Landsbankinn
Consolidated Financial Statements 2010

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Endorsement and Statement by the Board of Directors and the CEO

The Consolidated Financial Statements of NBI hf. (hereafter "Landsbankinn" or the "Bank") for the financial year 2010 include the Bank and its subsidiaries (collectively referred to as the "Group").

Landsbankinn was founded by the Ministry of Finance on 7 October 2008 and had initial capital of ISK 775 million, paid in cash. The Bank commenced operations on the basis of a decision by the Financial Supervisory Authority (FME) on 9 October 2008. Originally the Bank was named New Landsbanki Íslands hf., but at a shareholders' meeting held on 21 October 2008 a resolution was passed to change the name to NBI hf. The Bank has nevertheless operated under the trade name of Landsbankinn. The Group's primary lines of business are corporate and retail banking, investment banking, asset management and leasing services.

Landsbankinn is currently owned by two entities: Landsskil, which is owned by Landsbanki Íslands hf. and wields 18.7% of voting rights; and Icelandic State Financial Investments (ISFI), which wields 81.3% of voting rights.

In February 2010, a new Board of Directors was elected. The new Board engaged Steinþór Pálsson to replace Ásmundur Stefánsson as CEO of the Bank as of 1 June 2010.

All positions of managing directors of Landsbankinn were advertised for application and filled in October of 2010.

Operations in 2010

Consolidated profit amounted to ISK 27,231 million for the financial year 2010. The Board of Directors proposes that no dividend will be paid. Consolidated total equity amounted to ISK 184,866 million at the end of the year, including share capital amounting to ISK 24,000 million. The capital adequacy ratio of the Group, calculated according to the Act on Financial Undertakings, was 19.5% at year-end 2010.

The year 2010 can rightly be described as a year of preparation and restructuring. Foundations in the form of revised and new processes have been laid for the Bank to become a force for change in the Icelandic economy. Focus has been placed on internal rebuilding and renewal and a new strategy implemented to guide powerful participation in the economic recovery of Iceland.

Landsbankinn announced its new strategy on 1 October 2010, setting out its goals and vision for 2010 through 2015. At the same time, a new organisational chart entered into effect.

On 16 June 2010 the Supreme Court of Iceland ruled in two separate cases that foreign currency linked lease agreements constituted obligations in ISK indexed to foreign currencies, which is not permitted under the law.

On 23 February 2011 the District Court of Reykjavik ruled in a case involving a foreign currency loan agreement of NBI hf. that the loan is in fact denominated in Icelandic Krona bearing from inception the lowest interest rates on unindexed ISK denominated loans as published by the Central Bank of Iceland.

Based on the rulings of the Icelandic Courts and on the guidelines from the Financial Supervisory Authority in Iceland (FME), the Group has changed during the year 2010 the accounting for all types of foreign currency lease agreements which are within the scope of law no. 38/2001 and for certain types of foreign currency loan agreements. Accordingly, 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. Future legal processes and government actions may, however, lead to different outcomes, which could necessitate material adjustments to the carrying amounts of assets and liabilities within the next financial year.

Outlook

According to the financial budget, the Bank's results will meet profitability targets for the period 2011 - 2013.

Due to restrictions on movement of capital between Iceland and other countries the Group has limited ability to mitigate the risk from ISK related currency fluctuations. However, the Group has taken various measures to decrease its overall currency risk and expects future currency risk levels to be within acceptable limits.

Restructuring of the finances of households and companies remains Landsbankinn's key task for the next year. Various remedies were put in place in 2010 to ensure that goals will be met in this area.

As investment and economic growth still leave something to be desired the outlook for the Icelandic economy remains uncertain. Despite this, many economic indicators show that a turnaround can be expected in 2011.

Risk Management

It is the view of the Board of Directors that sound risk management is a strategic tool to enhance value generation. Internal control should ensure effective operations and prudent management of risks that could otherwise prevent the Bank from attaining its business targets.

The Bank has significantly improved the framework and policies in 2010, bringing them to a level with international best practices. To this end the Bank has re-evaluated the credit process, established a credit underwriting unit within the Risk Management division, designed and implemented an Early Warning System and enhanced risk modelling. The Bank aims to further strengthen the risk management process in the coming year. Further description of the Bank's risk management is provided in Notes 44-79.

According to a legislation passed in 2009 the salary of the CEO of Landsbankinn is determined by the Compensation Council ("Kjararáð"). The Council determines remuneration and terms of employment of high level government employees, including CEOs of companies in which the government holds a majority of shares. It is a great concern of the Board that the decision of Kjararáð regarding the salary of the CEO of Landsbankinn is not set at a competitive level.

Statement by the Board of Directors and the CEO

The Consolidated Financial Statements for the year ended 31 December 2010 have been prepared on a going concern basis in accordance with International Financial Reporting Standards as adopted by the EU.

In our opinion the Consolidated Financial Statements give a true and fair view of the consolidated financial performance of the Group for the year 2010, its consolidated financial position as at 31 December 2010 and its consolidated cash flows for the year 2010.

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

The Board of Directors and the CEO have today discussed the Consolidated Financial Statements of NBI hf. for the year 2010 and confirm them by their signatures. The Board of Directors and the CEO recommend that the Consolidated Financial Statements be approved at the Annual General Meeting of NBI hf.

Reykjavik, 31 March 2011.

Board of Directors

Gunnar Helgi Hálfdanarson

Chairman

Þórdís Ingadóttir

Sigríður Hrólfsdóttir

Guðríður Ólafsdóttir

Ólafur Helgi Ólafsson

CEO

Steinþór Pálsson

Independent Auditor's Report

To the Board of Directors and Shareholders of NBI hf.

We have audited the accompanying consolidated financial statements of NBI hf., which comprise the consolidated statement of financial position as at December 31, 2010, the consolidated income statement, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of NBI hf. as at December 31, 2010, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Report on the Board of Directors report

Pursuant to the legal requirement under Article 106, Paragraph 1, Item 5 of the Icelandic Financial Statement Act No. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the Financial Statements.

Reykjavík, 31 March 2011.

KPMG ehf.

Reynir Stefán Gylfason

Reynir Stefán Gylfason

Helgi F. Arnarson

Helgi F. Arnarson

Consolidated Statement of Financial Position as at 31 December 2010

Notes		2010	2009
	Assets		
7	Cash and balances with Central Bank	47,777	26,174
6, 8	Bonds and debt instruments	161,559	165,721
6, 8	Equities and equity instruments	29,429	23,411
6, 9	Derivative instruments	23	971
10	Loans and advances to financial institutions	91,882	83,129
11, 37	Loans and advances to customers	592,954	667,122
12	Investments in associates	3,340	2,945
13	Property and equipment	5,016	6,030
14	Intangible assets	878	1,058
21	Deferred tax assets	1,522	6,682
15	Other assets	17,965	13,980
		952,344	**997,223**
16	Assets classified as held for sale	128,789	63,878
	Total assets	**1,081,133**	**1,061,101**
	Liabilities		
17	Due to financial institutions and Central Bank	147,478	98,228
18	Deposits from customers	371,558	452,655
6, 9	Derivative instruments and short positions	7,119	5,943
21	Tax liabilities	1,979	83
19, 37	Secured bonds	261,313	306,493
6,20,37	Contingent bond	26,510	10,241
22	Other liabilities	18,702	8,177
		834,659	**881,820**
	Liabilities associated with assets classified as held for sale	61,609	21,689
	Total liabilities	**896,268**	**903,509**
23	**Equity**		
	Share capital	24,000	24,000
	Share premium	123,898	123,898
	Statutory reserve	2,932	741
	Retained earnings	31,828	6,791
	Total equity attributable to owners of the Bank	**182,658**	**155,430**
	Non-controlling interests	2,207	2,162
	Total equity	**184,866**	**157,592**
	Total liabilities and equity	**1,081,133**	**1,061,101**

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

NBI hf. Consolidated Financial Statements 2010 4 All amounts are in ISK million

Consolidated Income Statement for the Year ended 31 December 2010

Notes		2010	2009*
	Interest income	61,060	81,476
	Interest expense	(36,374)	(66,902)
24	**Net interest income**	**24,685**	**14,574**
25	Net adjustments to loans and advances acquired at deep discount	49,702	23,772
4(i), 25	Loss from foreign currency linkage of loans and advances to customers	(18,158)	-
25, 61	Net impairment loss on loans and advances	(14,636)	(6,577)
6, 20	Fair value change of contingent bond	(16,269)	(10,241)
	Net adjustments in valuation	**641**	**6,954**
	Net interest income after adjustments in valuation	**25,326**	**21,528**
	Fee and commission income	6,292	6,835
	Fee and commission expense	(2,710)	(2,622)
26	**Net fee and commission income**	**3,582**	**4,213**
27, 29	Net gain on financial assets designated as at fair value through profit or loss	6,359	4,020
28, 29	Net gain on financial assets and liabilities held for trading	2,536	3,062
30	Net foreign exchange gain (loss)	14,623	(3,000)
31	Other income and expenses	(1,577)	902
	Other net operating income	**21,941**	**4,984**
	Total operating income	**50,849**	**30,725**
32	Salaries and related expenses	9,331	8,468
33	Other operating expenses	7,312	6,064
13	Depreciation and amortisation	1,311	1,278
34	Acquisition-related costs	542	1,044
	Total operating expenses	**18,496**	**16,854**
12	Share of profit of associates, net of income tax	291	383
	Profit before tax	**32,644**	**14,254**
35	Income tax expense	(7,782)	(615)
22	Tax on liabilities of financial institutions	(400)	-
	Profit for the year from continuing operations	**24,462**	**13,639**
	Profit for the year from discontinued operations, net of income tax	2,769	693
	Profit for the year	**27,231**	**14,332**
	Profit (loss) for the year attributable to:		
	Owners of the Bank		
	Profit for the year from continuing operations	24,462	13,639
	Profit for the year from discontinued operations	2,766	838
	Profit for the year attributable to owners of the Bank	**27,228**	**14,477**
	Non-controlling interests		
	Profit for the year from continuing operations	-	-
	Profit (loss) for the year from discontinued operations	3	(145)
	Profit (loss) for the year attributable to non-controlling interests	**3**	**(145)**
	Profit for the year	**27,231**	**14,332**

* Certain comparative amounts have been changed in conformity with current year presentation (see Note 2 – Changes in presentation).

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

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Consolidated Statement of Changes in Equity for the Year ended 31 December 2010

Notes		Attributable to owners of the Bank						
	Change in equity for the year 2009	**Share capital**	**Share premium**	**Statutory reserve**	**Retained earnings**	**Total**	**Non-controlling interests**	**Total**
	Balance at 1 January 2009	24,000	125,898	-	(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
	Balance at 31 December 2009	**24,000**	**123,898**	**741**	**6,791**	**155,430**	**2,162**	**157,592**
	Change in equity for the year 2010							
	Balance at 1 January 2010	24,000	123,898	741	6,791	155,430	2,162	157,592
	Profit for the year				27,228	27,228	3	27,231
	Transfer to statutory reserve			2,191	(2,191)	0		0
	Changes in ownership interests in subsidiaries that do not result in loss of control					0	43	43
23	**Balance at 31 December 2010**	**24,000**	**123,898**	**2,932**	**31,828**	**182,658**	**2,208**	**184,866**

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

NBI hf. Consolidated Financial Statements 2010 6 All amounts are in ISK million

Consolidated Statement of Cash Flows for the Year ended 31 December 2010

Notes		2010	2009
	Operating activities		
	Profit for the year	27,231	14,332
	Adjustments for non-cash items included in profit for the year	(39,329)	(25,654)
	Changes in operating assets and liabilities	(11,300)	(29,770)
	Interest received	98,601	94,024
	Interest paid	(43,397)	(56,303)
	Dividends received	583	785
	Income tax paid	(470)	(461)
	Net cash from (used in) operating activities	**31,919**	**(3,047)**
	Investing activities		
	Acquisition of additional shares in associates	-	(44)
13	Purchase of property and equipment	(91)	(299)
13	Proceeds from sale of property and equipment	79	129
14	Acquisition of intangible assets	(104)	(112)
	Net cash used in investing activities	**(116)**	**(326)**
	Financing activities		
	Proceeds from issue of share capital in subsidiaries	-	88
	Net cash from financing activities	**0**	**88**
	Net change in cash and cash equivalents	31,803	(3,285)
	Cash and cash equivalents at the beginning of the year	21,166	22,897
	Effect of exchange rate changes on cash and cash equivalents held	(314)	1,554
	Cash and cash equivalents at 31 December	**52,654**	**21,166**

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 Íslar	-	4,270
Settlement of provisional liability due to Landsbanki Íslands hf. through borrowings	-	312,168

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

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Consolidated Statement of Cash Flows for the Year ended 31 December 2010

Notes		2010	2009
	Adjustments for non-cash items included in profit for the year		
24	Net interest income	(24,685)	(14,574)
25	Net adjustments to loans and advances acquired at deep discount	(49,702)	(23,772)
4(i)	Loss from foreign currency linkage of loans and advances to customers	18,158	-
25, 61	Net impairment loss on loans and advances	14,636	6,577
6, 20	Fair value change of contingent bond	16,269	10,241
13	Depreciation and amortisation	1,311	1,278
35	Income tax	7,782	615
22	Tax on liabilities of financial institutions	400	-
12	Share of profit of associates, net of income tax	(291)	(383)
27	Net (gain) loss on financial assets designated as at fair value through profit or loss	(6,359)	(4,020)
28	Net gain on financial assets held for trading	(2,536)	(3,062)
30	Net foreign exchange loss (gain)	(14,308)	1,446
		(39,329)	**(25,654)**
	Changes in operating assets and liabilities		
	Change in reserve requirement with Central Bank	3,400	(719)
	Change in bonds and equities	(5,455)	8,829
	Change in loans and advances to financial institutions	(4,514)	(21,895)
	Change in loans and advances to customers	23,117	(6,172)
	Change in other assets	200	5,003
	Change in assets classified as held for sale	(9,612)	-
	Change in due to financial institutions and Central Bank	51,560	(31,019)
	Change in deposits from customers	(80,954)	24,493
	Change in tax liability	(3,667)	-
	Change in repossessed collateral	2,152	(4,419)
	Change in other liabilities	3,069	(3,871)
	Change in liabilities associated with assets classified as held for sale	9,406	-
		(11,300)	**(29,770)**
	Cash and cash equivalents is specified as follow:		
7	Cash and unrestricted balances with Central Bank	45,810	16,538
10	Bank accounts with financial institutions	6,844	4,628
	Cash and cash equivalents at 31 December	**52,654**	**21,166**

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

NBI hf. Consolidated Financial Statements 2010 8 All amounts are in ISK million

Notes to the Consolidated Financial Statements

Notes to the Consolidated 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 consolidated financial statements of the Bank for the year ended 31 December 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 Group operates solely in Iceland.

The issue of these consolidated financial statements was authorised by the Board of Directors of the Bank on 31 March 2011.

2. Basis of preparation

Statement of compliance

These Consolidated Financial Statements for the year ended 31 December 2010 have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union.

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 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.

It is the view of the Bank's management that the Group is sufficiently capitalised to continue as a going concern (see further Notes 42 and 43). 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 36 and 44-79.

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 and new legislation as described in Note 4(i).

As described in Note 78 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 consolidated 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 Group entity are measured using the currency of the economic environment in which the respective entity operates (its functional currency). All amounts are presented in Icelandic Krona (ISK), which is also the Bank's functional currency, rounded to the nearest million unless otherwise stated.

Use of estimates and judgements

The preparation of financial statements requires 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.

Note 4 discusses estimates and assumptions which involve a substantial risk which could result in material adjustments to the carrying amounts of assets and liabilities during the next financial year.

2. Basis of preparation (continued)

Changes in presentation

The Group made the following changes in presentation of items in the consolidated financial statements during the year 2010:

The Group has changed the presentation in the income statement of the adjustments to the carrying amount of loans and advances acquired at deep discount which are due to changes in estimated future cash flows (see Note 25), other than those resulting from unbinding foreign currency linkage (see Note 4(i)). The net adjustments are now presented in a separate line on the face of the income statement called "Net adjustments to loans and advances acquired at deep discount" but they were previously included in the line item "Interest income" in the income statement. The comparison amounts for the year 2009 in the income statement have been adjusted in accordance with the new presentation. Accordingly, the amount of "Interest income" disclosed for the year 2009 decreased by ISK 23,772 million.

The Group has changed the presentation of the change in fair value of the contingent bond in the income statement. The change in fair value is now presented in a separate line on the face of the income statement but it was previously included in the line "Interest expense" in the income statement. The comparison amounts for the year 2009 in the income statement have been adjusted in accordance with the new presentation. Accordingly, the amount of "Interest expense" disclosed for the year 2009 decreased by ISK 10,241 million.

The Group has changed the presentation in the income statement of net foreign exchange differences arising from OTC currency options, which the Bank has bought to economicaly hedge its foreign currency imbalance (see Note 9). The net foreign exchange difference is now presented in the line "Net foreign exchange gain (loss)" in the income statement but it was previously included in the line "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 in accordance with the new presentation as follows:

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

The Group has changed the name of the line "Borrowings" in the statement of financial position into "Secured bonds" due to the fact that the Bank has issued the secured bonds to Landsbanki Íslands hf. on 12 October 2010 (see Note 19) in accordance with the settlement agreement signed on 15 December 2009 in respect of the transfer of assets and liabilities from Landsbanki Íslands hf. on 9 October 2008.

Other accounting developments

The new standards and amendments to standards which became effective for the Group from 1 January 2010 had no effect on the accounting policies applied by the Group. The revised standard IFRS 3 *Business Combinations* (revised 2008) and the amendments to IAS 27 *Consolidated and Separate Financial Statements* (2008) have been early adopted by the Group in its consolidated financial statements for the period ended 31 December 2008.

The Group has early adopted the whole revised standard IAS 24 *Related Party Disclosures* (revised 2009) in these consolidated financial statements. The revised standard amended the definition of a related party and introduced a partial exemption from the general disclosure requirements in IAS 24 in respect of related party transactions with government and government-related entities. The adoption of the revised IAS 24 has impacted only the disclosures provided by the Group in respect of transactions with government and government-related entities as the Group chose to apply the partial exemption provided in IAS 24 (see Note 40). The Group has applied the revised IAS 24 retrospectively, in accordance with its transitional provisions.

3. Significant accounting policies

These consolidated financial statements have been prepared using uniform accounting policies for like transactions and other events in similar circumstances. The accounting policies have been applied consistently to all periods presented. As explained in Note 2 certain changes were made during 2010 to the presentation of certain items in the income statement and statement of financial position. There were no items of revenue or expense that the Group had to recognise in other comprehensive income during the years 2010 and 2009.

The principal accounting policies used in preparing these consolidated financial statements are set out below.

Consolidation

(a) Subsidiaries

Subsidiaries are entities over which the Group has the power to govern financial and operating policies so as to obtain benefits from their activities, generally accompanied by a shareholding of over half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls an entity. Subsidiaries are fully consolidated from the date on which control is obtained, and are de-consolidated from the date on which control ceases.

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

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

(b) Non-controlling interests

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

(c) Associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity. Investments in associates are accounted for using the equity method as of the date on which significant influence is obtained and are initially recognised at cost. Goodwill relating to an associate is included in the carrying amount of the investment. Amortisation of goodwill is not permitted. Any excess of the Group's share of net fair value of the associate's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the Group's share of the associate's profit or loss in the period which the investment is acquired.

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

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

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

3. Significant accounting policies (continued)

Foreign currency translation

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

Due to varying customer financial strength, the Group has assessed the increase in credit risk due to exchange fluctuations in the foreign currency denominated loan portfolio. While some customers have part of or all of their income in foreign currency, other customers have very limited or no income in foreign currency. In many instances, customers with limited or no income in foreign currency will encounter difficulty in meeting their obligations if the ISK depreciates. Therefore, for customers who have limited or no income in foreign currency, the foreign exchange differences arising through loans and advances to these customers is presented in the income statement net of the amount of foreign exchange difference deemed to be uncollectible.

Financial assets and liabilities

(a) Recognition

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

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

(b) Classification

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

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

The Group designates certain financial assets upon initial recognition as at fair value through profit or loss when the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis.

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

(c) Derecognition

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

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

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

(d) Offsetting

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

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

3. Significant accounting policies (continued)

Financial assets and liabilities (continued)

(e) Amortised cost measurement

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

(f) Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction at the measurement date.

The Group measures the fair value of an instrument using quoted prices in an active market for that instrument, if available. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis. Where available, the relevant market's closing price determines the fair value of financial assets held for trading and of assets designated at fair value through profit or loss; this will generally be the last trading price.

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

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

(g) Impairment of financial assets

Impairment of loans and advances

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

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

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

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

3. Significant accounting policies (continued)

Financial assets and liabilities (continued)

(g) Impairment of financial assets (continued)

Impairment of loans and advances (continued)

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

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

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

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

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

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

Renegotiated loans

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

Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents are defined as cash, unrestricted balances with the Central Bank and unrestricted balances with financial institutions.

Bonds and equities

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

Bonds which are classified as loans and receivables are initially measured at fair value plus directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the bonds and it is recognised in the line item "Interest income" in the income statement.

3. Significant accounting policies (continued)

Derivative instruments

Derivatives are initially recognised in the statement of financial position at fair value, with transaction costs being recognised in the income statement. Subsequently, derivatives are carried at fair value, with all fair value changes recognised in the line item "Net gain on financial assets and liabilities held for trading" in the income statement, except for fair value changes of derivative currency forwards and net foreign exchange differences arising from OTC currency options, which are included in the line item "Net foreign exchange gain (loss)" in the income statement. In the statement of financial position, derivatives with positive fair values are recognised as assets and derivatives with negative fair values are recognised as liabilities. The Group does not apply hedge accounting.

Loans and advances

Loans and advances are initially measured at fair value plus directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of loans and advances. Interest income on loans and advances is recognised in the line item "Interest income" in the income statement and foreign exchange differences in the line item "Net foreign exchange gain (loss)".

Loans and advances acquired at deep discount

The Bank acquired loans and advances from Landsbanki Íslands hf. at deep discount that reflected credit losses which were already incurred at acquisition date. The deep discount was included in the fair value of these loans and advances estimated at initial recognition. The deep discount is also included in the estimated future cash flows used by the Group to calculate the amortised cost and effective interest rate of these loans and advances.

At each reporting date, the Group assesses the current status of these loans and advances and whether there is any objective evidence of changes in expected cash flows, for example due to differences in estimated and actual payments, changes in the value of collaterals and improvement in the financial situation of debtors. If there is any change in expected cash flows, the Group recalculates the carrying amount of these loans and advances as the present value of the revised estimated future cash flows, using their effective interest rate. The difference between the revised carrying amount of the loans and their current carrying amount, which includes accrued interest, indexation, foreign exchange differences and actual payments received by the Group, is recognised on a portfolio basis as follows:

• Positive differences are recognised in the income statement in the line “Net impairment loss on loans and advances” in order to reverse any negative differences recognised by the Group as impairment of the corresponding loan portfolio in previous accounting periods. The excess amount, if any, is recognised in the income statement in the line “Net adjustments to loans and advances acquired at deep discount”.

• Negative differences are recognised in the income statement in the line “Net adjustments to loans and advances acquired at deep discount” in order to reverse any positive differences recognised in respect of the corresponding loan portfolio in previous accounting periods. The excess amount, if any, is recognised in the income statement in the line “Net impairment loss on loans and advances”.

The Group recognises interest and indexation on these loans and advances based on their carrying amount and only to the extent that the interest and indexation are deemed to be collectible. The interest and indexation are recognised in the income statement in the line "Interest income”.

Due to varying customer financial strength, the Group has assessed the increase in credit risk due to exchange fluctuations in the foreign currency denominated loan portfolio. While some customers have part of or all of their income in foreign currency, other customers have very limited or no income in foreign currency. In many instances, customers with limited or no income in foreign currency will encounter difficulty in meeting their obligations if the ISK depreciates. Therefore, for customers who have limited or no income in foreign currency, the foreign exchange differences arising through loans and advances to these customers is presented in the income statement net of the amount of foreign exchange difference deemed to be uncollectible.

The amount of foreign exchange difference deemed to be uncollectible is calculated based on the estimated FX-delta on the FX loan book. The Bank implemented the FX-delta methodology during the valuation process of the loans acquired from Landsbanki Íslands hf. During that process the Bank analysed its largest corporate customers in great detail and estimated the FX-delta by analysing major customers which have loans denominated in foreign currency. Industry specialists performed this estimate by reviewing financial strength, collaterals and the currency composition of cash flows. The Group estimated the ability of customers to raise income in foreign currencies and to fulfil their obligations in regard to foreign currency dominated loans. The Group revises its estimated FX-delta at each reporting date if changes occur in the circumstances on which the FX-delta is based or as a result of new information or more experience.

3. Significant accounting policies (continued)

Property and equipment

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

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

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

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

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

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

Intangible assets

(a) Computer software licenses

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring them into service. Computer software licenses recognised as intangible assets are amortised over their useful life, which is estimated to be 3 - 5 years.

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

(b) Goodwill

Goodwill is recognised as an asset only if acquired in a business combination. It is recognised as of the acquisition date and measured as the aggregate of (a) the fair value of the consideration transferred, (b) the recognised amount of any non-controlling interest in the acquiree, and (c) the fair value of any previously held equity interest in the acquiree, less the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. The consideration transferred includes the fair value of assets transferred, liabilities incurred and equity interests issued by the Group. In addition, consideration transferred includes the fair value of any contingent consideration.

Following initial recognition, goodwill is measured at cost, less any accumulated impairment losses. Goodwill is generally reviewed for impairment annually, but more frequently if events or changes in circumstances indicate a potential impairment of the carrying amount. For the purpose of impairment testing, goodwill is allocated as of the acquisition date to each of the Group's cash-generating units (CGUs) or group of CGUs which are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. Each unit to which this goodwill is allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. Where goodwill is attached to a particular unit of a CGU (or of a group of CGUs) and part of the operations within that unit is disposed of, the goodwill that is associated with the operations disposed of is included in the carrying amount of these operations when determining the gain or loss incurred upon disposing of the operations.

Impairment of non-financial assets

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

3. Significant accounting policies (continued)

Deferred income tax

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

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

The principal temporary differences arise from fair value changes in various financial assets and liabilities and the difference between the fair values of acquired assets and their tax base.

Assets and liabilities classified as held for sale

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

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

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

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

Deposits and secured bonds

The Group's sources of debt funding consist of deposits, loans from financial institutions and debt securities.

When the Group sells a financial asset and simultaneously enters into an agreement to repurchase the asset or a similar asset at a fixed price on a future date ("repo"), this arrangement is accounted for as an amount due to financial institutions or the Central Bank, and the underlying asset continues to be recognised in the Group's financial statements.

The Group classifies financial instruments as financial liabilities or equity instruments in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset or an equity instrument.

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

Contingent bond

The contingent bond is a contingent obligation of the Bank to issue a bond to Landsbanki Íslands hf. on 31 March 2013 as an additional consideration for the assets and liabilities transferred from Landsbanki Íslands hf. on 9 October 2008. The issue of the bond and its nominal amount are contingent on the excess of the value of certain pools of assets, to be determined as at 31 December 2012, over the future value of the acquisition price of those assets as at 9 October 2008, subject to specified adjustments.

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 "Fair value change of contingent bond" in the income statement.

3. Significant accounting policies (continued)

Short positions

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

Financial guarantee contracts

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

Financial guarantees issued by the Group are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the Group's liability under such a guarantee is determined as the initial measurement, less amortisation of fee income earned on a straight line basis over the life of the guarantee, or the best estimate for settling any financial obligation that has arisen through the guarantee by the reporting date, whichever is higher. These estimates are determined on the basis of experience with similar transactions and the history of past losses, supplemented by management judgement.

Contingent liabilities and provisions

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

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

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

Employee benefits

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

Share capital

(a) Share issue costs

Costs directly attributable to the issue of new shares are presented separately in equity as a deduction from share premium, net of any related income tax benefits.

(b) Dividends on ordinary shares

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

Fiduciary activities

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

3. Significant accounting policies (continued)

Interest income and expense

The interest income and expense presented in the income statement include:
- Interest on financial assets and liabilities measured at amortised cost, calculated on an effective interest rate basis;
- Interest on unpaid capital contribution, calculated on an accrual basis;
- Interest on provisional liabilities, calculated on an accrual basis.

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

Net impairment loss on loans and advances

Impairment charges relating to loans and advances to financial institutions and customers are presented in the consolidated income statement under the item "Net impairment loss on loans and advances". After impairment has been recognised, interest income is recognised at the rate of interest used for discounting future cash flows when measuring impairment losses.

Fee and commission income and expense

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

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

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

Net gain on financial assets and liabilities held for trading

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

Net foreign exchange gain (loss)

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

Other income and expenses

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

3. Significant accounting policies (continued)

Leases

(a) When a Group entity is the lessee

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

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

(b) When a Group entity is the lessor

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

Discontinued operations

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

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

New standards, amendments to standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2010, and have not been applied in preparing these consolidated financial statements. None of them will have an effect on the consolidated financial statements of the Group, with the exception of:

The amendment to IFRS 7 *Financial Instruments: Disclosures* included in the *Improvements to IFRSs* (May 2010), according to which the Group will be required to disclose a quantification of the extent to which collateral and other credit enhancements mitigate the credit risk arising from financial assets. The amendment becomes mandatory for the Group's 2011 consolidated financial statements, with retrospective application required.

The amendments to IFRS 7 *Financial Instruments: Disclosures – Transfers of Financial Assets*, according to which the Group will be required to disclose information that enables users of financial statements (i) to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and (ii) to evaluate the nature of, and risks associated with, an entity's continuing involvement in derecognised financial assets. If endorsed by the EU, these amendments will become mandatory for the Group's 2012 consolidated financial statements, with earlier application permitted. The disclosures will not be required for any periods presented that begin before the date of initial application of the amendments. The amendments will impact only the disclosures made in the notes to consolidated financial statements in respect of transfers of financial assets.

3. Significant accounting policies (continued)

New standards, amendments to standards and interpretations not yet adopted (continued)

IFRS 9 *Financial instruments*, which replaces those parts of IAS 39 *Financial Instruments: Recognition and Measurement* relating to the classification and measurement of financial assets and financial liabilities. The key features of IFRS 9 are the following:

• Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

• An instrument is subsequently measured at amortised cost only if it is a debt instrument and both the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and the asset's contractual cash flows represent only payments of principal and interest. All other debt instruments are to be measured at fair value through profit or loss.

• All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There will be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

• Derivatives embedded in contracts with a host that is a financial asset within the scope of the standard are not to be separated; instead the hybrid financial instrument is to be assessed in its entirety as to whether it should be measured at amortised cost or fair value.

• IFRS 9 (2010) generally requires that the amount of change in fair value attributable to changes in the credit risk of liabilities designated by an entity as at fair value through profit or loss be presented in other comprehensive income, with only the remaining amount of the total gain or loss included in profit or loss. The amounts presented in other comprehensive income may not be subsequently reclassified to profit or loss but may be transferred within equity. However, if the recognition of gains and losses in other comprehensive income creates or enlarges an accounting mismatch in profit or loss, then the whole fair value change must be presented in profit or loss. Additionally, all fair value gains and losses continue to be included in profit or loss for loan commitments and financial guarantee contracts designated as fair value through profit or loss.

Currently, IASB has issued two versions of IFRS 9. The first version was issued in 2009 and the second version was issued in 2010. The 2010 version includes all the requirements of the 2009 version without amendment, but in addition, it also includes the requirements with respect to the classification and measurement of financial liabilities and the derecognition of financial assets and financial liabilities. The 2010 version supersedes the 2009 version. However, for annual periods beginning before 1 January 2013, an entity may elect to apply the 2009 version rather than the 2010 version.

If endorsed by the EU, IFRS 9 will become mandatory for the Group's 2013 consolidated financial statements, with retrospective application required with certain exceptions. Earlier application of the standard is permitted and prior periods need not be restated if the Group adopts the standard for reporting periods beginning before 1 January 2012. The Group is currently in the process of evaluating the potential effect of this standard and the timing of its adoption by the Group. Given the nature of the Group's operations, the standard is expected to have a pervasive impact on the consolidated financial statements of the Group.

4. Critical accounting estimates and judgements in applying accounting policies

(a) Effective interest rate on loans and advances

The Bank acquired loans and advances from Landsbanki Íslands hf. at a deep discount, reflecting incurred credit losses. The effective interest rate is computed for these loans by estimating their future cash flows and comparing it with their acquisition prices. Estimating the cash flows involves management judgements about the debtors' financial situation and ability to pay their debts, the net realisable value of any underlying collateral and the timing of any potential cash flows. These estimates have a significant risk of resulting in material adjustments to the carrying amounts of loans within the next financial year.

(b) Impairment losses on loans and advances

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

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

(c) Foreign exchange gains and losses on loans and advances

Due to varying customer financial strength, the Bank needs to assess risk increases occurring in the foreign currency denominated loan portfolio through foreign exchange fluctuation. Some Bank customers have partial or full income in foreign currencies, while other customers have very limited or no income in foreign currency. Customers with limited or no income in foreign currency will in many instances encounter difficulties in meeting their obligations, should the ISK depreciate. Therefore, concerning customers with limited or no income in foreign currency, the foreign exchange difference arising from loans and advances is presented in the income statement net of the amount of foreign exchange difference deemed to be uncollectible.

(d) Valuation of financial instruments

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

(e) Financial asset and liability classification

The Group´s accounting policies provide scope for assets and liabilities to be classified at initial recognition into different categories in certain circumstances:

• Where financial assets or liabilities have been classified as "held for trading", the Group has determined that they meet the description of such assets and liabilities set out in its accounting policies.

• Where financial assets have been designated as at fair value through profit or loss, the Group has determined that they meet the criteria set out in the accounting policies.

• Where financial assets have been classified as loans and receivables, the Group has determined that they meet the criteria set out in the accounting policies.

(f) Assets classified as held for sale

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

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

(g) Deferred tax assets

Deferred tax assets are recognised in the consolidated statement of financial position. In respect of tax losses carried forward, they are recognised to the extent that it is probable that taxable profits will be available against which to utilise the losses. Judgement is required to determine the amount of deferred tax assets that may be recognised, based upon the likely timing and level of future taxable profits, as well as tax-planning strategies.

(h) Liquidity

The key measure used by the Group for monitoring liquidity risk is the ratio of core liquid assets to deposits. The calculation of this ratio requires judgement as to which assets to consider liquid. Furthermore, the maturity of some assets included in the maturity analysis of the financial assets and liabilities disclosed in the notes, such as loans acquired from Landsbanki Íslands hf., is based on expected future cash flows rather than contractual maturities. The estimation of the amount and timing of the cash flows from these financial assets involves management judgements about the debtors' financial situations and their abilities to repay their debts, the net realisable value of any underlying collateral and the timing of any possible cash flows.

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

(i) 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 no. 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.

On 18 December 2010 the Parliament of Iceland passed a bill (law no. 151/2010) which amended, among other things, the law no. 38/2001 on interest and indexation. According to the amendments, certain types of foreign currency linked agreements are considered as denominated in Icelandic Krona. Furthermore, if the term of the agreements does not exceed 5 years, they are considered to bear from inception the lowest interest rates on unindexed ISK denominated loans as published by the Central Bank of Iceland. If the term of the agreements exceed 5 years, the borrowers can choose whether the agreements bear from inception the lowest interest rates on indexed or unindexed ISK denominated loans as published by the Central Bank of Iceland. The amendments also clarify that borrowers are entitled to reimbursement of payments which are in excess of the amount of their obligations calculated in accordance with the provisions of the law.

On 23 February 2011 the District Court of Reykjavik ruled in a case involving a foreign currency loan agreement of NBI hf. that the loan is in fact denominated in Icelandic Krona bearing from inception the lowest interest rates on unindexed ISK denominated loans as published by the Central Bank of Iceland.

Changes in the denomination currencies and interest rates of lease and loan agreements

Based on the rulings of the Icelandic Courts and on the guidelines from the Financial Supervisory Authority in Iceland (FME), the Group has changed during the year 2010 the accounting for all types of foreign currency lease agreements which are within the scope of law no. 38/2001 and for certain types of foreign currency loan agreements. Accordingly, 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. Previously, the Group accounted for these agreements as loans and advances to 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 lead to a decrease in their carrying amount in the consolidated statement of financial position from ISK 173,303 million to ISK 162,327 million. The decrease of ISK 10,976 million is accounted for as a change in accounting estimate and it is recognised in the consolidated income statement in the line „Loss from foreign currency linkage of loans and advances to customers". Part of this decrease, ISK 8,193 million, was recognised in the last quarter of 2010.

The law no. 151/2010 did not have any effect on the Group's consolidated financial statements for the year 2010 since by the time the law was passed by the Parliament of Iceland the Group had already accounted for the agreements falling under the scope of the law as agreements denominated in Icelandic Krona.

Provision for excess payments

The Group has recognised a provision in respect of those lease and loan agreements for which the Group changed its accounting as described 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 Icelandic courts and law no. 151/2010. The provision amounted to ISK 7,182 million as at 31 December 2010 and it is recognised in the consolidated statement of financial position among „Other liabilities". Part of this amount, ISK 1,714 million, was recognised in the last quarter of 2010.

The provision is measured at the amount that represents the management's best estimate of the expenditure required to settle the excess payment obligation. 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. The Group has recognised the amount of the provision as an expense in the consolidated income statement in the line item „Loss from foreign currency linkage of loans and advances to customers".

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 described 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 in respect of loans and advances to customers. This is because previously to the change, the carrying amount of those agreements were disclosed in Note 78 as financial assets denominated in foreign currencies but after the change they are no longer included in that disclosure. Prior to the change, the carrying amount of those agreements was specified by currency as follows:

	EUR	GBP	USD	JPY	CHF	Other	Total
Carrying amount	34,942	3,180	12,791	60,203	56,856	5,332	173,303

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

(i) Denomination currencies and interest rates of lease and loan agreements (continued)

The changes in the currencies and interest rates of lease and loan agreements described above have also resulted in the increase in the FX-delta (see Note 78) when compared to the FX-delta disclosed in the consolidated financial statements for the year 2009, as follows:

	EUR	GBP	USD	JPY	CHF	Other
Absolute increase in FX-delta	20%	6%	15%	21%	18%	5%

In respect of interest rate risk arising from those agreements, the change in interest rates has lead to a change in the nature of interest rate risk disclosed, from interest rates in foreign currencies to interest rates on unindexed ISK denominated loans. The borrowers' choice between unindexed and indexed interest rates based on law no. 151/2010 could affect the interest repricing gap as disclosed in Note 72 and the CPI indexation balance as disclosed in Note 75. The borrowers are required to confirm their choice during the first quarter of 2011.

The financial risk disclosures made in these consolidated 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.

Estimation uncertainty

As described above, all types of foreign currency lease agreements which are within the scope of law no. 38/2001 and certain types of foreign currency 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 carrying amount of all foreign currency loan agreements which the Group accounts for as denominated in foreign currencies and bearing interest rates in the respective foreign currencies as at 31 December 2010 amounted to ISK 163,084 million. These types of loan agreements are not currently under legal disputes and it is the view of the management of the Bank that there is limited legal uncertainty about the currencies of denomination and interest rates of these loan agreements.

The accounting treatment of the lease and loan agreements is based on the latest available information. Therefore, future legal processes and 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. For example, if the Supreme Court of Iceland confirms during the year 2011 that the types of loan agreements which are currently under legal dispute are in fact foreign currency loan agreements, it will result in the Group having to change the accounting for these types of loan agreements, from being currently accounted for as ISK denominated to being accounted for as foreign currency denominated. The total carrying amount of these types of loan agreements would increase from ISK 118,329 million to ISK 124,747 million as at 31 December 2010, with an equivalent before tax positive effect on profit or loss. In addition, the carrying amount of the provision for excess payments would decrease from ISK 7,182 million to ISK 5,481 million as at 31 December 2010, with an equivalent before tax positive effect on profit or loss. The confirmation of the Supreme Court of Iceland would also impact the nature and extent of financial risks arising from these types of loan agreements as disclosed in these consolidated financial statements. In respect of currency risk, the carrying amount of these types of loan agreements would be included in the carrying amount of loans and advances to customers disclosed in Note 78 as at 31 December 2010 as follows:

	EUR	GBP	USD	JPY	CHF	Other	Total
Carrying amount	28,986	3,141	9,949	38,733	38,897	5,042	124,747

The FX-delta disclosed currently in Note 78 would decrease as follows:

	EUR	GBP	USD	JPY	CHF	Other
Absolute decrease in FX-delta	8%	2%	5%	21%	19%	3%

The net effective currency position disclosed currently in Note 78 would be as follows:

At 31 December 2010	EUR	GBP	USD	JPY	CHF	Other	Total
Net effective currency position	(26,816)	(25,559)	5,389	29,052	22,024	19,525	23,616

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 year 2011.

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5. Operating segments

On 26 August 2010 the CEO of the Bank presented a new organisational chart for the Group which became formally effective from 1 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 the following eight main divisions: Retail Banking, Corporate Banking, Markets & Treasury, Asset Management, Risk Management, Finance, Corporate Development and Asset Restructuring. Commercial and profit-generating divisions are given increased prominence in order to sharpen the Group's focus and improve its services to customers.

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 years 2010 and 2009.

Notes to the Consolidated Statement of Financial Position

6. Classification and fair value of financial assets and liabilities

According to IAS 39, financial assets and liabilities must be classified into specific categories which affect how they are measured after initial recognition. Each category's basis of subsequent measurement is specified below:
- Loans and receivables, measured at amortised cost;
- Financial assets and liabilities held for trading, measured at fair value;
- Financial assets designated 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 31 December 2010:

Financial assets	Loans and receivables	Held for trading	Designated as at fair value	Liabilities at amortised cost	Other liabilities at fair value*	Total carrying amount	Fair value
Cash and balances with Central Bank	47,777	-	-	-	-	47,777	47,777
Bonds and debt instruments	100,244	43,734	17,580	-	-	161,559	161,559
Equities and equity instruments	-	3,178	26,251	-	-	29,429	29,429
Derivative instruments	-	23	-	-	-	23	23
Loans and advances to financial institutions	91,882	-	-	-	-	91,882	91,882
Loans and advances to customers	592,954	-	-	-	-	592,954	620,403
Other financial assets	7,070	-	-	-	-	7,070	7,070
Total	**839,927**	**46,936**	**43,831**	**0**	**0**	**930,693**	**958,143**
Financial liabilities							
Due to financial institutions and Central Bank	-	-	-	147,478	-	147,478	147,478
Deposits from customers	-	-	-	371,558	-	371,558	371,558
Derivative instruments and short positions	-	7,119	-	-	-	7,119	7,119
Secured bonds	-	-	-	261,313	-	261,313	261,313
Contingent bond	-	-	-	-	26,510	26,510	26,510
Other financial liabilities	-	-	-	4,237	-	4,237	4,237
Total	**0**	**7,119**	**0**	**784,585**	**26,510**	**818,215**	**818,215**

* The contingent bond was recognised in the year 2009 as part of the settlement for the assets acquired and liabilities assumed from Landsbanki Íslands 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.

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

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:

Financial assets	Loans and receivables	Held for trading	Designated as at fair value	Liabilities at amortised cost	Other liabilities at fair value	Total carrying amount	Fair value
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
Total	**884,076**	**34,891**	**54,551**	**0**	**0**	**973,518**	**990,514**
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
Secured bonds	-	-	-	306,493	-	306,493	306,493
Contingent bond	-	-	-	-	10,241	10,241	10,241
Other financial liabilities	-	-	-	2,138	-	2,138	2,138
Total	**0**	**5,943**	**0**	**859,514**	**10,241**	**875,698**	**875,698**

The fair value of financial assets and liabilities was determined based on the following methods and assumptions. For all financial assets and liabilities the foreign currency exchange rates used are from observable markets both for spot and forward contracts and futures in the world's major currencies.

Balances with Central Bank

The carrying amount of balances with Central Bank is a reasonable approximation of their fair value.

Bonds and debt instruments

Quoted prices are generally available for government bonds and certain corporate securities. Where this information is not available, fair value is estimated by adding credit spreads to quoted market rates for similar bonds or relevant interest rate curves.

For bonds issued by defaulting or greatly distressed parties recovery values are used for estimating the fair value. These are published by the defaulting issuers resolution committee or equivalent, estimated based on statement of financial position information or expert opinion.

Interest rates are principally benchmark interest rates such as the London Inter-Bank Offered Rate (LIBOR) and quoted interest rates in the swap, bond and futures markets.

Where available, credit spreads are derived from prices of credit default swaps (CDS) or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services. Counterparty credit spreds are estimated based on the creditworthness of the counterparty when differing from the assumed counterparty in the market.

Equities and equity instruments

Quoted prices are generally readily available for equity shares listed on the world's major stock exchanges and for major indices on such shares. When this information is not available the fair value is estimated based on market prices and earning multiples from similar securities, recent transactions or by using discounted cash flow methods.

Derivative instruments

The fair value of derivative instruments is determined using valuation methods whose most significant inputs is volatility, which are obtained from broker quotations, pricing services or derived from option prices.

Loans and advances to financial institutions

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

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

Loans and advances to customers

The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received based on future recovery of the loans. The recovery rates and loss given default are used as input to valuation models as an indicator of severity of losses on default. The loans are grouped by type and for each loan the estimated cash flows to be received during each month until end of 2011 are estimated and payments after 2011 are estimated to be received at the end of June each year. Expected cash flows are discounted at current market rates to determine fair value. Interest rates are principally benchmark interest rates such as London Inter-Bank Offered Rate (LIBOR), quoted interest rates in the swap, bond and future markets or the Group's current rates for new loans.

Due to financial institutions and Central Bank

Amounts due to financial institutions and Central Bank are repriced at least monthly and therefore their estimated fair value is the same as their carrying amount.

Deposits from customers

Deposits from customers are repriced at least monthly in accordance to changes in interest rates set by the Bank's treasury. The estimated fair value of the deposits is therefore the same as their carrying amount.

Short positions

The short positions are in Icelandic government bonds with readily available quoted market prices.

Secured bonds

The fair value of the secured bonds equals their carrying amount as the bonds have been discounted upon initial recognition at market rate and no significant changes have occurred in the market rate for these secured bonds since initial recognition.

Contingent bond

The fair value of the contingent bond is based on the expected value of the underlying loan portfolios and on how much it will exceed its expected return which is defined as 400 basis points over the relevant interbank rate. The estimate of the expected value is based on log-normal distribution where the minimum payment is ISK 0 and maximum payment is ISK 92 billion. Key input and assumptions used in the valuation model at 31 December 2010 include expected volatility for the loan portfolio of 15.0% (2009: 7%) and a risk free rate of 2.8% (2009: 7.6%). However, the issue and amount of the bond is subject to considerable outperformance of the underlying loan portfolios.

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.

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

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities, carried at fair value in the consolidated statement of financial position, are categorised as at 31 December 2010:

Financial assets	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	20,340	26,933	14,042	61,315
Equities and equity instruments	16,027	2,925	10,477	29,429
Derivative instruments	-	23	-	23
Total	**36,367**	**29,881**	**24,519**	**90,766**
Financial liabilities				
Derivative instruments	-	1,445	-	1,445
Short positions	5,675	-	-	5,675
Contingent bond	-	-	26,510	26,510
Total	**5,675**	**1,445**	**26,510**	**33,629**

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

Financial assets	Level 1	Level 2	Level 3	Total
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
Total	**12,457**	**36,059**	**40,926**	**89,442**
Financial liabilities				
Derivative instruments	-	675	-	675
Short positions	5,268	-	-	5,268
Contingent bond	-	-	10,241	10,241
Total	**5,268**	**675**	**10,241**	**16,184**

During the year 2010 there were transfers into Level 1 from Level 2 and Level 3 because quoted prices in active markets became observable during the year 2010.

The following tables show the reconciliation for fair value measurement in Level 3 for the years 2010 and 2009:

1 January - 31 December 2010	Bonds and debt instruments	Equities and equity instruments	Total financial assets	Contingent bond
Carrying amount at 1 January 2010	37,371	3,555	40,926	(10,241)
Total losses recognised in income statement	(1,342)	11	(1,331)	(16,269)
Purchases	6,433	4,260	10,693	-
Sales	(7,851)	(531)	(8,382)	-
Settlements	(15,368)	3,313	(12,055)	-
Transfers into Level 3	375	-	375	-
Transfers out of Level 3	(5,576)	(131)	(5,707)	-
Carrying amount at 31 December 2010	**14,042**	**10,477**	**24,519**	**(26,510)**
1 January - 31 December 2009				
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)	-
Carrying amount at 31 December 2009	**37,371**	**3,555**	**40,926**	**(10,241)**

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

The following tables show the line items in the consolidated income statement where the total gains (losses) were recognised during the years 2010 and 2009, for fair value measurements in Level 3:

1 January - 31 December 2010	Bonds and debt instruments	Equities and equity instruments	Contingent bond	Total
Interest expense	-	-	(16,269)	(16,269)
Net gain on financial assets designated as at fair value through profit or loss	350	185	-	535
Net foreign exchange gain (loss)	(1,692)	(174)	-	(1,866)
Total	**(1,342)**	**11**	**(16,269)**	**(17,600)**
1 January - 31 December 2009				
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 gain on financial assets and liabilities held for trading	665	28	-	693
Net foreign exchange gain (loss)	174	-	-	174
Total	**8,572**	**202**	**(10,241)**	**(1,467)**

The following table shows the line items in the consolidated income statement where gains (losses), relating only to financial assets and liabilities held by the Group at 31 December 2010 and categorised in Level 3, were recognised:

	Bonds and debt instruments	Equities and equity instruments	Contingent bond	Total
Fair value change of contingent bond	-	-	(16,269)	(16,269)
Net gain on financial assets designated as at fair value through profit or loss	(868)	246	-	(622)
Net foreign exchange gain (loss)	(1,592)	(134)	-	(1,726)
Total	**(2,460)**	**112**	**(16,269)**	**(18,617)**

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

	Effect on profit before tax	
Financial assets	**Favourable**	**Unfavourable**
Bonds and debt instruments	4,016	(2,948)
Equities and equity instruments	1,048	(1,048)
Total	**5,064**	**(3,996)**
Financial liabilities		
Contingent bond	3,600	(1,800)

The effect on profit was calculated using methods suitable for the models used. For equities valued using comparables or recent transactions the price was changed by +/-10%. For bonds issued by defaulting or greatly distressed parties the recovery value was changed by +/-500 basis points. For the contingent bond the volatility of the value of the underlying assets was changed by +/-500 basis points.

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7. Cash and balances with Central Bank

	2010	2009
Cash on hand	2,059	1,506
Reverse repurchase agreements with Central Bank	43,270	-
Unrestricted balances with Central Bank	482	15,032
Total cash and unrestricted balances with Central Bank	**45,810**	**16,538**
Restricted balances with Central Bank	1,967	9,636
Total cash and balances with Central Bank	**47,777**	**26,174**

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, including 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 6,328 million for December 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

	2010				2009			
Bonds and debt instruments	**Loans and receivables**	**Held for trading**	**Designated as at fair value**	**Total**	**Loans and receivables**	**Held for trading**	**Designated as at fair value**	**Total**
Domestic								
Listed	100,244	34,745	2,036	137,026	-	10,953	9,272	20,225
Unlisted	-	-	12,484	12,484	100,661	21,352	17,761	139,774
	100,244	**34,745**	**14,521**	**149,510**	**100,661**	**32,305**	**27,033**	**159,999**
Foreign								
Listed	-	8,989	1,690	10,679	-	-	3,958	3,958
Unlisted	-	-	1,370	1,370	-	-	1,764	1,764
	0	**8,989**	**3,060**	**12,049**	**0**	**0**	**5,722**	**5,722**
Total bonds and debt instruments	**100,244**	**43,734**	**17,580**	**161,559**	**100,661**	**32,305**	**32,755**	**165,721**
Equities and equity instruments								
Domestic								
Listed	-	199	10,129	10,328	-	774	9,198	9,972
Unlisted	-	-	10,023	10,023	-	-	2,864	2,864
	0	**199**	**20,152**	**20,351**	**0**	**774**	**12,062**	**12,836**
Foreign								
Listed	-	2,979	5,892	8,871	-	841	9,482	10,323
Unlisted	-	-	206	206	-	-	252	252
	0	**2,979**	**6,099**	**9,078**	**0**	**841**	**9,734**	**10,575**
Total equities and equity instruments	**0**	**3,178**	**26,251**	**29,429**	**0**	**1,615**	**21,796**	**23,411**
Total bonds and equities	**100,244**	**46,913**	**43,831**	**190,988**	**100,661**	**33,920**	**54,551**	**189,132**

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 31 December 2010 and 2009 consist of part of the government bonds which the Bank received in settlement of the capital contribution in 2009. The bonds were listed on the OMX stock exchange in Iceland during 2010.

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9. Derivative instruments and short positions

	2010			2009		
	Notional	Fair value		Notional	Fair value	
Foreign exchange derivatives	amount	Assets	Liabilities	amount	Assets	Liabilities
Currency forwards	22,359	20	769	9,323	262	1
Cross-currency interest rate swaps	1,897	-	659	2,415	-	672
OTC currency options	20,424	-	-	59,703	700	-
	44,680	**20**	**1,428**	**71,441**	**962**	**673**
Interest rate derivatives						
Interest rate swaps	3,294	3	17	3,318	9	2
	3,294	**3**	**17**	**3,318**	**9**	**2**
Short positions - listed bonds	**-**	**-**	**5,675**	**-**	**-**	**5,268**
Total	**47,974**	**23**	**7,119**	**74,759**	**971**	**5,943**

The Group uses derivatives both for hedging and trading purposes. The Bank has bought the OTC currency options in order to economically hedge its foreign currency imbalance against excessive adverse movements in some of the major foreign currencies. The delta of these options at 31 December 2010 is nil (2009: ISK 9,989 million).

10. Loans and advances to financial institutions

	2010	2009
Bank accounts with financial institutions	6,844	4,628
Money market loans	63,549	58,488
Overdrafts	6,844	6,247
Other loans	16,823	14,493
Less: Allowance for impairment	(2,178)	(727)
Total	**91,882**	**83,129**

11. Loans and advances to customers

	2010	2009
Public entities	13,928	10,582
Individuals	166,069	177,561
Corporations	434,080	486,739
Less: Allowance for impairment	(21,122)	(7,760)
Total	**592,954**	**667,122**

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 risk management section of the notes.

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12. Investments in associates

	2010	2009
Carrying amount at the beginning of the year	2,945	2,518
Acquisitions	103	44
Share of profit of associates, net of income tax	291	383
Total	**3,340**	**2,945**

At 31 December 2010	Total assets	Total liabilities	Profit (loss)	Ownership interest	Share of profit of associates	Carrying amount
Valitor Holding hf.	6,165	7	1,014	38%	385	2,340
Kredikort hf.	7,206	6,654	(299)	20%	(60)	110
Borgun hf.	15,394	14,188	191	20%	38	241
Reiknistofa bankanna	1,699	248	-	34%	-	515
Intrum hf.	615	293	7	33%	(1)	96
Auðkenni hf.	222	51	4	20%	(71)	37
Total	**31,079**	**21,389**	**913**		**291**	**3,340**
At 31 December 2009						
Valitor Holding hf.	37,699	32,554	1,008	38%	383	1,955
Kredikort hf.	8,365	7,514	2	20%	-	170
Borgun hf.	15,340	14,325	177	20%	34	206
Reiknistofa bankanna	1,772	254	-	34%	-	515
Intrum hf.	795	506	(108)	33%	(34)	99
Total	**63,971**	**55,153**	**1,079**		**383**	**2,945**

All associates are unlisted companies.

13. Property and equipment

	2010			2009		
	Buildings	Fixtures, equipment and vehicles	Total	Buildings	Fixtures, equipment and vehicles	Total
Carrying amount at the beginning of the year	3,447	2,583	6,030	3,422	3,442	6,864
Additions during the year	5	86	91	125	174	299
Sold during the year	(75)	(4)	(79)	(24)	(105)	(129)
Depreciation	(78)	(948)	(1,026)	(76)	(928)	(1,004)
Carrying amount at 31 December	**3,299**	**1,717**	**5,016**	**3,447**	**2,583**	**6,030**
Gross carrying amount	3,458	3,786	7,244	3,529	3,521	7,050
Accumulated depreciation	(159)	(2,070)	(2,228)	(82)	(938)	(1,020)
Carrying amount at 31 December	**3,299**	**1,717**	**5,016**	**3,447**	**2,583**	**6,030**
Depreciation rates	2-4%	10-33%		2-4%	10-33%	

Official assessment value of buildings at 31 December	2010	2009
Official assessment value used for tax purposes	3,732	3,913
Replacement value used for insurance purposes	7,142	7,179

Depreciation and amortisation presented in the income statement consists of:	2010	2009
Depreciation of property and equipment	1,026	1,004
Amortisation of intangible assets	285	274
Total	**1,311**	**1,278**

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14. Intangible assets

Computer software licenses	2010	2009
Carrying amount at the beginning of the year	1,058	1,220
Additions	104	112
Amortisation	(285)	(274)
Carrying amount at 31 December	**878**	**1,058**
Amortisation rates	20-33%	20-33%
Gross carrying amount	1,431	1,335
Accumulated amortisation	(554)	(277)
Carrying amount at 31 December	**878**	**1,058**

15. Other assets

	2010	2009
Claims on Landsbanki Íslands hf.	687	5,167
Legally disputed collections	3,669	-
Unsettled securities trading	3,168	1,089
Accounts receivable and prepayments	3,214	734
Sundry assets	7,227	6,990
Total	**17,965**	**13,980**

16. Assets and liabilities classified as held for sale

Assets classified as held for sale	2010	2009
Repossessed collateral	43,831	27,317
Assets of disposal groups classified as held for sale	84,959	36,561
Total	**128,789**	**63,878**

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

Repossessed collateral	2010	2009
Carrying amount at the beginning of the year	27,317	2,150
Repossessed during the period	25,465	27,270
Disposed during the period	(8,951)	(2,103)
Carrying amount at 31 December	**43,831**	**27,317**

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 presents the results of their operations as discontinued in the consolidated income statement, as required by IFRS 5 and IAS 1.

In 2010 the Bank negotiated the sale of its shares in the subsidiary Eignarhaldsfélagið Vestia ehf. (Vestia) and Icelandic Group hf. (IG) to Framtakssjóður Íslands slhf. (FSÍ). The initial agreement between the Bank and FSÍ was announced on 20 August 2010, subject to several conditions precedent being fulfilled. A final agreement was reached in November 2010 following a due diligence process but still subject to the sale being approved by the Icelandic Competition Authority. The final agreement specifies the sale of 100% shareholding in Vestia (comprising a 62% shareholding in Teymi hf., 100% shareholding in Húsasmiðjan ehf. and 100% shareholding in Plastprent ehf.) and 81% shareholding in IG. The sale price for the shares in Vestia amounted to ISK 4,250 million and for the shares in IG amounted to ISK 11,250 million. FSÍ also has the option to acquire the Bank´s remaining 19% shareholding in IG at the same price per share within 12 months from delivery of the 81% shareholding.

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16. Assets and liabilities classified as held for sale (continued)

The subsidiaries Vestia and IG are included in these consolidated financial statements because the sale was still subject to approval by the Icelandic Competition Authority at year-end 2010. The Icelandic Competition Authority approved the transaction on 14 January 2011, with certain conditions. The Bank has delivered the shares to FSÍ on 20 January 2011. The sale of the shareholding in the subsidiaries Vestia and IG is recognised by the Group in the first quarter of 2011. The sale will result in the derecognition of approximately ISK 83 billion from assets classified as held for sale and ISK 48 billion from liabilities associated with assets classified as held for sale, and the recognition of loans and receivables amounting to ISK 23 billion, the remaining 19% shareholding in IG amounting to ISK 3 billion, deposits amounting to ISK 2 billion and other assets amounting to ISK 1 billion. The Group will recognise a gain of approximately ISK 5 billion on the disposal of these shares in the first quarter of 2011.

As part of the agreement with FSÍ, the Bank committed itself to invest ISK 15.5 billion in FSÍ. This amount will be callable during the years 2011-2016 as needed to fund investments by FSÍ, in proportion to the Bank's holding in FSÍ. The maximum amount that the Bank can invest in FSÍ is 25% of total outstanding commitments of all investors in FSÍ. At the time these financial statements were authorised for issue the Bank had invested in FSÍ ISK 4,868 million representing 27.5% of called in commitments (ISK 17,642 million). FSÍ is required to redeem its shareholders with the proceeds from sales of assets.

The above changes will result in increase in the Group's capital adequacy ratio from 19.9% to 21.1%, assuming all other factors remain unchanged.

17. Due to financial institutions and Central Bank

	2010	2009
Loans and repurchase agreements with Central Bank	80	66
Loans and deposits from financial institutions	147,398	98,162
Total	**147,478**	**98,228**

18. Deposits from customers

	2010	2009
Demand deposits	271,977	317,330
Time deposits	99,581	135,325
Total	**371,558**	**452,655**

The total decrease of ISK 81.1 billion in deposits is mostly comprised of ISK 27.8 billion reduction in deposits from households, ISK 27.6 billion reduction in deposits from holding companies and ISK 16.7 billion reduction in deposits from pension funds.

19. Secured bonds

	Nominal amount				Carrying amount	
	Foreign	ISK		Contractual	ISK	
Secured bonds	currency	2010	2009	interest rate (%)	2010	2009
EUR	871 million	133,960	156,519	EURIBOR + 1.75/2.90	130,963	158,573
GBP	275 million	49,250	55,316	LIBOR + 1.75/2.90	48,132	56,086
USD	734 million	84,179	91,456	LIBOR + 1.75/2.90	82,218	91,834
Total		**267,388**	**303,291**		**261,313**	**306,493**

On 12 October 2010 the Bank issued secured bonds to Landsbanki Íslands hf. as part of the acquisition price for its Icelandic operations. These bonds are denominated in EUR, GBP and USD and carry interest from October 2008. The carrying amount of the bonds as at 31 December 2010 includes the effective interest of EURIBOR/LIBOR+2,90% which accrued since October 2010. The bonds are secured by pools of loans to customers (see Note 37).

The bonds mature in October 2018 and do not have instalment 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 was on 12 October 2010. From 30 June 2010, bondholders have had the right to require the Bank to convert the bonds into Eurobonds. Upon such conversion, the Bank will make reasonable endeavours to list such Eurobonds on a qualified stock exchange, as soon as feasible following conversion. The bondholders have not yet exercised their right to require the Bank to convert the bonds into Eurobonds.

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20. 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 "Fair value change of contingent bond" in the consolidated income statement.

21. Tax assets and liabilities

Tax assets and liabilities are specified as follows:

Tax assets	2010	2009
Deferred tax assets	1,522	6,682
Tax liabilities		
Current tax liabilities	1,979	83
Deferred tax liabilities	-	-
Total	**1,979**	**83**

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

	2010			2009		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Property and equipment	-	(1,943)	(1,943)	-	(2,342)	(2,342)
Investments in associates	-	(101)	(101)	-	(140)	(140)
Loans and advances to customers	4,301	-	4,301	6,382	-	6,382
Other assets	-	(43)	(43)	-	(68)	(68)
Deferred foreign exchange differences	-	(1,714)	(1,714)	357	-	357
Other items	-	(168)	(168)	-	(253)	(253)
Tax losses carried forward	1,190	-	1,190	2,746	-	2,746
	5,491	**(3,969)**	**1,522**	**9,485**	**(2,803)**	**6,682**
Set-off of deferred tax assets together with liabilities of the same taxable entities	(3,969)	3,969	-	(2,803)	2,803	-
Total	**1,522**	**0**	**1,522**	**6,682**	**0**	**6,682**

The deferred tax assets and liabilities are measured based on the tax rates and tax laws enacted by the end of 2010, according to which the domestic corporate income tax rate was 20%. In December 2010 the corporate income tax rate was increased from 18% to 20%. This change is effective for the fiscal year starting on 1 January 2011.

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21. Tax assets and liabilities (continued)

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

		Recognised in income statement		
2010	**Balance 1.1.2010**	**Tax (expense) income**	**Changes from prior year**	**Balance 31.12.2010**
Property and equipment	(2,342)	399	-	(1,943)
Investments in associates	(140)	39	-	(101)
Loans and advances to customers	6,383	(2,081)	-	4,302
Other assets	(68)	25	-	(43)
Deferred foreign exchange differences	357	(2,071)	-	(1,714)
Other items	(253)	85	-	(168)
Tax losses carried forward	2,745	(2,198)	642	1,189
Total	**6,682**	**(5,802)**	**642**	**1,522**

		Recognised in income statement		
2009	**Balance 1.1.2009**	**Tax (expense) income**	**Changes from prior year**	**Balance 31.12.2009**
Property and equipment	(173)	(2,169)	-	(2,342)
Equities and equity instruments	(45)	45	-	-
Investments in associates	(57)	(83)	-	(140)
Loans and advances to customers	-	6,383	-	6,383
Other assets	441	(509)	-	(68)
Derivative instruments and short positions	112	(112)	-	-
Deferred foreign exchange differences	(83)	458	(18)	357
Other items	(102)	(119)	(32)	(253)
Tax losses carried forward	7,171	(4,426)	-	2,745
Total	**7,264**	**(532)**	**(50)**	**6,682**

The aggregate amount of temporary differences associated with the Bank's investments in subsidiaries for which no deferred tax liability is recognised in the consolidate financial statements amounted to ISK 4,031 million at year-end 2010 (2009: ISK 3,882 million). If the Bank were to sell its subsidiaries at their carrying amounts the gains from their sale would have been used to offset any tax losses carried forward by the Bank in the year of sale. However, according to current tax legislation, the gains are tax-exempt if the Bank has not incurred a tax loss in the year of sale or it has no tax loss carried forward at the time.

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22. Other liabilities

	2010	2009
Unsettled securities trading	2,730	872
Withholding tax	2,893	3,927
Excess payments on lease and loan agreements (see Note 4(i))	7,182	-
Accounts payable	826	586
Unpaid contribution to the Depositors' and Investors' Guarantee Fund	680	680
Tax on liabilities of financial institutions	400	-
Sundry liabilities	3,991	2,112
Total	**18,702**	**8,177**

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

Unpaid contribution to the Depositors' and Investors' Guarantee Fund

According to Act No. 98/1999 on Deposit Guarantees and Investor Compensation Schemes, the Bank must, by 1 June of each year, contribute to the Depositors' and Investors' Guarantee Fund ("the Fund") an amount equivalent to 0.15% of the average of guaranteed deposits in the Bank, in the event of total Fund assets not equalling a minimum of 1% of the average amount of guaranteed deposits in commercial banks and savings banks during the preceding year. At the same time, the Bank must also submit to the Fund a declaration of liability whereby the Bank undertakes to render a special contribution to the Fund should the Fund become obliged to refund deposits to customers. This declaration of liability covers the proportion of the amount required to make up the minimum 1% of the average amount of guaranteed deposits. However, demands for contributions to the Fund based on declarations of liability may not exceed the equivalent of one-tenth of the Fund's minimum total assets.

The Bank's management has concluded that the amount to be recognised as a liability in respect of the 0.15% yearly contribution shall only equal the amount that the Bank has no realistic alternative but to settle at each reporting date in accordance with the Act. This is the amount of the 0.15% contribution to be made by the Bank during the following calendar year, in respect of the current calendar year. Other regular contributions to be made by the Bank to the Fund in future years do not exist independent of the Bank's future actions and therefore do not represent a present obligation of the Bank at the reporting date. Accordingly, they are not recognised as part of the liability towards the Fund. Therefore, the amount recognised as liability as at 31 December 2010 amounts to ISK 680 million to be paid no later than 1 June 2011 (31 December 2009: ISK 680 million, paid to the Fund in March 2010).

In respect of the declaration of liability of the Bank, the management of the Bank has concluded that a liability should be recognised in the statement of financial position in respect of its declaration outstanding at each reporting date only if an outflow of Bank resources is at the respective reporting date deemed more likely than not to occur. The Bank issued its first declaration of liability to the Fund in November 2009, for a maximum amount of ISK 3,769 million, of which no more than ISK 1,610 million may be requested as a special contribution to the Fund according to the Act. The Bank issued in 2010 a new declaration of liability to the Fund for a maximum amount of ISK 3,851 million, of which no more than ISK 1,611 million may be requested as a special contribution to the Fund according to the Act. The Bank did not issue a new declaration of liability between the end of the current reporting period and the date when these consolidated financial statements are authorised for issue. The Group did not recognise any liability in these consolidated financial statements in respect of the declarations of liability outstanding at year-end 2010 and 2009.

The Government of Iceland is currently working on changing the Act and a bill has been presented for approval by the Icelandic Parliament. Based on the current draft of this bill, the Bank's management expects its yearly contributions to increase as a result of changes in legal requirements.

Tax on liabilities of financial institutions

On 27 December 2010 the Parliament of Iceland passed a bill (Act no. 155/2010 on special tax on financial institutions) according to which certain types of financial institutions must pay annually a tax calculated as 0.041% of the carrying amount of their liabilities as determined for tax purposes.

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23. Equity

Share capital

The total number of ordinary shares authorised and issued by the Bank at year-end 2010 and 2009 was 24 billion shares, with par value of ISK 1 per share. One vote is attached to each share of one ISK and the holders of ordinary shares are entitled to one vote per share at general meetings of the Bank. All issued shares are fully paid.

Restriction of dividend payments

As part of the acquisition price for the Icelandic operations of Landsbanki Íslands hf., the Bank issued senior secured bonds (see Notes 19 and 37). If the Bank makes any dividend payments, it shall thereby redeem the bond on a pro-rata basis in amounts equal to the dividend payments. The bonds mature in 2018.

According to the Company Act No. 2/1995, it is only permissible to allocate as dividend profit in accordance with approved annual financial statements for the immediate past financial year, profit brought forward from previous years and free funds after deducting loss which has not been met and the moneys which according to laws or Articles of Association must be contributed to a reserve fund or for other use.

Share premium

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

Statutory reserve

The statutory reserve is created in accordance with requirements of the Company Act No. 2/1995, according to which at least 10% of the profit of the Bank, which is not devoted to meeting losses of previous years and is not contributed to other legally stipulated reserves must be contributed to the statutory reserve until it amounts to 10% of the share capital of the Bank. When that limit has been reached the contribution to the statutory reserve must be at a minimum 5% until the reserve amounts to a quarter of the share capital of the Bank.

Retained earnings

Retained earnings consist of undistributed profits and losses accumulated by the Group since the foundation of the Bank, less transfers to the statutory reserve of the Bank.

Notes to the Consolidated Income Statement

24. Net interest income

Interest income	2010	2009
Cash and balances with Central Bank	3,424	3,344
Bonds and debt instruments classified as loans and receivables	6,643	-
Loans and advances to financial institutions	1,290	1,749
Loans and advances to customers	49,644	58,518
Unpaid capital contribution	-	17,796
Other interest income	60	69
Total	**61,060**	**81,476**

Interest expense		
Due to financial institutions and Central Bank	(4,901)	(10,243)
Deposits from customers	(18,897)	(43,005)
Provisional liability due to Landsbanki Íslands hf.	-	(13,148)
Secured bonds	(12,464)	(445)
Other interest expense	(113)	(61)
Total	**(36,374)**	**(66,902)**

Net interest income	**24,685**	**14,574**
Interest spread (as the ratio of net interest income to the average carrying amount of total assets during the year)	**2.3%**	**1.4%**
Adjusted interest spread (as the ratio of net interest income after adjustment in valuation to the average carrying amount of total assets during the year)	**2.4%**	**2.1%**

Interest income accrued on impaired financial assets amounted to ISK 0 million in 2010 (2009: ISK 124 million).

Total interest income recognised in respect of financial assets not carried at fair value through profit or loss amounts to ISK 61,060 million (2009: ISK 63,680 million). Total interest expense recognised in respect of financial liabilities not carried at fair value through profit or loss amounts to ISK 36,374 million (2009: ISK 53,754 million).

25. Net valuation change in loans and advanses

	2010	2009
Net adjustments to loans and advances acquired at deep discount	49,702	23,772
Loss from foreign currency linkage of loans and advances to customers	(18,158)	-
Net impairment loss on loans and advances	(14,636)	(6,577)
Total	**16,909**	**17,195**

Individuals	(6,485)	5,831
Corporations	23,394	11,364
Total	**16,909**	**17,195**

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26. Net fee and commission income

Fee and commission income	2010	2009
Investment banking and capital markets	1,085	943
Asset management	757	878
Lending	935	1,266
Cards	1,204	1,402
Interbank clearing	870	859
Collection and payment services	673	704
Foreign trade	412	471
Other commissions and fees	356	312
Total	**6,292**	**6,835**
Fee and commission expense		
Investment banking and capital markets	(259)	(230)
Interbank clearing	(857)	(832)
Other fees	(1,594)	(1,560)
Total	**(2,710)**	**(2,622)**
Net fee and commission income	**3,582**	**4,213**

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.

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

	2010	2009
Bonds and debt instruments	571	850
Equities and equity instruments	5,788	3,170
Total	**6,359**	**4,020**

28. Net gain on financial assets and liabilities held for trading

	2010	2009
Bonds and debt instruments	2,338	3,646
Equities and equity instruments	465	(670)
Derivatives instruments	(267)	86
Total	**2,536**	**3,062**

29. Dividend income

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

	2010	2009
Net gain on financial assets designated as at fair value through profit or loss	558	730
Net gain on financial assets and liabilities held for trading	25	55
Total	**583**	**785**

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30. Net foreign exchange gain (loss)

	2010	2009
Assets:		
Cash and balances with Central Bank	(130)	38
Bonds and debt instruments	(3,580)	1,017
Equities and equity instruments	(652)	1,719
Derivative instruments	(4,436)	1,300
Loans and advances to financial institutions	(6,053)	2,783
Loans and advances to customers	(14,853)	17,975
Other assets	(89)	(260)
Total	**(29,793)**	**24,572**
Liabilities:		
Due to financial institutions and Central Bank	1,924	(2,380)
Deposits from customers	5,757	(7,056)
Provisional liability due to Landsbanki Íslands hf.	-	(24,233)
Secured bonds	36,721	6,119
Other liabilities	13	(22)
Total	**44,415**	**(27,572)**
Net foreign exchange gain (loss)	**14,623**	**(3,000)**

The foreign exchange differences which were recognised during the year 2010 in the consolidated income statement and arose on financial instruments not measured at fair value through profit or loss amounted to a ISK 21,125 million loss for financial assets (2009: gain of ISK 20,536 million) and gain of ISK 44,403 million for financial liabilities (2009: loss of ISK 9,458 million). As disclosed in Note 3, 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 year 2010, which is deemed to be uncollectible and is therefore offset by the FX-delta ratio, amounted to a loss of ISK 3,035 million (2009: gain of ISK 9,244 million).

31. Other income and expenses

	2010	2009
Recharged expenses	479	965
(Loss) gain on sale of property and equipment	(18)	23
Loss on repossessed collateral	(2,534)	(132)
Other	496	46
Total	**(1,577)**	**902**

32. Salaries and related expenses

	2010	2009
Salaries	7,497	6,969
Contributions to defined contribution pension plans	1,020	955
Other personnel expenses	814	544
Total	**9,331**	**8,468**
Number of full-time employment positions at year-end	1,146	1,161
Average number of full-time employment positions during the year	1,139	1,153

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33. Other operating expenses

	2010	2009
Software licensing and other information technology costs	1,047	868
Real estate and fixtures	909	791
Advertising and marketing	433	355
Contribution to the Depositors' and Investors' Guarantee Fund	680	680
Audit and related services	173	116
Other professional services	889	613
Operating lease rentals	495	484
Other operating expenses	2,687	2,157
Total	**7,312**	**6,064**

Audit and related services	2010	2009
Audit of financial statement and audit related service	109	96
Review of interim financial statement	61	-
Other services	2	20
Total	**173**	**116**

34. Acquisition-related costs

	2010	2009
Cost of acquisition of assets and liabilities from Landsbanki Íslands hf.	542	886
Claims on Landsbanki Íslands hf. which were written off due to a settlement	-	158
Total	**542**	**1,044**

35. Income tax expense

Income tax is recognised based on the tax rates and tax laws enacted by the end of the period, according to which the domestic corporate income tax rate was 18.0% (2009: 15.0%).

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

	2010	2009
Current tax expense	(1,979)	(83)
Effect of increase in tax rate	164	295
Deferred tax expense	(5,967)	(827)
Total	**(7,782)**	**(615)**

Further information on deferred income tax is presented in Note 21. The tax on Group profits differs to the following extent from the amount that would theoretically arise by the domestic corporate income tax rate:

	2010		2009	
Profit before tax		32,644		14,254
Tax on liabilities of financial institutions		(400)		-
Profit before income tax		32,244		14,254
Income tax calculated using the domestic corporate income tax rate	18.0%	(5,804)	15.0%	(2,138)
Effect of increase in tax rate	(0.5%)	164	(2.1%)	296
Effect of different tax rates in other countries	-	-	0.3%	(38)
Income not subject to tax	(5.0%)	1,641	(9.0%)	1,289
Non-deductable expenses	6.4%	(2,099)	0.8%	(110)
Other	5.2%	(1,684)	(0.6%)	86
Effective income tax	**24.1%**	**(7,782)**	**4.3%**	**(615)**

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Other notes

36. Litigation

Other than claims and legal proceedings that arise from time to time in the ordinary course of business, the Group has no pending legal proceedings other than the following:

1. In March 2009 Aresbank, a Spanish bank, commenced litigation against the Bank, submitting claims to the District Court of Reykjavík. Aresbank demanded that the Bank pay EUR 30 million, in addition to interests and litigation costs. Alternatively, the Icelandic Financial Supervisory Authority (FME) and the Icelandic government were subpoenaed for the acknowledgment of their obligation to pay damages on the basis of tort. The case involves two money market loans which each amount to EUR 15 million and have reached maturity. In addition, the case involves a third money market loan amounting to GBP 7 million. In short, Aresbank claims that money market loans are to be considered deposits according to the Act on Deposit Insurance, No. 98/1999. Aresbank cites the Icelandic government's declaration from 6 October 2008, which states that the Icelandic government insures all deposits in domestic commercial banks and their branches in Iceland. On 22 Desember 2010 the District Court of Reykjavik ruled in the case between Aresbank and the Bank. The Court ruled in favour of the Bank and confirmed that money market loans are not deposits according to the Act on Deposit Insurance, No. 98/1999. The ruling of the District Court was appealed to the Supreme Court. The Court procedure may take 12 to 18 months.

2. In September 2009, Handelsbanken AB, a Swedish bank, commenced litigation before the District Court of Reykjavík against the Bank, demanding a payment of SEK 42.4 million plus interest. The claim was based on a sub-guarantee issued by Landsbanki Íslands hf. to the plaintiff in 2003. In 2007, the guarantee was extended to 2013, and the court claim is that according to the decision of 9 October 2008 by the FME, on the disposal of assets and liabilities of Landsbanki Íslands hf., the Bank is now obliged to pay according to this guarantee. The Bank has responded to this claim by stating that according to an FME decision of 19 October 2008, the sub-guarantee in question was actually not transferred from Landsbanki Íslands hf. to the Bank. Even though the Bank believes that the claim is without merit and should be directed at Landsbanki Íslands hf., the final resolution of this matter cannot yet be determined. The District Court of Reykjavik has rendered its ruling in the legal proceeding between the Bank and Handelsbanken AB. The decision was in favour of the Bank and confirmed that the sub-guarantee in question was actually not transferred from Landsbanki Íslands hf. to the Bank by FME decision of 19 October 2008. The ruling of the District Court was appealed to the Supreme Court.

3. In December 2009 documents were served on the Bank by Basler Kantonalbank (BKB), a bank of the Swiss canton Basel City, as the initial step in starting ordinary proceedings against the Bank before the Commercial Court of the Swiss canton Zurich. BKB's claim amounts to CHF 19.2 million plus 5% interest since 9 October 2008, and is for the non-performance of FX Swap transactions by Landsbanki Íslands hf. BKB argues that according to an FME decision, the Bank took over Landsbanki Ísland hf. rights and obligations according to derivatives contracts. BKB also argues that the FME decision of 12 October 2008, whereby the decision of 9 October was amended so that derivative contracts were not transferred to the Bank, should be interpreted to apply only to derivative contracts after 12 October 2008. The Bank takes the view that the claim is without merit and should be directed at Landsbanki Íslands hf. The Bank intends to defend its position vigorously, although the final resolution of this matter cannot yet be determined.

4. In April 2009, the Bank's subsidary Landsvaki hf. received a demand for reversing certain transactions involving the purchase of bonds from the money market funds operated by Landsvaki, shortly before the collapse 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. On 21 Desember 2010 the District Court of Reykjavik ruled in a case between Landsvaki hf., and four of its clients. The District Court dismissed the case because the clients could not prove and determinate their claim for damages. On 18 February 2011 the Supreme Court ruled in the case and confirmed the District Court verdict to dismiss the case.

5. 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 Islands 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. On 13 January 2011 the District Court of Reykjavik ruled that the case was dismissed because the Skollaborg claims did not fulfil the requirments of the civil law, No. 91/1991.

6. In January 2010 Soffanías Cecilsson hf., an Icelandic limited liability company, commenced litigation before the District Court of Reykjavik against the Bank and demanded that two loan agreements and the distribution of the proceeds of the loans were declared null and void. The loan agreements are denominated in foreign currencies and the Bank claim according to the agreements is equivalent to ISK 7.4 billion. To support its case the company puts 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 Islands 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.

36. Litigation (continued)

7. The District Court of Reykjavik has in its ruling from 23 February 2011, established in the case of NBI hf. versus bankrupt estate of Motormax ehf., that certain foreign currency loan agreements to companys are in fact loan agreements in Icelandic kronas which fall under the scope of Act. No. 38/2001, on interest and indexation. The indexation of such ISK denominated loans to the exchange rate of foreign currencies constitutes indexation which is not authorised by the Act. The Bank has appealed the ruling of the District Court of Reykjavik to the Supreme Court of Iceland.

8. EFTA Surveillance Authority has decided to open a formal investigation into potential unlawful state aid in the winding up of investment funds operated by fund management companies linked to the three failed Icelandic banks. It is alleged that the Icelandic authorities intervened in the market shortly after the collapse by influencing decisions of the newly created banks to purchase bonds from these investment funds. If EFTA Surveillance Authority comes to the conclusion that the intervention by the Icelandic authorities constitutes state aid it is not unlikely that a recovery claim will be made on Landsvaki. Landsvaki has formally protested these allegations and has submitted its views and arguments to the EFTA Surveillance Authority.

37. Pledged assets

On 12 October 2010 the Bank and Landsbanki Íslands hf. signed a pledge agreement according to which the Bank pledged certain pools of loans to customers as collateral for the secured bonds issued on 12 October 2010 (see Note 19) and the contingent bond that the Bank might issue to Landsbanki Íslands hf. (see Note 20). The Bank must maintain a cover ratio of 127.5% (ISK 333,174 million) for the secure bonds and 118% (ISK 31,281 million) for the contingent bond. Pledged assets added to the pledged pool must comply with certain eligibility criteria.

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 5,500 million as at year-end 2010 (2009: ISK 5,500 million) 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 7,123 million as at year-end 2010 (2009: ISK 1,200 million).

38. Leasing

Operating lease commitments where the Group is lessee

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

	2010	2009
No later than 1 year	29	169
Later than 1 year and no later than 5 years	172	55
Later than 5 years	271	267
Total	**473**	**491**

Operating lease commitments where the Group is legal lessor

The Group acts as the legal lessor, through its subsidiary SP-fjármögnun hf., whereby tools and equipment are purchased and leased to third parties under arrangements that in substance are loans and advances accounted for under IAS 39 in the consolidated financial statements of the Group.

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

	2010	2009
Less than 1 year	3,356	5,281
More than 1 year and less than 5 years	3,570	6,945
More than 5 years	407	985
Total	**7,333**	**13,211**

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38. Leasing (continued)

Finance lease commitments where the Group is lessor

The Group acts as lessor, through its subsidiary SP-fjármögnun hf., whereby items of plant and equipment are leased to third parties under arrangements qualifying as finance leases. Finance lease receivables are included within loans and advances to customers.

The net investment in finance lease receivables was as follows:

At 31 December 2010	Gross investment in finance lease	Future finance income	Present value of minimum lease
Less than 1 year	7,573	(1,412)	6,161
More than 1 year and less than 5 years	16,870	(2,065)	14,805
More than 5 years	1,306	(41)	1,265
Total	**25,749**	**(3,518)**	**22,231**
At 31 December 2009			
Less than 1 year	12,962	(1,269)	11,692
More than 1 year and less than 5 years	32,850	(2,662)	30,187
More than 5 years	6,433	(365)	6,068
Total	**52,245**	**(4,296)**	**47,947**

Unguaranteed residual value at year end 2010 is nil (2009: nil).

39. Fiduciary activities

The Group provides asset custody, asset management, investment management and advisory services. All of them require the Group to make decisions on the handling, acquisition or disposal of financial instruments. Assets in Bank custody are not reported in the consolidated financial statements, since they are not assets of the Bank. One aspect of these services is that the Group is involved in approving objectives and criteria for investing assets in its custody. As of 31 December 2010, financial assets managed by the Group amounted to ISK 100 billion (2009: ISK 142 billion). Custody accounts amounted to ISK 998 billion (2009: ISK 1,209 billion).

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40. Related party transactions

Related parties

The Icelandic State Treasury, on behalf of the Icelandic State, holds 81,3% of the shares in the Bank. Government bodies and public institutions qualifying as related parties are the Ministry of Finance, the ISFI (Icelandic State Financial Investments), and entities and institutions related to them.

Transactions between the Bank and its subsidiaries meet the definition of related party transactions. All transactions with subsidiaries are eliminated on consolidation and are thus not disclosed in the Group's consolidated financial statements. The main subsidiaries of the Bank at 31 December 2010 were the following:

Company	Ownership interest	Activity
Landsbankinn eignarhaldsfélag ehf. (Iceland)	100%	Holding company
Eignarhaldsfélagið NBI ehf. (Iceland)	100%	Holding company
Horn fjárfestingarfélag ehf. (Iceland)	100%	Investment company
Eignarhaldsfélagið Vestia ehf. (Iceland)	100%	Holding company
Reginn ehf. (Iceland)	100%	Real estate company
SP-fjármögnun hf. (Iceland)	100%	Leasing company
Landsvaki hf. (Iceland)	100%	Management company for mutual funds
Hömlur ehf. (Iceland)	100%	Holding company
Blámi - fjárfestingafélag ehf (iceland)	100%	Holding company
Vörður líftrygging ehf. (Iceland)	60%	Insurance company
Verðbréfun hf. (Iceland)	100%	Securitisation company
Landsbanki Vatnsafl ehf. (Iceland)	100%	Holding company
Stofnlánadeild Samvinnufélaga (Iceland)	100%	Holding company
Span ehf. (Iceland)	100%	IT-services
Landsbanki Holdings UK plc (United Kingdom)	100%	Holding company

Landsbanki Íslands hf. has significant influence over the Bank, indirectly through its wholly-owned subsidiary Landsskil ehf., which holds 18.7% of the shares in the Bank. Landsskil ehf. appoints one of the five members of the Board of Directors of the Bank and Landsbanki Íslands hf. has also influence through its observer members of various committees of the Bank. Although these observer members do not have rights to take part in the decision process during meetings of the committees of the Bank they can submit their own comments outside such meetings, which can have a significant impact on decision outcomes. Due to the ownership, its member on the Board of Directors of the Bank and influence through the committees of the Bank, Landsbanki Íslands hf. meets the definition of related party.

The key management personnel of the Bank and its close family members meet the definition of related parties and in some cases the key management personnel of the Bank´s subsidiaries. The key management personnel of the Bank are the members of the Board of Directors, CEO, Managing Directors and other directors having authority and responsibility for planning, directing, and controlling the activities of the Bank. The Minister of Finance and the members of the Board of Directors of ISFI meet the definition of key management personnel of the Bank due to their ability to influence the policy of the Bank.

Transactions with related parties

(a) Transactions with the Icelandic government and government-related entities

The Group's products and services are offered to the Icelandic government and government-related entities in competition with other vendors and under generally accepted commercial terms. In a similar manner, the Bank and other Group entities purchase products and services from government-related entities at market price and otherwise under generally accepted commercial terms. The nature and outstanding amounts receivable from public entities are disclosed in Note 55.

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40. Related party transactions (continued)

(b) Transactions with other related parties

Information about the terms and amounts payable by the Bank to Landsbanki Íslands hf. is disclosed in Notes 19 and 20. The deposits from Landsbanki Íslands hf. amounted to ISK 33,418 million as at 31 December 2010 (2009: ISK 22,935 million). During the year 2010 the Bank recognised ISK 479 million from administrative services provided to Landsbanki Íslands hf. based on a service level agreement (2009: ISK 965 million).

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

	2010		2009	
Loans in ISK million	Balance at 31 December	Highest amounts outstanding during year	Balance at 31 December	Highest amounts outstanding during year
Key management personnel	161	200	84	99
Parties related to key management personnel	250	331	32	45
Associates	7,273	7,307	6,763	7,652
Total	**7,684**	**7,838**	**6,879**	**7,797**

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

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

(c) Compensation to directors, CEOs and managing directors

Salary and benefits for the year 2010	Salary and benefits	Termination benefits*	Total
Gunnar Helgi Hálfdanarson, Chairman of the Board of the Bank	5.3	-	5.3
Sigríður Hrólfsdóttir, Vice-chairman of the Board of the Bank	3.8	-	3.8
Guðríður Ólafsdóttir, member of the Board of the Bank	3.0	-	3.0
Þórdís Ingadóttir, member of the Board of the Bank	2.6	-	2.6
Ólafur Helgi Ólafsson, member of the Board of the Bank	0.6	-	0.6
Andri Geir Arinbjarnarson, alternate member of the Board of the Bank	2.7	-	2.7
Former members of the Board of the Bank	2.9	-	2.9
Other alternate directors of the board of the Bank	1.1	-	1.1
Ásmundur Stefánsson, former CEO of the Bank	6.0	9.3	15.3
Steinþór Pálsson, CEO of the Bank	7.9	-	7.9
8 Managing Directors of the Bank's divisions	57.8	-	57.8
5 former Managing Directors of the Bank	74.5	70.8	145.3
Managing Directors of subsidiaries Vestia, Horn, Reginn, Landsvaki and SP fjármögnun	56.0	-	56.0
Total	**224.4**	**80.1**	**304.5**

* Employment termination costs payable in the year 2011 were fully recognised as an expense in the year 2010.

In 2010 the total monthly salary and benefits of the current CEO of the Bank amounted to ISK 1.1 million and the average monthly salary and benefits of current Managing Directors of the Bank's divisions amounted to ISK 1.5 million. The average total monthly salary and benefits of the former CEO of the Bank amounted to ISK 1.3 million and the average monthly salary and benefits of former Managing Directors of the Bank's divisions amounted to ISK 1.5 million

In 2010 the Bank acquired two vehicles as part of the employment terms of two present Managing Directors of the Bank. The acquisition price of both vehicles amounted to ISK 7 million, which was equal to their market value at acquisition date. The vehicles have not been sold at year-end 2010.

40. Related party transactions (continued)

(c) Compensation to directors, CEOs and managing directors (continued)

Salary and benefits for the year 2009	Salary and benefits	Termination benefits	Total
Haukur Halldórsson, Chairman of the Board of the Bank	3.2	-	3.2
Erlendur Magnússon, Vice-chairman of the Board of the Bank	2.3	-	2.3
Stefanía K. Karlsdóttir, member of the Board of the Bank	1.6	-	1.6
Salvör Jónsdóttir, member of the Board of the Bank	1.6	-	1.6
Ása Richardsdóttir, alternate Director of the Board of the Bank	1.5	-	1.5
Alternate directors of the Board of Directors of the Bank	0.2	-	0.2
Ásmundur Stefánsson, CEO of the Bank	17.5	-	17.5
Elín Sigfúsdóttir, former CEO of the Bank	19.3	24.9	44.2
7 Managing Directors of the Bank's divisions	102.1	-	102.1
6 Managing Directors of subsidiaries	46.6	15.9	62.6
Total	**196.0**	**40.8**	**236.8**

(d) Transactions with the Minister of Finance and members of the Board of Directors of the ISFI

The Minister of Finance and the members of the Board of Directors of the ISFI did not receive any salaries or similar payments from the Group during the year 2010. The Group did not enter into any transactions with these persons or close members of their families, other than lending and deposit taking during the normal course of commercial banking operations, with the exception of the following transaction with Sigurður B. Stefánsson, a member of the Board of Directors of the ISFI.

On 9 March 2011 Eignarhaldsfélag NBI ehf., a subsidiary of the Bank, completed the acquisition of all shares in the company Rose Invest hf., half of which were owned by Sigurður B. Stefánsson, a member of the Board of the ISFI. Rose Invest hf. is licensed by the Icelandic Financial Supervisory Authority to operate UCITS and other funds for collective investment and investment advice. The acquisition will reinforce the Bank´s position further in the area of asset and fund management as the founders of Rose Invest hf., including Sigurður B. Stefánsson, have joined the Bank´s Asset Management Division. The acquisition price for the shares paid by Eignarhaldsfélag NBI ehf. to Sigurður B. Stefánsson amounted to ISK 23.7 million.

41. Events after the reporting period

The main events after the reporting period are as follow:

On 14 January 2011 the Icelandic Competition Authority approved the sale of controlling interests in the subsiaries Eignarhaldsfélagið Vestia ehf. and Icelandic Group hf. Further information about the transaction and an estimate of its financial effect is disclosed in Note 16.

As part of the composition of the leasing company Avant hf. the Bank aquired the company. This transaction has no effects on the consolidated financial position of the Group as the Bank was the only creditor of Avant hf.

On 7 March 2011, the Bank took over all assets, liabilities and operations of SpKef Savings Bank in accordance with the decision of the Financial Supervisory Authority in Iceland (FME). SpKef Savings Bank was owned entirely and directly by the Icelandic State Treasury previous to the transfer. The Icelandic State Treasury has committed to make a capital contribution to the Bank in order to compensate for the negative difference between the value of assets and liabilities taken over by the Bank. This takeover is done on an arm´s length basis under generally accepted commercial terms. The value of financial assets of SpKef is uncertain as due diligence is currently under progress where initial assumptions of fair value of assets and assumed liabilities taken over are being verified. Total liabilities of SpKef at 31 December 2010 where approximately ISK 60 billion.

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Capital management

42. 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.

43. Capital base and capital adequacy ratio

The Group's equity at 31 December 2010 amounted to ISK 184,866 million (2009: ISK 157,592 million), equivalent to 17.1% (2009: 14.8%) of total assets, according to the statement of financial position. The capital adequacy ratio, calculated in accordance with Article 84 of Act No. 161/2002 on Financial Undertakings, was 19.5% at the end of the year (2009: 14.9%). According to the Act, this ratio may not fall below 8.0%.

Capital base	2010	2009
Share capital	24,000	24,000
Share premium	123,898	123,898
Statutory reserve	2,932	741
Retained earnings	31,828	6,791
Non-controlling interests	2,207	2,162
Intangible assets	(878)	(1,058)
Deferred tax assets	(1,522)	-
Tier 1 capital	**182,466**	**156,534**
Deduction from original and additional own funds	(3,888)	(2,329)
Capital base	**178,579**	**154,205**

Risk-weighted assets		
Credit risk	699,716	748,574
Market risk	144,745	229,489
Operational risk	69,987	58,326
Total risk-weighted assets	**914,448**	**1,036,389**

Tier 1 capital ratio	20.0%	15.1%
Capital adequacy ratio	19.5%	14.9%

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Risk management

44. Material financial risks

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

The Group also examines other relevant risk dimensions, such as operational risk and compliance risk.

The above material risks are addressed in the notes below.

45. Risk management process

Risk is inherent in the Group's activities but is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. Risk identification involves finding the origins and structures of possible risk factors in the Group's operations and undertakings. Risk measurement entails applying relevant measures to identified risk factors in order to allow for benchmarking and comparison. Monitoring entails having a dedicated system and process to highlight possible risks. Finally, risk control and limits provides for using rules and procedures to monitor and limit any risk taken on by the Group and ensuring that it complies with the Group's risk appetite and policies.

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

46. Risk management framework

In 2010 the Bank implemented a new structure for risk management. This involved merging the two CEO level committees, the Asset and Liabilities Committee (ALCO) with the Risk Committee into a new committee, the Risk and Finance Committee. In addition, changes were made to the organisational structure of the Risk Management Division, where the following new units were established: the Credit Management Unit, the Internal Risk Model's Unit and the Economic Research Unit.

The Group's risk management governance structure as at year-end 2010 is as follows:

Supervision by the Board of Directors	**Board of Directors** Internal Audit, Remuneration Committee, Audit and Risk Committee				
Key management bodies and committees	**The CEO** Risk and Finance Committee Credit Committee Executive Management Committee				
Risk types	Compliance risk	Credit risk	Market risk	Operational risk	Liquidity risk

The Board of Directors of the Bank has overall responsibility for the establishment and oversight of the Group's risk management framework. The CEO is responsible for the effective implementation of the Bank's risk policies through the corporate governance structure and committees. The CEO has established the Risk and Finance Committee, the Credit Committee and the Executive Management Committee, which are responsible for developing and monitoring Group risk management policies in their specified areas. All committees report regularly to the Board of Directors on their activities. At operating entity level, primary responsibility for managing risk lies with the respective boards, CEOs and managers.

The Bank's CEO sits on three committees, each of which handles different aspects of risk: the Risk and Finance Committee, the Credit Committee and the Executive Management Committee. The Credit Committee deals with credit risk, while the Risk and Finance Committee covers market risk and liquidity risk. The Risk and Finance Committee monitors all Group risks and is responsible for enforcing the Bank's risk appetite and risk limits, and reviews and approves all changes to risk models before presented to the Board of Directors. The Risk and Finance Committee makes decisions in regard to pricing and interest rate changes, exposure limits and quality procedures in retail banking. Also, the CEO is a member of the Executive Management Committee, which serves as a forum for consultation and communication between the CEO and managing directors, addressing the main issues that are current in each division. This committee makes all major decisions which are not being consulted on elsewhere or being considered in other standing committees.

In order to ensure that it has procedures in place to supervise business operations, the Board has two committees of its own, the Remuneration Committee and the Audit and Risk Committee.

46. Risk management framework (continued)

The Bank's Risk Managment Division is responsible for managing risk within the Bank through setting and enforcing limits. Subsidiaries of the Bank have their own risk management functions, but the Risk Management Division receives information on exposures from the subsidiaries and collates them into Group exposures.

The Compliance Department ensures that the Group follows its rules on securities trading and insider trading and that operations comply with the Act on Securities Transactions, the Act on Actions to Combat Money Laundering and Terrorist Financing, and other relevant legislation and regulations. This department also concentrates on Group adherence to codes of ethics and on limiting market abuse, minimising conflicts of interest and ensuring best practice. Such compliance is one of the Group's support functions and is integral to its corporate culture.

Internal audit is part of the Group's risk management framework as well as being an aspect of the surveillance system. The purpose of internal audit in the risk management process is to confirm that risk management is functioning and is sufficient for the Group. The effectiveness of the Group's risk management and risk assessment procedures, including the ICAAP process, is evaluated by internal audit and the findings are reported to the Board of Directors. Internal audit activities extend to every operating unit, including the Bank's subsidiaries.

47. Risk management division

The Risk Management Division has seven units.

• The Credit Management Unit is responsible for risk assessment and secondary voting on credit applications for customers with exposures exceeding the credit limits of individual business units and customers which have been classified yellow, orange or red (see Note 53). Secondary voting on decisions exceeding the limits of the Risk Management Division is referred to the Bank's Credit Committee, as if there are any disagreements between the division and other units on credit decisions.

• The Credit Risk Monitoring Unit is responsible for monitoring the Bank's credit portfolio. This is done by operating an early warning system which classifies customers and transfers them between the categories standard/watchlist and restructuring. The unit also works with other units on large exposure and impairment analysis.

• The Asset, Liability and Market Risk Unit is responsible for the risk arising in the Bank's investment banking activities. The types of risks are liquidity risk, interest rate risk, foreign exchange rate risk, equity risk and commodity risk.

• The Operational Risk Unit is responsible for ensuring that Group operational risks are captured and that the Group implements, maintains and monitors an effective operational risk management framework.

• Internal Risk Models Unit's role is to provide, develop and maintain the Bank's internal models and related processes to measure risk, including linking risk to capital; as well as to support the implementation of such models and processes within the Bank.

• The Report and Risk Analysis Unit is responsible for credit risk reporting to regulators and within the Bank. The department is an architect for credit risk data warehousing, liaises with IT regarding credit risk and is responsible for ad hoc credit risk analysis as well as portfolio analysis.

• The Economic Research Unit is responsible for the analysis of the external domestic and international economic environment relevant to the Bank's operations. The analysis provides support to management in planning, risk management and decision-making. The main task of the department within the risk management context is to design and analyse the macroeconomic scenarios which are applied in the stress testing process.

48. Risk policy and appetite

The Board of Directors of the Bank is responsible for overall policy on risk, ensuring that it conforms to the Group's strategy, its capital adequacy goals and risk appetite, and the experience of its management. The CEO is responsible to the Board for daily operations, managing Group risk through committees. Managing directors report to the CEO on the activities of their division and compliance with the risk policies of the Group. Two aspects of this involved the Board of Directors approving a new credit policy as well as updating various risk based rules of the Bank in 2010. The Group has an established process in place for defining its risk appetite and the approval of risk policies for all risks.

49. Effects of the financial crisis

Due to economic conditions in Iceland following the events of October 2008, the Group has been experiencing uncertainty about borrowers' ability to pay back their loans. The uncertainty was especially prevalent in the case of loans denominated in foreign currencies granted to borrowers with limited or no income in foreign currencies. In general, the uncertainty about borrowers' ability to pay back their loans has decreased, in part due to the implementation of solutions for individuals and companies. In addition, 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 and new legislation as described in Note 4(i).

The Group has adopted various measures to assist individuals and corporations experiencing payment difficulties. As indicated by the number of customers experiencing payment difficulties and utilising the Group's solutions there has been a significant financial impact of these solutions. Due to the fact that the loan book was acquired at a deepdiscount, the impact on the Group's financial performance has so far been limited but has left the Group with limited room for further general write-down of loans.

49. Effects of the financial crisis (continued)

Situations may differ between individuals and this calls for varying solutions, customised to fit the needs of each customer. Solutions are based on an overall assessment of each customer's financial situation. The Group provides several remedies for individuals experiencing financial difficulties based on legislation or developed internally by the Group. The remedies variously consist of general measures and/or involve more extensive actions.

The Group has approved a framework to govern the financial restructuring of companies that have a business relation with the Group and are experiencing financial difficulties. The framework is intended to elaborate on the government's declaration, Act No. 107/2009 (on actions for the benefit of individuals, households and companies due to the collapse of the banks and currrency) and Joint Rules on the Financial Restructuring of Companies agreed upon by the members of the Icelandic Financial Services Association.

Credit risk

50. Credit risk

Credit risk is defined as the risk that a party to a financial instrument will cause a financial loss for the Group by failing to discharge its obligations.

Due to the effects of the financial crisis, there is rather high uncertainty concerning the recovery of the loan portfolio. This uncertainty is reflected by traditional measures of credit risk.

Credit risk is the greatest single risk faced by the Group and arises principally from loans and advances to customers and from investments in debt securities. However, it also arises from issued guarantees and letters of credit which commit the Group to pay a third party in the event of customer inability to fulfil obligations. Guarantees and documentary credits are secured by the goods shipments they cover, thus representing a lower risk than direct loans. Unused credit lines represent commitments to increase loans or guarantees. Conceivably, the Group could suffer losses equivalent to the total of open credit lines. Credit risk also arises from derivative contracts where the Group can incur financial losses if the amount to be settled is positive for the Group, after netting and realisation of collateral.

51. Credit risk management

The Group manages credit risk by setting limits on acceptable exposures to individual borrowers or groups of related borrowers. Such limits are monitored and regularly reviewed. Credit risk is also managed by modifying authorised credit limits or acquiring preferable collateral for existing client obligations.

The Group's management and control of credit risk is centralised. The Board of Directors sets the Group lending policy, with the purpose of controlling overall Group exposure by the combined, comprehensive monitoring of indirect risk exposure through clients and direct claims of the Bank and its subsidiaries.

Credit risk is managed by the Risk and Finance Committee, the Credit Committee and its sub-committees. The Risk Management Division manages, monitors and measures credit risk and reports on credit risk quarterly to the managing directors and the Board of Directors. The lending policy approved by the Board of Directors and the Risk and Finance Committee indicates the maximum allowable exposure to individual borrowers and groups of related borrowers.

The CEO sets detailed lending rules based on the policy approved by the Board of Directors. Lending authorisation levels are well-defined and incremental. Lending authorisations within the branch network vary according to branch size and the lending experience of credit officers, with higher lending authorisations being granted to branch managers and corporate relationship managers. The highest lending authorisation in the Group is in the hands of its Corporate Banking Division. Loans exceeding authorisations set by the lending rules require approval by the Credit Committee, which may approve loans falling outside the authorisations stipulated in Group lending rules. The Credit Committee delegates and reviews employee authorisation levels and is responsible for reviewing lending rules. Comprised of the Bank's CEO and the managing directors of Corporate Banking and Financial Operations, the Credit Committee meets regularly to discuss all credit decisions which exceed the authorisation levels of branches and the Corporate Banking Division.

Changes to the composition of the Credit Committee have been proposed and will be implemented in 2011. New lending rules have been approved by the Board of Directors and are in the process of being implemented. These changes aim to involve Risk Management Division to a larger extent than before in the lending process as well as setting credit approval limits on business units and credit committees. These changes will emphasis roles and responsibilities of all departments involved in the process.

52. Credit risk mitigation

Non-derivative financial instruments

Securing loans with collateral is the traditional method of mitigating credit risk. The Group applies the various instruments available towards reducing credit risk by obtaining collateral to secure client obligations where this is considered appropriate, normally in the form of a lien on client assets which gives the Group a claim on these assets for both existing and future client obligations.

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

Where possible, management monitors the market value of collateral and may require additional collateral in accordance with the underlying loan agreement.

The current discussion and political debate on possible changes to the fishing quota system in Iceland, which may include a gradual decrease in the quota awarded to current quota owners, may have an adverse effect on the value of the fishing vessels placed as security for a part of the corporate loan porftfolio of the Bank. This could therefore have an adverse effect on the value of the Bank's loan book. At the moment any such effect is impossible to determine.

The Group is implementing a new collateral system for the Bank. The new collateral system is developed internally and allows the Bank to analyse the quality and value of the collateral held to secure the loan portfolio.

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

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

Derivative financial instruments

In order to mitigate credit risk arising from derivatives the Group chooses the counterparties for derivatives trading based on stringent rules, according to which clients must qualify as professional clients but only if certain conditions are met. The Group also enters into standard ISDA master netting agreements with foreign counterparties and similar general netting agreements with domestic counterparties.

In addition, the Group has in place margin procedures for derivatives. The clients are required to hold a margin account with the Group where the collateral (i.e. cash or government bonds with rating at least BBB) is stored and managed. The client pledges the value of the margin account to the Group, thus reducing the risk of the Group should the client default. The margin system also defines that a client's collateral must be at least equal to the credit equivalent value of the derivative, which is the current potential cost of replacing the contract's expected net cash flows should the counterparty default.

The Group issues a margin call if a client's collateral balance falls below the maintenance margin, which is defined as a percentage of the notional amount of the derivative and varies by type of derivative. In a margin call the Group demands that the client must bring additional collateral, usually within two days, in order to cover the losses. Otherwise the Group closes all or several contracts and takes possession of the collateral so that the collateral balance covers the credit equivalent value again.

The Group's supervision system monitors derivatives exposure and collateral value intraday, it issues margin calls and manages netting agreements.

53. Credit risk measurement

The Group monitors exposures to identify signs of weakness in customer earnings and liquidity as soon as possible. On the basis of customer data, the Group has developed internally a number of statistical models to predict the probability of customers defaulting on their obligations to the Group, as defined in the internal rating based approach of the Basel II framework. Customers of the Group are assigned to a rating grade on the internal rating scale on the basis of the estimated probability of default. Work to validate and improve the Group's internal rating system started in 2010 and will continue in 2011, with the objective to ensure compliance with the internal rating based approaches, starting with the foundation approach.

Supplemental to using ratings, the Group uses a second classification for customer groups with loan exposures above ISK 500 million. A simple means of classification was devised initially, creating three credit risk groups (green, amber and red), which were used from the foundation of the Bank in 2008 until 2010. Following changes in the structure of the Risk Management Division in 2010 and the implementation of a credit risk early warning system, the colour classification used in 2010 was the following:

• Green customers are those that are considered performing without difficulties.

• Yellow customers are those that are on Watch list 1, which have temporary difficulties and may need some installments postponed or modification to terms or loan covenants.

• Orange customers are those that are on Watch list 2. They are still under the supervision of the relevant business unit but are likely to go through loan restucturing or installments postponed.

• Red customers are those that are under the supervision of the Asset Restructuring division and need restructuring, write-offs or debt-to-equity conversion. The management of the customer's operations will possibly be taken over by the Group. In some cases, collateral or guarantees will be collected and/or the operations sold.

Customer groups with loan exposure below ISK 500 million will be grouped into green, yellow, orange and red credit risk groups during the year 2011.

The following table presents the classification of loans and advances to customers by credit risk groups:

Carrying amount	2010	2009
Customer groups with loan exposures above ISK 500 million		
Green	197,331	199,521
Yellow	21,669	16,399
Orange	23,982	20,008
Red	51,867	113,711
Customer groups with loan exposures below ISK 500 million	298,105	317,483
Total	**592,954**	**667,122**

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.

The Group measures the credit risk of derivatives by calculating a credit equivalent value for each derivative. The credit equivalent value is the market value of a contract plus a percentage of the nominal amount of the derivative which depends on the type of derivative. The percentage is twice that of the 99% Value at Risk (VaR), calculated for each underlying security or currency based on historical volatility, for a holding period of five days.

54. Loan impairment

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

Should the expected cash flows be re-examined and the present value of the cash flows (calculated using the effective interest rate) be revised, the difference is then recognised in profit or loss (as either impairment or net adjustments to loans and advances). Impairment is calculated using the effective interest rate, before any revision of the expected cash flows. Any adjustments to the carrying amount which result from revising the expected cash flows are recognised in profit or loss. The impact of financial restructuring of the Group's customers in 2010 is reflected in loan impairment, or net adjustments to loans and advances, as the expected cash flow of customers has changed.

The Group measures and estimates the impact of foreign exchange rate changes on the financial strength of each borrower or group of borrowers. While some customers receive income partially or fully in foreign currency, other customers have very limited or no income in foreign currency. Customers with limited income in foreign currency will suffer more than others, should the ISK depreciate.

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Credit risk

55. Maximum exposure to credit risk and concentration by industry sectors

The following tables represent the Group's maximum credit risk exposure at 31 December 2010 and 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 statement of financial position. Off-balance sheet amounts in the tables below are the maximum amounts the Group might have to pay for guarantees, loan commitments in their full amount, and undrawn overdraft and credit card facilities. The 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.

				Corporations									
At 31 December 2010	**Financial institutions**	**Public entities***	**Individuals**	**Fisheries**	**Construction and real estate companies**	**Services**	**Retail**	**Holding companies**	**Manufacturing**	**Agriculture**	**ITC****	**Other**	**Carrying amount**
Cash and balances with Central Bank	-	47,777	-	-	-	-	-	-	-	-	-	-	**47,777**
Bonds and debt instruments	10,744	147,037	-	-	2	-	-	3,776	-	-	-	1	**161,559**
Derivative instruments	20	-	-	-	-	-	-	3	-	-	-	-	**23**
Loans and advances to financial institutions	91,882	-	-	-	-	-	-	-	-	-	-	-	**91,882**
Loans and advances to customers	-	13,591	163,203	134,037	100,038	66,752	33,582	37,243	22,872	11,666	6,597	3,373	**592,954**
Other financial assets	6,316	42	-	12	-	433	1	19	10	-	154	83	**7,070**
Total on-balance sheet exposure	**108,962**	**208,446**	**163,203**	**134,049**	**100,040**	**67,185**	**33,584**	**41,041**	**22,882**	**11,666**	**6,751**	**3,457**	**901,265**
Off-balance sheet exposure	**0**	**7,232**	**33,184**	**11,904**	**5,801**	**9,672**	**12,053**	**2,184**	**3,090**	**2,479**	**2,483**	**289**	**90,371**
Financial guarantees	-	12	478	884	3,240	2,325	1,222	228	618	340	855	31	10,232
Undrawn loan commitments	-	2,564	49	8,781	876	3,336	6,453	846	891	1,636	675	-	26,105
Debt underwriting commitments	-	1,090	-	-	-	-	-	-	-	-	-	-	1,090
Undrawn overdraft/credit card facilities	-	3,566	32,657	2,239	1,685	4,012	4,379	1,110	1,581	502	953	258	52,943
Maximum exposure to credit risk	**108,962**	**215,678**	**196,387**	**145,953**	**105,841**	**76,857**	**45,637**	**43,225**	**25,972**	**14,144**	**9,234**	**3,745**	**991,635**

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

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

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

				Corporations									
At 31 December 2009	**Financial institutions**	**Public entities***	**Individuals**	**Fisheries**	**Construction and real estate companies**	**Holding companies**	**Retail**	**Services**	**Manufacturing**	**ITC****	**Agriculture**	**Other**	**Carrying amount**
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	-	89	**6,990**
Total on-balance sheet exposure	**109,500**	**166,183**	**175,993**	**162,530**	**111,748**	**60,754**	**46,164**	**50,368**	**28,186**	**17,660**	**13,208**	**7,813**	**950,107**
Off-balance sheet exposure	**0**	**7,000**	**34,008**	**10,219**	**7,852**	**1,124**	**11,701**	**4,719**	**3,481**	**2,588**	**1,796**	**141**	**84,629**
Financial guarantees	-	412	378	598	3,521	215	423	1,313	581	493	6	95	8,035
Undrawn loan commitments	-	-	73	7,000	2,715	166	7,598	628	1,665	1,100	1,409	-	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
Maximum exposure to credit risk	**109,500**	**173,183**	**210,001**	**172,749**	**119,600**	**61,878**	**57,865**	**55,087**	**31,667**	**20,248**	**15,004**	**7,954**	**1,034,736**

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

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

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56. Loans and advances by industry sectors

	2010			2009		
Industry sectors	Gross carrying amount	Allowance for impairment	Carrying amount	Gross carrying amount	Allowance for impairment	Carrying amount
Financial institutions	94,060	(2,178)	91,882	83,856	(727)	83,129
Public entities	13,928	(337)	13,591	10,582	(194)	10,388
Individuals	166,069	(2,866)	163,203	177,110	(1,124)	175,986
Corporations						
Fisheries	136,985	(2,948)	134,037	162,677	(187)	162,490
Construction and real estate companies	104,092	(4,054)	100,038	111,791	(1,387)	110,404
Holding companies	41,937	(4,695)	37,243	56,985	(3,584)	53,401
Retail	35,248	(1,666)	33,582	46,866	(705)	46,161
Services	69,721	(2,970)	66,752	49,799	(210)	49,589
Information, technology and communication	6,780	(183)	6,597	17,719	(60)	17,659
Manufacturing	23,865	(993)	22,872	27,211	(278)	26,933
Agriculture	11,909	(243)	11,666	13,226	(18)	13,208
Other	3,542	(169)	3,373	916	(13)	903
Total	**708,136**	**(23,300)**	**684,836**	**758,738**	**(8,487)**	**750,251**

57. Credit quality of financial assets

	Gross carrying amount					
At 31 December 2010	Neither past due nor individually impaired	Past due but not individually impaired	Individually impaired	Total	Allowance for impairment	Carrying amount
Cash and balances with Central Bank	47,777	-	-	47,777	-	47,777
Bonds and debt instruments	152,216	9,343	-	161,559	-	161,559
Derivative instruments	23	-	-	23	-	23
Loans and advances to financial institutions	71,929	196	21,935	94,060	(2,178)	91,882
Loans and advances to customers	444,530	169,380	166	614,076	(21,122)	592,954
Other financial assets	7,070	-	-	7,070	-	7,070
Total	**723,544**	**178,919**	**22,101**	**924,565**	**(23,300)**	**901,265**
At 31 December 2009						
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
Total	**730,394**	**198,891**	**29,309**	**958,594**	**(8,487)**	**950,107**

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

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58. Loans and advances neither past due nor individually impaired

	Credit risk groups					
At 31 December 2010	Green	Yellow	Orange	Red	Exposures below ISK 500 million	Gross carrying amount
Financial institutions	71,821	-	-	-	107	71,929
Public entities	5,041	3,385	-	1,668	2,384	12,478
Individuals	-	-	-	-	120,162	120,162
Corporations						
Fisheries	96,309	4,838	1,551	2,400	9,424	114,523
Construction and real estate companies	16,474	5,237	12,015	3,170	18,840	55,735
Holding companies	2,951	1,180	1,030	7,662	11,556	24,378
Retail	17,750	1,987	1	97	7,440	27,275
Services	40,159	98	899	183	13,726	55,065
Information, technology and communication	4,493	-	2	-	1,912	6,406
Manufacturing	6,801	953	-	49	2,366	10,167
Agriculture	8,454	533	-	1,408	5,253	15,648
Other	1,618	-	-	535	542	2,694
Total	**271,869**	**18,211**	**15,496**	**17,171**	**193,712**	**516,459**
At 31 December 2009						
Financial institutions	52,947	-	-	-	1,260	54,207
Public entities	5,360	-	-	1,092	3,598	10,050
Individuals	-	-	-	-	140,299	140,299
Corporations						
Fisheries	84,149	1,961	2,150	34,482	8,854	131,597
Construction and real estate companies	12,303	799	11,051	7,938	23,574	55,664
Holding companies	21,213	1,224	1,097	1,735	12,519	37,788
Retail	24,942	-	-	1,237	4,661	30,841
Services	27,924	3,298	29	1,414	14,777	47,442
Information, technology and communication	4,352	-	-	-	3,195	7,547
Manufacturing	8,214	-	-	1,169	3,017	12,400
Agriculture	11,374	301	-	901	6,882	19,459
Other	-	-	-	593	261	854
Total	**252,779**	**7,584**	**14,327**	**50,563**	**222,896**	**548,148**

59. 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.

At 31 December 2010	Past due up to 30 days	Past due 31 - 60 days	Past due 61 - 90 days	Past due over 90 days	Gross carrying amount
Loans and advances to financial institutions	6	-	1	190	196
Loans and advances to customers	15,578	10,918	3,476	139,408	169,380
Total	**15,584**	**10,918**	**3,477**	**139,598**	**169,576**
At 31 December 2009					
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
Total	**29,561**	**16,075**	**14,056**	**121,589**	**181,281**

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60. Individually impaired loans and advances to financial institutions and customers

At 31 December 2010	Gross carrying amount	Allowance for impairment	Carrying amount
Loans and advances to financial institutions	21,935	(2,178)	19,757
Loans and advances to customers	166	(64)	102
Total	**22,101**	**(2,242)**	**19,859**
At 31 December 2009			
Loans and advances to financial institutions	26,852	(727)	26,125
Loans and advances to customers	2,457	(1,450)	1,007
Total	**29,309**	**(2,177)**	**27,132**

61. Allowance for impairment on loans and advances to financial institutions and customers

	2010			2009		
	Financial institutions	Customers	Total	Financial institutions	Customers	Total
Balance at the beginning of the year	727	7,760	8,487	727	1,183	1,910
Net impairment loss for the year	1,451	13,184	14,635	-	6,577	6,577
Collected previously written-off loans	-	177	177	-	-	-
Balance at the end of the year	**2,178**	**21,122**	**23,300**	**727**	**7,760**	**8,487**
Individual allowance	2,178	64	2,242	727	1,450	2,177
Collective allowance	0	21,058	21,058	-	6,310	6,310
Total	**2,178**	**21,122**	**23,300**	**727**	**7,760**	**8,487**

62. 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 has put remedies in place for those experiencing financial difficulties and also presented procedures for financial restructuring. These restructuring approaches include extended and modified repayment arrangements and approved external management plans. 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. During the year 2010 the Bank increased its focus and effort in restructuring loans to individuals and companies.

The restructuring of the loans acquired from Landsbanki Íslands hf. gives rise to uncertainties about the net expected future cash flows from the loans due to various reasons, including legal and tax implications.

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63. Large exposures

At 31 December 2010, two Group clients were rated as large exposures (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. The large exposures amount is calculated 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 as of 31 December 2010.

At 31 December 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 31 December 2010, one exposure exceeded 20% (2009: no exposure). Measures have already been taken to decrease the risk exposure of that client and today it is under 20%. 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.

At 31 December 2010	Number of large exposures	Large exposures
Large exposures above 20% of the Group's capital base	1	36,279
Large exposures between 10% and 20% of the Group's capital base	1	19,375
Total	**2**	**55,654**
Utilisation of 800% limit (%)		31%
At 31 December 2009		
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
Total	**3**	**67,189**
Utilisation of 800% limit (%)		43%

64. Bonds and debt instruments

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

Carrying amount	2010	2009
Aaa	8,989	-
Aa1	-	377
Aa3	-	274
A3 to A1	646	1,188
Baa1 to Baa3	136,339	130,355
Lower than Baa3	9,186	15,349
Unrated	6,400	18,178
Total	**161,559**	**165,721**

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:

At 31 December 2010	Past due up to 30 days	Past due 31 - 60 days	Past due 61 - 90 days	Past due over 90 days	Carrying amount
Financial institutions	-	-	-	8,843	8,843
Holding companies	-	-	-	500	500
Total	**0**	**0**	**0**	**9,343**	**9,343**
At 31 December 2009					
Financial institutions	-	-	-	10,536	10,536
Holding companies	105	111	-	5,200	5,416
Other	-	-	-	1,658	1,658
Total	**105**	**111**	**0**	**17,394**	**17,610**

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65. Derivative instruments

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

	2010			2009		
	Notional	Fair value		Notional	Fair value	
	amount	Assets	Liabilities	amount	Assets	Liabilities
A1	42,371	19	768	68,874	962	-
Baa3	1,897	-	659	2,415	-	672
C	-	-	-	90	-	-
Unrated	3,706	4	18	3,381	9	3
Total	**47,974**	**23**	**1,445**	**74,759**	**971**	**675**

Liquidity risk

66. Liquidity risk

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

67. Liquidity risk management

The Group has instituted a liquidity management policy for the Bank and its subsidiaries. The Risk and Finance Committee formulates this policy, while the Treasury Department implements it in co-operation with the The Asset, Liability and Market Risk Unit, which is part of the Risk Management Division. The objective of the liquidity management policy is to ensure, even in times of stress, that sufficient liquid assets and funding capacity are available to meet financial obligations in a timely manner and at reasonable cost. Enforcing this policy has the further objective of minimising fluctuations in liquidity.

The Group follows liquidity rules set by the Central Bank of Iceland to govern the ratio of weighted liquid assets and liabilities. These rules require the ratio of weighted assets to weighted liabilities to stay above 1 for the next three months, and involve a stress test, weighting assets and liabilities with specific coefficients and reflecting how accessible each asset would be in a liquidity crisis and how great the need would be to repay the liability in question when due. The Group submits monthly reports on its liquidity position to the Central Bank of Iceland.

Group liquidity risk is managed centrally by the Treasury Department and is monitored by the The Asset, Liability and Market Risk Unit, both of which are located at the head office of the Bank. This allows management to monitor and manage liquidity risk throughout the Group. The Risk and Finance Committee monitors the Group's liquidity risk, while the Group's internal audit assesses whether the liquidity management process is designed properly and operating effectively.

The Group monitors intraday liquidity risk, short-term liquidity risk, and risk arising from mismatches of longer term assets and liabilities. Short-term liquidity risk is defined as under 12 months. The Group has neither defaulted on any principal or interest nor breached any covenants in respect of liabilities, that could lead such liabilities to be accelerated, up to the date of these consolidated financial statements being authorised for issue.

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

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

The key 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 31 December 2010 was 46% (2009: 36%).

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68. Maturity analysis of financial assets and liabilities

The following table shows a maturity analysis of the Group's financial instruments as at 31 December 2010:

Non-derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total	Carrying amount
Cash and balances with Central Bank	47,777	-	-	-	-	47,777	47,777
Bonds and debt instruments	-	10,477	6,438	36,933	168,203	222,050	161,559
Loans and advances to financial institutions	-	88,965	3,051	-	-	92,016	91,882
Loans and advances to customers	29,807	123,424	79,498	286,884	631,211	1,150,824	592,954
Other financial assets	-	6,313	-	757	-	7,070	7,070
Total	**77,584**	**229,179**	**88,987**	**324,574**	**799,413**	**1,519,737**	**901,242**
Derivative financial assets							
Gross settled derivatives							
Inflow	-	5,482	-	-	-	5,482	
Outflow	-	(5,366)	-	-	-	(5,366)	
Total	**0**	**116**	**0**	**0**	**0**	**116**	**20**
Net settled derivatives	-	3	-	-	-	3	3
Total	**0**	**119**	**0**	**0**	**0**	**119**	**23**
Non-derivative financial liabilities							
Due to financial institutions and Central Bank	(138,503)	(8,583)	(421)	-	-	(147,507)	(147,478)
Deposits from customers	(271,977)	(53,196)	(28,715)	(20,309)	-	(374,197)	(371,558)
Short positions	-	(82)	(4,390)	(4,103)	(62)	(8,637)	(5,675)
Secured bonds	-	(1,588)	(4,865)	(191,171)	(109,193)	(306,817)	(261,313)
Contingent bond	-	-	-	(21,185)	(11,443)	(32,629)	(26,510)
Other financial liabilities	-	(4,237)	-	-	-	(4,237)	(4,237)
Total	**(410,480)**	**(67,685)**	**(38,391)**	**(236,768)**	**(120,698)**	**(874,023)**	**(816,771)**
Off-balance sheet items							
Financial guarantees	(5,188)	(1,099)	(1,854)	(2,092)	-	(10,232)	
Undrawn loan commitments	(26,105)	-	-	-	-	(26,105)	
Debt underwriting commitments	-	(1,090)	-	-	-	(1,090)	
Undrawn overdraft/credit card commitments	(52,943)	-	-	-	-	(52,943)	
Total	**(84,236)**	**(2,189)**	**(1,854)**	**(2,092)**	**0**	**(90,371)**	
Total non-derivative financial liabilities and off-balance sheet items	**(494,716)**	**(69,874)**	**(40,245)**	**(238,861)**	**(120,698)**	**(964,394)**	
Derivative financial liabilities							
Gross settled derivatives							
Inflow	-	20,149	277	1,145	552	22,122	
Outflow	-	(21,266)	(390)	(1,547)	(737)	(23,940)	
Total	**0**	**(1,117)**	**(113)**	**(402)**	**(186)**	**(1,818)**	**(17)**
Net settled derivatives	-	17	-	-	-	17	(1,428)
Total	**0**	**(1,100)**	**(113)**	**(402)**	**(186)**	**(1,801)**	**(1,445)**
Net liquidity position	**(417,132)**	**158,324**	**48,629**	**85,312**	**678,530**	**553,662**	

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68. 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:

Non-derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total	Carrying amount
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
Total	**63,866**	**155,456**	**119,236**	**414,256**	**659,061**	**1,411,875**	**949,136**
Derivative financial assets							
Gross settled derivatives							
Inflow	-	9,411	9,739	-	-	19,150	
Outflow	-	(8,900)	(9,989)	-	-	(18,889)	
Total	**0**	**511**	**(250)**	**0**	**0**	**261**	**962**
Net settled derivatives	-	9	-	-	-	9	9
Total	**0**	**520**	**(250)**	**0**	**0**	**270**	**971**
Non-derivative financial liabilities							
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)
Secured bonds	-	-	(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)
Total	**(406,987)**	**(95,447)**	**(33,241)**	**(139,251)**	**(273,269)**	**(948,195)**	**(875,023)**
Off-balance sheet items							
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)	
Total	**(76,594)**	**(4,576)**	**(335)**	**(3,124)**	**0**	**(84,629)**	
Total non-derivative financial liabilities and off-balance sheet items	**(483,581)**	**(100,023)**	**(33,576)**	**(142,375)**	**(273,269)**	**(1,032,824)**	
Derivative financial liabilities							
Gross settled derivatives							
Inflow	-	168	297	1,278	904	2,647	
Outflow	-	(167)	(412)	(1,668)	(1,182)	(3,429)	
Total	**0**	**1**	**(115)**	**(390)**	**(278)**	**(782)**	**(673)**
Net settled derivatives	-	(2)	-	-	-	(2)	(2)
Total	**0**	**(1)**	**(115)**	**(390)**	**(278)**	**(784)**	**(675)**
Net liquidity position	**(419,715)**	**55,952**	**85,295**	**271,491**	**385,514**	**378,537**	

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68. Maturity analysis of financial assets and liabilities (continued)

The amounts in the maturity analyses as at 31 December 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 the reporting date. Those bonds all fall in time band of 1-5 years.

Amounts presented in the maturity analyses are the undiscounted future cash flows receivable and payable by the Group, including both principal and interest cash flows. These amounts differ from the carrying amounts presented in the statement of financial position, which are based on discounted rather than undiscounted future cash flows. If an amount receivable or payable is not fixed, the amount presented in the maturity analyses has been determined by reference to the conditions existing at the reporting date. For example, for inflation-linked assets and liabilities, the Group estimates the inflation related future cash flows using an internally estimated inflation curve based on the Central Bank of Iceland's inflation target for the annualised inflation rate. 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 included 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.

69. Maturity analysis of financial assets and liabilities by currency

The following table shows a maturity analysis of the Group's financial instruments by currency of denomination as at 31 December 2010:

Non-derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total	Carrying amount
Total in foreign currencies	12,829	134,291	44,467	136,926	80,963	409,478	249,812
ISK	64,755	94,887	44,519	187,648	718,450	1,110,260	651,430
Total	**77,584**	**229,179**	**88,987**	**324,574**	**799,413**	**1,519,737**	**901,242**
Derivative financial assets							
Total in foreign currencies	-	287	-	-	-	287	20
ISK	-	(168)	-	-	-	(168)	3
Total	**0**	**119**	**0**	**0**	**0**	**119**	**23**
Non-derivative financial liabilities							
Total in foreign currencies	(49,351)	(3,567)	(6,468)	(191,171)	(109,193)	(359,750)	(314,244)
ISK	(361,128)	(64,119)	(31,923)	(45,597)	(11,505)	(514,273)	(502,527)
Total	**(410,480)**	**(67,685)**	**(38,391)**	**(236,768)**	**(120,698)**	**(874,023)**	**(816,771)**
Off-balance sheet items							
Total in foreign currencies	(12,059)	(567)	(816)	(1,121)	-	(14,563)	
ISK	(72,177)	(1,622)	(1,038)	(971)	-	(75,807)	
Total	**(84,236)**	**(2,189)**	**(1,854)**	**(2,092)**	**0**	**(90,371)**	
Derivative financial liabilities							
Total in foreign currencies	-	(964)	87	377	189	(312)	(1,428)
ISK	-	(136)	(200)	(779)	(375)	(1,489)	(17)
Total	**0**	**(1,100)**	**(113)**	**(402)**	**(186)**	**(1,801)**	**(1,445)**
Net liquidity position in foreign currencies	**(48,581)**	**129,481**	**37,270**	**(54,989)**	**(28,040)**	**35,140**	
Net liquidity position in ISK	**(368,551)**	**28,843**	**11,359**	**140,301**	**706,570**	**518,522**	
Net liquidity position	**(417,132)**	**158,324**	**48,629**	**85,312**	**678,530**	**553,662**	

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69. 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:

Non-derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total	Carrying amount
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
Total	**63,866**	**155,456**	**119,236**	**414,256**	**659,061**	**1,411,875**	**949,136**
Derivative financial assets							
Total in foreign currencies	-	511	(250)	-	-	261	962
ISK	-	9	-	-	-	9	9
Total	**0**	**520**	**(250)**	**0**	**0**	**270**	**971**
Non-derivative financial liabilities							
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)
Total	**(406,987)**	**(95,447)**	**(33,241)**	**(139,251)**	**(273,269)**	**(948,195)**	**(875,023)**
Off-balance sheet items							
Total in foreign currencies	(15,474)	(10)	(1)	(58)	-	(15,543)	
ISK	(61,120)	(4,566)	(334)	(3,066)	-	(69,086)	
Total	**(76,594)**	**(4,576)**	**(335)**	**(3,124)**	**0**	**(84,629)**	
Derivative financial liabilities							
Total in foreign currencies	-	163	89	408	296	956	(673)
ISK	-	(164)	(204)	(798)	(574)	(1,740)	(2)
Total	**0**	**(1)**	**(115)**	**(390)**	**(278)**	**(784)**	**(675)**
Net liquidity position in foreign currencies	**(89,045)**	**102,090**	**42,170**	**153,052**	**(27,628)**	**180,639**	
Net liquidity position in ISK	**(330,670)**	**(46,138)**	**43,125**	**118,439**	**413,142**	**197,898**	
Net liquidity position	**(419,715)**	**55,952**	**85,295**	**271,491**	**385,514**	**378,537**	

The amounts in the maturity analysis as at 31 December 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 68.

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Market risk

70. Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in market prices. Market risk arises from open positions regarding currency, equity and interest rate products, all of which are exposed to general and specific market movements and changing volatility levels in market rates and prices, for instance in interest rates, credit spreads, foreign exchange rates and equity prices. Other price risk is defined as equity price risk, inflation risk and commodity price risk, each of which is disclosed in the Notes below (except for commodity risk as the Group is not exposed to such risk).

71. Market risk management

The Group separates its exposure to market risk into trading and non-trading portfolios, managing each of them separately. Trading portfolios include all of the positions arising from investment banking operations of the Finance Division, such as positions arising from market-making and proprietary position-taking (i.e. bonds classified as held for trading, equities, unsettled securities trading, derivatives and short positions). Non-trading portfolios include positions arising from the Group's retail and commercial banking operations (i.e. loans and advances, deposits and bonds designated as at fair value through profit or loss or classified as loans and receivables). The overall authority for market risk management has been vested by the Board of Directors in the CEO and the Risk and Finance Committee. The Asset, Liability and Market Risk Unit is responsible for developing detailed risk management policies (which are subject to review and approval by the Risk and Finance Committee) and for reviewing their implementation from day to day. The objective of market risk management is to identify, locate and monitor market risk exposures and analysing and reporting to appropriate parties.

Market risks arising from trading and non-trading activities are monitored by two separate teams within the Risk Management Division, which submit daily, weekly and monthly reports to the head of each business unit along with detailed input to a comprehensive quarterly risk report. The Group's market risk is thereby measured on a daily basis, and the detailed limits set by the Risk and Finance Committee are monitored by the Asset, Liability and Market Risk Unit within the Risk Management Division. Several indicators are used, including daily profits and losses as well as net positions across different attributes such as the currency and issuer. Market risk in the trading and non-trading portfolios is managed separately by Treasury and monitored by the Asset, Liability and Market Risk Unit.

Risk-weighted assets are determined by applying specific risk weights to Group assets, following methodology developed by the Basel Committee on Banking Supervision. The following table summarises the Group's exposure to market risk at year-end 2010 and 2009:

	2010	2009
Market risk factor	**% of RWA**	**% of RWA**
Equity price risk	4.8%	3.4%
Interest rate risk	2.5%	5.1%
Foreign exchange risk	8.5%	13.7%
Total	**15.8%**	**22.1%**

The currency risk in the Group's trading portfolios is disclosed together with that in its non-trading portfolios in Notes 76-80, along with the related sensitivity analysis.

72. Interest rate risk

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

Changes in interest rates for the Group's assets and liabilities, other than those in its trading portfolios, have an impact on its interest rate margin. This risk results primarily from duration mismatch between assets and liabilities.

Interest rate risk is managed principally by monitoring interest rate gaps. Interest rate risk is managed centrally within the Group by the Treasury Department, and is monitored by the The Asset, Liability and Market Risk Unit of the Risk Management Division. In the current economic environment, the Group has no access to derivative instruments and other tools for managing interest rate risk.

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72. Interest rate risk (continued)

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.

At 31 December 2010	Up to 3 months	3-12 months	1-5 years	Over 5 years	Carrying amount
Financial assets					
Cash and balances with Central Bank	47,777	-	-	-	47,777
Bonds and debt instruments	150,243	108	1,804	9,404	161,559
Derivative instruments	23	-	-	-	23
Loans and advances to financial institutions	88,830	3,051	-	-	91,882
Loans and advances to customers	455,005	61,190	39,372	37,387	592,954
Other financial assets	6,313	-	757	-	7,070
Total	**748,191**	**64,349**	**41,933**	**46,791**	**901,264**
Financial liabilities					
Due to financial institutions and Central Bank	(147,478)	-	-	-	(147,478)
Deposits from customers	(371,558)	-	-	-	(371,558)
Derivative instruments and short positions	(1,514)	(4,123)	(1,482)	-	(7,119)
Secured bonds	(261,313)	-	-	-	(261,313)
Contingent bond	(26,510)	-	-	-	(26,510)
Other financial liabilities	(4,237)	-	-	-	(4,237)
Total	**(812,610)**	**(4,123)**	**(1,482)**	**0**	**(818,215)**
Net on-balance sheet position	(64,419)	60,226	40,452	46,791	83,050
Net off-balance sheet position	886	(117)	(500)	(269)	
Total interest repricing gap	**(63,533)**	**60,108**	**39,952**	**46,522**	

At 31 December 2009	Up to 3 months	3-12 months	1-5 years	Over 5 years	Carrying amount
Financial assets					
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
Total	**784,524**	**64,225**	**44,172**	**57,186**	**950,107**
Financial liabilities					
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)
Secured bonds	(306,493)	-	-	-	(306,493)
Contingent bond	(10,241)	-	-	-	(10,241)
Other financial liabilities	(2,138)	-	-	-	(2,138)
Total	**(871,785)**	**(798)**	**(2,044)**	**(1,071)**	**(875,698)**
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)	
Total interest repricing gap	**(88,362)**	**65,440**	**41,626**	**55,705**	

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73. Sensitivity analysis for trading portfolios

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

The following table shows how the Group's profit before tax would have been affected by parallel shifts in interest yield curves through changes in the fair value of its bond trading portfolios at year-end 2010 and 2009 and cash flows for the next 12 months after that, assuming a constant financial position.

	2010			2009		
Currency (ISK million)	**Parallel shift in yield curve in basis points**	**Effect of downward shift on profit**	**Effect of upward shift on profit**	**Parallel shift in yield curve in basis points**	**Effect of downward shift on profit**	**Effect of upward shift on profit**
ISK, unindexed	100	234	(233)	100	370	(360)
ISK, CPI indexed	50	77	(73)	50	(42)	40
Total		**311**	**(306)**		**328**	**(320)**

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

The following table shows how the Group's profit before tax would have been affected by a change of +/-10% in the price of equity and equity instruments held by the Group at year-end which are classified into Level 1 and 2 (as defined in Note 6):

	2010		2009	
Currency (ISK million)	**Increase**	**Decrease**	**Increase**	**Decrease**
ISK	1,033	(1,033)	100	(100)
EUR	-	-	10	(10)
SEK	375	(375)	53	(53)
NOK	374	(374)	36	(36)
Other	204	(204)	-	-
Total	**1,986**	**(1,986)**	**199**	**(199)**

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

The following table shows how the Group's profit before tax would have been affected by a change of +/-10% in the price of equity and equity instruments held by the Group at year-end which are classified into Level 3 (as defined in Note 6):

	2010		2009	
Currency (ISK million)	**Increase**	**Decrease**	**Increase**	**Decrease**
ISK	802	(802)	414	(414)
USD	-	-	18	(18)
EUR	225	(225)	19	(19)
NOK	21	(21)	23	(23)
Total	**1,048**	**(1,048)**	**474**	**(474)**

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

74. Sensitivity analysis for non-trading portfolios

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of financial assets and liabilities to various interest rate scenarios. The Group employs a monthly stress test of the interest rate risk in the Group's overall non-trading net on-balance sheet position. In this test, the interest rate curve is shifted for every currency. The following table shows how the Group's profit before tax would have been affected by a parallel shift in all yield curves, with all other variables kept constant, as related to risk exposure at year-end 2010 and 2009 and cash flows for the next 12 months after that, assuming a constant financial position.

	2010			2009		
Currency (ISK million)	Parallel shift in yield curve in basis points	Effect of downward shift on profit	Effect of upward shift on profit	Parallel shift in yield curve in basis points	Effect of downward shift on profit	Effect of upward shift on profit
ISK, unindexed	100	(108)	108	100	44	(44)
ISK, CPI indexed	50	(17)	17	50	(28)	28
EUR	20	(9)	9	20	(10)	10
USD	10	(7)	7	10	(7)	7
GBP	20	1	(1)	20	2	(2)
CAD	10	-	-	10	(1)	1
JPY	5	(1)	1	5	(4)	4
CHF	5	-	-	5	(5)	5
Other	10	(1)	1	10	(3)	3
Total		**(142)**	**142**		**(12)**	**12**

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

75. 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 31 December 2010 the CPI imbalance, calculated as the difference between CPI-indexed financial assets and liabilities, was ISK 94,641 million (31 December 2009: 71,812 million).

Carrying amount	2010	2009
Assets		
Bonds and debt instruments	8,119	5,438
Loans and advances to customers	171,017	154,823
Total	**179,136**	**160,261**
Liabilities		
Due to financial institutions and Central Bank	(421)	(441)
Deposits from customers	(82,215)	(84,725)
Short positions	(595)	(1,917)
Total	**(83,231)**	**(87,083)**
Total on-balance sheet position	95,905	73,178
Total off-balance sheet position	(1,264)	(1,366)
Total CPI indexation balance	**94,641**	**71,812**

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 31 December 2010, with no change in other variables, would have increased net interest income by ISK 9,591 million (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.

76. Currency risk (all portfolios)

Currency risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in foreign exchange rates.

Currency risk is managed centrally within the Group by the Treasury Department, and monitored by the The Asset, Liability and Market Risk Unit of the Risk Management Division. Group limits for foreign exchange risk are reviewed and monitored by the Risk and Finance Committee.

The Group follows the Rules No. 950/2010 on Foreign Exchange Balances, as set by the Central Bank of Iceland. The rules stipulate that an institution's foreign exchange balance (whether long or short) must always be within 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 December 2011, raising the required limits.

77. FX-delta

The inherent risk in the 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.

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78. Concentration of currency risk

The following tables summarise the Group's exposure to currency risk at 31 December 2010 and 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 amounts of foreign currency loans granted to customers with limited or no foreign currency income, if they are not financially strong enough to withstand adverse movements in the foreign exchange rate against ISK.

As explained in Note 4(i), the Group has changed during the year 2010 the accounting for all types of foreign currency lease agreements which are within the scope of law no. 38/2001 and for certain types of foreign currency loan agreements. Based on this change, their carrying amount is no longer included in the carrying amount of loans and advances to customers disclosed in this note. However, as explained in Note 36 the issue of the denomination currencies of these loans are still under legal dispute and the Bank has appealed the ruling of the District Court of Reykjavik to the Supreme Court of Iceland.

At 31 December 2010	EUR	GBP	USD	JPY	CHF	Other	Total
Assets							
Cash and balances with Central Bank	461	133	385	10	35	441	1,465
Bonds and debt instruments	2,152	149	9,747	-	-	-	12,049
Equities and equity instruments	2,246	-	625	-	-	8,201	11,072
Derivative instruments	2	1	16	-	-	-	20
Loans and advances to financial institutions	20,428	12,020	34,295	2,094	863	3,138	72,837
Loans and advances to customers	51,846	7,401	54,227	19,850	20,653	9,107	163,084
Other assets	4,467	7	122	1	-	305	4,902
Assets classified as held for sale	9,914	6,397	449	2,218	7	253	19,237
Total	**91,517**	**26,108**	**99,866**	**24,172**	**21,558**	**21,445**	**284,665**
Liabilities							
Due to financial institutions and Central Bank	(1,302)	(2,182)	(6,827)	(303)	(73)	(967)	(11,654)
Deposits from customers	(14,863)	(3,549)	(17,638)	(686)	(436)	(3,791)	(40,964)
Derivative instruments and short positions	(706)	-	(722)	-	-	-	(1,428)
Secured bonds	(130,963)	(48,132)	(82,218)	-	-	-	(261,313)
Other liabilities	(10)	(7)	(1)	-	-	(294)	(313)
Total	**(147,844)**	**(53,870)**	**(107,406)**	**(990)**	**(510)**	**(5,052)**	**(315,672)**
Net on-balance sheet position	(56,327)	(27,762)	(7,540)	23,182	21,048	16,393	**(31,006)**
Net off-balance sheet position	12,322	79	8,150	(6,719)	(13,503)	(354)	**(24)**
Net currency position	**(44,005)**	**(27,683)**	**610**	**16,463**	**7,545**	**16,039**	**(31,031)**
FX-delta on Loans and advances to customers and assets classified as held for sale	95%	96%	97%	78%	78%	92%	
FX-delta adjustments to currency imbalance	(3,088)	(552)	(1,640)	(4,855)	(4,545)	(711)	**(15,392)**
Net effective currency position	**(47,093)**	**(28,235)**	**(1,030)**	**11,609**	**3,000**	**15,327**	**(46,422)**

If the Supreme Court of Iceland will reverse the ruling of the District Court of Iceland and rule that the loan agreements referred to in the preceding paragraph of this note are in fact foreign currency loan agreements, the Group's exposure to currency risk will be different from that disclosed in the table above. The carrying amount of these loan agreements would then be included in the carrying amount of loans and advances to customers and the FX-delta used by the Group would decrease, resulting in the following net effective currency position at 31 December 2010:

At 31 December 2010	EUR	GBP	USD	JPY	CHF	Other	Total
Adjustments to loans and advances to customers	28,986	3,141	9,949	38,733	38,897	5,042	**124,747**
Net currency position	**(15,019)**	**(24,542)**	**10,559**	**55,196**	**46,442**	**21,081**	**93,718**
FX-delta after adjustments to loans and advances to customers	87%	94%	92%	57%	59%	89%	
FX-delta adjustments to currency imbalance	(11,797)	(1,016)	(5,170)	(26,144)	(24,419)	(1,555)	**(70,101)**
Adjusted net effective currency position	**(26,816)**	**(25,559)**	**5,389**	**29,052**	**22,024**	**19,525**	**23,616**

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78. Concentration of currency risk (continued)

At 31 December 2009	EUR	GBP	USD	JPY	CHF	Other	Total
Assets							
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
Total	**109,072**	**33,509**	**124,837**	**108,599**	**108,601**	**40,074**	**524,692**
Liabilities							
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)
Secured bonds	(158,573)	(56,086)	(91,834)	-	-	-	(306,493)
Other liabilities	(216)	(11)	(99)	-	-	(164)	(490)
Total	**(194,441)**	**(74,366)**	**(121,025)**	**(1,511)**	**(1,824)**	**(7,129)**	**(400,296)**
Net on-balance sheet position	(85,369)	(40,857)	3,812	107,088	106,777	32,945	**124,396**
Net off-balance sheet position	5,298	2,390	10,183	(12,834)	(3,905)	-	**1,132**
Net currency position	**(80,071)**	**(38,467)**	**13,995**	**94,254**	**102,872**	**32,945**	**125,528**
FX-delta on Loans and advances to customers	75%	90%	82%	57%	60%	87%	
FX-delta adjustments to currency imbalance	(21,917)	(1,494)	(13,056)	(44,288)	(40,823)	(3,644)	**(125,222)**
Net effective currency position	**(101,988)**	**(39,961)**	**939**	**49,966**	**62,049**	**29,301**	**306**

79. Sensitivity to currency risk

The following table shows how other net operating income would have been affected by a 10% depreciation/appreciation of ISK against each foreign currency, with all other variables held constant. The sensitivity analysis is applied to the Group's overall position in foreign currency on-balance sheet as disclosed in Note 78.

	2010		2009	
Currency (ISK million)	**-10%**	**+10%**	**-10%**	**+10%**
EUR	(4,709)	4,709	(10,199)	10,199
GBP	(2,824)	2,824	(3,996)	3,996
USD	(103)	103	94	(94)
JPY	1,161	(1,161)	4,997	(4,997)
CHF	300	(300)	6,205	(6,205)
Other	1,533	(1,533)	2,930	(2,930)
Total	**(4,642)**	**4,642**	**31**	**(31)**

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

The sensitivity to changes in foreign currency rates of the carrying amount of foreign currency denominated loans depends on the FX-delta, calculated as described in Note 77. Thus, the depreciation of ISK results in less foreign exchange gains from loans to customers with ISK denominated income when compared to customers with foreign currency denominated income.

80. Foreign exchange rates used

The following foreign exchange rates were used by the Group:

	At 31 December 2010	At 31 December 2009	% Change	Average for 2010	Average for 2009
EUR/ISK	153.80	179.70	(14.4%)	162.66	171.80
GBP/ISK	179.09	201.15	(11.0%)	189.30	192.28
USD/ISK	114.69	124.60	(8.0%)	122.26	122.96
JPY/ISK	1.41	1.35	4.7%	1.40	1.32
CHF/ISK	122.75	121.01	1.4%	118.01	114.08
CAD/ISK	115.35	118.78	(2.9%)	118.08	108.12
DKK/ISK	20.63	24.15	(14.6%)	21.84	23.07
NOK/ISK	19.71	21.64	(8.9%)	20.26	19.62
SEK/ISK	17.07	17.49	(2.4%)	17.02	16.22

Operational risk

81. Operational risk

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

Whereas the managing director of each division is responsible for that division's operational risk, the daily management of operational risk is in the hands of department heads. The Bank establishes, maintains and co-ordinates its operational risk management framework on a group level. This framework complies with the Basel Committee's 2003 publication "Sound Practice for the Management and Supervision of Operational Risk" and meets the new regulatory requirements which concern the solvency ratio. The Bank ensures that operational risk management stays consistent throughout the Bank by upholding a system of prevention and control that entails detailed procedures, permanent supervision and insurance policies, together with active monitoring by the Internal Audit Department. By managing operational risk in this manner, the Bank intends to ensure that all of the Bank's business units are kept aware of any operational risks, that a robust monitoring system remains in place and that controls are implemented efficiently and effectively.

In 2009 and 2010 the Bank has experienced increased turnover in key personnel, especially lawyers and personnel with IT competences. This increase in turnover may in the short term impact the Bank's ability to execute its policies and increases the operational risk of the Bank.

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