



**Landsbankinn**

**Condensed Consolidated Interim Financial Statements**  
for the six months ended 30 June 2010

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## Endorsement and Statement by the Board of Directors and Chief Executive Officer

The Condensed Consolidated Interim Financial Statements for the first six months of 2010 consist of the Condensed Consolidated Interim Financial Statements of NBI hf. (the Bank) and its subsidiaries, together referred to as "the Group". These Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Accounting Standard (IAS) 34 *Interim Financial Reporting* as adopted by the EU, with the exception described in Note 2 to these financial statements regarding comparative amounts.

According to the condensed consolidated income statement, the Group's after tax-profit for the first six months of the year 2010 amounted to ISK 9,405 million after taking into account a loss due to foreign currency linkage of loans and advances amounting to ISK 8,251 million. The Group's equity at the end of this period amounted to ISK 166,997 million. The capital adequacy ratio of the Group was 16.7%. As of 30 June 2010, the Group's total assets amounted to ISK 1,087,241 million. The Board of Directors and Chief Executive Officer would like to point out that the Group's profit is diminished due to the recognition of changes in the fair value of the contingent bond that the Bank might have to issue to Landsbanki Íslands hf. (see Note 16). If the fair value of the contingent bond was not recognised the Group's profit after tax would have increased from ISK 9,405 million to ISK 15,438 million and return on equity after tax would have increased from 11.9% to 19.6%. It is the view of the Bank's management that these are the figures to be used when analyzing the Group's performance and when comparing the Group's performance with other financial institutions, see Note 16.

On 26 August 2010 the Chief Executive Officer announced changes to the organisation of the Bank which would take effect in October 2010. The Bank will be set up with eight main divisions and the position of each Managing Director has been advertised for application. According to the Directors' best knowledge, these Condensed Consolidated Interim Financial Statements comply with IAS 34 *Interim Financial Reporting* as adopted by the EU and give a true and fair view of the Group's assets and liabilities, financial position and performance. They also describe the principal risks and uncertainty factors faced by the Group. The Endorsement and Statement by the Board of Directors and Chief Executive Officer provides a clear overview of developments and achievements in the Group's operations and its situation.

The Bank's management has assessed the Group's ability to continue as a going concern and it is satisfied that the Group has the resources to continue its operations. Accordingly, these consolidated financial statements have been prepared on a going concern basis. However, there are certain risk factors inherent in the Group's assets and liabilities that may hinder the ability of the Bank or its subsidiaries to continue as a going concern, as further discussed in Note 2.

The Board of Directors of the Bank and Chief Executive Officer hereby endorse the Condensed Consolidated Interim Financial Statements of NBI hf. for the six months ended 30 June 2010.

Reykjavík, 30 September 2010.

Board of Directors

Gunnar Helgi Hárdánarson

Chairman

Guðríður Ólafsdóttir

Sigríður Hrólfsdóttir

Andri Geir Arinbjarnarson

Lárentsínus Kristjánsson

Chief Executive Officer

Steinþór Pálsson

# Independent Auditors' Review Report

To the board of NBI hf.

We have reviewed the accompanying Condensed Consolidated Interim Financial Statements of NBI hf., which comprise the Endorsement and Statement by the Board of Directors and Chief Executive Officer, the Condensed Consolidated Statement of Financial Position as at 30 June 2010 and the Condensed Consolidated Income Statement, Condensed Consolidated Statement of Changes in Equity and Condensed Consolidated Statement of Cash Flows for the six month period then ended and the related notes ("the condensed consolidated interim financial information"). Management is responsible for the preparation and fair presentation of this condensed consolidated interim financial information in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU. Our responsibility is to express a conclusion on this condensed consolidated interim financial information based on our review.

## Scope of Review

We conducted our review in accordance with the International Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

## Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying Condensed Consolidated Interim Financial Statements are not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU.

## Emphasis of Matter

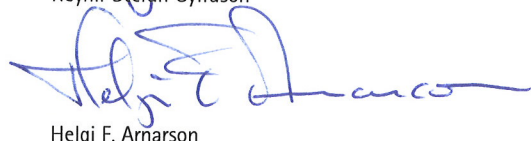
Without qualifying our opinion we draw attention to Note 2 in the Condensed Consolidated Interim Financial Statements regarding going concern. The Bank's management has assessed the Group's ability to continue as a going concern and it is satisfied that the Group has the resources to continue its operations. However, as discussed in Note 2, there are certain risk factors inherent in the Group's assets and liabilities that may hinder the ability of the Group to continue as a going concern. We also draw attention to Note 4 regarding the denomination currencies and interest rates of lease and loan agreements.

Without qualifying our opinion we also draw attention to Note 2 regarding the comparative amounts for the year 2009. According to Note 2, these Condensed Consolidated Interim Financial Statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU, with the exception that comparative amounts in the Condensed Consolidated Income Statement, Condensed Consolidated Statement of Changes in Equity, Condensed Consolidated Statement Cash Flows and related notes are for the whole year 2009. As a result comparatives for the year 2009 are not fully comparable. This results in a non-compliance with IAS 34 regarding the disclosure of comparative information in interim financial statements.

Reykjavik, 30 September 2010.

KPMG hf.

  
Reynir Stefan Gylfason

  
Helgi F. Arnarson

## Condensed Consolidated Statement of Financial Position as at 30 June 2010

| Notes              |  | 30.6.2010        | 31.12.2009       |
|--------------------|--|------------------|------------------|
| <b>Assets</b>      |  |                  |                  |
| 7                  | Cash and balances with Central Bank                            | 49,867           | 26,174           |
| 6, 8               | Bonds and debt instruments                                     | 169,160          | 165,721          |
| 6, 8               | Equities and equity instruments                                | 20,285           | 23,411           |
| 6, 9               | Derivative instruments   | 134              | 971              |
| 10                 | Loans and advances to financial institutions                   | 61,177           | 83,129           |
| 11, 28             | Loans and advances to customers                                | 624,941          | 667,122          |
|                    | Investments in associates                                      | 3,068            | 2,945            |
|                    | Property and equipment   | 5,501            | 6,030            |
|                    | Intangible assets  | 1,018            | 1,058            |
|                    | Deferred tax assets  | 4,570            | 6,682            |
|                    | Other assets   | 16,049           | 13,980           |
|                    |  | <b>955,771</b>   | <b>997,223</b>   |
| 12                 | Assets classified as held for sale                             | 131,470          | 63,878           |
|                    | <b>Total assets</b>  | <b>1,087,241</b> | <b>1,061,101</b> |
| <b>Liabilities</b> |  |                  |                  |
| 13                 | Due to financial institutions and Central Bank                 | 144,272          | 98,228           |
| 14                 | Deposits from customers  | 379,721          | 452,655          |
| 6, 9               | Derivative instruments and short positions                     | 10,119           | 5,943            |
|                    | Tax liabilities  | 494              | 83               |
| 15                 | Borrowings   | 290,343          | 306,493          |
| 6, 16              | Contingent bond  | 17,600           | 10,241           |
|                    | Other liabilities  | 11,981           | 8,177            |
|                    |  | <b>854,529</b>   | <b>881,820</b>   |
|                    | Liabilities associated with assets classified as held for sale | 65,715           | 21,689           |
|                    | <b>Total liabilities</b>                                       | <b>920,244</b>   | <b>903,509</b>   |
| <b>Equity</b>      |  |                  |                  |
|                    | Share capital  | 24,000           | 24,000           |
|                    | Share premium  | 123,898          | 123,898          |
|                    | Statutory reserve  | 741              | 741              |
|                    | Retained earnings  | 16,197           | 6,791            |
|                    | <b>Total equity attributable to owners of the Bank</b>         | <b>164,836</b>   | <b>155,430</b>   |
|                    | Non-controlling interests                                      | 2,161            | 2,162            |
|                    | <b>Total equity</b>  | <b>166,997</b>   | <b>157,592</b>   |
|                    | <b>Total liabilities and equity</b>                            | <b>1,087,241</b> | <b>1,061,101</b> |

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

## Condensed Consolidated Income Statement for the six months ended 30 June 2010

|  |   | 2010           | 2010          | 2009          |
|--|---|----------------|---------------|---------------|
| Notes  |   | 1.4-30.6       | 1.1-30.6      | 1.1-31.12     |
|  | Interest income   | 25,614         | 45,910        | 105,248       |
|  | Interest expense  | (17,044)       | (27,928)      | (77,143)      |
| 17   | <b>Net interest income</b>  | <b>8,570</b>   | <b>17,982</b> | <b>28,105</b> |
| 18, 39   | Net impairment loss on loans and advances                                       | (1,275)        | (3,949)       | (6,577)       |
|  | <b>Net interest income less net impairment loss on loans and advances</b>       | <b>7,295</b>   | <b>14,033</b> | <b>21,528</b> |
|  | Fee and commission income   | 1,454          | 2,970         | 6,835         |
|  | Fee and commission expense  | (721)          | (1,342)       | (2,622)       |
| 19   | <b>Net fee and commission income</b>  | <b>733</b>     | <b>1,628</b>  | <b>4,213</b>  |
| 6,20,22  | Net gain on financial assets designated as at fair value through profit or loss | 512            | 1,090         | 4,020         |
| 6,21,22  | Net (loss) gain on financial assets and liabilities held for trading            | (40)           | 979           | 3,062         |
| 23   | Net foreign exchange gain (loss)  | 3,836          | 9,147         | (3,000)       |
| 24   | Other income and expenses   | (337)          | (208)         | 902           |
|  | <b>Other net operating income</b>   | <b>3,971</b>   | <b>11,008</b> | <b>4,984</b>  |
|  | <b>Total operating income</b>   | <b>11,999</b>  | <b>26,669</b> | <b>30,725</b> |
| 25   | Salaries and related expenses   | 2,198          | 4,416         | 8,468         |
|  | Other administrative expenses   | 1,971          | 3,441         | 6,064         |
|  | Depreciation and amortisation   | 329            | 656           | 1,278         |
| 26   | Acquisition-related costs   | 484            | 484           | 1,044         |
|  | <b>Total operating expenses</b>   | <b>4,982</b>   | <b>8,996</b>  | <b>16,854</b> |
|  | Share of profit of associates, net of income tax                                | 130            | 132           | 383           |
| 4  | Loss from foreign currency linkage of loans and advances to customers           | (8,251)        | (8,251)       | -             |
|  | <b>(Loss) profit before income tax</b>  | <b>(1,104)</b> | <b>9,553</b>  | <b>14,254</b> |
|  | Income tax  | (871)          | (2,911)       | (615)         |
|  | <b>(Loss) profit for the period from continuing operations</b>                  | <b>(1,975)</b> | <b>6,642</b>  | <b>13,639</b> |
|  | Profit for the period from discontinued operations, net of income tax           | 3,046          | 2,762         | 693           |
|  | <b>Profit for the period</b>  | <b>1,071</b>   | <b>9,405</b>  | <b>14,332</b> |
| <b>Profit (loss) for the period attributable to:</b> |   |                |               |               |
| <b>Owners of the Bank</b>                            |   |                |               |               |
|  | (Loss) profit for the period from continuing operations                         | (1,978)        | 6,642         | 13,639        |
|  | Profit for the period from discontinued operations                              | 3,047          | 2,763         | 838           |
|  | <b>Profit for the period attributable to owners of the Bank</b>                 | <b>1,070</b>   | <b>9,406</b>  | <b>14,477</b> |
| <b>Non-controlling interests</b>                     |   |                |               |               |
|  | Profit for the period from continuing operations                                | -              | -             | -             |
|  | Profit (loss) for the period from discontinued operations                       | 1              | (1)           | (145)         |
|  | <b>Profit (loss) for the period attributable to non-controlling interests</b>   | <b>1</b>       | <b>(1)</b>    | <b>(145)</b>  |
|  | <b>Profit for the period</b>  | <b>1,071</b>   | <b>9,405</b>  | <b>14,332</b> |

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

## Condensed Consolidated Statement of Changes in Equity for the six months ended 30 June 2010

### Notes

|  | Attributable to owners of the Bank |                |                   |                   |                | Non-                  | Total          |
|--|------------------------------------|----------------|-------------------|-------------------|----------------|-----------------------|----------------|
|  | Share capital                      | Share premium  | Statutory reserve | Retained earnings | Total          | controlling interests |                |
| <b>Change in equity for the year 2009</b>  |                                    |                |                   |                   |                |                       |                |
| Balance at 1 January 2009  | 24,000                             | 125,898        | 0                 | (6,945)           | 142,953        | 332                   | 143,285        |
| Profit for the year  |                                    |                |                   | 14,477            | 14,477         | (145)                 | 14,332         |
| Transfer to statutory reserve  |                                    |                | 741               | (741)             | 0              |                       | 0              |
| Deemed capital distribution  |                                    | (2,000)        |                   |                   | (2,000)        |                       | (2,000)        |
| Changes in ownership interests in subsidiaries that do not result in loss of control |                                    |                |                   |                   | 0              | 1,975                 | 1,975          |
| <b>Balance at 31 December 2009</b>   | <b>24,000</b>                      | <b>123,898</b> | <b>741</b>        | <b>6,791</b>      | <b>155,430</b> | <b>2,162</b>          | <b>157,592</b> |
| <b>Change in equity for the six months ended 30 June 2010</b>                        |                                    |                |                   |                   |                |                       |                |
| Balance at 1 January 2010  | 24,000                             | 123,898        | 741               | 6,791             | 155,430        | 2,162                 | 157,593        |
| Profit for the period  |                                    |                |                   | 9,406             | 9,406          | (1)                   | 9,405          |
| <b>Balance at 30 June 2010</b>   | <b>24,000</b>                      | <b>123,898</b> | <b>741</b>        | <b>16,197</b>     | <b>164,836</b> | <b>2,161</b>          | <b>166,997</b> |

The accompanying notes are an integral part of these condensed consolidated interim financial statements.



## Condensed Consolidated Statement of Cash Flows for the six months ended 30 June 2010

|   | 2010          | 2009          |
|---|---------------|---------------|
| Notes   | 1.1–30.6      | 1.1–31.12     |
| Profit for the period   | 9,405         | 14,332        |
| Net cash from (used in) operating activities                      | 27,438        | (3,047)       |
| Net cash used in investing activities                             | (66)          | (326)         |
| Net cash from financing activities                                | 0             | 88            |
| Net change in cash and cash equivalents                           | 27,372        | (3,285)       |
| Cash and cash equivalents at the beginning of the period          | 21,166        | 22,897        |
| Effect of exchange rate changes on cash and cash equivalents held | (438)         | 1,554         |
| <b>Cash and cash equivalents at the end of the period</b>         | <b>48,100</b> | <b>21,166</b> |

### Cash and cash equivalents is specified as follow:

|    |   |               |               |
|----|---|---------------|---------------|
| 7  | Cash and unrestricted balances with Central Bank          | 44,816        | 16,538        |
| 10 | Bank accounts with financial institutions                 | 3,285         | 4,628         |
|    | <b>Cash and cash equivalents at the end of the period</b> | <b>48,100</b> | <b>21,166</b> |

### Investing and financing activities not affecting cash flows

|   |         |
|---|---------|
| Settlement of capital contribution through receipt of Icelandic government bonds  | 121,225 |
| Settlement of capital contribution through offset against provisional liability due to Landsbanki Íslands hf.             | 28,000  |
| Settlement of interest on capital contribution through offset against provisional liability due to Landsbanki Íslands hf. | 4,270   |
| Settlement of provisional liability due to Landsbanki Íslands hf. through borrowings                                      | 312,168 |

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

# Notes to the Condensed Consolidated Interim Financial Statements

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# Notes to the Condensed Consolidated Interim Financial Statements

## 1. Reporting entity

NBI hf. (hereinafter referred to as the "Bank") was founded on 7 October 2008 by the Ministry of Finance on behalf of the Icelandic State Treasury. The Bank is a limited liability company incorporated and domiciled in Iceland. The Bank operates based on Act No. 161/2002, on Financial Undertakings. The Bank has a license to operate based on Act No. 125/2008, on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances and it is supervised by the Financial Supervisory Authority of Iceland. The registered address of the Bank's office is Austurstræti 11, 155 Reykjavík. The condensed consolidated interim financial statements of the Bank for the six months ended 30 June 2010 include the Bank and its subsidiaries (together referred to as the "Group" and individually as "Group entities"). The Group's primary lines of business are corporate and retail banking, investment banking and asset management.

The issue of these condensed consolidated interim financial statements was authorised by the Board of Directors of the Bank on 30 September 2010.

## 2. Basis of preparation

### Statement of compliance

These Condensed Consolidated Interim Financial Statements for the six months ended 30 June 2010 have been prepared in accordance with International Accounting Standard (IAS) 34 *Interim Financial Reporting* as adopted by the EU, with the exception that comparative amounts in the Condensed Consolidated Income Statement, Condensed Consolidated Statement of Changes in Equity, Condensed Consolidated Statement Cash Flows and related notes are for the whole year 2009. As a result comparatives for the year 2009 are not fully comparable.

These Condensed Consolidated Interim Financial Statements do not include all the information required for full annual financial statements and should be read in conjunction with the Consolidated Financial Statements of the Group as at and for the year ended 31 December 2009, which are available on the Bank's website [www.landsbanki.is](http://www.landsbanki.is).

### Going concern

The Bank's management has assessed the Group's ability to continue as a going concern and it is satisfied that the Group has the resources to continue its operations. Accordingly, these condensed consolidated interim financial statements have been prepared on a going concern basis. However, there are certain risk factors inherent in the Group's assets and liabilities that may hinder the ability of the Bank or its subsidiaries to continue as a going concern.

It is the view of the Bank's management that the Group is sufficiently capitalised to continue as a going concern (see further Notes 30 and 31). Of critical importance is the Group's access to funding to fulfill the maturity of existing short-term liabilities and to continue financing the Group's assets. Further information regarding the nature and extent of risks arising from the Group's financial assets and liabilities and from off-balance sheet exposures is provided in Notes 27 and 32-51.

The uncertainty about borrowers' ability to pay back their loans to the Group is rather high, due to current economic conditions in Iceland. The uncertainty regarding the currencies of denomination and interest rates of lease and loan agreements has decreased as a result of the rulings of the Supreme Court of Iceland as described in Note 4.

As described in Note 51 the Group is exposed to currency risk that may increase fluctuation in the Group's profit and loss. Due to restrictions on movement of capital between Iceland and other countries the Group has limited ability to mitigate the risk from currency fluctuations.

### Basis of measurement

The condensed consolidated interim financial statements have been prepared on a historical cost basis except for:

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

### Functional and presentation currency

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

## Notes to the Condensed Consolidated Interim Financial Statements

### 3. Accounting policies

These condensed consolidated interim financial statements have been prepared using uniform accounting policies for like transactions and other events in similar circumstances. Except as described below, the accounting policies applied by the Group in these condensed consolidated interim financial statements are the same as those applied by the Group in its consolidated financial statements as at and for the year ended 31 December 2009. The accounting policies applied have been applied consistently to all periods presented.

#### Changes in accounting policies

The Group has changed in the current interim period the presentation of net foreign exchange differences arising from OTC currency options, which the Bank has bought to economically hedge its foreign currency imbalance. The net foreign exchange difference is now presented in the line item "Net foreign exchange gain (loss)" in the income statement but it was previously included in the line item "Net (loss) gain on financial assets and liabilities held for trading". The comparison amounts for the year 2009 in the income statement have been adjusted retrospectively in accordance with the new presentation as follows:

- "Net (loss) gain on financial assets and liabilities held for trading" increased by ISK 186 million;
- "Net foreign exchange gain (loss)" decreased by ISK 186 million.

### 4. Estimates and judgements

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

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

In preparing these condensed consolidated interim financial statements, the significant judgements made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at and for the year ended 31 December 2009, except for the following:

#### Denomination currencies and interest rates of lease and loan agreements

On 16 June 2010 the Supreme Court of Iceland ruled in two separate cases that the foreign currency linked lease agreements that were under dispute were in fact loan agreements which fall under the scope of law 38/2001 on interest and indexation. The Supreme Court ruled that the agreements are in fact obligations in Icelandic Krona which are indexed to foreign currencies, which is not permitted by the law. Accordingly, the Supreme Court ruled that the foreign currency provisions of those lease agreements are unbinding. In addition, on 16 September 2010 the Supreme Court ruled that the interest rate applicable to the agreement is the same as the interest rate published by the Central Bank of Iceland based on the lowest interest rates on new unindexed loans offered by commercial banks in Iceland.

#### (a) Change in accounting estimates

Based on these rulings of the Supreme Court and on the guidelines from the Financial Supervisory Authority in Iceland (FME), the Group has changed the accounting for certain types of foreign currency linked lease agreements and for foreign currency linked loan agreements. Accordingly, starting from 16 June 2010, the Group accounts for these agreements as denominated in Icelandic Krona (ISK) bearing from inception the lowest interest rates on unindexed ISK denominated loans as published by the Central Bank of Iceland. Previous to 16 June 2010, the Group accounted for these agreements as loans and receivables from customers denominated in foreign currencies, whereby the Group estimated their cash flows, among other things, based on their contractual interest rates in foreign currencies. The change in the accounting for these agreements has led to a decrease in their carrying amount in the consolidated statement of financial position as at 16 June 2010 from ISK 48,556 million to ISK 45,773 million. The decrease of ISK 2,783 million is accounted for as a change in accounting estimate and it is recognised in the condensed consolidated income statement of the current interim period in the line item „Loss from foreign currency linkage of loans and advances to customers“.

#### (b) Provision for excess payments

The Group has recognised in the current interim period a provision in the amount of ISK 5,468 million in respect of those lease and loan agreements for which the Group changed its accounting as described in (a) above. The provision is a liability of the Group arising from the legal obligation of the Group to repay the cash it received from customers in excess of the payments that they should have paid based on the rulings of the Supreme Court. The liability is recognised based on currently effective law, which does not allow the Group to offset the excess payments against the outstanding balances of lease or loan agreements with the corresponding counterparty. However, the Government of Iceland has publicly announced its intention to submit a new bill for the vote of the Parliament of Iceland whereby the offset of the excess payments against the outstanding balances of lease or loan agreements will be permitted. The provision is recognised in the condensed consolidated statement of financial position as at 30 June 2010 among „Other liabilities“ and it is measured at the amount that represents the management's best estimate of the expenditure required to settle the obligation as at 30 June 2010 based on the rulings of the Supreme Court of Iceland. However, the amount and timing of the payments that the Group will ultimately have to settle is uncertain as the claims may be subject to further legal processes, for example as some individuals may challenge whether the interest rate ruling by the Supreme Court ruling on 16 September 2010 is also applicable to mortgage loans. The Group has recognised the amount of the provision as an expense in the condensed consolidated income statement in the line item „Loss from foreign currency linkage of loans and advances to customers“.

## Notes to the Condensed Consolidated Interim Financial Statements

### 4. Estimates and judgements (continued)

#### (c) Estimation uncertainty

As described above, certain types of foreign currency linked lease agreement and foreign currency linked loan agreements are accounted for as being denominated in Icelandic Krona (ISK) and bearing unindexed ISK interest rates while other types are accounted for as being denominated in foreign currencies, bearing interest rates in the respective foreign currencies. The accounting treatment of the lease and loan agreements is based on the latest available information. Therefore, future legal processes and possible government actions may lead to different conclusions, which could lead to material adjustments to the carrying amounts of the assets and liabilities within the next financial year.

The carrying amount of agreements for which the foreign currency feature raises some uncertainty about the currency of denomination and which continue to be accounted for by the Group as agreements denominated in foreign currencies amounted to ISK 254,624 million as at 30 June 2010. The Bank's management has estimated that in the unlikely event that all these agreements are considered to be ISK loans bearing from inception floating unindexed interest rate as published by the Central Bank of Iceland, it would lead to a decrease in their carrying amount by ISK 8,631 million as at 30 June 2010, with an equivalent before tax negative effect on profit and loss. In addition, the Bank's management has estimated that the Group would have to repay additional excess payments in the amount of ISK 15,750 million, which the Group would need to expense in profit and loss.

These changes would lead to a decrease in the Group's capital adequacy ratio from 16.7% to 13.4% as at 30 June 2010. The Group would satisfy the 8% legal minimum capital ratio, but it would fall short of the current capital requirement of 16% set by the FME. The additional excess payments would decrease the liquidity ratio of the Group from 41% to 38% as at 30 June 2010 and it would not cause the Bank to breach the liquidity requirement.

The Group might also be required by court of law in the future to pay damages due to losses incurred by clients which can be proven to have been directly caused by foreign currency linkage of lease and loan agreements of the Group. The Group has not recognised any liability in its consolidated financial statements in respect of such payments because it has yet to be confirmed whether the Group has a present obligation that could lead to an outflow of resources embodying economic benefits.

The Bank's management expects the Supreme Court of Iceland to rule on most of the legal issues surrounding foreign currency linked lease and loans agreements during the years 2010 and 2011.

#### (d) Nature and extent of financial risks arising from lease and loan agreements

The changes in the currencies and interest rates of lease and loan agreements as described in (a) above have resulted in changes in the nature and extent of financial risks arising from those agreements since they were disclosed in the consolidated financial statements for the year 2009. In particular, the change in respect of the denomination currency of those agreements has affected the extent of currency risk disclosed by the Group. This is because previously to the change, the agreements were disclosed as financial assets denominated in foreign currencies but after the change they are no longer included in the disclosure of concentration of currency risk. The carrying amount of the agreements was specified as follows immediately prior to the change on 16 June 2010:

|                 | EUR   | GBP | USD   | JPY    | CHF    | Other | Total  |
|-----------------|-------|-----|-------|--------|--------|-------|--------|
| Carrying amount | 5,956 | 39  | 2,842 | 21,470 | 17,959 | 290   | 48,556 |

In respect of interest rate risk arising from these agreements, the change in respect of interest rates has led to a change in the nature of interest rate risk disclosed, from interest rates in foreign currencies to interest rates on unindexed Icelandic Krona denominated loans as published by the Central Bank of Iceland. However, this change does not affect the total interest repricing gap as disclosed in Note 48.

The financial risk disclosures made in these consolidated interim financial statements are based on the assumptions about the denomination currencies and interest rates of lease and loan agreements as described in this note. The resolution of the uncertainties surrounding these agreements could have a significant impact on the nature and extent of the financial risks arising from these agreements.

### 5. Operating segments

On 26 August 2010 the CEO of the Bank presented a new organisational chart for the Group which will be formally effective from 2 October 2010. Management of the Bank has already started the implementation of the necessary changes of the infrastructure in order to have the Group fully operational in line with the new organisational chart from 1 January 2011.

The organisational chart is structured around eight main divisions. Commercial and profit-generating units are given increased prominence, comprising of five units: Retail Banking, Corporate Banking, Treasury & Markets, Asset Management and Asset Restructuring, the last of which is a new division. This change is intended to sharpen the Group's focus and improve its services to customers.

The other three main divisions are Risk Management, Finance and a new unit titled Corporate Development. These divisions function as support units for the commercial and profit-generating division.

The positions of managing director for all eight divisions have been advertised for application. The CEO and Board of Directors of the Bank place great emphasis on ensuring that the new executives have the full trust of both employees and customers.

Other key units in the Group's organisational structure are Internal Audit, which reports directly to the Board of Directors of the Bank, Customer Ombudsman, Compliance and Legal Advisory, in addition to the CEO's Office.

From the foundation of the Bank on 7 October 2008, the financial information available for evaluation by management in deciding how to allocate resources and assess performance is that of the business as a whole. For this reason the Group had a single reportable segment during the period from 1 January 2010 to 30 June 2010.

## Notes to the Condensed Consolidated Interim Financial Statements

### Notes to the Condensed Consolidated Statement of Financial Position

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

According to IAS 39, financial assets and liabilities are classified into specific categories which affect how they are measured after initial recognition. Each category's basis of subsequent measurement is specified below:

- Loans and receivables, measured at amortised cost;
- Financial assets and liabilities held for trading, measured at fair value;
- Financial assets designated as at fair value through profit or loss, measured at fair value;
- Other financial liabilities, measured at amortised cost.

The following table shows the classification of the Group's financial assets and liabilities according to IAS 39 and their fair values as at 30 June 2010:

|  | Loans and<br>receivables | Held for<br>trading | Designated<br>as at fair<br>value | Liabilities at<br>amortised<br>cost | Other<br>liabilities at<br>fair value* | Total<br>carrying<br>amount | Fair value     |
|--|--------------------------|---------------------|-----------------------------------|-------------------------------------|--|-----------------------------|----------------|
| <b>Financial assets</b>                      |                          |                     |                                   |                                     |  |                             |                |
| Cash and balances with Central Bank          | 49,867                   | -                   | -                                 | -                                   | -                                      | 49,867                      | 49,867         |
| Bonds and debt instruments                   | 100,408                  | 42,112              | 26,639                            | -                                   | -                                      | 169,160                     | 169,160        |
| Equities and equity instruments              | -                        | 1,217               | 19,068                            | -                                   | -                                      | 20,285                      | 20,285         |
| Derivative instruments                       | -                        | 134                 | -                                 | -                                   | -                                      | 134                         | 134            |
| Loans and advances to financial institutions | 61,177                   | -                   | -                                 | -                                   | -                                      | 61,177                      | 61,177         |
| Loans and advances to customers              | 624,941                  | -                   | -                                 | -                                   | -                                      | 624,941                     | 643,276        |
| Other financial assets                       | 7,593                    | -                   | -                                 | -                                   | -                                      | 7,593                       | 7,593          |
| <b>Total</b>                                 | <b>843,986</b>           | <b>43,463</b>       | <b>45,707</b>                     | <b>0</b>                            | <b>0</b>                               | <b>933,157</b>              | <b>951,492</b> |

#### Financial liabilities

|  |          |               |          |                |               |                |                |
|--|----------|---------------|----------|----------------|---------------|----------------|----------------|
| Due to financial institutions and Central Bank | -        | -             | -        | 144,272        | -             | 144,272        | 144,272        |
| Deposits from customers                        | -        | -             | -        | 379,721        | -             | 379,721        | 379,721        |
| Derivative instruments and short positions     | -        | 10,119        | -        | -              | -             | 10,119         | 10,119         |
| Borrowings                                     | -        | -             | -        | 290,343        | -             | 290,343        | 290,343        |
| Contingent bond                                | -        | -             | -        | -              | 17,600        | 17,600         | 17,600         |
| Other financial liabilities                    | -        | -             | -        | 3,003          | -             | 3,003          | 3,003          |
| <b>Total</b>                                   | <b>0</b> | <b>10,119</b> | <b>0</b> | <b>817,339</b> | <b>17,600</b> | <b>845,057</b> | <b>845,057</b> |

\* The contingent bond was recognised in the year 2009 as part of the settlement for the assets acquired and liabilities assumed from Landsbanki Islands hf. The bond is a financial liability which the Group is required to measure at fair value in accordance with IFRS 3 (2008), with any resulting gain or loss to be recognised in income statement.

The following table shows the classification of the Group's financial assets and liabilities according to IAS 39 and their fair values as at 31 December 2009:

|  | Loans and<br>receivables | Held for<br>trading | Designated<br>as at fair<br>value | Liabilities at<br>amortised<br>cost | Other<br>liabilities at<br>fair value | Total<br>carrying<br>amount | Fair value     |
|--|--------------------------|---------------------|-----------------------------------|-------------------------------------|---------------------------------------|-----------------------------|----------------|
| <b>Financial assets</b>                      |                          |                     |                                   |                                     |                                       |                             |                |
| Cash and balances with Central Bank          | 26,174                   | -                   | -                                 | -                                   | -                                     | 26,174                      | 26,174         |
| Bonds and debt instruments                   | 100,661                  | 32,305              | 32,755                            | -                                   | -                                     | 165,721                     | 165,721        |
| Equities and equity instruments              | -                        | 1,615               | 21,796                            | -                                   | -                                     | 23,411                      | 23,411         |
| Derivative instruments                       | -                        | 971                 | -                                 | -                                   | -                                     | 971                         | 971            |
| Loans and advances to financial institutions | 83,129                   | -                   | -                                 | -                                   | -                                     | 83,129                      | 83,129         |
| Loans and advances to customers              | 667,122                  | -                   | -                                 | -                                   | -                                     | 667,122                     | 684,118        |
| Other financial assets                       | 6,990                    | -                   | -                                 | -                                   | -                                     | 6,990                       | 6,990          |
| <b>Total</b>                                 | <b>884,076</b>           | <b>34,891</b>       | <b>54,551</b>                     | <b>-</b>                            | <b>-</b>                              | <b>973,518</b>              | <b>990,514</b> |

#### Financial liabilities

|  |          |              |          |                |               |                |                |
|--|----------|--------------|----------|----------------|---------------|----------------|----------------|
| Due to financial institutions and Central Bank | -        | -            | -        | 98,228         | -             | 98,228         | 98,228         |
| Deposits from customers                        | -        | -            | -        | 452,655        | -             | 452,655        | 452,655        |
| Derivative instruments and short positions     | -        | 5,943        | -        | -              | -             | 5,943          | 5,943          |
| Borrowings                                     | -        | -            | -        | 306,493        | -             | 306,493        | 306,493        |
| Contingent bond                                | -        | -            | -        | -              | 10,241        | 10,241         | 10,241         |
| Other financial liabilities                    | -        | -            | -        | 2,138          | -             | 2,138          | 2,138          |
| <b>Total</b>                                   | <b>-</b> | <b>5,943</b> | <b>-</b> | <b>859,514</b> | <b>10,241</b> | <b>875,698</b> | <b>875,698</b> |

## Notes to the Condensed Consolidated Interim Financial Statements

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

The fair value of financial assets and liabilities was determined based on the same valuation methods as those described in the Group's consolidated financial statements as at and for the year ended 31 December 2009.

#### Fair value hierarchy

The Group has used a valuation hierarchy for disclosure of inputs to valuation used to measure fair value. This hierarchy prioritises the inputs into three broad levels as follows:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: Valuation technique using observable inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3: Valuation technique with significant unobservable inputs for the asset or liability that are not based on observable market data (unobservable inputs). Level 3 includes all instruments that are valued according to quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect the differences between instruments.

A financial assets or liability's classifications within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities, carried at fair value in the condensed consolidated statement of financial position, are categorised as at 30 June 2010:

| <b>Financial assets</b>         | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b>  |
|---------------------------------|----------------|----------------|----------------|---------------|
| Bonds and debt instruments      | 18,748         | 27,602         | 22,402         | 68,752        |
| Equities and equity instruments | 4,800          | 12,473         | 3,012          | 20,285        |
| Derivative instruments          | -              | 134            | -              | 134           |
| <b>Total</b>                    | <b>23,548</b>  | <b>40,209</b>  | <b>25,414</b>  | <b>89,171</b> |
| <b>Financial liabilities</b>    |                |                |                |               |
| Derivative instruments          | -              | 2,337          | -              | 2,337         |
| Short positions                 | 7,782          | -              | -              | 7,782         |
| Contingent bond                 | -              | -              | 17,600         | 17,600        |
| <b>Total</b>                    | <b>7,782</b>   | <b>2,337</b>   | <b>17,600</b>  | <b>27,718</b> |

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities, carried at fair value in the condensed consolidated statement of financial position, are categorised as at 31 December 2009:

| <b>Financial assets</b>         | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b>  |
|---------------------------------|----------------|----------------|----------------|---------------|
| Bonds and debt instruments      | 6,303          | 21,386         | 37,371         | 65,060        |
| Equities and equity instruments | 6,154          | 13,702         | 3,555          | 23,411        |
| Derivative instruments          | -              | 971            | -              | 971           |
| <b>Total</b>                    | <b>12,457</b>  | <b>36,059</b>  | <b>40,926</b>  | <b>89,442</b> |
| <b>Financial liabilities</b>    |                |                |                |               |
| Derivative instruments          | -              | 675            | -              | 675           |
| Short positions                 | 5,268          | -              | -              | 5,268         |
| Contingent bond                 | -              | -              | 10,241         | 10,241        |
| <b>Total</b>                    | <b>5,268</b>   | <b>675</b>     | <b>10,241</b>  | <b>16,184</b> |

During the period from 1 January to 30 June 2010 there were no transfers into Level 1. Financial assets and liabilities were transferred into Level 2 from Level 3 because significant inputs used in their fair value measurement became observable during the period from 1 January to 30 June 2010, such as market prices or rates.

The fair value of financial assets and liabilities classified within Level 3 was determined based on the same assumptions as those described in the Group's consolidated financial statements as at and for the year ended 31 December 2009.

## Notes to the Condensed Consolidated Interim Financial Statements

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

The following tables show the reconciliation for fair value measurement in Level 3 for the six months ended 30 June 2010 and for the year 2009:

|   | Bonds and<br>debt<br>instruments | Equities and<br>equity<br>instruments | Total<br>financial<br>assets | Contingent<br>bond |
|---|----------------------------------|---------------------------------------|------------------------------|--------------------|
| <b>Six months ended 30 June 2010</b>                |                                  |                                       |                              |                    |
| Carrying amount at 1 January 2010                   | 37,371                           | 3,555                                 | 40,926                       | (10,241)           |
| Total losses recognised in income statement         | (885)                            | (113)                                 | (997)                        | (7,359)            |
| Purchases   | 1,244                            | 113                                   | 1,357                        | -                  |
| Sales   | -                                | (530)                                 | (530)                        | -                  |
| Settlements   | (10,125)                         | -                                     | (10,125)                     | -                  |
| Transfers into Level 3                              | 375                              | -                                     | 375                          | -                  |
| Transfers out of Level 3                            | (5,578)                          | (14)                                  | (5,592)                      | -                  |
| <b>Carrying amount at 30 June 2010</b>              | <b>22,402</b>                    | <b>3,012</b>                          | <b>25,414</b>                | <b>(17,600)</b>    |
| <b>1 January – 31 December 2009</b>                 |                                  |                                       |                              |                    |
| Carrying amount at 1 January 2009                   | 26,746                           | 5,007                                 | 31,753                       | -                  |
| Total gains (losses) recognised in income statement | 8,572                            | 202                                   | 8,774                        | (10,241)           |
| Purchases   | 20,313                           | 3,144                                 | 23,457                       | -                  |
| Sales   | (17,000)                         | (5,361)                               | (22,361)                     | -                  |
| Settlements   | (1,697)                          | -                                     | (1,697)                      | -                  |
| Transfers into Level 3                              | 962                              | 563                                   | 1,525                        | -                  |
| Transfers out of Level 3                            | (525)                            | -                                     | (525)                        | -                  |
| <b>Carrying amount at 31 December 2009</b>          | <b>37,371</b>                    | <b>3,555</b>                          | <b>40,926</b>                | <b>(10,241)</b>    |

The following tables show the line items in the condensed consolidated income statement where the total gains (losses) were recognised during the six months ended 30 June 2010 and during the year 2009, for fair value measurements in Level 3:

|   | Bonds and<br>debt<br>instruments | Equities and<br>equity<br>instruments | Contingent<br>bond | Total          |
|---|----------------------------------|---------------------------------------|--------------------|----------------|
| <b>Six months ended 30 June 2010</b>  |                                  |                                       |                    |                |
| Interest expense  | -                                | -                                     | (7,359)            | (7,359)        |
| Net gain on financial assets designated as at fair value through profit or loss | 722                              | -                                     | -                  | 722            |
| Net foreign exchange gain (loss)  | (1,606)                          | (113)                                 | -                  | (1,719)        |
| <b>Total</b>  | <b>(885)</b>                     | <b>(113)</b>                          | <b>(7,359)</b>     | <b>(8,356)</b> |
| <b>1 January – 31 December 2009</b>   |                                  |                                       |                    |                |
| Interest expense  | -                                | -                                     | (10,241)           | (10,241)       |
| Net gain on financial assets designated as at fair value through profit or loss | 7,733                            | 174                                   | -                  | 7,907          |
| Net (loss) gain on financial assets and liabilities held for trading            | 665                              | 28                                    | -                  | 693            |
| Net foreign exchange gain (loss)  | 174                              | -                                     | -                  | 174            |
| <b>Total</b>  | <b>8,572</b>                     | <b>202</b>                            | <b>(10,241)</b>    | <b>(1,467)</b> |

The following table shows the line items in the condensed consolidated income statement where gains (losses), relating only to financial assets and liabilities held by the Group at 30 June 2010 and categorised in Level 3, were recognised:

|   | Bonds and<br>debt<br>instruments | Equities and<br>equity<br>instruments | Contingent<br>bond | Total          |
|---|----------------------------------|---------------------------------------|--------------------|----------------|
| Interest expense  | -                                | -                                     | (7,359)            | (7,359)        |
| Net gain on financial assets designated as at fair value through profit or loss | (841)                            | -                                     | -                  | (841)          |
| Net foreign exchange gain (loss)  | (1,619)                          | (113)                                 | -                  | (1,731)        |
| <b>Total</b>  | <b>(2,459)</b>                   | <b>(113)</b>                          | <b>(7,359)</b>     | <b>(9,931)</b> |



## Notes to the Condensed Consolidated Interim Financial Statements

### 7. Cash and balances with Central Bank

|   | 30.6.2010     | 31.12.2009    |
|---|---------------|---------------|
| Cash on hand  | 2,276         | 1,506         |
| Reverse repurchase agreements with Central Bank               | 38,603        | -             |
| Unrestricted balances with Central Bank                       | 3,936         | 15,032        |
| <b>Total cash and unrestricted balances with Central Bank</b> | <b>44,816</b> | <b>16,538</b> |
| Restricted balances with Central Bank                         | 5,051         | 9,636         |
| <b>Total cash and balances with Central Bank</b>              | <b>49,867</b> | <b>26,174</b> |

The Group has entered into short-term reverse repurchase agreements with the Central Bank of Iceland according to which the Group acquired certificates of deposit issued by the Central Bank and committed to resell the certificates to the Central Bank at a fixed price at the end of the contractual period. The Group does not recognise the certificates of deposit as its assets because the Group does not bear substantially all the risks and rewards of ownership of the certificates. However, the Group derecognised the cash transferred to the Central Bank and recognised a receivable from the Central Bank, along with accrued interest.

The Bank holds a mandatory reserve deposit account with the Central Bank of Iceland. The average balance of this account for each month must be equivalent to at least mandatory reserve deposits which amounted to ISK 7,402 for June 2010. Any excess balance is available for use by the Group. Other cash and balances with the Central Bank are available for the Group's immediate use.

### 8. Bonds and equities

|  | 30.6.2010             |                  |                             |                | 31.12.2009            |                  |                             |                |
|--|-----------------------|------------------|-----------------------------|----------------|-----------------------|------------------|-----------------------------|----------------|
|  | Loans and receivables | Held for trading | Designated as at fair value | Total          | Loans and receivables | Held for trading | Designated as at fair value | Total          |
| <b>Bonds and debt instruments</b>            |                       |                  |                             |                |                       |                  |                             |                |
| <b>Domestic</b>                              |                       |                  |                             |                |                       |                  |                             |                |
| Listed                                       | 100,408               | 32,123           | 5,893                       | 138,425        | -                     | 10,953           | 9,272                       | 20,225         |
| Unlisted                                     | -                     | -                | 17,282                      | 17,282         | 100,661               | 21,352           | 17,761                      | 139,774        |
|  | <b>100,408</b>        | <b>32,123</b>    | <b>23,175</b>               | <b>155,707</b> | <b>100,661</b>        | <b>32,305</b>    | <b>27,033</b>               | <b>159,999</b> |
| <b>Foreign</b>                               |                       |                  |                             |                |                       |                  |                             |                |
| Listed                                       | -                     | 9,989            | 1,656                       | 11,645         | -                     | -                | 3,958                       | 3,958          |
| Unlisted                                     | -                     | -                | 1,808                       | 1,808          | -                     | -                | 1,764                       | 1,764          |
|  | <b>0</b>              | <b>9,989</b>     | <b>3,464</b>                | <b>13,453</b>  | <b>0</b>              | <b>0</b>         | <b>5,722</b>                | <b>5,722</b>   |
| <b>Total bonds and debt instruments</b>      | <b>100,408</b>        | <b>42,112</b>    | <b>26,639</b>               | <b>169,160</b> | <b>100,661</b>        | <b>32,305</b>    | <b>32,755</b>               | <b>165,721</b> |
| <b>Equities and equity instruments</b>       |                       |                  |                             |                |                       |                  |                             |                |
| <b>Domestic</b>                              |                       |                  |                             |                |                       |                  |                             |                |
| Listed                                       | -                     | 355              | 9,198                       | 9,553          | -                     | 774              | 9,198                       | 9,972          |
| Unlisted                                     | -                     | -                | 2,589                       | 2,589          | -                     | -                | 2,864                       | 2,864          |
|  | <b>0</b>              | <b>355</b>       | <b>11,786</b>               | <b>12,142</b>  | <b>0</b>              | <b>774</b>       | <b>12,062</b>               | <b>12,836</b>  |
| <b>Foreign</b>                               |                       |                  |                             |                |                       |                  |                             |                |
| Listed                                       | -                     | 862              | 7,142                       | 8,004          | -                     | 841              | 9,482                       | 10,323         |
| Unlisted                                     | -                     | -                | 140                         | 140            | -                     | -                | 252                         | 252            |
|  | <b>0</b>              | <b>862</b>       | <b>7,282</b>                | <b>8,144</b>   | <b>0</b>              | <b>841</b>       | <b>9,734</b>                | <b>10,575</b>  |
| <b>Total equities and equity instruments</b> | <b>0</b>              | <b>1,217</b>     | <b>19,068</b>               | <b>20,285</b>  | <b>0</b>              | <b>1,615</b>     | <b>21,796</b>               | <b>23,411</b>  |
| <b>Total bonds and equities</b>              | <b>100,408</b>        | <b>43,329</b>    | <b>45,707</b>               | <b>189,445</b> | <b>100,661</b>        | <b>33,920</b>    | <b>54,551</b>               | <b>189,132</b> |

Bonds and equities are classified as "domestic" or "foreign" according to the country of incorporation of the issuer.

Bonds and debt instruments classified as loans and receivables as at 30 June 2010 and 31 December 2009 consist of part of the government bonds which the Bank received in settlement of the capital contribution. The bonds are listed on the OMX stock exchange in Iceland.

## Notes to the Condensed Consolidated Interim Financial Statements

### 9. Derivative instruments and short positions

|                                       | 30.6.2010       |            |               | 31.12.2009      |            |              |
|---------------------------------------|-----------------|------------|---------------|-----------------|------------|--------------|
|                                       | Notional amount | Fair value |               | Notional amount | Fair value |              |
| Foreign exchange derivatives          |                 | Assets     | Liabilities   |                 | Assets     | Liabilities  |
| Currency forwards                     | 41,991          | 27         | 1,817         | 9,323           | 262        | 1            |
| Cross-currency interest rate swaps    | 2,344           | -          | 498           | 2,415           | -          | 672          |
| OTC currency options*                 | 77,210          | 84         | -             | 59,703          | 700        | -            |
|                                       | <b>121,545</b>  | <b>111</b> | <b>2,315</b>  | <b>71,441</b>   | <b>962</b> | <b>673</b>   |
| <b>Interest rate derivatives</b>      |                 |            |               |                 |            |              |
| Interest rate swaps                   | 7,555           | 23         | 22            | 3,318           | 9          | 2            |
|                                       | <b>7,555</b>    | <b>23</b>  | <b>22</b>     | <b>3,318</b>    | <b>9</b>   | <b>2</b>     |
| <b>Short positions – listed bonds</b> | <b>-</b>        | <b>-</b>   | <b>7,782</b>  | <b>-</b>        | <b>-</b>   | <b>5,268</b> |
| <b>Total</b>                          | <b>129,100</b>  | <b>134</b> | <b>10,119</b> | <b>74,759</b>   | <b>971</b> | <b>5,943</b> |

\* The Bank has bought out-of-the-money OTC currency options to economically hedge its foreign currency imbalance against excessive adverse movements in some of the major foreign currencies. The delta of these options amounted to ISK 2,177 million at 30 June 2010 (31 December 2009: ISK 9,989 million).

### 10. Loans and advances to financial institutions

|   | 30.6.2010     | 31.12.2009    |
|---|---------------|---------------|
| Bank accounts with financial institutions | 3,285         | 4,628         |
| Money market loans                        | 37,165        | 58,488        |
| Overdrafts                                | 4,336         | 6,247         |
| Other loans                               | 18,396        | 14,493        |
| Less: Allowance for impairment            | (2,004)       | (727)         |
| <b>Total</b>                              | <b>61,177</b> | <b>83,129</b> |

### 11. Loans and advances to customers

|                                | 30.6.2010      | 31.12.2009     |
|--------------------------------|----------------|----------------|
| Public entities                | 13,308         | 10,582         |
| Individuals                    | 172,340        | 177,561        |
| Corporations                   | 449,733        | 486,739        |
| Less: Allowance for impairment | (10,440)       | (7,760)        |
| <b>Total</b>                   | <b>624,941</b> | <b>667,122</b> |

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

Further disclosures on loans and advances are provided in the financial risk management section of the notes.

## Notes to the Condensed Consolidated Interim Financial Statements

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

| Assets classified as held for sale                    | 30.6.2010      | 31.12.2009    |
|---|----------------|---------------|
| Reposessed collateral                                 | 32,520         | 27,317        |
| Assets of disposal groups classified as held for sale | 98,950         | 36,561        |
| <b>Total</b>  | <b>131,470</b> | <b>63,878</b> |

Reposessed collateral consists mainly of property and equipment resulting from collateral foreclosed by the Group as security for loans and advances. The Group's policy is to pursue timely realisation of the reposessed collateral in an orderly manner. The Group generally does not use the non-cash reposessed collateral for its own operations.

| Reposessed collateral                          | 30.6.2010     | 31.12.2009    |
|--|---------------|---------------|
| Carrying amount at the beginning of the period | 27,317        | 2,150         |
| Reposessed during the period                   | 7,114         | 27,270        |
| Disposed during the period                     | (1,911)       | (2,103)       |
| <b>Total</b>                                   | <b>32,520</b> | <b>27,317</b> |

#### Disposal groups classified as held for sale

Disposal groups classified as held for sale consist of the assets and liabilities of subsidiaries acquired by the Group exclusively with a view to resale. Because these subsidiaries meet the definition of discontinued operations in IFRS 5, the Group has presented the results of their operations as discontinued in the condensed consolidated income statement, as required by IFRS 5 and IAS 1.

On 20 August 2010, the Bank entered into a sale agreement with Framtakssjóður Íslands slhf. for the sale of all the shares in the Bank's 100% subsidiary, Vestia ehf., for a consideration of ISK 19,500 million. The sale is subject to several conditions having to be fulfilled, the most significant of which are that the due diligence to be made by the buyer before 28 October 2010 in relation to Vestia's assets and liabilities does not lead to material observations and that the Competition Authorities approve the acquisition. In the event the conditions are not met at delivery, the buyer may terminate the sale contract without any further obligations. When the conditions will be fulfilled the Bank will recognise a gain on the disposal of Vestia of approximately ISK 5,889 million, estimated based on the sale price and carrying amounts of the assets and liabilities of Vestia in these condensed consolidated interim financial statements, which amounted to ISK 90,806 million in assets classified as held for sale and ISK 52,256 million in liabilities associated with assets classified as held for sale.

As part of the sale agreement of Vestia ehf., the Bank committed to acquire a 30% interest in Framtakssjóður Íslands slhf. for ISK 18,000 million, subject to the perfection of the sale of the shares in Vestia. This amount will be callable during the years 2010-2016, as needed to fund investments by Framtakssjóður Íslands slhf. made prior to the acquisition of Vestia, due from that investment and subject to future investments being made so that the Bank remains up to 30% shareholder at all times.

### 13. Due to financial institutions and Central Bank

|   | 30.6.2010      | 31.12.2009    |
|---|----------------|---------------|
| Loans and repurchase agreements with Central Bank | 4              | 66            |
| Loans and deposits from financial institutions    | 144,268        | 98,162        |
| <b>Total</b>                                      | <b>144,272</b> | <b>98,228</b> |

### 14. Deposits from customers

|                 | 30.6.2010      | 31.12.2009     |
|-----------------|----------------|----------------|
| Demand deposits | 284,017        | 317,330        |
| Time deposits   | 95,704         | 135,325        |
| <b>Total</b>    | <b>379,721</b> | <b>452,655</b> |

## Notes to the Condensed Consolidated Interim Financial Statements

### 15. Borrowings

|                      | Foreign<br>currency | Nominal amount |                | Contractual<br>interest rate (%) | Carrying amount |                |
|----------------------|---------------------|----------------|----------------|----------------------------------|-----------------|----------------|
|                      |                     | ISK            | ISK            |                                  | ISK             | ISK            |
| Senior secured bonds |                     | 30.6.2010      | 31.12.2009     |                                  | 30.6.2010       | 31.12.2009     |
| EUR                  |                     | 136,486        | 156,519        | EURIBOR + 1.75/2.90              | 140,722         | 158,573        |
| GBP                  | 871 million         | 52,456         | 55,316         | LIBOR + 1.75/2.90                | 54,106          | 56,086         |
| USD                  | 275 million         | 93,658         | 91,456         | LIBOR + 1.75/2.90                | 95,516          | 91,834         |
| <b>Total</b>         | 734 million         | <b>282,600</b> | <b>303,291</b> |                                  | <b>290,343</b>  | <b>306,493</b> |

The senior secured bonds mature in October 2018 and do not have installment payments during the first 5 years. The interest rates are 3 months EURIBOR for the EUR-denominated bond and 3 months LIBOR for the GBP and USD-denominated bonds, plus a margin of 1.75% for the first 5 years and a margin of 2.90% for the remaining 5 years. The first interest payment date is at the time when the Bank will formally issue the bonds, subject to finalising the pledge agreement (see note 28). The Bank expects discussions on the Pledge Agreement will be completed in Q4 2010. On or after 30 June 2010, bondholders have the right to require the Bank to convert the bonds into Eurobonds. Upon such conversion, the Bank will make reasonable endeavors to list such Eurobonds on a qualified stock exchange, as soon as feasible following conversion.

The Group did not default on any principal and interest nor breached any covenants with respect to liabilities during the reporting period.

### 16. Contingent bond

According to the provisions of the settlement agreement signed on 15 December 2009, the Bank might have to issue to Landsbanki Íslands hf. a bond on 31 March 2013 as an additional consideration for the assets and liabilities transferred from Landsbanki Íslands hf. on 9 October 2008. The contingent bond can have a nominal amount of up to ISK 92 billion, with the amount being contingent on whether the value of certain pools of assets, to be determined as at 31 December 2012, exceeds the future value of the acquisition price of those assets agreed for as at 9 October 2008, subject to specified adjustments. The value will be determined by a third-party valuation agent based on agreed-upon valuation procedures. The additional value at year-end 2012 that might exceed the future value of the 2008 acquisition price would be divided between Landsbanki Íslands hf., which would be assigned 85% (though no higher than ISK 92 billion) and the Bank, 15%. If issued, this bond would be denominated in EUR or such other currencies as may be agreed between the Bank and Landsbanki Íslands hf., whereby the ISK nominal amount would be converted into EUR using the exchange rate at 31 December 2012. The bond would bear floating interest rate and it would mature in October 2018 with quarterly instalments starting in 2014.

The contingent obligation of the Bank is classified as a financial liability and measured initially at fair value. Subsequently, it is measured at fair value, with any resulting gain or loss recognised in the line item "Interest expense" in the condensed consolidated income statement.

#### Pro forma information

It is the view of the management of the Bank that the fair value changes of the contingent bond should be accounted for as a dividend to shareholders rather than interest expense as reported in the Group's income statement according to IAS 34 (see Note 17). It is management believe that it gives a better view to eliminate the fair value change in the contingent bond when analysing the Group's performance.

|  | As reported according to<br>IAS 34 as at 30 June 2010 | Non-IFRS<br>adjustment | Pro forma<br>information |
|--|---|------------------------|--------------------------|
| Net interest income (see Note 17)  | 17,982  | 7,359                  | 25,340                   |
| Profit after income tax  | 9,405   | 6,034                  | 15,439                   |
| Interest spread (see Note 18)  | 2.6%  |                        | 4.0%                     |
| Return on equity (as the annualised ratio of profit for the period to total equity as at 1 January 2010) | 11.9%   |                        | 19.6%                    |

## Notes to the Condensed Consolidated Interim Financial Statements

### Notes to the Condensed Consolidated Income Statement

#### 17. Net interest income

|  | 2010<br>1.4–30.6 | 2010<br>1.1–30.6 | 2009<br>1.1–31.12 |
|--|------------------|------------------|-------------------|
| <b>Interest income</b>   |                  |                  |                   |
| Cash and balances with Central Bank                            | 1,061            | 1,808            | 3,344             |
| Bonds and debt instruments classified as loans and receivables | 1,838            | 3,795            | -                 |
| Loans and advances to financial institutions                   | 465              | 944              | 1,749             |
| Loans and advances to customers                                | 14,219           | 27,718           | 58,518            |
| Net adjustments to the carrying amount of loans and advances*  | 8,018            | 11,619           | 23,772            |
| Unpaid capital contribution                                    | -                | -                | 17,796            |
| Other interest income  | 14               | 26               | 69                |
| <b>Total</b>   | <b>25,615</b>    | <b>45,910</b>    | <b>105,248</b>    |
| <b>Interest expense</b>  |                  |                  |                   |
| Due to financial institutions and Central Bank                 | (1,450)          | (2,656)          | (10,243)          |
| Deposits from customers  | (5,829)          | (12,193)         | (43,005)          |
| Provisional liability due to Landsbanki Íslands hf.            | -                | -                | (13,148)          |
| Borrowings   | (3,134)          | (5,660)          | (445)             |
| Fair value change of contingent bond                           | (6,576)          | (7,359)          | (10,241)          |
| Other interest expense   | (56)             | (61)             | (61)              |
| <b>Total</b>   | <b>(17,044)</b>  | <b>(27,928)</b>  | <b>(77,143)</b>   |
| <b>Net interest income</b>                                     | <b>8,571</b>     | <b>17,982</b>    | <b>28,105</b>     |

\* Net adjustments to the carrying amount of loans and advances consist of adjustments to reflect actual and revised estimated cash flows.

Interest spread (as the annualised ratio of net interest income to the average carrying amount of total assets during the period)

3.1% 3.3% 2.8%

Interest income accrued on impaired financial assets during the period from 1 January to 30 June 2010 amounted to ISK 59 million (1.1–31.12.2009: ISK 124 million).

Total interest income recognised during the period from 1 January to 30 June 2010 in respect of financial assets not carried at fair value through profit or loss amounts to ISK 45,910 million (1.1–31.12.2009: ISK 87,452 million). Total interest expense recognised during the period in respect of financial liabilities not carried at fair value through profit or loss amounts to ISK 20,569 million (1.1–31.12.2009: ISK 66,902 million).

#### 18. Net interest income less net impairment loss on loans and advances

|  | 2010<br>1.4–30.6 | 2010<br>1.1–30.6 | 2009<br>1.1–31.12 |
|--|------------------|------------------|-------------------|
| Net interest income  | 8,571            | 17,982           | 28,105            |
| Net impairment gain (loss) on loans and advances to financial institutions   | 7                | (1,278)          | -                 |
| Net impairment loss on loans and advances to customers   | (1,289)          | (2,680)          | (6,577)           |
| Collected previously written-off loans   | 5                | 8                | -                 |
| <b>Total impairment on loans and advances</b>  | <b>(1,276)</b>   | <b>(3,949)</b>   | <b>(6,577)</b>    |
| <b>Net interest income less net impairment loss on loans and advances</b>  | <b>7,295</b>     | <b>14,033</b>    | <b>21,528</b>     |
| Interest spread (as the annualised ratio of net interest income less net impairment loss on loans and advances to the average carrying amount of total assets during the period) | 2.7%             | 2.6%             | 2.1%              |

## Notes to the Condensed Consolidated Interim Financial Statements

### 19. Net fee and commission income

|  | 2010<br>1.4-30.6 | 2010<br>1.1-30.6 | 2009<br>1.1-31.12 |
|--|------------------|------------------|-------------------|
| <b>Fee and commission income</b>       |                  |                  |                   |
| Investment banking and capital markets | 196              | 384              | 943               |
| Asset management                       | 134              | 339              | 878               |
| Lending                                | 259              | 507              | 1,266             |
| Cards                                  | 299              | 609              | 1,402             |
| Interbank clearing                     | 218              | 431              | 859               |
| Collection and payment services        | 155              | 342              | 704               |
| Foreign trade                          | 95               | 182              | 471               |
| Other commissions and fees             | 99               | 177              | 312               |
| <b>Total</b>                           | <b>1,454</b>     | <b>2,970</b>     | <b>6,835</b>      |
| <b>Fee and commission expense</b>      |                  |                  |                   |
| Investment banking and capital markets | (87)             | (135)            | (230)             |
| Interbank clearing                     | (217)            | (429)            | (832)             |
| Other fees                             | (418)            | (779)            | (1,560)           |
| <b>Total</b>                           | <b>(721)</b>     | <b>(1,342)</b>   | <b>(2,622)</b>    |
| <b>Net fee and commission income</b>   | <b>733</b>       | <b>1,628</b>     | <b>4,213</b>      |

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

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

|                                 | 2010<br>1.4-30.6 | 2010<br>1.1-30.6 | 2009<br>1.1-31.12 |
|---------------------------------|------------------|------------------|-------------------|
| Bonds and debt instruments      | 860              | 1,121            | 850               |
| Equities and equity instruments | (349)            | (31)             | 3,170             |
| <b>Total</b>                    | <b>511</b>       | <b>1,090</b>     | <b>4,020</b>      |

### 21. Net (loss) gain on financial assets and liabilities held for trading

|                                 | 2010<br>1.4-30.6 | 2010<br>1.1-30.6 | 2009<br>1.1-31.12 |
|---------------------------------|------------------|------------------|-------------------|
| Bonds and debt instruments      | 106              | 995              | 3,646             |
| Equities and equity instruments | (41)             | 30               | (670)             |
| Derivatives instruments         | (105)            | (46)             | 86                |
| <b>Total</b>                    | <b>(40)</b>      | <b>979</b>       | <b>3,062</b>      |

### 22. Dividend income

Dividend income was recognised in the condensed consolidated income statement in the following line items:

|   | 2010<br>1.4-30.6 | 2010<br>1.1-30.6 | 2009<br>1.1-31.12 |
|---|------------------|------------------|-------------------|
| Net gain on financial assets designated as at fair value through profit or loss | 382              | 558              | 730               |
| Net (loss) gain on financial assets and liabilities held for trading            | 16               | 18               | 55                |
| <b>Total</b>  | <b>398</b>       | <b>576</b>       | <b>785</b>        |

## Notes to the Condensed Consolidated Interim Financial Statements

### 23. Net foreign exchange gain (loss)

|   | 2010<br>1.4-30.6 | 2010<br>1.1-30.6 | 2009<br>1.1-31.12 |
|---|------------------|------------------|-------------------|
| <b>Assets:</b>                                      |                  |                  |                   |
| Cash and balances with Central Bank                 | (57)             | (80)             | 38                |
| Bonds and debt instruments                          | (1,981)          | (2,046)          | 1,017             |
| Equities and equity instruments                     | (344)            | (763)            | 1,719             |
| Derivative instruments                              | (2,821)          | (3,273)          | 1,300             |
| Loans and advances to financial institutions        | (1,244)          | (2,851)          | 2,783             |
| Loans and advances to customers                     | (5,766)          | (7,522)          | 17,975            |
| Other assets  | 9                | (461)            | (260)             |
| <b>Total</b>  | <b>(12,204)</b>  | <b>(16,996)</b>  | <b>24,572</b>     |
| <b>Liabilities:</b>                                 |                  |                  |                   |
| Due to financial institutions and Central Bank      | 459              | 905              | (2,380)           |
| Deposits from customers                             | 1,771            | 4,120            | (7,056)           |
| Provisional liability due to Landsbanki Íslands hf. | -                | -                | (24,233)          |
| Borrowings  | 13,800           | 21,105           | 6,119             |
| Other liabilities                                   | 10               | 13               | (22)              |
| <b>Total</b>  | <b>16,040</b>    | <b>26,143</b>    | <b>(27,572)</b>   |
| <b>Net foreign exchange gain (loss)</b>             | <b>3,836</b>     | <b>9,147</b>     | <b>(3,000)</b>    |

The foreign exchange differences which were recognised during the period from 1 January to 30 June 2010 in the condensed consolidated income statement and arose on financial instruments not measured at fair value through profit or loss amounted to a ISK 10,913 million loss for financial assets (1.1-31.12.2009: gain of ISK 20,536 million) and gain of ISK 5,038 million for financial liabilities (1.1-31.12.2009: loss of ISK 9,458 million). As disclosed in Note 3 in the Group's consolidated financial statements as at and for the year ended 31 December 2009, the Group applied the average FX-delta ratio to foreign exchange differences arising on loans and advances to customers that were acquired from Landsbanki Íslands hf. on 9 October 2008. The amount of foreign exchange difference arising on loans and advances to customers for the six months ended 30 June 2010, which is deemed to be uncollectible and is therefore offset by the FX-delta ratio, amounted to a gain of ISK 2,315 million (1.1-31.12.2009: gain of ISK 9,244 million).

### 24. Other income and expenses

|  | 2010<br>1.4-30.6 | 2010<br>1.1-30.6 | 2009<br>1.1-31.12 |
|--|------------------|------------------|-------------------|
| Recharged expenses                     | 135              | 257              | 965               |
| Loss on sale of property and equipment | (2)              | (2)              | 23                |
| Loss on repossessed collateral         | (553)            | (564)            | (132)             |
| Other                                  | 83               | 101              | 46                |
| <b>Total</b>                           | <b>(337)</b>     | <b>(208)</b>     | <b>902</b>        |

### 25. Salaries and related expenses

|   | 2010<br>1.4-30.6 | 2010<br>1.1-30.6 | 2009<br>1.1-31.12 |
|---|------------------|------------------|-------------------|
| Salaries  | 1,759            | 3,578            | 6,969             |
| Contributions to defined contribution pension plans | 244              | 467              | 955               |
| Other personnel expenses                            | 194              | 370              | 544               |
| <b>Total</b>  | <b>2,198</b>     | <b>4,416</b>     | <b>8,468</b>      |

### 26. Acquisition-related costs

|   | 2010<br>1.4-30.6 | 2010<br>1.1-30.6 | 2009<br>1.1-31.12 |
|---|------------------|------------------|-------------------|
| Cost of acquisition of assets and liabilities from Landsbanki Íslands hf.   | 484              | 484              | 886               |
| Claims on Landsbanki Íslands hf. which were written off due to a settlement | -                | -                | 158               |
| <b>Total</b>  | <b>484</b>       | <b>484</b>       | <b>1,044</b>      |

# Notes to the Condensed Consolidated Interim Financial Statements

## Other notes

### 27. Litigation

The status of the legal proceedings of the Group at the end of the period is unchanged from the issuance of the consolidated financial statements of the Group as at and for the year ended 31 December 2009, except for the following:

1) The Supreme Court of Iceland has, in its ruling from 16 June 2010, established in the cases of SP Fjármögnun hf. and Lýsing hf. that certain foreign currency linked lease agreements are in fact loan agreements in Icelandic Kronas which fall under the scope of Act No. 38/2001 on interest and indexation. The Supreme Court further ruled that the indexation of such ISK denominated loans to the exchange rate of foreign currencies constitutes indexation as defined in Chapter VI of the Interest Act; such indexation is not expressly authorised by the Act.

Following the judgement the Financial Supervisory Authority in Iceland (FME) and the Central Bank of Iceland issued guidelines that required financial undertakings to review their loan portfolio to identify loans with non-binding exchange rate indexation clauses. In a statement on 7 July 2010 it was informed that the loans granted by the Group had been reviewed and classified according to the court ruling and the guidelines. It was further informed that certain mortgages to individuals were to be recalculated in line with the guidelines.

On 16 September 2010 the Supreme Court of Iceland ruled that the interest rate applicable to the agreement is, in line with provisions of Act No. 38/2001, the same as the interest rate published by the Central Bank of Iceland based on the lowest interest rates on new unindexed loans offered by commercial banks in Iceland. This ruling of the Supreme Court has precedent for the recalculation of other loans deemed to include unlawful foreign currency indexation provisions.

The Bank issued a statement on 16 September 2010 whereby it offered all individuals with mortgage in foreign currency a recalculation of the loan in line with the above decision of the Supreme Court.

It is expected that a number of court cases will commence in the coming months that will decide on the legality of certain types of loans granted by the Group that are denominated in foreign currency. The ultimate resolution of these matters or direct effects on the Group cannot yet be determined. In addition it can be expected that court cases will commence where it will be argued that the Group is liable for the losses incurred by clients which have been directly caused by foreign currency linkage of loan agreement and also on whether mortgages with non-binding exchange rate indexation shall be recalculated the same way as lease agreements. The Group considers that the claims for damages are without merit and that there are no legal arguments for different recalculation for mortgages.

In a Court Order rendered by the District Court of Reykjavik on 30 April 2010, a petition by the Bank that the estate of a customer was declared bankrupt was denied. The Order was, among other things, based on the assumption that loan agreements denominated in foreign currencies were in fact granted in Icelandic kronas and therefore with unlawful provision that peg repayments to the exchange rate of foreign currencies. This Order was appealed to the Supreme Court of Iceland that did not base its decision on whether the loans were granted in Icelandic kronas or foreign currency.

2) The Supreme Court of Iceland has issued its ruling in the legal proceedings between the trustee in bankruptcy of the estate of Fons hf. and the Bank. The decision was in favour of the Bank and confirmed the legality of the pledge that the Bank holds in the 99.38% of the issued share capital of Securitas hf. valued at about ISK 640 million.

3) In June 2010 Skollaborg ehf. and Hraðfrystihúsið – Gunnvör hf. commenced litigation before the District Court of Reykjavik against the Bank. Skollaborg ehf. demanded that loans granted on the basis of a loan agreement and the distribution of the proceeds of the loans were declared null and void. The loan agreement are denominated in foreign currencies and the Bank claim according to the agreements is equivalent to ISK 2.1 billion. Hraðfrystihúsið – Gunnvör hf. demands that its guarantee for the repayment of the above mentioned loan agreement is declared null and void. To support its case the companies put forward various arguments mainly relating to the possibility for the company to enter into loan agreements to finance securities transactions and the conduct and advice of the employees of Landsbanki Íslands hf. in relation to the transactions. The Bank considers the claim to be without merit and will defend this claim vigorously before court; however the ultimate resolution of this matter cannot yet be determined.

4) After 30 June 2010, the Bank's subsidiary Landsvaki hf. has received a demand for reversing certain transactions involving the purchase of bonds from the money market funds operated by Landsvaki, shortly before the fall of Landsbanki Íslands hf. in October 2008. Four such claims have been put forward and the total amount of the claims amounts to ISK 2 billion. Landsvaki considers the claim to be without merit and will defend this claim vigorously before court; however the ultimate resolution of this matter cannot yet be determined.



## Notes to the Condensed Consolidated Interim Financial Statements

### 28. Pledged assets

According to the provisions of the settlement agreement signed on 15 December 2009, certain pools of loans to customers will be pledged as collateral for the senior secured bonds, amounting to ISK 290.3 billion, to be issued and the contingent bond, now estimated to amount to ISK 17.6 billion, that the Bank might issue to Landsbanki Íslands hf. as a part of the acquisition price for its Icelandic operations. The Bank is obliged to maintain a cover ratio of 127.5% for the senior secure bonds and 118% for the additional notes of the contingent bond with an appropriate adjustment period. Pledged assets added to the pledge pool must comply with an eligibility criteria. NBI hf. and Landsbanki Íslands hf. have continued to discuss in good faith how to create and perfect a pledge in accordance with Icelandic law. The Bank expects discussions on the Pledge Agreement will be completed in Q4 2010.

In addition, the Bank has pledged assets, in the ordinary course of banking business, to the Central Bank of Iceland in the amount of ISK 5.5 billion (31.12.2009: ISK 5.5 billion) to secure settlement in the Icelandic clearing systems. Further pledges have been placed in the ordinary course of banking business for netting and set-off arrangements in the total amount of ISK 11.7 billion (31.12.2009: ISK 1.2 billion).

### 29. Related-party transactions

The Icelandic State Treasury holds 81.3% of the shares in the Bank. The Group's products and services are offered to the Icelandic State, State authorities and State companies in competition with other vendors and under generally accepted commercial terms. In a similar manner, the Bank and other Group entities purchase products and services from State authorities and companies at market price and otherwise under generally accepted commercial terms. No significant share of the Group's net interest, expenditure or earnings is attributable to the Icelandic State or any of its authorities or companies. The transactions involved are related-party transactions as defined in IAS 24 *Related Party Disclosures* but are not disclosed owing to the volume of transactions conducted.

The Bank has a related-party relationship with its subsidiaries, associates, the Board of Directors of the Bank, the key management personnel of the Bank and its subsidiaries and close family members of the individuals just referred to. In addition, Landsbanki Íslands hf. is a related party, indirectly through its wholly-owned subsidiary Landsskil ehf., which holds 18,7% of the shares in the Bank and has appointed one of the five members of the Board of Directors of the Bank.

No unusual transactions took place with related parties during the periods presented in these interim financial statements. Transactions with related parties have been conducted on an arm's length basis.

#### Associates and government-controlled entities

The Group provides banking services to its associates, government entities and government controlled companies and is provided with various goods and services by these entities. All transactions are conducted on the same terms as third-party transactions.

#### Key management

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

|                       | 2010         |   | 2009         |   |
|-----------------------|--------------|---|--------------|---|
|                       | Balance at   | Highest amounts outstanding during period | Balance at   | Highest amounts outstanding during period |
| Loans in ISK million  | 30 June      |   | 31 December  |   |
| Key management        | 82           | 91  | 85           | 100                                       |
| Associates            | 6,163        | 7,041                                     | 6,763        | 7,651                                     |
| Other related parties | 27           | 53  | 40           | 54  |
| <b>Total</b>          | <b>6,273</b> | <b>7,185</b>                              | <b>6,888</b> | <b>7,805</b>                              |

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

## Notes to the Condensed Consolidated Interim Financial Statements

### Capital management

#### 30. Capital management

The Financial Supervisory Authority (FME) has decided that the Group is to maintain a Tier 1 capital ratio of at least 12% which must be maintained for at least 3 years after the initial capitalisation unless revised by FME. Furthermore, the Group must maintain a capital adequacy ratio (CAD ratio) above 16% unless FME approves a lower CAD ratio on the basis of additional capital resources available for the Group.

The FME has decided that the Bank shall maintain a capital ratio of at least 16%. This is higher than the current ICAAP capital requirement estimated by the Bank. It is the aim of the Bank to always comply with decisions of the FME.

#### 31. Capital base and capital adequacy ratio

The Group's equity at 30 June 2010 amounted to ISK 166,997 million (31 December 2009: ISK 157,592 million), equivalent to 17.0% (31 December 2009: 15.2%) of total assets, according to the balance sheet. The capital adequacy ratio, calculated in accordance with Article 84 of Act No. 161/2002 on Financial Undertakings, was 16.7% at the end of the period (31 December 2009: 15.0%). According to the Act, this ratio may not fall below 8.0%.

| Capital base                                     | 30.6.2010      | 31.12.2009       |
|--|----------------|------------------|
| Share capital                                    | 24,000         | 24,000           |
| Share premium                                    | 123,898        | 123,898          |
| Statutory reserve                                | 741            | 741              |
| Retained earnings (accumulated deficit)          | 16,197         | 6,791            |
| Non-controlling interests                        | 2,161          | 2,162            |
| Deferred tax assets                              | (4,570)        | 0                |
| <b>Tier 1 capital</b>                            | <b>162,427</b> | <b>157,592</b>   |
| Deduction from original and additional own funds | (2,451)        | (2,329)          |
| <b>Capital base</b>                              | <b>159,976</b> | <b>155,263</b>   |
| <b>Risk-weighted assets</b>                      |                |                  |
| Credit risk                                      | 748,883        | 749,632          |
| Market risk                                      | 149,834        | 229,489          |
| Operational risk                                 | 58,326         | 58,326           |
| <b>Total risk-weighted assets</b>                | <b>957,043</b> | <b>1,037,447</b> |
| Tier 1 capital ratio                             | 17.0%          | 15.2%            |
| Capital adequacy ratio                           | 16.7%          | 15.0%            |

## Notes to the Condensed Consolidated Interim Financial Statements

### Financial risk management

The following risk disclosures are based on the assumptions about the denomination currencies and interest rates of lease and loan agreements described in Note 4. Accordingly, the resolution of the uncertainties surrounding these agreements could have a significant impact on the nature and extent of the financial risks arising from these agreements.

### Credit risk

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

The following tables represent the Group's maximum credit risk exposure at 30 June 2010 and 31 December 2009, without taking into account any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures set out below are based on net carrying amounts as reported in the balance sheet. Off-balance sheet amounts in the tables below are the maximum amounts the Group might have to pay for guarantees, loan commitments in their full amount, and undrawn overdraft and credit card facilities. The loans to individuals are residential mortgages and consumer lending. Consumer lending consists of current account loans, ISK term loans and loans dominated in foreign currencies, to name a few of the lending forms.

The Group uses the ISAT 08 industry classification for corporate customers. This classification is based on the NACE Rev. 2 industry classification used by EEA countries.

| At 30 June 2010                              | Corporations           |                  |                |                |  |               |               |                   |               |               |               |              | Carrying amount  |
|--|------------------------|------------------|----------------|----------------|--|---------------|---------------|-------------------|---------------|---------------|---------------|--------------|------------------|
|  | Financial institutions | Public entities* | Individuals    | Fisheries      | Construction and real estate companies | Services      | Retail        | Holding companies | Manufacturing | Agriculture   | ITC**         | Other        |                  |
| Cash and balances with Central Bank          | -                      | 49,867           | -              | -              | -                                      | -             | -             | -                 | -             | -             | -             | -            | 49,867           |
| Bonds and debt instruments                   | 15,090                 | 145,213          | -              | -              | 2                                      | -             | -             | 6,543             | 2,218         | -             | -             | 94           | 169,160          |
| Derivative instruments                       | 115                    | -                | 5              | -              | -                                      | -             | -             | 14                | -             | -             | -             | -            | 134              |
| Loans and advances to financial institutions | 61,177                 | -                | -              | -              | -                                      | -             | -             | -                 | -             | -             | -             | -            | 61,177           |
| Loans and advances to customers              | -                      | 12,607           | 170,185        | 148,487        | 106,786                                | 58,442        | 40,417        | 38,662            | 25,607        | 12,814        | 8,327         | 2,606        | 624,941          |
| Other financial assets                       | 6,927                  | -                | -              | 12             | -                                      | 252           | 13            | 3                 | 4             | -             | -             | 382          | 7,593            |
| <b>Total on-balance sheet exposure</b>       | <b>83,309</b>          | <b>207,688</b>   | <b>170,190</b> | <b>148,499</b> | <b>106,788</b>                         | <b>58,694</b> | <b>40,430</b> | <b>45,222</b>     | <b>27,829</b> | <b>12,814</b> | <b>8,327</b>  | <b>3,082</b> | <b>912,872</b>   |
| <b>Off-balance sheet exposure</b>            | <b>-</b>               | <b>5,335</b>     | <b>32,554</b>  | <b>9,151</b>   | <b>5,815</b>                           | <b>10,054</b> | <b>14,345</b> | <b>2,557</b>      | <b>3,144</b>  | <b>2,816</b>  | <b>3,055</b>  | <b>59</b>    | <b>88,884</b>    |
| Financial guarantees                         | -                      | 51               | 365            | 904            | 3,587                                  | 2,474         | 1,907         | 238               | 772           | 2             | 831           | 32           | 11,163           |
| Undrawn loan commitments                     | -                      | 2,500            | 85             | 5,932          | 864                                    | 4,571         | 7,611         | 1,132             | 916           | 2,201         | 1,100         | 0            | 26,912           |
| Undrawn overdraft/credit card facilities     | -                      | 2,784            | 32,104         | 2,315          | 1,363                                  | 3,009         | 4,826         | 1,188             | 1,455         | 613           | 1,124         | 27           | 50,808           |
| <b>Maximum exposure to credit risk</b>       | <b>83,309</b>          | <b>213,023</b>   | <b>202,743</b> | <b>157,650</b> | <b>112,602</b>                         | <b>68,748</b> | <b>54,776</b> | <b>47,780</b>     | <b>30,973</b> | <b>15,630</b> | <b>11,382</b> | <b>3,142</b> | <b>1,001,756</b> |

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

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

# Notes to the Condensed Consolidated Interim Financial Statements

## 32. Maximum exposure to credit risk and concentration by industry sectors (continued)

| At 31 December 2009                          | Corporations           |                  |                |                |  |                   |               |               |               |               |               |              | Carrying amount  |
|--|------------------------|------------------|----------------|----------------|--|-------------------|---------------|---------------|---------------|---------------|---------------|--------------|------------------|
|  | Financial institutions | Public entities* | Individuals    | Fisheries      | Construction and real estate companies | Holding companies | Retail        | Services      | Manufacturing | ITC**         | Agriculture   | Other        |                  |
| Cash and balances with Central Bank          | -                      | 26,174           | -              | -              | -                                      | -                 | -             | -             | -             | -             | -             | -            | 26,174           |
| Bonds and debt instruments                   | 19,985                 | 129,571          | -              | -              | 1,343                                  | 6,759             | -             | -             | 1,251         | -             | -             | 6,812        | 165,721          |
| Derivative instruments                       | 962                    | -                | -              | -              | -                                      | -                 | -             | -             | -             | -             | -             | 9            | 971              |
| Loans and advances to financial institutions | 83,129                 | -                | -              | -              | -                                      | -                 | -             | -             | -             | -             | -             | -            | 83,129           |
| Loans and advances to customers              | -                      | 10,388           | 175,986        | 162,490        | 110,404                                | 53,401            | 46,161        | 49,589        | 26,933        | 17,659        | 13,208        | 903          | 667,122          |
| Other financial assets                       | 5,424                  | 50               | 7              | 40             | 1                                      | 594               | 3             | 779           | 2             | 1             | 0             | 89           | 6,990            |
| <b>Total on-balance sheet exposure</b>       | <b>109,500</b>         | <b>166,183</b>   | <b>175,993</b> | <b>162,530</b> | <b>111,748</b>                         | <b>60,754</b>     | <b>46,164</b> | <b>50,368</b> | <b>28,186</b> | <b>17,660</b> | <b>13,208</b> | <b>7,813</b> | <b>950,107</b>   |
| <b>Off-balance sheet exposure</b>            | <b>-</b>               | <b>7,000</b>     | <b>34,008</b>  | <b>10,219</b>  | <b>7,852</b>                           | <b>1,124</b>      | <b>11,701</b> | <b>4,719</b>  | <b>3,481</b>  | <b>2,588</b>  | <b>1,796</b>  | <b>141</b>   | <b>84,629</b>    |
| Financial guarantees                         | -                      | 412              | 378            | 598            | 3,521                                  | 215               | 423           | 1,313         | 581           | 493           | 6             | 95           | 8,035            |
| Undrawn loan commitments                     | -                      | 0                | 73             | 7,000          | 2,715                                  | 166               | 7,598         | 628           | 1,665         | 1,100         | 1,409         | 0            | 22,354           |
| Undrawn overdraft/credit card facilities     | -                      | 6,588            | 33,557         | 2,621          | 1,616                                  | 743               | 3,680         | 2,778         | 1,235         | 995           | 381           | 46           | 54,240           |
| <b>Maximum exposure to credit risk</b>       | <b>109,500</b>         | <b>173,183</b>   | <b>210,001</b> | <b>172,749</b> | <b>119,600</b>                         | <b>61,878</b>     | <b>57,865</b> | <b>55,087</b> | <b>31,667</b> | <b>20,248</b> | <b>15,004</b> | <b>7,954</b> | <b>1,034,736</b> |

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

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

## Notes to the Condensed Consolidated Interim Financial Statements

### 33. Classification of loans and advances to customers by credit risk groups

| Carrying amount   | 30.6.2010      | 31.12.2009     |
|---|----------------|----------------|
| Customer groups with loan exposures above ISK 500 million |                |                |
| Green   | 71,786         | 107,407        |
| Amber   | 178,511        | 220,150        |
| Red   | 27,058         | 40,027         |
| Customer groups with loan exposures below ISK 500 million | 347,586        | 299,538        |
| <b>Total</b>  | <b>624,941</b> | <b>667,122</b> |

External ratings were used where applicable to assist in managing the credit risk exposure of bonds. Otherwise the Group used fair value estimates based on available information and the Group's own estimates.

### 34. Loans and advances by industry sectors

| Industry sectors                          | 30.6.2010             |                          |                 | 31.12.2009            |                          |                 |
|---|-----------------------|--------------------------|-----------------|-----------------------|--------------------------|-----------------|
|   | Gross carrying amount | Allowance for impairment | Carrying amount | Gross carrying amount | Allowance for impairment | Carrying amount |
| Financial institutions                    | 63,182                | (2,004)                  | 61,177          | 83,856                | (727)                    | 83,129          |
| Public entities                           | 13,308                | (701)                    | 12,607          | 10,582                | (194)                    | 10,388          |
| Individuals                               | 172,340               | (2,156)                  | 170,185         | 177,110               | (1,124)                  | 175,986         |
| Corporations                              |                       |                          |                 |                       |                          |                 |
| Fisheries                                 | 148,754               | (267)                    | 148,487         | 162,677               | (187)                    | 162,490         |
| Construction and real estate companies    | 108,068               | (1,282)                  | 106,786         | 111,791               | (1,387)                  | 110,404         |
| Holding companies                         | 42,446                | (3,784)                  | 38,662          | 56,985                | (3,584)                  | 53,401          |
| Retail                                    | 41,651                | (1,234)                  | 40,417          | 46,866                | (705)                    | 46,161          |
| Services                                  | 58,952                | (510)                    | 58,442          | 49,799                | (210)                    | 49,589          |
| Information, technology and communication | 8,372                 | (45)                     | 8,327           | 17,719                | (60)                     | 17,659          |
| Manufacturing                             | 26,012                | (405)                    | 25,607          | 27,211                | (278)                    | 26,933          |
| Agriculture                               | 12,862                | (47)                     | 12,814          | 13,226                | (18)                     | 13,208          |
| Other                                     | 2,615                 | (9)                      | 2,606           | 916                   | (13)                     | 903             |
| <b>Total</b>                              | <b>698,562</b>        | <b>(12,444)</b>          | <b>686,118</b>  | <b>758,738</b>        | <b>(8,487)</b>           | <b>750,251</b>  |

### 35. Credit quality of financial assets

| At 30 June 2010                              | Gross carrying amount                      |  |                       |                | Allowance for impairment | Carrying amount |
|--|--|--|-----------------------|----------------|--------------------------|-----------------|
|  | Neither past due nor individually impaired | Past due but not individually impaired | Individually impaired | Total          |                          |                 |
| Cash and balances with Central Bank          | 49,867                                     | -                                      | -                     | 49,867         | -                        | 49,867          |
| Bonds and debt instruments                   | 154,636                                    | 14,525                                 | -                     | 169,160        | -                        | 169,160         |
| Derivative instruments                       | 134  | -                                      | -                     | 134            | -                        | 134             |
| Loans and advances to financial institutions | 43,148                                     | 29                                     | 20,005                | 63,182         | (2,004)                  | 61,177          |
| Loans and advances to customers              | 437,496                                    | 195,680                                | 2,205                 | 635,381        | (10,440)                 | 624,941         |
| Other financial assets                       | 7,593                                      | -                                      | -                     | 7,593          | -                        | 7,593           |
| <b>Total</b>                                 | <b>692,873</b>                             | <b>210,234</b>                         | <b>22,209</b>         | <b>925,317</b> | <b>(12,444)</b>          | <b>912,872</b>  |
| <b>At 31 December 2009</b>                   |  |  |                       |                |                          |                 |
| Cash and balances with Central Bank          | 26,174                                     | -                                      | -                     | 26,174         | -                        | 26,174          |
| Bonds and debt instruments                   | 148,111                                    | 17,610                                 | -                     | 165,721        | -                        | 165,721         |
| Derivative instruments                       | 971  | -                                      | -                     | 971            | -                        | 971             |
| Loans and advances to financial institutions | 54,207                                     | 2,797                                  | 26,852                | 83,856         | (727)                    | 83,129          |
| Loans and advances to customers              | 493,941                                    | 178,484                                | 2,457                 | 674,882        | (7,760)                  | 667,122         |
| Other financial assets                       | 6,990                                      | -                                      | -                     | 6,990          | -                        | 6,990           |
| <b>Total</b>                                 | <b>730,394</b>                             | <b>198,891</b>                         | <b>29,309</b>         | <b>958,594</b> | <b>(8,487)</b>           | <b>950,107</b>  |

The impairment allowances above include both the allowance for financial assets that are individually impaired as well as the allowance for financial assets that are subject to collective impairment. Assets covered by collective impairment allowance are not included under financial assets that are past due or impaired.

## Notes to the Condensed Consolidated Interim Financial Statements

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

|   | Credit risk groups |                |               | Exposures<br>below ISK<br>500 million | Gross<br>carrying<br>amount |
|---|--------------------|----------------|---------------|---------------------------------------|-----------------------------|
|   | Green              | Amber          | Red           |                                       |                             |
| <b>At 30 June 2010</b>                    |                    |                |               |                                       |                             |
| Financial institutions                    | -                  | -              | -             | 43,148                                | 43,148                      |
| Public entities                           | -                  | -              | -             | 10,333                                | 10,333                      |
| Individuals                               | 28                 | -              | 2             | 121,763                               | 121,793                     |
| Corporations                              |                    |                |               |                                       |                             |
| Fisheries                                 | 39,695             | 58,916         | 68            | 18,348                                | 117,027                     |
| Construction and real estate companies    | 1,307              | 22,158         | 72            | 30,744                                | 54,282                      |
| Holding companies                         | 3,671              | 6,266          | 883           | 17,801                                | 28,621                      |
| Retail                                    | 2,298              | 4,838          | 6,586         | 9,967                                 | 23,688                      |
| Services                                  | 14,761             | 10,201         | 59            | 18,618                                | 43,639                      |
| Information, technology and communication | 1,583              | 1,819          | 1,047         | 2,179                                 | 6,629                       |
| Manufacturing                             | 5,093              | 3,338          | -             | 3,144                                 | 11,575                      |
| Agriculture                               | 526                | 8,605          | -             | 8,856                                 | 17,987                      |
| Other                                     | -                  | 212            | -             | 1,711                                 | 1,924                       |
| <b>Total</b>                              | <b>68,963</b>      | <b>116,351</b> | <b>8,717</b>  | <b>286,612</b>                        | <b>480,644</b>              |
| <b>At 31 December 2009</b>                |                    |                |               |                                       |                             |
| Financial institutions                    | -                  | -              | -             | 80,332                                | 80,332                      |
| Public entities                           | 4,706              | 576            | -             | 3,676                                 | 8,958                       |
| Individuals                               | 33                 | 148            | 89            | 140,029                               | 140,299                     |
| Corporations                              |                    |                |               |                                       |                             |
| Fisheries                                 | 55,185             | 68,338         | 382           | 10,534                                | 134,439                     |
| Construction and real estate companies    | 4,283              | 28,684         | 2,151         | 21,788                                | 56,906                      |
| Holding companies                         | 8,935              | 8,226          | 1,186         | 18,708                                | 37,055                      |
| Retail                                    | 5,718              | 16,078         | 6,685         | 6,940                                 | 35,421                      |
| Services                                  | 6,522              | 7,574          | 694           | 16,223                                | 31,013                      |
| Information, technology and communication | 12,454             | 2,777          | -             | 1,553                                 | 16,784                      |
| Manufacturing                             | 4,862              | 4,387          | 230           | 2,929                                 | 12,408                      |
| Agriculture                               | 895                | 13,338         | -             | 5,580                                 | 19,813                      |
| Other                                     | -                  | 221            | 588           | 36                                    | 845                         |
| <b>Total</b>                              | <b>103,593</b>     | <b>150,347</b> | <b>12,005</b> | <b>308,328</b>                        | <b>574,273</b>              |

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

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

|  | Past due up               |                                   |                                   |                          | Gross<br>carrying<br>amount |
|--|---------------------------|-----------------------------------|-----------------------------------|--------------------------|-----------------------------|
|  | Past due up<br>to 30 days | Past due up<br>to 31 – 60<br>days | Past due up<br>to 61 – 90<br>days | Past due<br>over 90 days |                             |
| <b>At 30 June 2010</b>                       |                           |                                   |                                   |                          |                             |
| Loans and advances to financial institutions | 2                         | -                                 | 27                                | -                        | 29                          |
| Loans and advances to customers              | 30,935                    | 14,004                            | 15,173                            | 135,568                  | 195,680                     |
| <b>At 31 December 2009</b>                   |                           |                                   |                                   |                          |                             |
| Loans and advances to financial institutions | 2,632                     | -                                 | -                                 | 165                      | 2,797                       |
| Loans and advances to customers              | 26,929                    | 16,075                            | 14,056                            | 121,424                  | 178,484                     |

### 38. Individually impaired loans and advances to financial institutions and customers

|  | Gross              |                             | Carrying<br>amount |
|--|--------------------|-----------------------------|--------------------|
|  | carrying<br>amount | Allowance for<br>impairment |                    |
| <b>At 30 June 2010</b>                       |                    |                             |                    |
| Loans and advances to financial institutions | 20,005             | (2,004)                     | 18,001             |
| Loans and advances to customers              | 2,205              | (1,323)                     | 882                |
| <b>At 31 December 2009</b>                   |                    |                             |                    |
| Loans and advances to financial institutions | 26,852             | (727)                       | 26,125             |
| Loans and advances to customers              | 2,457              | (1,450)                     | 1,007              |

## Notes to the Condensed Consolidated Interim Financial Statements

### 39. Allowance for impairment on loans and advances to customers

|   | 2010<br>1.1–30.6 | 2009<br>1.1–31.12 |
|---|------------------|-------------------|
| Balance at beginning of period            | 7,760            | 1,183             |
| Net impairment loss on loans and advances | 2,680            | 6,577             |
| <b>Total</b>                              | <b>10,440</b>    | <b>7,760</b>      |
| Specific allowance                        | 1,323            | 1,450             |
| Collective allowance                      | 9,117            | 6,310             |
| <b>Total</b>                              | <b>10,440</b>    | <b>7,760</b>      |

### 40. Renegotiated loans

Financial restructuring and renegotiation of loans to the Group's customers acquired from Landsbanki Íslands hf. started in 2009. In regard to financial restructuring of customers, the Group put remedies in place for those experiencing financial difficulties and also presented procedures for financial restructuring. These restructuring approaches include extended and modified repayment arrangements and approved external management plans. Restructuring may be suitable for borrowers in financial difficulties as well as those who are not, and is available whether loans have become past due or not.

The following table shows the status of restructuring of loans and advances to customers of the Group based on classification of the customers:

|  | 30.6.2010                  |                                | 31.12.2009                 |                                |
|--|----------------------------|--------------------------------|----------------------------|--------------------------------|
|  | % of<br>carrying<br>amount | % of<br>number of<br>customers | % of<br>carrying<br>amount | % of<br>number of<br>customers |
| <b>Status of loans to corporations</b>                         |                            |                                |                            |                                |
| Performing without restructuring                               | 43%                        | 61%                            | 45%                        | 63%                            |
| Performing after restructuring                                 | 29%                        | 9%                             | 15%                        | 10%                            |
| Non-performing (90 days in arrears or unlikely to pay in full) | 28%                        | 30%                            | 40%                        | 27%                            |
| <b>Total</b>   | <b>100%</b>                | <b>100%</b>                    | <b>100%</b>                | <b>100%</b>                    |
| <b>Status of loans to individuals</b>                          |                            |                                |                            |                                |
| Performing without restructuring                               | 34%                        | 75%                            | 36%                        | 77%                            |
| Performing after restructuring                                 | 37%                        | 16%                            | 39%                        | 15%                            |
| Non-performing (90 days in arrears or unlikely to pay in full) | 29%                        | 9%                             | 25%                        | 8%                             |
| <b>Total</b>   | <b>100%</b>                | <b>100%</b>                    | <b>100%</b>                | <b>100%</b>                    |

### 41. Large exposures

At 30 June 2010, three Group clients were rated as large exposures (31 December 2009: three clients), including subsidiaries classified as held for sale. Clients are rated as large exposures if their total obligations, or those of financially or administratively connected parties, exceed 10% of the Group's equity after taking account of collateral held, in accordance with the Financial Supervisory Authority's Rules on Large Exposures Incurred by Financial Undertakings No. 216/2007. According to these rules, no exposure may attain the equivalent of 25% of equity, as defined by the Basel II regulatory framework. All of the Group's large exposures were within these limits at the end of 30 June 2010.

At 30 June 2010, the Group's internal rules on large exposures stated that clients could comprise up to 20% of the Group's equity as defined by the Basel II regulatory framework ("capital base"). At 30 June 2010, no exposure exceeded 20% (31 December 2009: no exposure). According to the Group's risk appetite, the total utilisation percentage of a large exposure ought to remain below 200% of the Group's capital base.

|   | Number of<br>large<br>exposures | Large<br>exposures |
|---|---------------------------------|--------------------|
| <b>At 30 June 2010</b>  |                                 |                    |
| Large exposures above 20% of the Group's capital base           | –                               | –                  |
| Large exposures between 10% and 20% of the Group's capital base | 3                               | 63,764             |
| <b>Total</b>  | <b>3</b>                        | <b>63,764</b>      |
| Utilisation of 800% limit (%)                                   |                                 | 40%                |
| <b>At 31 December 2009</b>                                      |                                 |                    |
| Large exposures above 20% of the Group's capital base           | –                               | –                  |
| Large exposures between 10% and 20% of the Group's capital base | 3                               | 67,189             |
| <b>Total</b>  | <b>3</b>                        | <b>67,189</b>      |
| Utilisation of 800% limit (%)                                   |                                 | 43%                |

## Notes to the Condensed Consolidated Interim Financial Statements

### 42. Bonds and debt instruments

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

| Carrying amount | 30.6.2010      | 31.12.2009     |
|-----------------|----------------|----------------|
| Aaa             | 9,989          | -              |
| Aa1             | -              | 377            |
| Aa3             | 192            | 274            |
| A3 to A1        | 258            | 1,188          |
| Baa1 to Baa3    | 134,451        | 130,355        |
| Lower than Baa3 | 8,807          | 15,349         |
| Unrated         | 15,463         | 18,178         |
| <b>Total</b>    | <b>169,160</b> | <b>165,721</b> |

Unrated bonds and bonds with ratings lower than Baa3 are primarily bonds issued by domestic corporations, some of which developed into liquidating estates.

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

|                            | Past due up<br>to 30 days | Past due up<br>to 31 – 60<br>days | Past due up<br>to 61 – 90<br>days | Past due<br>over 90 days | Carrying<br>amount |
|----------------------------|---------------------------|-----------------------------------|-----------------------------------|--------------------------|--------------------|
| <b>At 30 June 2010</b>     |                           |                                   |                                   |                          |                    |
| Financial institutions     | -                         | -                                 | -                                 | 9,380                    | 9,380              |
| Holding companies          | -                         | -                                 | -                                 | 5,145                    | 5,145              |
| <b>Total</b>               | <b>0</b>                  | <b>0</b>                          | <b>0</b>                          | <b>14,525</b>            | <b>14,525</b>      |
| <b>At 31 December 2009</b> |                           |                                   |                                   |                          |                    |
| Financial institutions     | -                         | -                                 | -                                 | 10,536                   | 10,536             |
| Holding companies          | 105                       | 111                               | -                                 | 5,200                    | 5,416              |
| Other                      | -                         | -                                 | -                                 | 1,658                    | 1,658              |
| <b>Total</b>               | <b>105</b>                | <b>111</b>                        | <b>0</b>                          | <b>15,736</b>            | <b>17,610</b>      |

### 43. Derivative instruments

The following table shows a breakdown of the Group's derivative instruments classified by Moody's rating:

|              | 30.6.2010          |            |              | 31.12.2009         |            |             |
|--------------|--------------------|------------|--------------|--------------------|------------|-------------|
|              | Notional<br>amount | Fair value |              | Notional<br>amount | Fair value |             |
|              |                    | Assets     | Liabilities  |                    | Assets     | Liabilities |
| A1           | 119,013            | 110        | 1,815        | 68,874             | 962        | -           |
| Baa3         | 2,344              | -          | 498          | 2,415              | -          | 672         |
| C            | -                  | -          | -            | 90                 | -          | -           |
| Unrated      | 7,743              | 24         | 23           | 3,381              | 9          | 3           |
| <b>Total</b> | <b>129,100</b>     | <b>134</b> | <b>2,337</b> | <b>74,759</b>      | <b>971</b> | <b>675</b>  |

The largest derivative counterparties are financial institutions and public entities. The Group has entered into master netting agreements with financial institutions in order to limit the counterparty credit risk. Individuals and corporations need to maintain margin accounts with the Group as collateral in the form of deposits or highly liquid bonds, such as government bonds.



## Notes to the Condensed Consolidated Interim Financial Statements

### Liquidity risk

#### 44. Liquidity risk management

The key measure used by the Group for monitoring liquidity risk is the ratio of core liquid assets to deposits, which shows the ratio of deposits that the Group could deliver on demand without incurring any significant losses due to forced asset sales or other costly actions. Core liquid assets are comprised of cash at hand, balances with Central Bank, loans to financial institutions (maturity within seven days) and assets eligible for repo transactions with Central Bank (such as government bonds). The core liquidity ratio as at 30 June 2010 was 41% (31 December 2009: 36%).

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

The following table shows a maturity analysis of the Group's financial instruments as at 30 June 2010:

|   | On demand        | Up to 3 months  | 3-12 months     | 1-5 years        | Over 5 years     | Total              | Carrying amount  |
|---|------------------|-----------------|-----------------|------------------|------------------|--------------------|------------------|
| <b>Non-derivative financial assets</b>  |                  |                 |                 |                  |                  |                    |                  |
| Cash and balances with Central Bank   | 50,107           | -               | -               | -                | -                | 50,107             | 49,867           |
| Bonds and debt instruments  | -                | 14,139          | 8,253           | 57,594           | 179,637          | 259,623            | 169,160          |
| Loans and advances to financial institutions                                  | -                | 57,664          | 3,701           | -                | 11               | 61,376             | 61,177           |
| Loans and advances to customers   | 33,303           | 53,114          | 92,569          | 349,393          | 412,004          | 940,383            | 624,941          |
| Other financial assets  | -                | 4,255           | 3,338           | -                | -                | 7,593              | 7,593            |
| <b>Total</b>  | <b>83,410</b>    | <b>129,172</b>  | <b>107,861</b>  | <b>406,987</b>   | <b>591,652</b>   | <b>1,319,082</b>   | <b>912,737</b>   |
| <b>Derivative financial assets</b>  |                  |                 |                 |                  |                  |                    |                  |
| <b>Gross settled derivatives</b>  |                  |                 |                 |                  |                  |                    |                  |
| Inflow  | -                | 7,726           | 2,177           | -                | -                | 9,903              |                  |
| Outflow   | -                | (7,492)         | (2,177)         | -                | -                | (9,668)            |                  |
| <b>Total</b>  | <b>0</b>         | <b>235</b>      | <b>0</b>        | <b>0</b>         | <b>0</b>         | <b>235</b>         | <b>111</b>       |
| <b>Net settled derivatives</b>  |                  |                 |                 |                  |                  |                    |                  |
|   | -                | 23              | -               | -                | -                | 23                 | 23               |
| <b>Total</b>  | <b>0</b>         | <b>258</b>      | <b>0</b>        | <b>0</b>         | <b>0</b>         | <b>258</b>         | <b>134</b>       |
| <b>Non-derivative financial liabilities</b>                                   |                  |                 |                 |                  |                  |                    |                  |
| Due to financial institutions and Central Bank                                | (127,162)        | (413)           | (16,795)        | -                | -                | (144,369)          | (144,272)        |
| Deposits from customers   | (284,017)        | (46,318)        | (12,589)        | (36,808)         | -                | (379,732)          | (379,721)        |
| Short positions   | -                | (3,125)         | (5,556)         | (5,463)          | (2,640)          | (16,785)           | (7,782)          |
| Borrowings  | -                | (17,049)        | (4,784)         | (115,237)        | (211,141)        | (348,212)          | (290,343)        |
| Contingent bond   | -                | -               | -               | (8,773)          | (14,624)         | (23,397)           | (17,600)         |
| Other financial liabilities   | -                | (3,003)         | -               | -                | -                | (3,003)            | (3,003)          |
| <b>Total</b>  | <b>(411,179)</b> | <b>(69,908)</b> | <b>(39,725)</b> | <b>(166,282)</b> | <b>(228,405)</b> | <b>(915,499)</b>   | <b>(842,721)</b> |
| <b>Off-balance sheet items</b>  |                  |                 |                 |                  |                  |                    |                  |
| Financial guarantees  | -                | (4,941)         | (2,852)         | (3,371)          | -                | (11,163)           |                  |
| Undrawn loan commitments  | (26,912)         | -               | -               | -                | -                | (26,912)           |                  |
| Undrawn overdraft/credit card commitments                                     | (50,809)         | -               | -               | -                | -                | (50,809)           |                  |
| <b>Total</b>  | <b>(77,721)</b>  | <b>(4,941)</b>  | <b>(2,852)</b>  | <b>(3,371)</b>   | <b>0</b>         | <b>(88,884)</b>    |                  |
| <b>Total non-derivative financial liabilities and off-balance sheet items</b> | <b>(488,900)</b> | <b>(74,849)</b> | <b>(42,577)</b> | <b>(169,652)</b> | <b>(228,405)</b> | <b>(1,004,383)</b> |                  |
| <b>Derivative financial liabilities</b>                                       |                  |                 |                 |                  |                  |                    |                  |
| <b>Gross settled derivatives</b>  |                  |                 |                 |                  |                  |                    |                  |
| Inflow  | -                | 41,916          | 9               | 1,087            | 834              | 43,846             |                  |
| Outflow   | -                | (43,747)        | (10)            | (1,308)          | (1,044)          | (46,109)           |                  |
| <b>Total</b>  | <b>0</b>         | <b>(1,831)</b>  | <b>(1)</b>      | <b>(222)</b>     | <b>(210)</b>     | <b>(2,263)</b>     | <b>(2,315)</b>   |
| <b>Net settled derivatives</b>  |                  |                 |                 |                  |                  |                    |                  |
|   | -                | (22)            | -               | -                | -                | (22)               | (22)             |
| <b>Total</b>  | <b>0</b>         | <b>(1,852)</b>  | <b>(1)</b>      | <b>(222)</b>     | <b>(210)</b>     | <b>(2,285)</b>     | <b>(2,337)</b>   |
| <b>Net liquidity position</b>   | <b>(405,490)</b> | <b>52,728</b>   | <b>65,284</b>   | <b>237,113</b>   | <b>363,037</b>   | <b>312,672</b>     |                  |

## Notes to the Condensed Consolidated Interim Financial Statements

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

The following table shows a maturity analysis of the Group's financial instruments as at 31 December 2009:

|   | On demand        | Up to 3 months   | 3–12 months     | 1–5 years        | Over 5 years     | Total              | Carrying amount  |
|---|------------------|------------------|-----------------|------------------|------------------|--------------------|------------------|
| <b>Non-derivative financial assets</b>  |                  |                  |                 |                  |                  |                    |                  |
| Cash and balances with Central Bank   | 26,174           | -                | -               | -                | -                | 26,174             | 26,174           |
| Bonds and debt instruments  | -                | 10,291           | 10,387          | 73,767           | 190,467          | 284,912            | 165,721          |
| Loans and advances to financial institutions                                  | -                | 78,570           | 4,349           | 77               | 213              | 83,209             | 83,129           |
| Loans and advances to customers   | 37,692           | 64,769           | 99,336          | 340,412          | 468,381          | 1,010,590          | 667,122          |
| Other financial assets  | -                | 1,826            | 5,164           | -                | -                | 6,990              | 6,990            |
| <b>Total</b>  | <b>63,866</b>    | <b>155,456</b>   | <b>119,236</b>  | <b>414,256</b>   | <b>659,061</b>   | <b>1,411,875</b>   | <b>949,136</b>   |
| <b>Derivative financial assets</b>  |                  |                  |                 |                  |                  |                    |                  |
| <b>Gross settled derivatives</b>  |                  |                  |                 |                  |                  |                    |                  |
| Inflow  | -                | 9,411            | 9,739           | -                | -                | 19,150             |                  |
| Outflow   | -                | (8,900)          | (9,989)         | -                | -                | (18,889)           |                  |
| <b>Total</b>  | <b>0</b>         | <b>511</b>       | <b>(250)</b>    | <b>0</b>         | <b>0</b>         | <b>261</b>         | <b>962</b>       |
| <b>Net settled derivatives</b>  |                  |                  |                 |                  |                  |                    |                  |
|   | -                | 9                | -               | -                | -                | 9                  | 9                |
| <b>Total</b>  | <b>0</b>         | <b>520</b>       | <b>(250)</b>    | <b>0</b>         | <b>0</b>         | <b>270</b>         | <b>971</b>       |
| <b>Non-derivative financial liabilities</b>                                   |                  |                  |                 |                  |                  |                    |                  |
| Due to financial institutions and Central Bank                                | (89,657)         | (8,177)          | -               | (441)            | -                | (98,275)           | (98,228)         |
| Deposits from customers   | (317,330)        | (83,068)         | (13,147)        | (39,932)         | -                | (453,477)          | (452,655)        |
| Short positions   | -                | (2,064)          | (325)           | (3,690)          | (2,657)          | (8,736)            | (5,268)          |
| Borrowings  | -                | -                | (19,769)        | (91,266)         | (260,449)        | (371,484)          | (306,493)        |
| Contingent bond   | -                | -                | -               | (3,922)          | (10,163)         | (14,085)           | (10,241)         |
| Other financial liabilities   | -                | (2,138)          | -               | -                | -                | (2,138)            | (2,138)          |
| <b>Total</b>  | <b>(406,987)</b> | <b>(95,447)</b>  | <b>(33,241)</b> | <b>(139,251)</b> | <b>(273,269)</b> | <b>(948,195)</b>   | <b>(875,023)</b> |
| <b>Off-balance sheet items</b>  |                  |                  |                 |                  |                  |                    |                  |
| Financial guarantees  | -                | (4,576)          | (335)           | (3,124)          | -                | (8,035)            |                  |
| Undrawn loan commitments  | (22,354)         | -                | -               | -                | -                | (22,354)           |                  |
| Undrawn overdraft/credit card commitments                                     | (54,240)         | -                | -               | -                | -                | (54,240)           |                  |
| <b>Total</b>  | <b>(76,594)</b>  | <b>(4,576)</b>   | <b>(335)</b>    | <b>(3,124)</b>   | <b>0</b>         | <b>(84,629)</b>    |                  |
| <b>Total non-derivative financial liabilities and off-balance sheet items</b> | <b>(483,581)</b> | <b>(100,023)</b> | <b>(33,576)</b> | <b>(142,375)</b> | <b>(273,269)</b> | <b>(1,032,824)</b> | <b>(875,023)</b> |
| <b>Derivative financial liabilities</b>                                       |                  |                  |                 |                  |                  |                    |                  |
| <b>Gross settled derivatives</b>  |                  |                  |                 |                  |                  |                    |                  |
| Inflow  | -                | 168              | 297             | 1,278            | 904              | 2,647              |                  |
| Outflow   | -                | (167)            | (412)           | (1,668)          | (1,182)          | (3,429)            |                  |
| <b>Total</b>  | <b>0</b>         | <b>1</b>         | <b>(115)</b>    | <b>(390)</b>     | <b>(278)</b>     | <b>(782)</b>       | <b>(673)</b>     |
| <b>Net settled derivatives</b>  |                  |                  |                 |                  |                  |                    |                  |
|   | -                | (2)              | -               | -                | -                | (2)                | (2)              |
| <b>Total</b>  | <b>0</b>         | <b>(1)</b>       | <b>(115)</b>    | <b>(390)</b>     | <b>(278)</b>     | <b>(784)</b>       | <b>(675)</b>     |
| <b>Net liquidity position</b>   | <b>(419,715)</b> | <b>55,952</b>    | <b>85,295</b>   | <b>271,491</b>   | <b>385,514</b>   | <b>378,537</b>     |                  |

## Notes to the Condensed Consolidated Interim Financial Statements

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

The amounts in the maturity analyses as at 30 June 2010 and 31 December 2009 are allocated to maturity buckets in respect of remaining contractual maturity (i.e. based on the timing of future cash flows according to contractual terms). Exceptions to this are loans and advances to customers and bonds issued by companies in moratorium or in the process of liquidation. For loans and advances to larger customers the Group estimates both the timing and amounts of cash flows by taking into consideration the expected financial restructuring of the customer. For loans and advances to smaller customers the Group estimates the timing of the cash flows based on the contractual terms but the amounts are based on the historical recovery rate. For bonds issued by companies in moratorium or in the process of liquidation the amounts presented are future cash flows estimated as their fair value at balance sheet date.

Amounts presented in the maturity analyses are the undiscounted future cash flows receivable and payable by the Group, including both principal and interest cash flows. These amounts differ from the carrying amounts presented in the balance sheet, which are based on discounted rather than undiscounted future cash flows. If an amount receivable or payable is not fixed, the amount presented in the maturity analyses has been determined by reference to the conditions existing at the balance sheet date. When there is a choice of when an amount shall be paid, future cash flows are calculated on the basis of the earliest date at which the Group can be required to pay, which is the worst case scenario from Group perspectives. An example of this is that demand deposits are figured in the earliest time band. Where the Group is committed to have amounts available in instalments, each instalment is allocated to the earliest period in which the Group might be required to pay. Thus undrawn loan commitments are included in the time band together with the earliest date at which such loans may be drawn. For financial guarantee contracts issued by the Group, the amount included in the maturity analysis is the guarantee's maximum amount, allocated to the earliest period in which the guarantee might be called.

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

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

The following table shows a maturity analysis of the Group's financial instruments by currency of denomination as at 30 June 2010:

|   | On demand        | Up to 3 months  | 3-12 months     | 1-5 years        | Over 5 years     | Total            | Carrying amount  |
|---|------------------|-----------------|-----------------|------------------|------------------|------------------|------------------|
| <b>Non-derivative financial assets</b>              |                  |                 |                 |                  |                  |                  |                  |
| Total in foreign currencies                         | 19,382           | 87,763          | 52,132          | 213,615          | 188,321          | 561,212          | 413,141          |
| ISK   | 64,028           | 41,410          | 55,729          | 193,373          | 403,330          | 757,869          | 499,596          |
| <b>Total</b>  | <b>83,410</b>    | <b>129,172</b>  | <b>107,861</b>  | <b>406,987</b>   | <b>591,652</b>   | <b>1,319,082</b> | <b>912,737</b>   |
| <b>Derivative financial assets</b>                  |                  |                 |                 |                  |                  |                  |                  |
| Total in foreign currencies                         | -                | 30              | -               | -                | -                | 30               | 111              |
| ISK   | -                | 227             | -               | -                | -                | 227              | 23               |
| <b>Total</b>  | <b>0</b>         | <b>258</b>      | <b>0</b>        | <b>0</b>         | <b>0</b>         | <b>258</b>       | <b>134</b>       |
| <b>Non-derivative financial liabilities</b>         |                  |                 |                 |                  |                  |                  |                  |
| Total in foreign currencies                         | (46,433)         | (18,190)        | (7,246)         | (115,237)        | (211,141)        | (398,247)        | (340,377)        |
| ISK   | (364,746)        | (51,719)        | (32,479)        | (51,044)         | (17,264)         | (517,251)        | (502,343)        |
| <b>Total</b>  | <b>(411,179)</b> | <b>(69,908)</b> | <b>(39,725)</b> | <b>(166,282)</b> | <b>(228,405)</b> | <b>(915,499)</b> | <b>(842,721)</b> |
| <b>Off-balance sheet items</b>                      |                  |                 |                 |                  |                  |                  |                  |
| Total in foreign currencies                         | (11,748)         | (542)           | (1,769)         | (1,590)          | -                | (15,649)         |                  |
| ISK   | (65,973)         | (4,399)         | (1,083)         | (1,781)          | -                | (73,235)         |                  |
| <b>Total</b>  | <b>(77,721)</b>  | <b>(4,941)</b>  | <b>(2,852)</b>  | <b>(3,371)</b>   | <b>0</b>         | <b>(88,884)</b>  |                  |
| <b>Derivative financial liabilities</b>             |                  |                 |                 |                  |                  |                  |                  |
| Total in foreign currencies                         | -                | (1,606)         | 9               | 428              | 321              | (848)            | (2,315)          |
| ISK   | -                | (246)           | (10)            | (650)            | (531)            | (1,437)          | (22)             |
| <b>Total</b>  | <b>0</b>         | <b>(1,852)</b>  | <b>(1)</b>      | <b>(222)</b>     | <b>(210)</b>     | <b>(2,285)</b>   | <b>(2,337)</b>   |
| <b>Net liquidity position in foreign currencies</b> |                  |                 |                 |                  |                  |                  |                  |
|   | <b>(38,800)</b>  | <b>67,455</b>   | <b>43,127</b>   | <b>97,215</b>    | <b>(22,499)</b>  | <b>146,499</b>   |                  |
| <b>Net liquidity position in ISK</b>                |                  |                 |                 |                  |                  |                  |                  |
|   | <b>(366,691)</b> | <b>(14,726)</b> | <b>22,157</b>   | <b>139,898</b>   | <b>385,536</b>   | <b>166,174</b>   |                  |
| <b>Net liquidity position</b>                       |                  |                 |                 |                  |                  |                  |                  |
|   | <b>(405,490)</b> | <b>52,728</b>   | <b>65,284</b>   | <b>237,113</b>   | <b>363,037</b>   | <b>312,672</b>   |                  |

## Notes to the Condensed Consolidated Interim Financial Statements

### 46. Maturity analysis of financial assets and liabilities by currency (continued)

The following table shows a maturity analysis of the Group's financial instruments by currency of denomination as at 31 December 2009:

|   | On demand        | Up to 3 months  | 3–12 months     | 1–5 years        | Over 5 years     | Total            | Carrying amount  |
|---|------------------|-----------------|-----------------|------------------|------------------|------------------|------------------|
| <b>Non-derivative financial assets</b>              |                  |                 |                 |                  |                  |                  |                  |
| Total in foreign currencies                         | 14,963           | 102,579         | 65,337          | 243,968          | 232,525          | 659,372          | 511,641          |
| ISK   | 48,903           | 52,877          | 53,899          | 170,288          | 426,536          | 752,503          | 437,495          |
| <b>Total</b>  | <b>63,866</b>    | <b>155,456</b>  | <b>119,236</b>  | <b>414,256</b>   | <b>659,061</b>   | <b>1,411,875</b> | <b>949,136</b>   |
| <b>Derivative financial assets</b>                  |                  |                 |                 |                  |                  |                  |                  |
| Total in foreign currencies                         | -                | 511             | (250)           | -                | -                | 261              | 962              |
| ISK   | -                | 9               | -               | -                | -                | 9                | 9                |
| <b>Total</b>  | <b>0</b>         | <b>520</b>      | <b>(250)</b>    | <b>0</b>         | <b>0</b>         | <b>270</b>       | <b>971</b>       |
| <b>Non-derivative financial liabilities</b>         |                  |                 |                 |                  |                  |                  |                  |
| Total in foreign currencies                         | (88,534)         | (1,153)         | (23,005)        | (91,266)         | (260,449)        | (464,407)        | (399,418)        |
| ISK   | (318,453)        | (94,294)        | (10,236)        | (47,985)         | (12,820)         | (483,788)        | (475,605)        |
| <b>Total</b>  | <b>(406,987)</b> | <b>(95,447)</b> | <b>(33,241)</b> | <b>(139,251)</b> | <b>(273,269)</b> | <b>(948,195)</b> | <b>(875,023)</b> |
| <b>Off-balance sheet items</b>                      |                  |                 |                 |                  |                  |                  |                  |
| Total in foreign currencies                         | (15,474)         | (10)            | (1)             | (58)             | -                | (15,543)         |                  |
| ISK   | (61,120)         | (4,566)         | (334)           | (3,066)          | -                | (69,086)         |                  |
| <b>Total</b>  | <b>(76,594)</b>  | <b>(4,576)</b>  | <b>(335)</b>    | <b>(3,124)</b>   | <b>0</b>         | <b>(84,629)</b>  |                  |
| <b>Derivative financial liabilities</b>             |                  |                 |                 |                  |                  |                  |                  |
| Total in foreign currencies                         | -                | 163             | 89              | 408              | 296              | 956              | (673)            |
| ISK   | -                | (164)           | (204)           | (798)            | (574)            | (1,740)          | (2)              |
| <b>Total</b>  | <b>0</b>         | <b>(1)</b>      | <b>(115)</b>    | <b>(390)</b>     | <b>(278)</b>     | <b>(784)</b>     | <b>(675)</b>     |
| <b>Net liquidity position in foreign currencies</b> |                  |                 |                 |                  |                  |                  |                  |
|   | <b>(89,045)</b>  | <b>102,090</b>  | <b>42,170</b>   | <b>153,052</b>   | <b>(27,628)</b>  | <b>180,639</b>   |                  |
| <b>Net liquidity position in ISK</b>                |                  |                 |                 |                  |                  |                  |                  |
|   | <b>(330,670)</b> | <b>(46,138)</b> | <b>43,125</b>   | <b>118,439</b>   | <b>413,142</b>   | <b>197,898</b>   |                  |
| <b>Net liquidity position</b>                       |                  |                 |                 |                  |                  |                  |                  |
|   | <b>(419,715)</b> | <b>55,952</b>   | <b>85,295</b>   | <b>271,491</b>   | <b>385,514</b>   | <b>378,537</b>   |                  |

The amounts in the maturity analysis as at 30 June 2010 and 31 December 2009 are allocated to maturity buckets in respect of remaining contractual maturity (i.e. based on the timing of future cash flows according to contractual terms). Exceptions to this are loans and advances to customers and bonds issued by companies in moratorium or in the process of liquidation as disclosed in Note 45.

The expected cash flows of loans are based on the currency of denomination. However, cash inflows of loans granted in foreign currency to customers with limited or no foreign income may not be in the denominated foreign currency (see Note 51).

## Notes to the Condensed Consolidated Interim Financial Statements

### Market risk

#### 47. Market risk management

In February 2010 the Board of Directors changed the ceiling for market risk from being 15% based on total risk-weighted asset base to being 15% based on the Group's equity according to the most recently published consolidated financial statements. Accordingly, exposure to equity price risk may not exceed 15%; exposure to currency risk may not exceed 10%, neither for long nor short positions; and the maximum exposure to interest rate risk may not exceed 5%. The Group's exposure to market risk as at 30 June 2010 was 7.5% of equity (31 December 2009: 22.1% of its total risk-weighted asset base), with the exposure to equity price risk measuring 1.5% of equity (31 December 2009: 3.4% of its total risk-weighted asset base), the exposure to interest rate risk measuring 1.6% of equity (31 December 2009: 5.1% of its total risk-weighted asset base) and the exposure to foreign exchange risk measuring 4.4% of equity (31 December 2009: 13.7% of its total risk-weighted asset base).

#### 48. Interest rate risk

The following tables summarise the Group's exposure to interest rate risk. The tables include interest-bearing financial assets and liabilities at their carrying amounts, while off-balance sheet amounts are the notional amounts of the derivative instruments (see Note 9). The amounts presented are categorised by the earlier of either the contractual repricing or the maturity date.

|  | Up to 3<br>months | 3-12<br>months | 1-5<br>years   | Over 5 years   | Carrying<br>amount |
|--|-------------------|----------------|----------------|----------------|--------------------|
| <b>At 30 June 2010</b>                         |                   |                |                |                |                    |
| <b>Financial assets</b>                        |                   |                |                |                |                    |
| Cash and balances with Central Bank            | 49,867            | -              | -              | -              | 49,867             |
| Bonds and debt instruments                     | 159,944           | 1,004          | 873            | 7,340          | 169,160            |
| Derivative instruments                         | 50                | 84             | -              | -              | 134                |
| Loans and advances to financial institutions   | 57,525            | 3,641          | -              | 11             | 61,177             |
| Loans and advances to customers                | 482,071           | 43,341         | 63,276         | 36,252         | 624,941            |
| Other financial assets                         | 4,255             | 3,338          | -              | -              | 7,593              |
| <b>Total</b>                                   | <b>753,712</b>    | <b>51,408</b>  | <b>64,148</b>  | <b>43,603</b>  | <b>912,872</b>     |
| <b>Financial liabilities</b>                   |                   |                |                |                |                    |
| Due to financial institutions and Central Bank | (144,272)         | -              | -              | -              | (144,272)          |
| Deposits from customers                        | (379,721)         | -              | -              | -              | (379,721)          |
| Derivative instruments and short positions     | (1,993)           | (5,146)        | (1,901)        | (1,079)        | (10,119)           |
| Borrowings                                     | (290,343)         | -              | -              | -              | (290,343)          |
| Contingent bond                                | (17,600)          | -              | -              | -              | (17,600)           |
| Other financial liabilities                    | (3,003)           | -              | -              | -              | (3,003)            |
| <b>Total</b>                                   | <b>(836,932)</b>  | <b>(5,146)</b> | <b>(1,901)</b> | <b>(1,079)</b> | <b>(845,058)</b>   |
| Net on-balance sheet position                  | (83,220)          | 46,262         | 62,247         | 42,524         | 67,814             |
| Net off-balance sheet position                 | -                 | 972            | (535)          | (437)          | -                  |
| <b>Total interest repricing gap</b>            | <b>(83,220)</b>   | <b>47,234</b>  | <b>61,713</b>  | <b>42,087</b>  |                    |
|  | Up to 3<br>months | 3-12<br>months | 1-5<br>years   | Over 5 years   | Carrying<br>amount |
| <b>At 31 December 2009</b>                     |                   |                |                |                |                    |
| <b>Financial assets</b>                        |                   |                |                |                |                    |
| Cash and balances with Central Bank            | 26,174            | -              | -              | -              | 26,174             |
| Bonds and debt instruments                     | 150,635           | 5,151          | 4,236          | 5,699          | 165,721            |
| Derivative instruments                         | 282               | 689            | -              | -              | 971                |
| Loans and advances to financial institutions   | 81,904            | 1,002          | 26             | 197            | 83,129             |
| Loans and advances to customers                | 518,539           | 57,383         | 39,910         | 51,290         | 667,122            |
| Other financial assets                         | 6,990             | -              | -              | -              | 6,990              |
| <b>Total</b>                                   | <b>784,524</b>    | <b>64,225</b>  | <b>44,172</b>  | <b>57,186</b>  | <b>950,107</b>     |
| <b>Financial liabilities</b>                   |                   |                |                |                |                    |
| Due to financial institutions and Central Bank | (98,228)          | -              | -              | -              | (98,228)           |
| Deposits from customers                        | (452,655)         | -              | -              | -              | (452,655)          |
| Derivative instruments and short positions     | (2,030)           | (798)          | (2,044)        | (1,071)        | (5,943)            |
| Borrowings                                     | (306,493)         | -              | -              | -              | (306,493)          |
| Contingent bond                                | (10,241)          | -              | -              | -              | (10,241)           |
| Other financial liabilities                    | (2,138)           | -              | -              | -              | (2,138)            |
| <b>Total</b>                                   | <b>(871,785)</b>  | <b>(798)</b>   | <b>(2,044)</b> | <b>(1,071)</b> | <b>(875,698)</b>   |
| Net on-balance sheet position                  | (87,261)          | 63,427         | 42,128         | 56,115         | 74,409             |
| Net off-balance sheet position                 | (1,101)           | 2,013          | (502)          | (410)          |                    |
| <b>Total interest repricing gap</b>            | <b>(88,362)</b>   | <b>65,440</b>  | <b>41,626</b>  | <b>55,705</b>  |                    |

## Notes to the Condensed Consolidated Interim Financial Statements

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

The consumer price index (CPI) indexation risk is the risk that the fair value or future cash flows of CPI-indexed financial instruments may fluctuate due to changes in the Icelandic CPI index. The Group has a considerable imbalance in its CPI-indexed assets and liabilities. The majority of the Group's mortgage loans and consumer loans are indexed to the CPI. Going forward, however, the asset side will increase, since it is expected that loans in foreign currency will be converted to CPI-indexed loans and that overall lending will increase.

At 30 June 2010 the CPI imbalance, calculated as the difference between CPI-indexed financial assets and liabilities, was ISK 91,149 million (31 December 2009: 71,812 million).

| Carrying amount                                | 30.6.2010       | 31.12.2009      |
|--|-----------------|-----------------|
| <b>Assets</b>                                  |                 |                 |
| Bonds and debt instruments                     | 4,953           | 5,438           |
| Loans and advances to customers                | 171,653         | 154,823         |
| <b>Total</b>                                   | <b>176,606</b>  | <b>160,261</b>  |
| <b>Liabilities</b>                             |                 |                 |
| Due to financial institutions and Central Bank | (413)           | (441)           |
| Deposits from customers                        | (84,525)        | (84,725)        |
| Short positions                                | (2,181)         | (1,917)         |
| <b>Total</b>                                   | <b>(87,119)</b> | <b>(87,083)</b> |
| Total on-balance sheet position                | 89,487          | 73,178          |
| Total off-balance sheet position               | 1,662           | (1,366)         |
| <b>Total CPI indexation balance</b>            | <b>91,149</b>   | <b>71,812</b>   |

Management of the Group's CPI indexation risk is supplemented by monitoring the sensitivity of the Group's overall position in CPI-indexed financial assets and liabilities net on-balance sheet to various inflation/deflation scenarios. As an example, a 10% inflation applied to the inflation risk exposures in existence at 30 June 2010, with no change in other variables, would have increased net interest income by ISK 8,949 million (31.12.2009: 7,318 million). Group equity would have been affected by the same amount as the income statement, but net of income tax. This is because the increase/decrease in net interest income would have affected retained earnings (accumulated deficit).

### 50. Currency risk (all portfolios)

The Group follows the Rules No. 707/2009 on Foreign Exchange Balances, as set by the Central Bank of Iceland. The rules stipulate that an institution's foreign exchange balance (whether long or short) must always be within certain limits in each currency. The Group submits daily reports to the Central Bank with information on its foreign exchange balance. The Central Bank has granted the Group a temporary dispensation from these rules until the end of January 2011, raising the required limits.

The inherent risk in the considerable foreign exchange imbalance is limited by the FX-delta. The FX-delta is calculated as the average elasticity of loans in foreign currency towards foreign exchange movements. This is because some of the Bank's customers have pledged collateral or have full or partial income in foreign currency, while others have limited or no income in foreign currency. As a result, depreciation of the ISK impacts customers with limited or no income in foreign currency more than those with full or partial income in foreign currency, and vice versa when ISK appreciates.

## Notes to the Condensed Consolidated Interim Financial Statements

### 51. Concentration of currency risk

The following tables summarise the Group's exposure to currency risk at 30 June 2010 and 31 December 2009. The off-balance sheet amounts shown are the notional amounts of the Group's derivative instruments, except for FX options which are delta amounts (see Note 9). The amounts presented as FX-delta adjustment to currency imbalance represent the amounts of foreign currency loans granted to customers with limited or no foreign currency income. Such loans are deducted from the net currency position, as changes in foreign exchange rates in regard to the ISK do not affect the carrying amounts of these loans and therefore do not affect Group results.

| At 30 June 2010   | EUR              | GBP             | USD              | JPY             | CHF             | Other          | Total            |
|---|------------------|-----------------|------------------|-----------------|-----------------|----------------|------------------|
| <b>Assets</b>   |                  |                 |                  |                 |                 |                |                  |
| Cash and balances with Central Bank   | 899              | 184             | 575              | 10              | 30              | 471            | 2,169            |
| Bonds and debt instruments  | 5,373            | 153             | 9,414            | -               | -               | 92             | 15,032           |
| Equities and equity instruments   | 746              | -               | 58               | -               | -               | 7,794          | 8,597            |
| Derivative instruments  | 25               | 11              | 74               | -               | -               | -              | 111              |
| Loans and advances to financial institutions  | 18,128           | 3,395           | 18,896           | 4,971           | 4,810           | 2,238          | 52,438           |
| Loans and advances to customers   | 74,399           | 9,857           | 71,740           | 81,915          | 79,622          | 25,467         | 342,999          |
| Other assets  | 873              | 27              | 189              | 1               | -               | 94             | 1,183            |
| Assets classified as held for sale  | 8,738            | 7,100           | 1,512            | 2,108           | 101             | 103            | 19,663           |
| <b>Total</b>  | <b>109,181</b>   | <b>20,727</b>   | <b>102,458</b>   | <b>89,005</b>   | <b>84,562</b>   | <b>36,259</b>  | <b>442,192</b>   |
| <b>Liabilities</b>  |                  |                 |                  |                 |                 |                |                  |
| Due to financial institutions and Central Bank  | (2,626)          | (1,625)         | (2,805)          | (336)           | (70)            | (2,090)        | (9,552)          |
| Deposits from customers   | (15,305)         | (3,237)         | (17,694)         | (356)           | (447)           | (3,020)        | (40,059)         |
| Derivative instruments and short positions  | (1,277)          | -               | (1,038)          | -               | -               | -              | (2,315)          |
| Borrowings  | (140,722)        | (54,106)        | (95,516)         | -               | -               | -              | (290,343)        |
| Other liabilities   | (125)            | (643)           | (174)            | -               | (1)             | (97)           | (1,040)          |
| <b>Total</b>  | <b>(160,055)</b> | <b>(59,611)</b> | <b>(117,226)</b> | <b>(691)</b>    | <b>(517)</b>    | <b>(5,207)</b> | <b>(343,309)</b> |
| Net on-balance sheet position   | (50,874)         | (38,884)        | (14,769)         | 88,314          | 84,045          | 31,052         | <b>98,883</b>    |
| Net off-balance sheet position  | 21,910           | 288             | 18,836           | (19,573)        | (21,033)        | (1,245)        | <b>(818)</b>     |
| <b>Net currency position</b>  | <b>(28,964)</b>  | <b>(38,597)</b> | <b>4,067</b>     | <b>68,740</b>   | <b>63,012</b>   | <b>29,807</b>  | <b>98,066</b>    |
| <b>FX-delta on Loans and advances to customers and assets classified as held for sale</b> | <b>83%</b>       | <b>90%</b>      | <b>88%</b>       | <b>39%</b>      | <b>49%</b>      | <b>73%</b>     |                  |
| <b>FX-delta adjustments to currency imbalance</b>   | <b>(14,300)</b>  | <b>(1,628)</b>  | <b>(8,497)</b>   | <b>(51,170)</b> | <b>(40,419)</b> | <b>(6,903)</b> | <b>(122,917)</b> |
| <b>Net effective currency position</b>  | <b>(43,264)</b>  | <b>(40,224)</b> | <b>(4,430)</b>   | <b>17,570</b>   | <b>22,592</b>   | <b>22,904</b>  | <b>(24,851)</b>  |
| At 31 December 2009   | EUR              | GBP             | USD              | JPY             | CHF             | Other          | Total            |
| <b>Assets</b>   |                  |                 |                  |                 |                 |                |                  |
| Cash and balances with Central Bank   | 517              | 265             | 197              | 12              | 32              | 282            | 1,305            |
| Bonds and debt instruments  | 4,105            | 241             | 24,534           | -               | -               | -              | 28,880           |
| Equities and equity instruments   | 1,780            | -               | 175              | -               | -               | 9,161          | 11,116           |
| Derivative instruments  | 185              | 224             | 553              | -               | -               | -              | 962              |
| Loans and advances to financial institutions  | 14,669           | 17,067          | 24,536           | 5,471           | 5,817           | 2,204          | 69,764           |
| Loans and advances to customers   | 86,662           | 15,528          | 74,392           | 103,116         | 102,750         | 28,227         | 410,675          |
| Other assets  | 1,154            | 184             | 450              | -               | 2               | 200            | 1,990            |
| <b>Total</b>  | <b>109,072</b>   | <b>33,509</b>   | <b>124,837</b>   | <b>108,599</b>  | <b>108,601</b>  | <b>40,074</b>  | <b>524,692</b>   |
| <b>Liabilities</b>  |                  |                 |                  |                 |                 |                |                  |
| Due to financial institutions and Central Bank  | (4,952)          | (1,163)         | (3,927)          | (313)           | (97)            | (257)          | (10,709)         |
| Deposits from customers   | (30,478)         | (17,106)        | (24,714)         | (1,198)         | (1,727)         | (6,708)        | (81,931)         |
| Derivative instruments and short positions  | (222)            | -               | (451)            | -               | -               | -              | (673)            |
| Borrowings  | (158,573)        | (56,086)        | (91,834)         | -               | -               | -              | (306,493)        |
| Other liabilities   | (216)            | (11)            | (99)             | -               | -               | (164)          | (490)            |
| <b>Total</b>  | <b>(194,441)</b> | <b>(74,366)</b> | <b>(121,025)</b> | <b>(1,511)</b>  | <b>(1,824)</b>  | <b>(7,129)</b> | <b>(400,296)</b> |
| Net on-balance sheet position   | (85,369)         | (40,857)        | 3,812            | 107,088         | 106,777         | 32,945         | <b>124,396</b>   |
| Net off-balance sheet position  | 5,298            | 2,390           | 10,183           | (12,834)        | (3,905)         | -              | <b>1,132</b>     |
| <b>Net currency position</b>  | <b>(80,071)</b>  | <b>(38,467)</b> | <b>13,995</b>    | <b>94,254</b>   | <b>102,872</b>  | <b>32,945</b>  | <b>125,528</b>   |
| <b>FX-delta on Loans and advances to customers</b>  | <b>75%</b>       | <b>90%</b>      | <b>82%</b>       | <b>57%</b>      | <b>60%</b>      | <b>87%</b>     |                  |
| <b>FX-delta adjustments to currency imbalance</b>   | <b>(21,917)</b>  | <b>(1,494)</b>  | <b>(13,056)</b>  | <b>(44,288)</b> | <b>(40,823)</b> | <b>(3,644)</b> | <b>(125,222)</b> |
| <b>Net effective currency position</b>  | <b>(101,988)</b> | <b>(39,961)</b> | <b>939</b>       | <b>49,966</b>   | <b>62,049</b>   | <b>29,301</b>  | <b>306</b>       |

## Notes to the Condensed Consolidated Interim Financial Statements

### 52. Foreign exchange rates used

The following foreign exchange rates were used by the Group:

|         | At 30<br>June<br>2010 | At 31<br>December<br>2009 | % Change | Average for<br>1.1–30.6<br>2010 | Average for<br>1.1–31.12<br>2009 |
|---------|-----------------------|---------------------------|----------|---------------------------------|----------------------------------|
| EUR/ISK | 156.70                | 179.70                    | (12.8%)  | 169.86                          | 171.80                           |
| GBP/ISK | 190.75                | 201.15                    | (5.2%)   | 195.60                          | 192.28                           |
| USD/ISK | 127.60                | 124.60                    | 2.4%     | 127.45                          | 122.96                           |
| JPY/ISK | 1.44                  | 1.35                      | 6.7%     | 1.40                            | 1.32                             |
| CHF/ISK | 118.44                | 121.01                    | (2.1%)   | 118.71                          | 114.08                           |
| CAD/ISK | 120.32                | 118.78                    | 1.3%     | 122.29                          | 108.12                           |
| DKK/ISK | 21.04                 | 24.15                     | (12.9%)  | 22.82                           | 23.07                            |
| NOK/ISK | 19.68                 | 21.64                     | (9.1%)   | 21.09                           | 19.62                            |
| SEK/ISK | 16.45                 | 17.49                     | (5.9%)   | 17.29                           | 16.22                            |