in foreign currencies for the year 2017. The Group submits monthly reports on its liquidity position to the Central Bank and the FME.

	<b>LCR – Total</b>	<b>LCR – FX</b>	<b>NSFR – FX</b>
As at 31 December 2016	128%	743%	154%
As at 30 September 2017	158%	873%	185%

## 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 Group'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 Group and the market risk policies set the overall limits that govern market risk management within the Group.

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 Group monitors early indicators that can provide warning of an increased risk of future losses. Market risk indicators need to be concise, reported in a timely manner, give clear signals, highlight portfolio risk concentrations and reflect current risk positions. The risk reports show the Group'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 Group 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 Group's banking book by measuring the impact on profit of shifting the interest rate curves for every currency. 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 Group's imbalance in its CPI-indexed assets and liabilities, 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 Group'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 Group’s capital management policies and practices ensure that the Group has sufficient capital to cover the risk associated with its activities on a consolidated basis. The capital management framework of the Group comprises four interdependent areas: capital assessment, risk appetite/capital target, capital planning and reporting/monitoring. The Group regularly monitors and assesses its risk profile in its most important business areas on a consolidated basis and for the most important risk types. Risk appetite sets out the level of risk the Group is willing to take in pursuit of its business objectives.

The Group’s capital requirements are defined in Icelandic law and regulations, on the one hand, and by the FME, on the other. The requirements are based on the European legal framework for capital requirements (CRD IV and CRR) implementing the Basel III capital framework. The regulatory minimum capital requirement under Pillar I of the Basel framework is 8 per cent. of risk weighted assets (“**RWA**”) for credit risk, market risk and operational risk. In conformity with Pillar II A requirements of the Basel framework, the Issuer annually assesses its own capital needs through the Internal Capital Adequacy Assessment Process (“**ICAAP**”). The ICAAP results are subsequently reviewed by the FME in the Supervisory Review and Evaluation Process (“**SREP**”). The Group’s minimum capital requirement, the “**Minimum Capital requirement**” as determined by the FME, is the sum of Pillar I and Pillar II A requirements.

In addition to the minimum capital requirement, the Issuer is required by law to maintain certain capital buffers determined by the FME, which may, depending on the situation, be based on recommendations from the Icelandic Financial Stability Counsel (“**FSC**”). The FSC has defined the Issuer as a systematically important financial institution in Iceland.

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

	<b>CET1</b>	<b>Tier 1</b>	<b>Total</b>
Pillar I	4.5%	6.0%	8.0%
Pillar II A	2.8%	3.7%	4.9%
<b>Minimum requirement under Pillar I and Pillar II A</b>	<b>7.3%</b>	<b>9.7%</b>	<b>12.9%</b>
Systemic risk buffer	2.8%	2.8%	2.8%
Capital buffer for systematically important institutions	2.0%	2.0%	2.0%
Countercyclical capital buffer*	1.0%	1.0%	1.0%
Capital conservation buffer	2.5%	2.5%	2.5%
<b>Combined buffer requirement under Pillar II B</b>	<b>8.3%</b>	<b>8.3%</b>	<b>8.3%</b>
<b>Total Capital Requirement</b>	<b>15.5%</b>	<b>17.9%</b>	<b>21.2%</b>

- The combined buffer requirement (“**CBR**”) shall be met in full with Common Equity Tier 1 (“**CET1**”) capital
- Tier 1 capital is the sum of Common Equity Tier 1 (CET1) capital and Additional Tier 1 (AT1) capital
- Total capital is the sum of Tier 1 capital and Tier 2 capital

The Issuer’s target for the Group’s minimum total capital ratio is to maintain at all times capital ratios above the fully phased-in FME capital requirements, in addition to the management capital buffer that is defined in the Issuer’s risk appetite. The Issuer also aims to be in the highest category for risk-adjusted capital ratio, as determined and measured by the relevant credit rating agencies.

## LITIGATION

The Issuer and its subsidiaries are from time to time party to litigation cases, which arise due to the nature of its business. The Issuer has formal controls and policies for managing legal claims. Once 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.

In June 2013, a payment card company commenced litigation against the Issuer and other financial undertakings claiming tort liability in the amount of around ISK 1.2 billion, plus interest. The plaintiff argues that the defendants are liable in tort for alleged violation of competition rules. On 1 June 2017, the Supreme Court confirmed the decision of the District Court of Reykjavík to dismiss the case on grounds of insufficient substantiation. In September 2017, the same payment card company commenced litigation against the same defendants as in the previous case claiming tort liability in the amount of around ISK 923 million, plus interest. The plaintiff, again, argues that the defendants are liable in tort for alleged violation of competition rules.

In October 2017 the Icelandic Supreme Court rendered a judgment in case no. 623/2016 concluding that a provision in a consumer credit agreement between an individual and a commercial bank, other than the Issuer, did not fulfil the requirement stipulated in the Act on Consumer Credit Agreements no 121/1994 to specify the circumstances under which the interest rate may be changed. The Issuer is currently assessing the potential impact of the judgment.

In December 2014, the Issuer sold to Arion Bank all its shares in Valitor Holding hf. (Valitor), the mother company of Valitor hf. The agreement includes an indemnity clause under which the Issuer is to proportionally compensate Arion Bank with regards to certain cases concerning Valitor that relate to events that occurred before delivery of the sold shares, inter alia, for potential compensatory damages that Valitor may be obligated to pay for an alleged loss sustained due to Valitor’s termination of a vendor agreement. A case on the matter has been filed before the District Court of Reykjavík. The next hearing of the case is expected early 2018.

## COMPETITION

The Icelandic competitive landscape is comprised of four commercial banks, four savings banks and five credit institutions. The financial markets also include ten securities companies, one securities brokerage and ten UCITS management companies. 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. Such competition is affected by various factors including, but not limited to, consumer demand, technological changes, new entrants, regulatory actions and impact of consolidation.

The Issuer’s main competitors are the other large commercial banks in Iceland, namely Íslandsbanki, Arion Bank and Kvika Bank. With the recovery of the Icelandic economy, demand for new lending and other financial products has increased. Competition from smaller specialised institutions as well as shadow banking has intensified in the last few years. The Icelandic pension funds have also become more active competitors after they started increasing their mortgage lending to the public at aggressive interest rates, partially as a result of the fact that they are not subject to the special tax which was placed on financial institutions (see “*Changes in Tax laws or in their interpretation could harm the Issuer’s Business*”). The pension funds also provide competition for deposits, as a proportion of an individual’s savings (proportion of person’s salary and contribution from employers) are held in pension funds, rather than in bank deposits, since it is a requirement to do so by law. In the next couple of years Iceland will implement the PSD2 act No. 2015/2366, (Revised Payment Service Directive). It is likely that there will be increased competition, especially in the fintech area, where online solutions may have greater impact on the market. Furthermore, foreign banks are creating competition in the Icelandic corporate market with loan offerings to larger companies. If merger activity among smaller financial institutions manages to produce larger, better capitalised companies that are able to offer a wider array of products and services at more competitive prices, competition may intensify even further in the coming years.

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 increased competition from domestic competitors as well as foreign banks potentially seeking to establish operations in Iceland.

The AGM of the Issuer held on 14 April 2016 entrusted the Board of Directors to add to its protocols provisions on the competitive independence of the Issuer towards other state-owned commercial banks.

## ADMINISTRATIVE, MANAGEMENT, AND SUPERVISORY BODIES

As the date of this Base Prospectus, the Senior Management and Directors of the Issuer, their functions and their principal outside activities (if any) are as follows:

Name	Function	Principal Outside Activities
<b>Senior Management</b>		
Ms. Lilja Björk Einarsdóttir	CEO	Board member of the Icelandic Financial Services Association, Samtök atvinnulífsins, and Háskólasjóðsins.
Mr. Arinbjörn Ólafsson	Managing Director of Information Technology (“IT”)	Board member of Flygildi ehf. and Aðgerðarannsóknafélag Íslands.
Mr. Árni Þór Þorbjörnsson	Managing Director of Corporate Banking	Board member of Motus ehf., Greiðslumiðlun Íslands ehf. and the Icelandic Bar Association.
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”)	Alternate board member of The Depositors and Investors Guarantee Fund (“TIF”). Board member of Eyrir Invest hf.
Ms. Perla Ösp Ásgeirsdóttir	Managing Director of Risk Management, CRO	N/A
<b>Board of Directors</b>		
Ms. Helga Björk Eiríksdóttir	Chairman	Chairman of the Board of Directors of Firkir ehf. General Manager and Board Member of Integrum ehf. Board Member of Budz Boot Camp ehf. General Manager and Alternate Board Member of Förli ehf. Alternate Board Member of Slysabætur ehf., Fösull ehf. and Fenlogi ehf.
Mr. Magnús Pétursson	Vice Chairman	Chairman of the Board of Directors of Fylki ráðgjöf ehf.
Ms. Berglind Svavarsdóttir	Board Member	Lawyer at Lögmannstofa Reykjavíkur. Board Member of Kulygin ehf.
Mr. Einar Þór Bjarnason	Board Member	General Manager and Board Member of Gyrus ehf. Chairman of the Board of Directors of Intellecta ehf. Alternate Board Member of Glöggvir ehf
Mr. Hersir Sigurgeirsson	Board Member	Associate Professor in the Faculty of Business Administration of the University of Iceland, and independent consultant. Board Member of Endurreisnarsjóðurinn ehf. and Auðfræðasetur sf. General Manager and Board Member of Kvant ehf.
Mr. Jón Guðmann Pétursson	Board Member	General Manager and Board Member of Krumur ehf.
Ms. Sigríður Benediksdóttir	Board Member	Works in research and teaching at Yale University in the US, where she was awarded her doctorate in

economics in May 2005

Mr. Samúel Guðmundsson

Alternate

General Manager and Board  
Member of S67 ehf. and  
Hreinlætislausnir ehf.

General Manager of Sjávarkaup hf.  
Chairman of the Board of Directors  
of SILO ehf.

Board Member of Lagardère travel  
retail ehf.

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.