BASE PROSPECTUS

ARION BANK HF.
(*incorporated with limited liability in Iceland*)

€3,000,000,000
Euro Medium Term Note Programme

Under this €3,000,000,000 Euro Medium Term Note Programme (the **Programme**), Arion Bank hf. (the **Bank**) may from time to time issue notes (the **Notes**) denominated in any currency agreed between the Bank and the relevant Dealer (as defined below).

The maximum aggregate nominal amount of all Notes from time to time outstanding under the Programme will not exceed €3,000,000,000 (or its equivalent in other currencies calculated as described in the Programme Agreement (as defined in "*Subscription and Sale*")), subject to increase as described herein. The Notes may be issued on a continuing basis to one or more of the Dealers specified under "*Overview of the Programme*" and any additional Dealer appointed under the Programme from time to time by the Bank (each a **Dealer** and together the **Dealers**), which appointment may be for a specific issue or on an ongoing basis. References in this Base Prospectus to the **relevant Dealer** shall, in the case of an issue of Notes being (or intended to be) subscribed by more than one Dealer, be to all Dealers agreeing to subscribe such Notes.

An investment in Notes issued under the Programme involves certain risks. For a discussion of these risks see "*Risk Factors*".

Application has been made to the *Commission de Surveillance du Secteur Financier* (the **CSSF**) in its capacity as competent authority under the Luxembourg Act dated 10 July 2005 on prospectuses for securities (the **Prospectus Act 2005**) to approve this document as a base prospectus. By approving this Base Prospectus, the CSSF assumes no responsibility for the economic and financial soundness of the transactions contemplated by this Base Prospectus or the quality or solvency of the Bank in accordance with Article 7(7) of the Prospectus Act 2005. Application has also been made to the Luxembourg Stock Exchange for Notes issued under the Programme to be admitted to trading on the Luxembourg Stock Exchange's regulated market and to be listed on the Official List of the Luxembourg Stock Exchange.

References in this Base Prospectus to Notes being **listed** (and all related references) shall mean that such Notes have been admitted to trading on the Luxembourg Stock Exchange's regulated market and have been admitted to the Official List of the Luxembourg Stock Exchange. The Luxembourg Stock Exchange's regulated market is a regulated market for the purposes of Directive 2014/65/EU (as amended, **MiFID II**).

Notice of the aggregate nominal amount of Notes, interest (if any) payable in respect of Notes, the issue price of Notes and certain other information which is applicable to each Tranche (as defined under "*Terms and Conditions of the Notes*") of Notes will be set out in a final terms document (the **Final Terms**) which will be filed with the CSSF. Copies of Final Terms in relation to Notes to be listed on the Luxembourg Stock Exchange will also be published on the website of the Luxembourg Stock Exchange (www.bourse.lu).

The Notes have not been and will not be registered under the U.S. Securities Act of 1933, as amended (the **Securities Act**) or any U.S. State securities laws and may not be offered or sold in the United States or to, or for the account or the benefit of, U.S. persons as defined in Regulation S under the Securities Act unless an exemption from the registration requirements of the Securities Act is available and in accordance with all applicable securities laws of any state of the United States and any other jurisdiction (see "*Subscription and Sale*").

The Programme provides that Notes may be listed or admitted to trading, as the case may be, on such other or further stock exchanges or markets as may be agreed between the Bank and the relevant Dealer. The Bank may also issue unlisted Notes and/or Notes not admitted to trading on any market.

The Bank has been rated BBB+ by Standard & Poor's Credit Market Services Europe Limited (**Standard & Poor's**). Standard & Poor's is established in the European Union and is registered under Regulation (EC) No. 1060/2009 (as amended) (the **CRA Regulation**). As such Standard & Poor's is included in the list of credit rating agencies published by the European Securities and Markets Authority (**ESMA**) on its website (at http://www.esma.europa.eu/page/List-registered-and-certified-CRAs) in accordance with the CRA Regulation. Notes issued under the Programme may be rated or unrated by the rating agency referred to above. Where a Tranche of Notes is rated, such rating will be disclosed in the Final Terms. A security rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency.

Interest amounts payable on Floating Rate Notes and Fixed Reset Notes may be calculated by reference to one of LIBOR, EURIBOR, NIBOR, STIBOR, REIBOR or CIBOR, as specified in the relevant Final Terms. As at the date of this Base Prospectus, (i) the administrator of LIBOR (ICE Benchmark Administration Limited) is included in ESMA's register of administrators under Article 36 of Regulation (EU) No. 2016/1011 (the **Benchmarks Regulation**) and (ii) the administrators of EURIBOR, NIBOR, STIBOR, REIBOR and CIBOR are not included in ESMA's register of administrators under the Benchmarks Regulation. As far as the Bank is aware: REIBOR does not fall within the scope of the Benchmarks Regulation by virtue of Article 2 of that regulation; and the transitional provisions in Article 51 of the Benchmarks Regulation apply, such that the administrator of EURIBOR (European Money Markets Institute), the administrator of NIBOR (Norske Finansielle Referanser AS), the administrator of STIBOR (Swedish Bankers' Association) and the administrator of CIBOR (Finance Denmark) are not currently required to obtain authorisation/registration.

Arranger

Deutsche Bank

Dealers

Barclays	**Citigroup**
Deutsche Bank	**Goldman Sachs International**
J.P. Morgan	**Morgan Stanley**
Nomura	**Pareto Securities**

UBS Investment Bank

The date of this Base Prospectus is 10 July 2018.

IMPORTANT INFORMATION

This Base Prospectus comprises a base prospectus in respect of all Notes issued under the Programme for the purposes of Article 5.4 of the Prospectus Directive. When used in this Base Prospectus, **Prospectus Directive** means Directive 2003/71/EC (as amended), and includes any relevant implementing measure in a relevant Member State of the European Economic Area (the **EEA**).

The Bank accepts responsibility for the information contained in this Base Prospectus and the Final Terms for each Tranche of Notes issued under the Programme. To the best of the knowledge of the Bank (having taken all reasonable care to ensure that such is the case) the information contained in this Base Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

This Base Prospectus is to be read in conjunction with all documents which are deemed to be incorporated in it by reference (see "*Documents Incorporated by Reference*"). This Base Prospectus shall be read and construed on the basis that those documents are incorporated and form part of this Base Prospectus.

The Dealers have not independently verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Dealers as to the accuracy or completeness of the information contained or incorporated in this Base Prospectus or any other information provided by the Bank in connection with the Programme. No Dealer accepts any liability in relation to the information contained or incorporated by reference in this Base Prospectus or any other information provided by the Bank in connection with the Programme.

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

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

Neither the delivery of this Base Prospectus nor the offering, sale or delivery of any Notes shall in any circumstances imply that the information contained in it concerning the Bank is correct at any time subsequent to its date or that any other information supplied in connection with the Programme is correct as of any time subsequent to the date indicated in the document containing the same. The Dealers expressly do not undertake to review the financial condition or affairs of the Bank during the life of the Programme or to advise any investor in Notes issued under the Programme of any information coming to their attention.

IMPORTANT INFORMATION RELATING TO THE USE OF THIS BASE PROSPECTUS AND OFFERS OF NOTES GENERALLY

This Base Prospectus may only be used for the purposes for which it has been published.

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

IMPORTANT – EEA RETAIL INVESTORS

If the Final Terms in respect of any Notes includes a legend entitled "Prohibition of Sales to EEA Retail Investors", the Notes are not intended to be offered, sold or otherwise made available to and should not be offered, sold or otherwise made available to any retail investor in the EEA. For these purposes, a retail investor means a person who is one (or more) of: (i) a retail client as defined in point (11) of Article 4(1) of MiFID II; (ii) a customer within the meaning of Directive 2002/92/EC (as amended, the Insurance Mediation Directive), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or (iii) not a qualified investor as defined in the Prospectus Directive. Consequently no key information document required by Regulation (EU) No 1286/2014 (as amended, the **PRIIPs Regulation**) for offering or selling the Notes or otherwise making them available to retail investors in the EEA has been prepared and therefore offering or selling the Notes or otherwise making them available to any retail investor in the EEA may be unlawful under the PRIIPs Regulation.

MIFID II PRODUCT GOVERNANCE/TARGET MARKET

The Final Terms in respect of any Notes will include a legend entitled "MiFID II product governance" which will outline the target market assessment in respect of the Notes and which channels for distribution of the Notes are appropriate. Any person subsequently offering, selling or recommending the Notes (a **distributor**) should take into consideration the target market assessment; however, a distributor subject to MiFID II is responsible for undertaking its own target market assessment in respect of the Notes (by either adopting or refining the target market assessment) and determining appropriate distribution channels.

A determination will be made in relation to each issue about whether, for the purpose of the Product Governance rules under EU Delegated Directive 2017/593 (the **MiFID Product Governance Rules**), any Dealer subscribing for any Notes is a manufacturer in respect of such Notes, but otherwise neither the Arranger nor the Dealers nor any of their respective affiliates will be a manufacturer for the purpose of the MiFID Product Governance Rules.

SUITABILITY OF INVESTMENT

The Notes may not be a suitable investment for all investors. Each potential investor in the Notes must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor may wish to consider, either on its own or with the help of its financial and other professional advisers, whether it:

(i) has sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained or incorporated by reference in this Base Prospectus or any applicable supplement;

(ii) has access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact the Notes will have on its overall investment portfolio;

(iii) has sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes, including Notes where the currency for principal or interest payments is different from the potential investor's currency;

(iv) understands thoroughly the terms of the Notes and is familiar with the behaviour of financial markets; and

(v) is able to evaluate possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

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

PRESENTATION OF FINANCIAL AND OTHER INFORMATION

Presentation of Financial Information

The consolidated financial information as of and for the years ended 31 December 2017 and 2016 has, unless otherwise stated, and except for the below, been derived from the 2017 Consolidated Financial Statements and the 2016 Consolidated Financial Statements incorporated by reference in this Base Prospectus (together, the **Annual Financial Statements**). The Annual Financial Statements have been prepared in accordance with International Financial Reporting Standards, as adopted by the European Union (**IFRS**), and additional requirements set forth in Act No. 3/2006 on Annual Accounts, as amended (the **Annual Accounts Act**), Act No. 161/2002 on Financial Undertakings, as amended (the **Financial Undertakings Act**) and rules No. 532/2003 on Accounting for Credit Institutions. Financial information in this Base Prospectus is presented on a consolidated basis unless otherwise indicated.

Due to the following reclassification, certain line items in the selected consolidated information for the years ended 31 December 2016 differ from the respective audited Annual Financial Statements included herein:

In the periods prior to the year ended 31 December 2017, net income from non-current assets held for sale was classified as “Discontinued operations, net of tax”. In the 2017 Consolidated Financial Statements, net income from non-current assets held for sale was presented among “Other operating income”.

In the periods prior to the year ended 31 December 2017, non-current assets and disposal groups held for sale were presented within “Other assets”. In the 2017 Consolidated Financial Statements “Non-current assets and disposal groups held for sale” were presented as a separate line item.

In the periods prior to the year ended 31 December 2017, “Cash and cash equivalents acquired through business combination” was presented as a separate reconciling line item below “Net increase in cash and cash equivalents”. In the 2017 Consolidated Financial Statements “Cash and cash equivalents acquired through business combination” was presented within “Net cash (to) from investing activities”.

In the periods prior to the year ended 31 December 2017, the operating segment information has been presented without allocated expense from supporting divisions to business segments. Bank levy has also been excluded from the operating segment information. In the 2017 Consolidated Financial Statements, allocated expense from supporting divisions to business segments has been added as well as allocation of bank levy.

In the periods prior to the year ended 31 December 2016, the earned premium of subsidiary Okkar líftryggingar hf. was presented as “Other operating income” and claims incurred were presented as “Other operating expense”. Since 2016 those amounts are presented in the separate line item “Net insurance income”.

Accordingly, the selected consolidated financial information as of and for the years ended 31 December 2017, has, unless otherwise stated, been derived from the 2017 Consolidated Financial Statements. In order to present information on a consistent basis with the presentation adopted in the 2017 Consolidated Financial Statements, the selected consolidated financial information as of and for the year ended 31 December 2016 has, unless otherwise stated, been derived from the unaudited comparative information included in the 2017 Consolidated Financial Statements that reflects those line item reclassifications.

The selected condensed consolidated interim financial information as of and for the three months ended 31 March 2018 has, unless otherwise stated, been derived from the Bank’s unaudited condensed consolidated interim financial statements for the three months ended 31 March 2018 (the **Interim Financial Statements**) prepared in accordance with International Accounting Standard 34, Interim Financial Reporting (IAS 34), as adopted by the European Union, and additional requirements set forth in the Annual Accounts Act, the Financial Undertakings Act and rules on Accounting for Credit Institutions.

On 1 January 2018, the Group adopted IFRS 9, Financial Instruments (**IFRS 9**) and, as permitted by the transition provisions of IFRS 9, the comparative period was not restated; accordingly, all comparative period information presented in this Base Prospectus is presented in accordance with International Accounting Standard 39, Financial Instruments: Recognition and Measurement (**IAS 39**). The Group also elected, as a policy choice permitted under IFRS 9, to continue to apply hedge accounting under IAS 39. The impact of the adoption of the new standard of ISK 942 million has been recognised directly in retained earnings on 1 January 2018.

In addition, on 1 January 2018 the Group also adopted IFRS 15, Revenue from Contracts with Customers (**IFRS 15**). IFRS 15 was applied using the modified retrospective method, with the effect of initial application recognised on the date of initial application and without restatement of the comparative periods. The adoption of IFRS 15 did not, in the Bank’s view, have a material impact on the consolidated statement of comprehensive income.

The audited consolidated financial statements as of and for the years ended 31 December 2017 and 2016 do not reflect the changes from the application of IFRS 9 and IFRS 15. Those audited consolidated financial statements applied IAS 39 and IAS 18, Revenue, which were the accounting standards in effect at the time for each period. Therefore, due to the adoption of the new accounting standards, the consolidated financial statements as of and for the years ended 31 December 2017 and 2016 and the comparative figures as of and for the three month period ended 31 March 2017, are not directly comparable with the Interim Financial Statements.

The Annual Financial Statements have been audited by Deloitte ehf. (**Deloitte**). No other information in this Base Prospectus has been audited or reviewed by Deloitte or any other independent auditors.

Operating Segment Reporting

Segment information is presented in respect of the Group’s operating segments based on the Group’s management and internal reporting structure. Segment performance is evaluated based on earnings before tax. In presenting geographic information, segment revenue has been based on the geographic location of customers. Inter segment pricing is determined on an arm’s length basis. Operating segments pay and receive interest to and from Treasury on an arm's length basis to reflect the allocation of capital, funding costs and relevant risk premium, which intragroup metrics disappear upon consolidation.

The Bank has the following operating segments: (1) Corporate Banking; (2) Retail Banking; (3) Asset Management; (4) Investment Banking; (5) Treasury; and (6) Other Divisions and Subsidiaries, consisting of Valitor, Vördur, Landey and other smaller entities. See "*Description of the Bank - Business*".

KPIs and Non-IFRS Information

This Base Prospectus contains certain financial measures that are not defined or recognised under IFRS, exclude amounts that are included in, or include amounts that are excluded from, the most directly comparable measure calculated and presented in accordance with IFRS, or are calculated using financial measures that are not calculated in accordance with IFRS.

The Bank's financial key performance indicators (**KPIs**) in this Base Prospectus comprise return on equity, return on assets, return on risk-weighted assets, net interest margin on interest-earning assets, net interest margin on total assets, cost-to-income ratio and cost-to-total assets ratio, cost of risk and loan-to-deposit ratio.

The Bank's non-IFRS measures comprise return on equity excluding Valitor, cost-to-income ratio excluding Valitor and loan-to-deposit ratio excluding covered bonds (collectively, the **Non-IFRS Information**).

The Bank uses these indicators in its business operations, among other things, to evaluate the performance of its operations, to develop budgets and to measure the Bank's performance against those budgets. The Bank believes the Non-IFRS Information and the KPIs to be useful supplemental tools to assist in evaluating operating performance because it considers the Non-IFRS Information and KPIs to reflect its underlying business performance and believes that these measures provide additional useful information for prospective investors on its performance, enhance comparability from period to period and with other companies and are consistent with how business performance is measured internally.

The Non-IFRS Information and related measures are not measurements of performance or liquidity under IFRS and should not be considered by investors in isolation or as a substitute for measures of earnings, or as an indicator of the Bank's operating performance or cash flows from operating activities as determined in accordance with IFRS or otherwise as a substitute for analysis of the Bank's operating results reported under IFRS as set out in the 2017 Consolidated Financial Statements. The Bank has presented these supplemental measures because they are used by the Bank to monitor the underlying performance of its business and operations. The Non-IFRS Information and related measures may not be comparable to similarly titled measures disclosed by other banks and have limitations as analytical tools. The Bank does not regard the Non-IFRS Information as a substitute for, or superior to, the equivalent measures calculated and presented in accordance with IFRS or those calculated using financial measures that are calculated in accordance with IFRS. The Non-IFRS Information described in this Base Prospectus is unaudited and has not been prepared in accordance with IFRS or any other generally accepted accounting principles.

For definitions of the non-IFRS measures included in the Non-IFRS Information and KPIs, see "*Key Financial Indicators*".

General

Capitalised terms which are used but not defined in any particular section of this Base Prospectus will have the meaning attributed to them in "*Terms and Conditions of the Notes*" or any other section of this Base Prospectus.

In addition, in this Base Prospectus, all references to:

2017 Consolidated Financial Statements means the audited consolidated annual financial statements of the Bank for the financial year ended 31 December 2017;

2016 Consolidated Financial Statements means the audited consolidated annual financial statements of the Bank for the financial year ended 31 December 2016;

References in this Base Prospectus to the **Group** are to the Bank and its consolidated subsidiaries, taken as a whole;

U.S. dollars, **U.S.$** and **$** refer to United States dollars;

ISK, **krona** and **kronur** refer to Icelandic Krona;

Sterling and **£** refer to pounds sterling; and

euro and **€** refer to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty on the Functioning of the European Union, as amended.

Certain figures in this Base Prospectus, including financial information, have been subject to rounding adjustments. Accordingly, in certain instances (a) the sum or percentage change of such numbers may not conform exactly to the total figure given and (b) the sum of the numbers in a column or row in certain tables may not conform exactly to the total figure given for that column or row.

Forward Looking Statements

This Base Prospectus contains forward looking statements that reflect the Bank's intentions, beliefs or current expectations and projections about its future business, results of operations, financial condition, liquidity, performance, prospects, anticipated growth, strategies and opportunities and the markets in which it operates. Forward looking statements involve all matters that are not historical facts. The Bank has tried to identify forward looking statements by using words such as "may", "will", "would", "could", "should", "expects", "intends", "estimates", "anticipates", "projects", "believes", "could", "hopes", "seeks", "plans", "aims", "objective", "potential", "goal", "strategy", "target", "continue" and similar expressions or negatives thereof or other variations thereof or comparable terminology or by discussions of strategy that involve risks and uncertainties. Forward looking statements may be found principally in sections of this Base Prospectus titled "*Risk Factors*" and "*Description of the Bank*" as well as elsewhere.

Forward looking statements are based on the Bank's beliefs, assumptions and expectations regarding future events and trends that affect the Bank's future performance, taking into account all information currently available to the Bank, and are not guarantees of future performance. These beliefs, assumptions and expectations can change as a result of possible events or factors, not all of which are known to the Bank or are within its control. If a change occurs, the Bank's business, results of operations, financial condition, liquidity, performance, prospects, anticipated growth, strategies or opportunities may vary materially from those expressed in, or suggested by, these forward looking statements. In addition, forward looking estimates and forecasts reproduced in this Base Prospectus from third party reports could prove to be inaccurate. A number of important factors could cause actual results or outcomes to differ materially from those expressed in any forward-looking statement as a result of risks and uncertainties facing the Bank. Such risks, uncertainties and other important factors include, but are not limited to, those listed in the section of this Base Prospectus titled "*Risk Factors*".

The following include some but not all of the factors that could cause actual results or events to differ materially from the anticipated results or events:

- deterioration of the economic conditions or the banking system in Iceland, as a result of political and economic factors, either domestic or international;

- exposure to Iceland’s key industry sectors, in particular tourism, seafood, aluminium, energy and real estate;
- an adverse shift in public sentiment and potential political or legislative action;
- exposure to liquidity, maturity, foreign exchange, and market funding risks, and various other typical financial institution market risks relating to interest rates, equity pricing and inflation;
- failure or breach of the Bank’s information technology systems;
- unauthorised disclosure of confidential information and any resulting liability, litigation, and reputational damage;
- exposure to tax liabilities or competitive disadvantages in respect of VAT on the Bank’s services;
- existing customer loan portfolio exposure to problem and impaired loans;
- costs and competitive disadvantages resulting from the Bank Levy and other taxes;
- domestic economic constraints on near-term growth;
- failure to implement the Bank’s strategy or failure to achieve the anticipated benefits of this strategy;
- exposure to existing and increasing competition in Iceland;
- regulatory and legal risks inherent in the Bank’s businesses;
- ongoing legal proceedings and investigations by government authorities;
- inadequate implementation by Iceland of the EEA rules;
- potential inability to successfully maintain salary levels, and overrunning salaries and related expense may give rise to reputational risk while heavy cost-cutting measures may have adverse effects on operations;
- restrictions under the Capital Controls on the Bank’s operations and abnormal pricing and financial bubbles that may result from the Capital Controls;
- potential inability to recruit or retain experienced personnel or key members of the Executive Committee;
- credit rating downgrade or a change in outlook;
- various operational risks, including risk of systems failures, human error, regulatory breaches, and employee misconduct;
- damage to the reputation of the Bank, its subsidiaries or its shareholders;
- exposure to unidentified, unanticipated or incorrectly quantified risks as a result of risk management methods;
- reliance on third party service providers;
- violation of anti-money laundering or anti-bribery regulations;

- application of CRD IV;
- restriction, suspension or termination of relationships with key card scheme operators;
- failure of the Asset Management division to sustain or increase its level of assets under management and is subject to pressure on fee margins;
- incurrence of unforeseen liabilities from prior and future acquisitions and disposals; and
- inadequate insurance coverage.

Should one or more of these risks or uncertainties materialise or should any of the assumptions underlying the above or other factors prove to be incorrect, the Bank's future business, results of operations, financial condition, liquidity, performance, prospects, anticipated growth, strategies or opportunities could differ materially from those described herein as currently anticipated, believed, estimated or expected.

Investors or potential investors should not place undue reliance on the forward looking statements in this Base Prospectus. The Bank urges investors to read the sections of this Base Prospectus titled "*Risk Factors*" and "*Description of the Bank*" for a more complete discussion of the factors that could affect the Bank's future performance and the markets in which it operates. In light of the possible changes to the Bank's beliefs, assumptions and expectations, the forward looking events described in this Base Prospectus may not occur. Additional risks currently not known to the Bank or that the Bank has not considered material as of the date of this Base Prospectus could also cause the forward looking events discussed in this Base Prospectus not to occur. Forward looking statements involve inherent risks and uncertainties and speak only as of the date they are made. The Bank undertakes no duty to and will not necessarily update any of the forward looking statements in light of new information or future events, except to the extent required by applicable law.

STABILISATION

In connection with the issue of any Tranche of Notes, the Dealer or Dealers (if any) named as the Stabilisation Manager(s) (or persons acting on behalf of any Stabilisation Manager(s)) in the applicable Final Terms may over-allot Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However stabilisation may not necessarily occur. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the relevant Tranche of Notes is made and, if begun, may cease at any time, but it must end no later than the earlier of 30 days after the issue date of the relevant Tranche of Notes and 60 days after the date of the allotment of the relevant Tranche of Notes. Any stabilisation action or over-allotment must be conducted by the relevant Stabilisation Manager(s) (or persons acting on behalf of any Stabilisation Manager(s)) in accordance with all applicable laws and rules.

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OVERVIEW OF THE PROGRAMME

The following overview does not purport to be complete and is taken from, and is qualified in its entirety by, the remainder of this Base Prospectus and, in relation to the terms and conditions of any particular Tranche of Notes, the applicable Final Terms.

This Overview constitutes a general description of the Programme for the purposes of Article 22.5(3) of Commission Regulation (EC) No 809/2004 implementing Directive 2003/71/EC (the **Prospectus Regulation**).

Words and expressions defined in "*Form of the Notes*" and "*Terms and Conditions of the Notes*" shall have the same meanings in this Overview.

Issuer:	Arion Bank hf.
Legal Entity Identifier (LEI):	RIL4VBPDB0M7Z3KXSF19
Risk Factors:	There are certain factors that may affect the Bank's ability to fulfil its obligations under Notes issued under the Programme. In addition, there are certain factors which are material for the purpose of assessing the market risks associated with Notes issued under the Programme and risks relating to the structure of a particular series of Notes issued under the Programme. All of these are set out under "*Risk Factors*".
Description:	Euro Medium Term Note Programme
Arranger:	Deutsche Bank AG, London Branch
Dealers:	Barclays Bank PLC Citigroup Global Markets Limited Deutsche Bank AG, London Branch Goldman Sachs International J.P. Morgan Securities plc Morgan Stanley & Co. International plc Nomura International plc Pareto Securities AB UBS Limited and any other Dealers appointed in accordance with the Programme Agreement.
Certain Restrictions:	Each issue of Notes denominated in a currency in respect of which particular laws, guidelines, regulations, restrictions or reporting requirements apply will only be issued in circumstances which comply with such laws, guidelines, regulations, restrictions or reporting requirements from time to time (see "*Subscription and Sale*") including the following restrictions applicable at the date of this Base Prospectus. **Notes having a maturity of less than one year**

	Notes having a maturity of less than one year will, if the proceeds of the issue are accepted in the United Kingdom, constitute deposits for the purposes of the prohibition on accepting deposits contained in section 19 of the Financial Services and Markets Act 2000 (**FSMA**) unless they are issued to a limited class of professional investors and have a denomination of at least £100,000 or its equivalent, see "*Subscription and Sale*".
Fiscal Agent:	Citibank N.A., London Branch
Listing Agent:	Banque Internationale à Luxembourg, société anonyme
Programme Size:	Up to €3,000,000,000 (or its equivalent in other currencies calculated as described in the Programme Agreement) outstanding at any time. The Bank may increase the amount of the Programme in accordance with the terms of the Programme Agreement.
Distribution:	Notes may be distributed by way of private or public placement and in each case on a syndicated or non-syndicated basis.
Currencies:	Notes may be denominated in, subject to any applicable legal or regulatory restrictions, any currency agreed between the Bank and the relevant Dealer.
Maturities:	The Notes will have such maturities as may be agreed between the Bank and the relevant Dealer, subject to such minimum or maximum maturities as may be allowed or required from time to time by the relevant central bank (or equivalent body) or any laws or regulations applicable to the Bank or the relevant Specified Currency.
Issue Price:	Notes may be issued on a fully-paid basis and at an issue price which is at par or at a discount to, or premium over, par.
Form of Notes:	The Notes will be issued in bearer form as described in "*Form of the Notes*".
Fixed Rate Notes:	Fixed interest will be payable on such date or dates as may be agreed between the Bank and the relevant Dealer and on redemption and will be calculated on the basis of such Day Count Fraction as may be agreed between the Bank and the relevant Dealer.
Fixed Reset Notes:	The interest rate on Fixed Reset Notes will reset on each Reset Date by reference to the relevant Reset Margin and Mid-Swap Rate.
Floating Rate Notes:	Floating Rate Notes will bear interest at a rate determined:
	(a) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the

2006 ISDA Definitions (as published by the International Swaps and Derivatives Association, Inc., and as amended and updated as at the Issue Date of the first Tranche of the Notes of the relevant Series); or

(b) on the basis of the reference rate set out in the applicable Final Terms.

Interest on Floating Rate Notes in respect of each Interest Period, as agreed prior to issue by the Bank and the relevant Dealer, will be payable on such Interest Payment Dates, and will be calculated on the basis of such Day Count Fraction, as may be agreed between the Bank and the relevant Dealer.

The margin (if any) relating to such floating rate will be agreed between the Bank and the relevant Dealer for each Series of Floating Rate Notes.

Floating Rate Notes may also have a maximum interest rate, a minimum interest rate or both.

Change of Interest Basis: Notes may be offered in circumstances where the provisions relating to Floating Rate Notes will apply for a certain period and, at the end of such period, the provisions relating to Fixed Rate Notes will apply until the Maturity Date (or vice versa), as set out in the applicable Final Terms.

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

Redemption: The applicable Final Terms will indicate either that the relevant Notes cannot be redeemed prior to their stated maturity (other than for taxation reasons or following an Event of Default or, in the case of Subordinated Notes, upon the occurrence of a Capital Event) or that such Notes will be redeemable at the option of the Bank and/or the Noteholders upon giving notice to the Noteholders or the Bank, as the case may be, on a date or dates specified prior to such stated maturity and at a price or prices and on such other terms as may be agreed between the Bank and the relevant Dealer. The Notes will only be redeemed at an amount of more than 100 per cent. of their nominal amount in the case of certain Zero Coupon Notes.

Notes having a maturity of less than one year may be subject to restrictions on their denomination and distribution, see "*Certain Restrictions - Notes having a maturity of less than one year*" above.

Benchmark Discontinuation: In the case of Fixed Reset Notes or Floating Rate Notes, if the Bank determines that a Benchmark Event has occurred, the relevant benchmark or screen rate may be replaced by a Successor Rate or, if there is no Successor Rate but the Bank determines there is an Alternative Rate (acting in good faith, in a commercially reasonable manner and by reference to such sources as it deems appropriate, which may include consultation with an Independent Adviser), such Alternative Rate. An Adjustment Spread may also be applied to the Successor Rate or the Alternative Rate (as the case may be), together with any Benchmark Amendments (which in the case of any Alternative Rate, any Adjustment Spread unless formally recommended or provided for and any Benchmark Amendments shall be determined by the Bank, acting in good faith, in a commercially reasonable manner and by reference to such sources as it deems appropriate, which may include consultation with an Independent Adviser). This is further described in Condition 3.4.

Denomination of Notes:	The Notes will be issued in such denominations as may be agreed between the Bank and the relevant Dealer save that the minimum denomination of each Note will be such amount as may be allowed or required from time to time by the relevant central bank (or equivalent body) or any laws or regulations applicable to the relevant Specified Currency, see "*Certain Restrictions - Notes having a maturity of less than one year*" above, and save that the minimum denomination of each Note will be €100,000 (or, if the Notes are denominated in a currency other than euro, the equivalent amount in such currency).
Taxation:	All payments in respect of the Notes will be made without deduction for or on account of withholding taxes imposed by any Tax Jurisdiction as provided in Condition 7. In the event that any such deduction is made, the Bank will, save in certain limited circumstances provided in Condition 7, be required to pay additional amounts to cover the amounts so deducted.
Negative Pledge:	The terms of the Notes will not contain a negative pledge provision.
Cross Default:	The terms of the Notes will contain a cross default provision as further described in Condition 9.1(c).
Status of the Notes:	The Notes may be issued on an unsubordinated (**Unsubordinated Notes**) or a subordinated (**Subordinated Notes**) basis, as described in Conditions 2.1 and 2.2, respectively, and as specified in the applicable Final Terms.
Point of Non-Viability Loss Absorption	If a Non-Viability Event occurs at any time on or after the Issue Date and prior to the date on which any Applicable Statutory Loss Absorption Regime becomes effective in respect of the Notes, the Prevailing Principal Amount of the Notes may be Written-Down by the Bank as further discussed in Condition 6.
Rating:	Series of Notes issued under the Programme may be rated or unrated. Where a Series of Notes is rated, such rating will be disclosed in the applicable Final Terms. A security rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency.

Listing and admission to trading:	Application has been made to the CSSF to approve this document as a base prospectus. Application has also been made for Notes issued under the Programme to be listed the Luxembourg Stock Exchange. Notes may be listed or admitted to trading, as the case may be, on other or further stock exchanges or markets agreed between the Bank and the relevant Dealer in relation to the Series. Notes which are neither listed nor admitted to trading on any market may also be issued. The applicable Final Terms will state whether or not the relevant Notes are to be listed and/or admitted to trading and, if so, on which stock exchanges and/or markets.
Governing Law:	The Notes and any non-contractual obligations arising out of or in connection with the Notes will be governed by, and shall be construed in accordance with, English law, except for the subordination provisions in Condition 2.2 of the Subordinated Notes, which will be governed by, and construed in accordance with, Icelandic law.
Selling Restrictions:	There are restrictions on the offer, sale and transfer of the Notes in the United States, the EEA (including the United Kingdom, Iceland and Belgium), Japan and Hong Kong and such other restrictions as may be required in connection with the offering and sale of a particular Tranche of Notes, see "*Subscription and Sale*".
United States Selling Restrictions:	Regulation S, Category 2. TEFRA C or D/TEFRA not applicable, as specified in the applicable Final Terms.

RISK FACTORS

In purchasing Notes, investors assume the risk that the Bank may become insolvent or otherwise be unable to make all payments due in respect of the Notes. There is a wide range of factors which individually or together could result in the Bank becoming unable to make all payments due in respect of the Notes. It is not possible to identify all such factors or to determine which factors are most likely to occur, as the Bank may not be aware of all relevant factors and certain factors which it currently deems not to be material may become material as a result of the occurrence of events outside the Bank's control. The Bank has identified in this Base Prospectus a number of factors which could materially adversely affect its business and ability to make payments due under the Notes.

In addition, factors which are material for the purpose of assessing the market risks associated with Notes issued under the Programme are also described below.

Prospective investors should also read the detailed information set out elsewhere in this Base Prospectus and reach their own views prior to making any investment decision.

FACTORS THAT MAY AFFECT THE BANK'S ABILITY TO FULFIL ITS OBLIGATIONS UNDER NOTES ISSUED UNDER THE PROGRAMME

The Bank's business is materially affected by the strength of Iceland's economy which remains vulnerable to a range of domestic and international economic and political factors

The Bank currently conducts substantially all of its business in Iceland. Accordingly, its performance is influenced by the level and cyclical nature of business activity in Iceland, and the overall strength of Iceland's economy, which in turn has been and will continue to be affected by both domestic and international economic and political factors.

Following the collapse of the Icelandic banking system in October 2008 resulting in the winding up proceedings of Glitnir Bank hf. (**Glitnir**), Landsbanki Islands hf. (later renamed LBI hf.) (**Landsbanki**) and Kaupthing Bank hf. (**Kaupthing**) and a severe recession beginning in the fourth quarter of 2008, Iceland's economy has demonstrated a significant recovery since 2011, with gross domestic product (**GDP**) growth of 1.2 per cent. in 2012, 4.4 per cent. in 2013, 1.9 per cent. in 2014, 4.3 per cent. in 2015, 7.5 per cent. in 2016 and 3.6 per cent. in 2017 *(source: Statistics Iceland)*. However, no assurance can be given that the present health of Iceland's economy will be sustained, particularly in view of the difficulties in resolving the problems arising out of the 2008 financial crisis.

The domestic factors that could affect the strength of Iceland's economy include:

- *Fluctuations in the value of Icelandic Krona:* In 2017, Icelandic Krona appreciated significantly by 8.0 per cent. against the U.S. dollar and 4.7 per cent. against the euro (source: *Bloomberg*). The continued appreciation in the value of Icelandic Krona could lead to decreased demand for Icelandic exports or services, including tourism (i.e. as a source of foreign income), and could make Iceland less competitive relative to other economies and currencies. Alternatively, a devaluation of Icelandic Krona and an increase in the cost of imports could diminish consumer confidence and lead to contraction in certain sectors, such as real estate.

- *Inflation:* While inflation currently remains within the target rate of 2.5 per cent. per annum set by the Central Bank of Iceland (*Seðlabanki Íslands*) (the **Icelandic Central Bank**), the Icelandic Central Bank's current inflation outlook is that the rate of inflation could rise in excess of the target rate in 2018 and again in 2020, while falling below target in 2019 due to proposed changes in VAT (source: *Icelandic Central Bank*). In the view of the International Monetary Fund (the **IMF**), inflation was being contained by falling import prices and appreciation of Icelandic Krona. Wage growth is expected to erode competitiveness over time, and an increase in salary costs as a result of inflation could have a direct impact on the Bank's profitability. In addition, the current account surplus is expected to shrink steadily as a percentage of GDP. In the view of the IMF, these processes, if not sufficiently restrained by macroeconomic policies, could overheat the economy (source*: IMF*).

- *Lack of foreign direct investment:* No assurance can be given that sufficient levels of foreign direct investment in Iceland will materialise following the easing or complete lifting of the Capital Controls (as defined below), which may result in fiscal and balance of payments deficits and a worsening of Iceland's economic and fiscal positions.

- *Other factors:* Other domestic factors also pose significant risks to Iceland's economic and fiscal position, including the high level of corporate and household debt, political factors (particularly in light of public sentiment regarding the financial sector), the remainder of the capital controls enacted in Iceland in November 2008 (the **Capital Controls**), any restructuring of the financial sector and winding down of Kaupthing, Glitnir and Landsbanki, as well as levels of consumption.

Iceland's economy also remains vulnerable to external factors, including conditions in Europe and other international economic and political developments, many of which are outside the control of the Icelandic government. In particular, instability or deterioration of the international financial markets, whether as a result of uncertainty surrounding ongoing negotiations over the terms of the United Kingdom's exit from the European Union and the ultimate economic and political effects of such exit or other events, could have a material adverse effect on the recovery of the Icelandic economy, especially given the relatively small size of the Icelandic economy and its dependence on trade with external partners, particularly the European Union. Although the financial sector in Iceland is still nominally subject to the Capital Controls and is mostly funded by domestic deposits, a global recession is likely to affect demand for, and the price of, Iceland's most important products and exports (i.e. tourism, seafood and aluminium).

The occurrence of any of the above factors could adversely affect Iceland's economy, which in turn could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank's operations are exposed to Iceland's key industry sectors, particularly tourism, seafood, aluminium, energy and real estate

Iceland's economy depends in large measure on a select number of industry sectors. In terms of exports, which accounted for 47 per cent. of Iceland's GDP in 2017, the largest are tourism (i.e. as a source of foreign income), seafood, aluminium and other industrial goods and services (including energy), which accounted for 42 per cent., 16 per cent., 17 per cent. and 25 per cent., respectively, of total exports in 2017 *(source: IMF, Statistics Iceland)*. In addition, growth in the real estate industry sector has recently helped to fuel the domestic economy and, as of 31 December 2017, loans in the real estate industry sector accounted for 16.7 per cent. of the Bank's customer loan portfolio (the **customer loan portfolio**).

Key risks in these industry sectors include:

- *Tourism:* In 2011, the Icelandic government approved a new public strategy for tourism in Iceland in recognition of tourism's potential as a means to diversify and stimulate national, regional and local economic growth, as well as to create jobs, attract foreign direct investment and earn foreign currency income. As a result, the tourism industry sector has emerged in recent years as an important contributor to Iceland's GDP, with the number of tourists increasing 30 per cent. in 2015, 40 per cent. in 2016 and 24 per cent. in 2017, in each case as compared to the previous year, but growth is expected to moderate in the medium term (source: *Statistics Iceland, Isavia, Arion Bank Research*). In view of its contribution to the Icelandic economy, any decline of the Icelandic tourism industry sector, whether as a result of a global economic downturn, financial difficulties of key companies in the tourism industry, natural disasters, a significant appreciation of Icelandic Krona or otherwise, could have an adverse impact on the Icelandic economy.

- *Seafood:* Although Iceland's exports of other products have increased in relative terms, seafood remains a principal export for Iceland. The principal focus of the Icelandic seafood industry sector is the fishing, farming and processing of different seafood species. The seafood industry in Iceland therefore depends on the availability of plentiful stocks of various seafood species and the international demand for seafood, and any decline in stocks, a decrease in quotas for a particular seafood species, a decrease in international demand or a significant appreciation of Icelandic Krona could have a material adverse effect on the seafood industry sector.

- *Aluminium:* Iceland's aluminium industry sector has developed as a result of the availability of extensive, relatively inexpensive renewable energy sources to support energy-intensive aluminium smelting operations. Consequently, aluminium (smelted from imported raw materials) has become a principal component of Iceland's exports. Should the price of aluminium decline, to the point where it is no longer economical for aluminium producers to ship raw materials for smelting in Iceland, or if aluminium producers are able to find equivalent or cheaper sources of energy for their smelting operations, Iceland's aluminium exports could decline.

- *Energy:* According to the National Energy Authority of Iceland (*Orkustofnun*), nearly all stationary energy in Iceland is derived from renewable sources, such as hydro, wind and geothermal sources, and Iceland has become a key exporter of know-how regarding renewable energy sources. If Iceland is not able to keep up with the pace of worldwide developments in energy technology, for example, due to a shortage of skilled technicians or a lack of educational programmes specialising in energy, or if foreign investment in Icelandic energy projects and initiatives is not sufficient for its projected growth, Iceland's advantage in the energy industry sector could be impaired.

- *Real estate:* As tourism and the Icelandic population continue to increase, and assuming continued low levels of unemployment in Iceland, there will be a corresponding need for additional real estate development. For example, the Research subdivision of the Bank estimates that 8,000 to 9,000 housing units will be needed in the next three years (an increase of approximately 6-7 per cent. from current levels). However, any deterioration of the underlying factors which are driving this increased demand for real estate, such as a decline in tourism or an unexpected macroeconomic event increasing unemployment, could have a material adverse effect on the real estate industry sector in Iceland.

As a universal relationship bank with substantially all of its operations in Iceland, a decline in any of these industry sectors as a result of the occurrence of any of the above or other factors, including natural disasters or other cataclysmic events outside the control of the Bank, could, for example, result in higher levels of problem loans, defined as loans more than 90 days past due but not impaired and other problem (i.e. individually impaired) loans, and provisions for losses on such problem loans (particularly in the Corporate Banking division), reduced demand for mortgage loans (in the Retail Banking division) and a reduction of transactions executed for customers. In addition, a decline in any of these industry sectors may negatively affect the broader Icelandic economy. Accordingly, a decline in any of the key industry sectors may have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

Public sentiment and political activity in Iceland could impair the Bank's operations

Due to the financial crisis in 2008 and the subsequent deep recession in Iceland, public sentiment towards the banking sector has at times been negative. Any such negative sentiment could ultimately be reflected in political and legislative decisions, which could have material adverse effects on the Bank. One possibility which has been discussed in Iceland is the potential for a law requiring the separation of commercial banking activities from investment banking activities, which could require the Bank to divest or otherwise restructure some of its most significant operations. Since 2017, the Minister of Finance has established various committees to examine the structure of the banking system in Iceland. In February 2018, the Minister of Finance announced a committee for the preparation of a white paper focusing on a full strategic review of the Icelandic financial system, with results expected to be published later in 2018.

Although no changes have yet been proposed or enacted, no assurance can be given that such a law or similar or related measures will not be proposed and ultimately enacted, which could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

Also, as the Bank was established in order to assume certain assets and liabilities of Kaupthing, and the Bank employs a number of individuals previously employed by Kaupthing, negative sentiment by certain customers of Kaupthing can be directed at the Bank and its employees, by virtue of perceived connections with Kaupthing, and could cause reputational damage for the Bank. The Bank has received correspondence from an individual who previously had business dealings with Kaupthing, alleging that the Bank has not conducted sufficient internal due diligence to ensure that its management and directors are fit and proper to carry on the operations of a financial institution, on the basis that certain individuals who are employed by the Bank were also employed by its predecessor Kaupthing or the other Icelandic banks at the time of the financial crisis in 2008. In May 2018, the Bank received further correspondence from this individual, which stated that he had filed a criminal complaint with the prosecutor in Iceland concerning Kaupthing's alleged wrongful appropriation of assets during the "winding up" process of Kaupthing. Included in the correspondence described above was information which the individual claimed supports his allegations against the Bank and those employees named in the correspondence. The Bank has considered the allegations in this correspondence, along with the related materials, and has conducted its own review of these allegations and related materials, including with support of external counsel, and it remains of the view that the allegations are without merit and that those employees named in the correspondence are indeed fit and proper. There can be no assurance that this individual will not seek to make his allegations more public or seek to bring further claims against the Bank or its employees or directors, or that the Bank would prevail in any such claims.

In addition, various decision-making processes within the Bank may continue to be affected by perceived public sentiment and reputational risk due to the financial crisis in 2008 and the resulting lack of trust in the banking sector. This could, for example, lead to the Bank deciding to refrain from engaging in activities which it might otherwise consider to be in its interests and the interests of its shareholders, such as whether to divest or otherwise restructure any of its operations, provide credit to a particular borrower or hire the best qualified individual for a job because of their association with or involvement in events leading up to or in the aftermath of the financial crisis.

During the financial crisis, the Icelandic government was not able to provide liquidity and guarantees to the banking sector, mostly due to the size of the banking sector before 2008. It is unclear whether, and in what capacity, the Icelandic government would assist the banking sector during difficult times in the future.

Any negative public sentiment in Iceland relating to the Bank's shareholders and other stakeholders, including professional financial and institutional investors, could also lead to a loss of customers or business opportunities for the Bank.

The Bank is exposed to significant liquidity risk

Banking institutions are exposed to liquidity risk, resulting from the fact that the maturity of assets (typically loans) exceeds the maturity of liabilities (the majority of which are demand deposits or otherwise short term) or might not otherwise be adequately matched with the maturity profile of other sources of funding.

The Bank's primary source of funding has historically been deposits from individuals, corporations and financial institutions, although it also accesses international and domestic capital markets for funding through bond issuances under the Programme and covered bond facilities. For additional information on the Group's deposits, see "*Risk Management - Liquidity Risk*".

The Bank has recently extended the maturity profile of its liabilities, strengthened its liquidity reserve and converted a large portion of its demand deposits to term deposits (with 71.8 per cent. of the Bank's deposits being on demand as of 31 December 2017, as compared to over 90 per cent. as of 31 December 2009). See "*Risk Management - Liquidity Risk*". However, no assurance can be given that the Bank will continue to be successful in converting its demand deposits to term deposits or will otherwise be able to increase the maturity profile of its funding.

The Bank's non-deposit funding primarily consists of Notes issued under the Programme that are denominated, among others, in euro, Norwegian krone (**NOK** or **Norwegian Krone**) and U.S. dollars, as well as bonds issued under the Bank's covered bond facilities (including covered bonds previously issued by Kaupthing and assured by the Bank since January 2012), other loans and equity funding.

The Bank has recently sought to further diversify its funding profile through increased debt issuances and will continue to do so if its deposit base declines or fails to grow relative to any increases in its assets, as there will be a natural limit on the scope for growth in deposits in view of Iceland's relatively small economy and in view of competition for funding with other banks and with pension funds. The Bank's loan-to-deposit ratio was 165.5 per cent. as of 31 December 2017 (129.0 per cent. excluding covered bonds (which is Non-IFRS Information)), as compared to 172.9 per cent. as of 31 December 2016 (133.8 per cent. excluding covered bonds) and, as a result, the Bank continues to rely significantly on non-deposit funding to fund its customer loan portfolio. The ability of the Bank to access the domestic and international capital markets depends on a variety of factors, including market conditions, the general availability of credit, the volume of trading activities and rating agencies' and investors' assessment of the Bank's credit strength and of the state of Iceland's economy. These and other factors could limit the Bank's ability to raise funding in the capital markets, which could in turn result in an increase in its cost of funding or could have other material adverse effects on the Bank's business, prospects, financial position and/or results of operations.

Following the further easing of the Capital Controls in March 2017, the Bank's funding did not experience any significant withdrawal of deposits denominated in Icelandic Krona by customers who were restricted to some extent from doing so due to the Capital Controls. However, no assurance can be given that the Icelandic Central Bank will be able to halt capital flight in the event further Capital Controls are imposed in the future.

To the extent that the Bank fails to match more closely the maturity profiles of its assets and liabilities or otherwise ensure that its funding grows in line with any growth in its customer loan portfolio, the Bank will continue to be exposed to a material risk that it may be unable to repay its obligations under its funding instruments when due, or will only be able to do so at excessive cost, which could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank is exposed to a range of other typical financial institution market risks, including interest rate risk and equity price risk, as well as inflation risk in connection with its inflation-linked assets and liabilities

As a financial institution, the Bank is exposed to various market risks, including interest rate risk and equity price risk; in addition, the Bank is exposed to inflation risk in connection with its inflation-linked assets and liabilities. The Bank's exposure to these market risks arises from imbalances on the Bank's balance sheet as well as in market making activities and position taking in certain securities traded by it. The Bank's strategy towards market risk is to seek to limit the risk exposure that arises as a result of imbalances on the Bank's balance sheet but to accept limited market risk in its trading book. The market risk in the trading book arises from market-making activities, whereas market risk in the banking book arises from mismatches in assets and liabilities, primarily in relation to currencies, maturities and interest rates. The Bank's market-making activities are largely in Icelandic treasury notes and listed equity securities. The Bank's own account equity price risk principally arises as a result of the fact that, through the loan restructuring process, it acquired significant shareholdings in a number of companies. See "*Description of the Bank – History – 2010-2012: Restructuring of the Bank and its customers*". The Bank has implemented a number of position limits and other controls designed to limit its trading book exposure, but no assurance can be given that these controls will be effective in all circumstances. The Bank is exposed to the risk that these controls do not prove to be effective in all circumstances and that the Bank could therefore experience material losses in its trading book. In addition, to the extent that these securities are marked to market, the Bank could experience significant fluctuations in its consolidated income statement as a result of movements in the market value of these securities. The results of operations of the asset management operations of the Bank are also subject to market risk, as fluctuations in the markets in which the asset management operations of the Bank hold assets under management can have a significant impact on their results of operations.

In relation to its balance sheet, the Bank's operations are subject to interest rate risk associated with mismatches between its interest-earning assets and its interest-bearing liabilities. The principal mismatch arises from the Bank's fixed interest liabilities as against its floating rate assets. The Bank also faces interest rate risk between its interest-earning assets and interest-bearing liabilities due to different floating rate calculations in different currencies.

The current environment of particularly low interest rates has resulted in interest-earning assets (in particular residential mortgage loans) generating lower yields upon origination or refinancing and other loans and securities held also generating lower levels of interest income when compared to historical levels. In addition, the Icelandic government has recently introduced legislation to abolish the stamp fee on collateral and has imposed restrictions on repayment fees which banks can charge, which has increased the ability of customers to refinance their debts. The Bank has seen a consequential increase in refinancings as interest rates have decreased, and there can be no assurance that the Bank can obtain funding at similarly low interest rates in order to maintain net interest income.

In a period of increasing interest rates, the Bank's level of interest expense may increase more rapidly than the interest it earns on its loans and other assets. Unfavourable market movements in interest rates (for example, a prolonged period of flatter than usual interest rate curves, a stronger than expected rise in interest rates, in certain circumstances negative interest rates or an inverse yield curve) could materially adversely affect earnings and current and future cash flows. Changes in interest rates may also negatively affect the value of the Bank's assets and its ability to realise gains or avoid losses from the sale of such assets, all of which would ultimately affect the Bank's net results.

In addition, the Bank is exposed to inflation risk when there is a mismatch between its assets and liabilities linked to the Consumer Price Index (the **CPI)**. As of 31 December 2017, the total amount of the Bank's CPI-linked assets was ISK 363,791 million and the total amount of its CPI-linked liabilities was ISK 230,851 million. In the event of periods of very low inflation or of deflation, CPI-linked assets would generate diminished levels of net interest income, which could have a material adverse effect on the Bank's net interest margin. Such assets would also decrease in value during periods of very low inflation or of deflation.

The Bank also has significant maturity mismatches in its CPI-linked assets and liabilities, which arise from the fact that a significant proportion of the Bank's CPI-linked mortgages is not match-funded. The Bank is faced with interest rate risk and liquidity risk when CPI-linked mortgages are funded with liabilities which have a shorter interest-fixing period and maturity. Although the Bank has implemented a range of risk management procedures designed to mitigate these risks, no assurance can be given that these controls will be effective in all circumstances, in which case the Bank could experience material losses. Any losses experienced by the Bank as a result of its market risk exposures could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank is exposed to the risk of failure and breaches of its information technology systems

The availability, integrity, reliability and operational performance of the Bank's information technology (**IT**) systems, including Valitor Holding hf.'s (**Valitor**) international payments platform, are critical to the Bank's operations. The Bank's business relies on the efficient and uninterrupted operation of numerous systems, including computer hardware and software systems, data centres, third party telecommunications networks and the systems of third parties. Although the Bank's IT systems and Valitor's international payments platform have demonstrated a high level of reliability and performance to date, no assurance can be given that the Bank will be able to continue to maintain past levels of performance. In particular, the Bank currently uses a system provided by Reiknistofa Bankanna (**RB**), which is a centralised cash settlement system in Iceland, as its core system for deposits and payments, with all payment instructions settled through the RB system. RB is in the process of replacing its legacy deposit and payment system with the Sopra Banking system. One of the other Icelandic banks has already migrated to the new platform, and the other plans to migrate in September 2018. This in turn requires the Bank to replace its core deposit and payment systems, and the Bank is currently in negotiations with RB on the Sopra implementation. The implementation of a new cash settlement system or any other IT operations, outsourced or otherwise, could be subject to unexpected difficulties, implementation costs and delays, and no assurance can be given that such implementations will be delivered on time or within budget.

The Bank's ability to provide products and services to its customers on a timely basis or at all would be impaired by damage, interruption, failure or lack of capacity of its IT systems, core deposit and payment systems, international payments platform, any other systems in its clearing operations or the systems of third parties on which it relies due to malicious increases in usage or cyber-attacks by hackers (including as a result of denial of service or similar attacks which exceed network or gateway capacity), hardware or software defects, human error, unauthorised access, natural hazards, disasters or similarly disruptive events as well as due to planned upgrades and improvements which may be subject to developmental delay or fail to be effective. In addition, the Bank is at risk of breaches of its IT systems for illegal purposes such as cyber fraud or theft. The Bank considers that, with the easing of the Capital Controls in March 2017, Icelandic financial institutions could be subject to a greater risk of cyber-attacks going forward. The insurance policies which the Bank maintains may not be adequate to compensate the Bank for all losses that may occur as a result of any damage, interruption, failure or lack of capacity. A sustained failure of the Bank's IT system centrally or across its branches, or of critical third-party systems, would have a significant impact on its operations and the confidence of its customers in the reliability and safety of its banking systems and Valitor's international payments platform and could, in turn, have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations.

Unauthorised disclosure of confidential information and personal data, whether through cyber security breaches, computer viruses or otherwise, could expose the Bank to fines, liability and protracted and costly litigation and damage its reputation

The secure transmission of confidential information is a critical element of the Bank's operations, with the Bank processing personal customer data (including, in certain instances, customer names, addresses, credit and debit card numbers and bank account details), merchant data (including merchant names, addresses, sales data and bank account details), transaction data (including payment instructions, money transfers, securities trading and various other electronic communications and transfers within Iceland and cross-border) and other confidential information as part of its business. Therefore, the Bank is responsible for safeguarding such confidential information and must comply with strict data protection and privacy laws when dealing with such data in the jurisdictions in which it operates, including through the Bank's subsidiaries Valitor, Stefnir hf. (**Stefnir**) and Vördur tryggingar hf. (**Vördur**). The Bank seeks to ensure that procedures are in place for compliance with the relevant data protection and privacy laws by its employees and any third party service providers. Although the Bank is also taking steps to implement and maintain appropriate security measures to protect confidential information, such measures could prove not to be effective in all cases.

Data protection requirements are evolving in the jurisdictions in which the Group operates. One significant change is the European General Data Protection Regulation (the **GDPR**) which became effective in May 2018 and brought a number of changes to data protection legislation in the European Union. Notwithstanding steps taken by the Bank in preparation for compliance with the GDPR, the Bank is exposed to the enhanced data protection requirements under the GDPR and has needed to make additional changes to its operations, and will potentially incur additional costs, in order to comply with the GDPR. Failure to comply with the GDPR could subject the Bank to substantial fines.

The Bank could be liable in the event of a breach of applicable law including any loss of control of such confidential information or as a result of unauthorised third party access. Unauthorised disclosure of confidential information could occur in a number of circumstances, including as a result of cyber security breaches, malware infection, malicious or accidental user activity, errors in software development, internal security breaches or as a result of human error as well as physical security breaches due to unauthorised personnel gaining physical access to confidential information.

The loss, destruction or unauthorised modification of confidential information by the Bank or third parties could result in significant reputational damage, additional costs relating to customer and/or merchant compensation or other charges, fines, loss of relationships with financial institutions, sanctions and legal proceedings or adverse regulatory actions against the Bank by the governmental authorities, customers, merchants or other third parties. Although the Bank generally requires that its agreements with third party partners or service providers who may have access to confidential information include confidentiality obligations that restrict such third parties from using or disclosing any such confidential information, these contractual measures may not prevent the unauthorised use, modification, destruction or disclosure of confidential information or allow the Bank to seek reimbursement from such third party in case of a breach of confidentiality or data security obligations. In addition, certain of the small- to medium-sized enterprise customers of the Bank and/or its subsidiaries, defined as corporates with loans up to ISK 2.0 billion (**SME**), may have limited data security capability and experience loss of confidential information when using the Group's business-to-business services. Any unauthorised use, modification, destruction or disclosure of confidential information could also result in protracted and costly litigation. Any of these or other factors could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank is subject to additional taxes beyond corporate income tax, which impose costs and competitive disadvantages

In addition to the basic corporate income tax rate of 22 per cent. in Iceland, the Bank is subject to certain other taxes which are specific to financial institutions in Iceland and increase its effective tax rate and its effective cost of funding, which in turn can inhibit its ability to compete effectively with domestic and foreign lenders who are not subject to such additional taxes.

In particular, in December 2010, the Parliament of Iceland passed Act No. 155/2010 on Special Tax on Financial Institutions, pursuant to which certain types of financial institutions, including the Bank, are required to pay an annual levy (the **Bank Levy**), which, since the year ended 31 December 2013, has been calculated at 0.376 per cent. on the total debt of the Bank in excess of ISK 50.0 billion as of the end of the applicable period. Non-financial subsidiaries are exempt from the Bank Levy. Whereas the Bank Levy was originally introduced as a temporary measure, there is currently no fixed date for its removal and no assurance can be given as to whether the Bank Levy will be reduced, eliminated or increased further in the future. In addition, in December 2011, the Parliament of Iceland enacted Act No. 165/2011 on Financial Activities Tax, pursuant to which certain types of financial institutions, including the Bank, are currently required to pay a special additional 5.5 per cent. tax levied on all remuneration paid to employees (the **Financial Activity Tax**). Under Income Tax Act No. 90/2003, as amended (the **Income Tax Act**), the Bank is subject to an additional tax of 6.0 per cent. as a financial institution in respect of taxable profit exceeding ISK 1.0 billion irrespective of joint taxation or carry-forward losses (the **Special Financial Activity Tax**). The Bank Levy, the Financial Activity Tax and the Special Financial Activity Tax place an increased cost burden on the Bank and subject it to a competitive disadvantage relative to other lenders not subject to such taxes, including international banks, domestic pension funds and the Housing Financing Fund. The Bank (on a standalone basis) was the highest corporate tax payer in Iceland in respect of operations in 2016, with total tax amounting to ISK 10.5 billion (*source: Icelandic Directorate of Internal Revenue*). In addition, the Bank's results of operations could be harmed by changes in tax laws and tax treaties or the interpretation thereof, changes in corporate tax rates and the refusal of tax authorities to issue or extend advanced tax rulings, any of which could result in the Bank being subject to a higher effective tax rate. The unavailability of tax rulings could also diminish the range of structured transactions the Bank can enter into with its customers.

Moreover, the Bank may be subject to additional taxes or levies in the future. For example, the governor of the Icelandic Central Bank has suggested the possible imposition of a levy on banks to help fund the negative carry costs of the significant foreign currency reserves which the Icelandic Central Bank maintains, which, if enacted, could impose significant additional costs on financial institutions in Iceland, including the Bank.

Any additional tax or levy could increase the Bank's cost of funding and operating costs generally, impair the ability of the Bank to compete effectively with other lenders and/or decrease the Bank's lending volumes and margins, any of which could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank could face tax liabilities or competitive disadvantages in respect of VAT on some of its services

The services of banks, savings banks and other credit institutions are currently exempt from value added tax (**VAT**) under the Value Added Tax Act no. 50/1988. The tax authorities in Iceland have historically construed the exemption to be limited to the services that banks and other credit institutions provide according to the Financial Undertakings Act. For certain of the services provided by the Bank to customers and under the terms of its intra-Group arrangements with subsidiaries, the Bank has not historically collected VAT, and there is uncertainty whether VAT should be collected for some of such services. While the Bank believes that its practices with respect to collection of VAT are common among financial institutions in Iceland, there can be no assurance that Icelandic tax authorities will not reassess VAT on services provided by the Bank and conclude that the Bank has failed to collect VAT properly on certain services in the past. Should this occur, the Bank could be liable retroactively for six years' unpaid amounts, plus penalties and interest. To the extent that, going forward, the Bank decided, or was obliged, to start claiming VAT in respect of such services but its competitors did not, it would be at a competitive disadvantage and could be priced out of competing effectively for provision of certain services. Any of the foregoing could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations.

The Bank is exposed to credit risk and its customer loan portfolio contains certain problem and impaired loans

As a financial institution engaged in lending to individuals and companies, the Bank faces credit risk which arises from the possible failure of repayment by the borrower and/or the loans not being secured sufficiently. Although the Bank attempts to manage this risk through its credit risk management policies by monitoring the extension of credit to customers and taking of collateral, there is no guarantee that such precautions will be effective, and the Bank could be exposed to more credit risk than it finds acceptable. For example, non-compliance by employees with the Bank's credit risk management policies can result in riskier loans being extended than permitted. In addition, the Bank may fail to assess the inherent risk in each loan application correctly, the credit quality of borrowers or the value of collateral could decline, and deviations from the rules by committees allowed to make such deviations could become more frequent, especially in response to increased competition amongst lenders due to any deterioration in the economic situation in Iceland. Any of the foregoing could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

At 31 December 2016, the Bank held a loan of ISK 6,277 million against Sameinad silicon hf. (**United Silicon**), collateralised with shares in the company and other assets. The Bank also had a 6 per cent. equity interest in United Silicon and an unsecured bond in the total amount of ISK 877 million. In the second quarter of 2017, the Bank invested ISK 907 million in United Silicon, obtaining an interest ownership of 16.3 per cent., with voting rights of 23.9 per cent. and thus United Silicon became an associate of the Bank, accounted for according to the equity method, less impairment. The purpose of the investment was to support the company in a time of operating difficulties. Due to these operating difficulties the Bank made full provision for the value of the equity holdings in United Silicon of ISK 1,164 million at the end of the second quarter of 2017, recognising ISK 907 million through Share of profit of associates and ISK 257 million through Net financial income in the consolidated statement of comprehensive income.

In September 2017 the Bank foreclosed on its collateral and took possession of the shares in United Silicon and became the largest shareholder of the company, with an interest ownership of 66.58 per cent. and voting rights of 66.68 per cent., while remaining United Silicon's primary lender as well. With this transaction the Bank acquired the control of United Silicon and thus the company became a subsidiary of the Bank. The fair value calculation of the underlying assets at the time of the foreclosure resulted in a provision on loans of ISK 2,962 million recognised in Net impairment as well as fair value loss of unsecured bond of ISK 708 million recognised in Net financial income of the consolidated statement of comprehensive income. Including the impact of the calculated income tax effect, the total impact of United Silicon on the Group's results of operations for 2017 amounted to a reduction of the Group's net earnings in the amount of ISK 4,068 million.

The book value of assets of United Silicon held by the Group was ISK 5,219 million as at 31 December 2017. As the company was acquired exclusively with a view to resale, it has been classified as an asset held for sale and as a discontinued operation as of 31 December 2017 in accordance with IFRS 5. Although the Bank does not anticipate further impairments at this time, there can be no assurance that further impairments or losses relating to United Silicon will not occur, or that a sale of United Silicon will be achieved. The Bank is also involved in litigation concerning United Silicon; see "*—The Bank is involved in a number of ongoing legal proceedings and is subject to investigations by governmental authorities*".

As demonstrated by the impairments the Bank incurred in respect of United Silicon, no assurance can be given that any currently performing loans will not become problem loans in the future, whether as a result of a general impairment of conditions in a particular customer or class of customers, a deterioration of the Icelandic economy or otherwise, or that impairments or losses relating to problem loans will not occur. Actions the Bank may take with respect to problem loans, such as enforcing collateral or forcing a bankruptcy in respect of problem loans, may have an adverse impact on customers in the Bank's other divisions, for example if such customers had invested in equity of the relevant problem borrowers or had other exposure to such borrowers through products and services provided by other divisions of the Bank, such as Investment Banking or Asset Management, and experienced losses as a result.

In particular:

- as of 31 December 2017, 1.0 per cent. of the Bank's customer loan portfolio was classified as problem loans, which are defined as (i) the book value of loans more than 90 days past due but not impaired, plus (ii) the book value of other problem (i.e. individually impaired) loans. As of 31 December 2017, the Bank's provisions on its customer loan portfolio amounted to 1.7 per cent. of the total gross amount of the customer loan portfolio and 1.6 per cent. of the gross amount of loans to customers outstanding had been wholly or partially impaired. As of 31 December 2017, the value of collateral that the Bank holds relating to loans to customers determined to be individually impaired amounted to ISK 3,795 million. When discounts and other adjustments have been applied, the book value of those loans amounted to ISK 2,491 million or 19.5 per cent. of the aggregate carrying amount of such loans to customers;

- the Bank has significant lending exposure to the real estate and construction and fishing industry sectors, with exposure amounting to 16.7 per cent. and 10.3 per cent., respectively, of the total net carrying value of the Bank's customer loan portfolio as of 31 December 2017;

- as of 31 December 2017, the aggregate amount of the Bank's 10 largest loans to customers equalled 12.1 per cent. of the total gross amount of the Bank's customer loan portfolio as of such date;

- the Bank's customer loan portfolio is also highly concentrated among Icelandic borrowers; and

- on 1 January 2018, the Bank implemented IFRS 9. IFRS 9 replaced the "incurred credit loss" model used under IAS 39 with an "expected credit loss" model. The changes from incurred to expected credit losses requires professional judgment over various factors used in the calculation of expected credit losses, such as how macroeconomic scenarios affect the calculation. The application of the IFRS 9 impairment requirements could increase volatility in profit and loss of the Group.

Should any customers or an industry sector to which the Bank is exposed default or experience a significant deterioration in their business or prospects, as the case may be, this could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

Iceland's banking system has been subject to restructuring and is relatively small given the small size of the Icelandic economy, which could limit opportunities for growth in the near term

Early in October 2008, the Icelandic banking system faced a serious banking crisis, as a consequence of which Kaupthing, Glitnir and Landsbanki were placed first into restructuring and later into winding up proceedings. As part of the restructuring of the banking sector, the Icelandic Financial Supervisory Authority (the **FME**) transferred certain of their assets and liabilities, including their domestic deposits, into three newly established banks, Íslandsbanki hf. (**Íslandsbanki**), Landsbankinn hf. (**Landsbankinn**) and the Bank, respectively, which held a combined market share of 52 per cent. of loans to households, 80 per cent. of loans to corporates and 98 per cent. of deposits from customers as of 31 December 2017 (source: *Ministry of Finance and Economic Affairs, Arion Bank, Landsbankinn and Íslandsbanki annual reports*). The small size of the Icelandic economy and any changes to the Icelandic banking sector have affected and could continue to affect the Icelandic banks.

Uncertainty about the quality of the loan assets held by the Bank, Íslandsbanki and Landsbankinn and the relatively high levels of problem loans on their balance sheets have been a risk to the business, prospects, financial position and/or results of operations of the Icelandic banks. Although the levels of problem loans on the balance sheets of the Bank, Íslandsbanki and Landsbankinn have declined from 42 per cent. of total loans as of 31 December 2009 to 2.2 per cent. as of 31 December 2017 (*source: Icelandic Central Bank*), no assurance can be given that the rate of problem loans will not increase in the future. Levels of problem loans, determination of loan values and the levels of write-offs will depend, in the medium term, on general economic developments and on the operating and financial condition of the particular borrowers as well as decisions by the Supreme Court of Iceland affecting the value of loans linked to foreign currencies. Worldwide financial and economic developments, in particular financial and economic developments in the United Kingdom and the other European countries that constitute Iceland's main trading partners, may also have an effect.

Given the relatively small size of the Icelandic economy and the short period of time since the financial crisis in 2008, Icelandic households and businesses may be reluctant to engage in new borrowing activities and, as a result, the Icelandic banks are not expected to grow significantly through domestic lending in the near term and may experience increased competition and consequently pressures on net interest income. In addition, the Bank has limited funding opportunities in Icelandic krona, namely its ISK-denominated deposits and its covered bond facilities, neither of which is capable of fully funding the Bank's ISK corporate lending volumes. Consequently, the Bank's ability to increase its corporate lending is limited and will continue to be limited unless the Bank is able to find additional sources of funding in Icelandic krona. It is also unlikely that the Bank, Íslandsbanki or Landsbankinn will grow significantly through international operations in the near future. Iceland's economy remains vulnerable to renewed disruptions, cessation or reversal of growth and a return to recession. Moreover, the Icelandic banks could also be adversely affected if other developments in the Icelandic economy or internationally result in slowing of growth in Iceland's economy or trigger a recession, any of which could in turn have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank may be unable to successfully implement its strategy or its strategy may not yield the anticipated benefits

The Bank's strategy is based on assumptions and expectations, including in respect of macroeconomic developments, competition, interest rates, revenue, expenses and cost of risk and future demand for Bank's services, which may prove to be incorrect. Also, the benefits and impact of the Bank's strategy could fall short of what the Bank anticipates. For example, the Bank might not be able to realise the full benefits of its lean banking or digitalisation initiatives, which could result in less than expected customer satisfaction improvements and cost reductions and negatively impact revenues and operating results, respectively. In addition, the expansion of Valitor's operations and the integration of Vördur might take longer or cost more than expected and not realise the currently expected benefits. For additional information on the Bank's strategy, see "*Description of the Bank - Strategy*".

Since the global financial crisis in 2008, macroeconomic volatility has made it more difficult to predict GDP development in many economies, resulting in frequent modifications to growth expectations published by economic research institutions as well as in adjustments by market research specialists, sometimes giving rise to significant revisions to growth expectations for specific markets. As a result, many financial institutions, including the Bank, may find it difficult to accurately model and predict the prospects for their businesses and set viable financial targets, and it may be difficult for investors to use historical financial results as an indicator for future results. Any failure by the Bank to accurately predict macroeconomic developments, interest rates, revenue, expenses and cost of risk and/or future demand for the Bank's services could lead to misjudgments with respect to its strategy and increase the risk of failed implementation. If the Bank's strategy is not implemented successfully or if the Bank's strategy does not yield the anticipated benefits, this could have a material adverse effect on the Group's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank is exposed to competition and expects competition will increase

The Icelandic banking sector is dominated by the Bank, Íslandsbanki and Landsbankinn (the latter two being wholly owned by the Icelandic government, and each of which is classified as a systemically important financial institution), but also includes other commercial banks and savings banks, the Housing Financing Fund (a provider of financing for residential housing in Iceland and also a systemically important financial institution) and pension funds, which have increased their mortgage lending to individuals at aggressive interest rates, partially as a result of the fact that they are not subject to the Bank Levy. Pension funds in Iceland also provide competition for the Bank's deposits, as a vast proportion of individuals' savings in Iceland are held in pensions rather than in bank deposits, and a significant portion of payments to pension funds, representing a proportion of salary and a contribution by employers, are required by law. Pension funds also represent a significant source of the Bank's funding in Icelandic Krona as purchasers of the Bank's covered bonds. In addition, the Icelandic government has recently introduced legislation in order to facilitate customers switching banks in an effort to promote competition, for example, by abolishing the stamp fee on collateral, which has had the effect of increasing the rate of refinancings, and there can be no assurance that the Bank will be able to obtain funding at similarly low interest rates in order to maintain net interest margin.

In addition, in respect of Valitor's operations, the market for card and electronic payments is highly competitive and has many players, including dedicated payment processing companies, financial institutions and non-traditional payment processors, such as PayPal. Valitor is currently subject to a high degree of customer concentration, particularly in its partner channel. Loss of a significant customer would be expected to have a material adverse impact on Valitor's acquiring volumes and consequently on its business and results of operations. The partner channel provides high volumes at lower margins than in the direct channel, balancing risk and contributing to operational economies of scale. The largest partner in the partner channel has informed Valitor that it intends to become its own acquirer in 2018 and effectively compete with Valitor. It is expected that the relationship will be gradually reduced, resulting in lower levels of revenue for Valitor. For a summary of the results of operations of Valitor, see "*Description of the Bank—Other Divisions and Subsidiaries—Subsidiaries—Valitor*". Should Valitor be unable to replace this customer, its results of operations would be substantially affected. Valitor's main competitor in the Icelandic card and electronic payments market is Borgun, a card issuing and acquiring subsidiary of Íslandsbanki. As Valitor expands outside of Iceland, it also faces increasing competition from global card issuing and acquiring companies, such as Worldpay which has an established presence in many markets where Valitor seeks to expand.

The Bank is subject to considerable regulatory scrutiny that can hinder its competitiveness. At the same time, fintech companies and initiatives, which are not subject to the same regulatory burden, also pose an emerging source of competition for the Bank. The implementation of Directive (2015/2366/EU) on payment services in the internal market (the **Payment Services Directive 2**) in Iceland is likely to increase this regulatory burden for the Bank, as well as competitive pressure, when it comes into force (expected to be in 2019). Furthermore, the fact that the Bank is currently classified as a systemically important financial institution in Iceland adds to its regulatory burden. For example, the Bank, Íslandsbanki and Landsbankinn were for some time under investigation by the Icelandic Competition Authority (*Samkeppniseftirlitid*) (the **ICA**) in relation to alleged abuse of the alleged collective dominant position of these three banks relating to their mortgage loan arrangements. That investigation was concluded with a settlement with the ICA in which the Bank agreed to take certain measures which have the objective of stimulating competition in retail banking services for individuals and small businesses. The measures have the objective of reducing switching costs in financial services, promoting active competition among banks toward individuals and small businesses and negating circumstances that could enforce tacit co-ordination in the market for retail banking services in Iceland. According to the Icelandic Competition Act, a failure to implement or comply with measures agreed to in a settlement can lead to administrative fines being administered pending an investigation by the ICA.

As Iceland's economy continues to recover and demand for new lending and other banking products increases, the Bank expects to face increased competition from the other large Icelandic banks, pension funds and smaller specialised institutions. In addition, if there is sufficient credit demand, the Bank could potentially face increased competition from foreign banks seeking to establish operations in Iceland, in particular with respect to the customers of the Corporate Banking division. The Bank may have to comply with regulatory requirements that may not apply to such foreign competitors, creating an unequal playing field and resulting in higher costs of regulatory compliance for the Bank. Foreign competitors may also have substantially more resources and financial means available to them than the Bank does (particularly given the Bank's relatively smaller size and lack of scale advantage in light of its regulatory obligations as a systemically important financial institution in Iceland), permitting them to invest more in business development and expansion or being able to increase lending volumes or endure a greater reduction in margins.

The Bank expects to compete on the basis of a number of factors, including transaction execution, its products and services, its local know-how, its ability to innovate, reputation and price. If the Bank is unable to compete effectively in the future in any market in which it has a significant presence, this could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

There are regulatory, compliance and legal risks inherent in the Bank's businesses

The Bank's operations entail considerable regulatory, compliance and legal risks, including litigation and liability risk. The Bank and certain of its subsidiaries are subject to government regulation and supervision as financial institutions in Iceland, and regulations may be extensive and may change piecemeal, rapidly, at times unexpectedly and with only a very short period of notice and consultation, as they have done since the global financial crisis in 2008. The regulatory and compliance risks faced by the Bank and its subsidiaries arise not only from regulation within Iceland or specific to financial services firms, but also from other, more broadly applicable regulations and from risks relating to the ability of Icelandic authorities to adopt, implement and administer applicable regulations and to supervise Icelandic banks. The implementation of new European directives and regulations into Icelandic legislation will be subject to the ability of the Icelandic ministries, legislature and regulators to apply additional, more stringent requirements where they are permitted or required to do so, for example with respect to capital requirements. The Bank and its subsidiaries are also subject to regulatory scrutiny from certain other supervisory bodies, such as the ICA and the Data Protection Authority. In addition, the Bank's ability to conduct certain of its and its subsidiaries' operations is contingent upon licences issued by financial authorities. Compliance with the requirements of these licences, or with an administrative decision or supervisory guidance or any new or revised law, regulation or licensing requirement, may require significant resources and manpower, impose significant costs on the Bank and require changes in the Bank's operations and management. Failure to comply with any of the above could potentially expose the Bank to civil or criminal liability, reputational damage and sanctions including fines, the loss or limitation of licences, authorisations or permits necessary for the Bank's business and stricter regulatory scrutiny or supervision by Icelandic authorities. Such failures may arise despite the Bank's risk management system.

Leading up to the financial crisis in 2008, there was a significant imbalance between the resources of the FME and those of Icelandic banks, which may have limited the ability of the FME to adequately supervise such banks. Although these resource constraints have since been addressed through measures such as the appointment of more staff at the FME and revision and expansion of the regulatory framework surrounding the banking industry, there can be no assurance that the FME or other regulatory authorities will be able to successfully identify and remedy weaknesses in Iceland's financial services sector. Prior to the financial crisis, Icelandic banks engaged in activities of which the FME was aware and on which it did not offer negative comment, but which have since been found unlawful by the Icelandic courts. Despite the increased FME resources and expanded regulatory framework, the possibility exists that employees of the Bank could, in good faith, engage in activities, which may be widespread and might later be found to conflict with regulations. Pursuant to the introduction of the act on the European Surveillance System in the Financial Markets on 9 May 2017, Iceland has adopted the European framework for bank surveillance which aims to enhance stability and the health of the financial system.

In addition, as a result of a lack of a formally defined procedural protocol for correspondence, discussions and meetings between the FME and the Bank, at times the FME has sought to communicate with management in preference to the Board of Directors, or to individual Icelandic members of the Board of Directors as opposed to the Board of Directors as an entity. These circumstances create a risk that the Bank might be unable to have a complete overview of all the correspondence with the FME or that information relevant to the Bank could be lost in translation, delayed or not relayed to the Board of Directors. Inaccurate or insufficient information can prevent the Board of Directors from carrying out its supervisory function and could lead to failure by the Bank to comply with corporate governance requirements.

Violations of rules and regulations, whether intentional or unintentional, or failure to comply with licensing or other requirements, may adversely affect the Bank's reputation or financial condition, results of operations and prospects. In addition, existing laws and regulations could be amended, the manner in which laws and regulations are enforced or interpreted could change and new laws or regulations could be adopted in ways unfavourable to the Bank's operations, which could adversely affect the way the Bank operates its business and its market reputation. See *"- Public sentiment and political activity in Iceland could impair the Bank's operations*" and "*Description of the Bank - Legal Proceedings*".

Occurrence of any of the foregoing could have a material adverse effect on the Bank's reputation, business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank is involved in a number of ongoing legal proceedings and is subject to investigations by governmental authorities

The Bank is involved in, or could be affected by, a number of ongoing legal proceedings and is subject to investigations by governmental authorities, including, but not limited to:

- *legal proceedings on disclosure requirements for borrowers*: In October 2017, the Supreme Court of Iceland ruled against Íslandsbanki in a case concerning disclosure requirements vis-à-vis borrowers, which lenders must fulfil when a loan agreement allows adjustable interest rates. The disclosure requirement calls on lenders to inform consumers of the condition under which the annual rate of interest may be amended. The proceedings were initiated by Íslandsbanki which submitted that an earlier ruling by the Consumer Rights Appeal Committee, where it was concluded that said disclosure requirements as set out in the Consumer Credit Act (No 121/1994) had not been fulfilled and as a result Íslandsbanki could not unilaterally raise the applicable rate, should be annulled. According to the Supreme Court, the terms and conditions of the loan agreement did not meet the aforementioned disclosure requirements. In accordance with a statutory obligation, a lender was obliged to specify in the loan agreement what conditions would allow for unilateral changes to the annual rate. Whereas Íslandsbanki had merely stipulated that the rate might be amended every five years, the Supreme Court rejected Íslandsbanki's submission. The Bank has reviewed the potential impact on its own loan portfolio. In 2012 and 2013, the Bank amended the applicable terms and conditions vis-à-vis interest rates for mortgage credit. As a result, no agreements concluded post-2013 are viewed as purportedly lacking. In the Bank's view, uncertainty remains concerning the legality of potential reimbursement claims, with issues of indifference on behalf of claimants and statutory time limitations still unresolved;

- *legal proceedings on legacy mortgage collateral:* The Bank is involved in court cases which question claims to property pledged as collateral in mortgage loan agreements. Under dispute are questions as to whether part owners unequivocally granted the property as collateral. Case law from the Supreme Court of Iceland, in cases which did not involve the Bank, has so far yielded conflicting results but in the majority of cases the Supreme Court has invalidated the collateral, and the Bank is awaiting further rulings to assess the borderline cases. In judicial decisions to date, invalidation of 50 per cent. of the collateral for a given pledge has not affected the remaining 50 per cent. of the collateral or the borrower's obligation to repay the debt in full. Therefore, the Bank has not recorded any provision in respect of the matter;

- *claim for alleged violations of the Competition Act*: With a writ issued in June 2013, Kortathjonustan claimed damages in the amount of up to ISK 1.2 billion plus interest in aggregate from the Bank, Íslandsbanki, Landsbankinn, Borgun hf. and Valitor as a result of losses that Kortathjonustan contends the five parties caused by violations of the Competition Act. The case was dismissed on procedural grounds rather than the merits by the District Court of Reykjavík by a ruling in March 2017. The ruling was confirmed by the Supreme Court on 2 June 2017, citing in particular that the plaintiff had not met with requirements related to standing. In September 2017, Kortathjonustan brought proceedings against the Bank and the other defendants on the same grounds, this time claiming damages in the amount of ISK 922 million plus interest. The case was again dismissed on procedural grounds by the District Court of Reykjavík by a ruling in March 2018, which was confirmed by the Court of Appeal in May 2018. Kortathjonustan has appealed the Court of Appeal's ruling to the Supreme Court. If the defendants would be ordered to pay damages, they would be jointly responsible for the payment of damages. The Bank has not recorded any provision in respect of this matter;

- *legal proceedings regarding conduct in bankruptcy of BM Valla and Artun:* Lindarflot ehf. (**Lindarflot**) and the former chairman of the board of directors of BM Valla hf. (**BM Valla**) have claimed damages from the Bank as a result of losses Lindarflot and the former chairman contend that the Bank caused them losses by its conduct in relation to the bankruptcy of BM Valla and Artun ehf. (**Artun**) in 2010. Lindarflot and the chairman claim that the Bank, at the time a lender to BM Valla and Artun, rejected their proposal for the financial restructuring of BM Valla and Artun on illegitimate grounds, forcing the companies into insolvency proceedings and therefore causing them losses. The dispute is currently over recognition of liability and not the amount of damages, which will follow in the event that the Bank is found liable. Lindarflot and the former chairman had earlier claimed losses of approximately ISK 4 billion. In April 2018, the District Court of Reykjavík dismissed the case. The plaintiffs have appealed the judgment to the Court of Appeal. The Bank believes that it will be acquitted of the plaintiffs' claims in both cases and has therefore not recorded any provision in respect of this matter;

- *legal proceedings in relation to Valitor's rescission of a vendor agreement:* Datacell ehf. (**Datacell**) and Sunshine Press Productions ehf. (**Sunshine Press Productions**) have claimed compensatory damages in the amount of approximately ISK 8.1 billion, plus accrued interest, in relation to Valitor's rescission of a vendor agreement with Datacell in 2011. The Supreme Court of Iceland had ruled in an earlier case that the rescission by Valitor was unlawful, as a result of which the companies have now commenced proceedings seeking damages from Valitor for the losses allegedly incurred by Datacell and Sunshine Press Productions due to the unlawful rescission. A court-appointed evaluators' report assessing damages was presented in March 2016. Valitor disagreed with the assessment stated in the report and filed a motion to appoint three court evaluators to re-evaluate the plaintiffs' alleged losses. The District Court of Reykjanes granted this motion. The reassessment has been completed, but it was not filed with the District Court. Valitor requested a new assessment, which would have examined particular aspects which had not yet been assessed, but the District Court has rejected the request. Valitor has appealed the decision to the Court of Appeal. Recently Datacell and Sunshine Press Production claimed a freezing of Valitor's assets on the basis of the aforementioned claim of compensatory damages but the district magistrate declined the claim. Datacell and Sunshine Press Productions have submitted that decision to the District Court, which has not yet ruled on this claim;

- *disputes relating to United Silicon*: United Silicon was granted a moratorium on payments on 14 August 2017 and filed for bankruptcy on 22 January 2018. The Bank had collateral in United Silicon's assets and the estate conveyed the assets to the Bank. The bankruptcy trustee has approved the Bank's collateral claims but two unsecured creditors have contested that approval and the dispute has been referred to the District Court. The Bank has examined these challenges and believes they are without merit. However, the Bank and the estate have agreed that if the Bank's collateral claims are judged invalid by the District Court, the Bank will refund the estate the amount of the invalidated bond;

- *possible criminal complaint and related correspondence*: In 2017 and 2018, the Bank received a series of correspondence from a former customer of the Bank's predecessor Kaupthing. The correspondence alleged that the Bank had not conducted sufficient internal due diligence to ensure that its management and directors are fit and proper to carry on the operations of a financial institution, on the basis that certain individuals who are employed by the Bank were employed by its predecessor Kaupthing or the other Icelandic banks at the time of the financial crisis in 2008. In May 2018, the Bank received further correspondence from this individual, which stated that he had filed a criminal complaint with the prosecutor in Iceland concerning Kaupthing's alleged wrongful appropriation of assets during the "winding up" process of Kaupthing. The individual alleges that the complaint involves both the Bank and certain of its employees. To date, there has been no indication from authorities in Iceland that any criminal proceedings will be brought against Kaupthing, the Bank or any of its employees in connection with this allegation. Included in the correspondence described above was information which the individual claimed supports his allegations against the Bank and those employees named in the correspondence. The Bank has considered the allegations in this correspondence, along with the related materials, and has conducted its own review of these allegations and related materials, including with support of external counsel, and it remains of the view that the allegations are without merit and that those employees named in the correspondence are indeed fit and proper; and

- *penalty interest during extension of payments*: In March 2018, the Supreme Court of Iceland issued a judgment in case no. 159/2017, which concluded that the Bank was not permitted to calculate penalty interest on customers' debts during the period in which the customer was granted an extension of payments under the law on debt mitigation. The Bank is examining how many customers have paid penalty interest on their debts to the Bank during such extension period. A more detailed examination of these cases will reveal whether any customers may be able to claim repayment from the Bank or be entitled to have their debts reduced, particularly in cases where the debt has been paid in full. An evaluation is currently being made of what the impact will be on the Bank.

For additional information on legal proceedings, see "*Description of the Bank - Legal Proceedings*".

The Bank and Valitor, as relevant, have made objections to and are defending the complaints regarding damages by Lindarflot, BM Valla's former chairman, Datacell and Sunshine Press Productions and the United Silicon claimants as described above. The extent and outcome of the legal proceedings or investigations, as the case may be, as well as any effect on the Bank, remain uncertain.

The Bank is also exposed to risks of lawsuits or other claims inherent in its role as a financial intermediary and consultant to third-party businesses through its Investment Banking division. These risks include potential liability for the Bank's role in determining the price of a company and for advice the Bank provides to participants in corporate transactions and in disputes over the terms and conditions of trading arrangements. The Bank also faces the possibility that counterparties in the above-mentioned activities, as well as trading transactions will claim that the Bank failed to properly inform them of the associated risks.

The Bank may also be subject to claims arising from disputes with employees for, among other things, alleged illegal dismissal, discrimination or harassment, and it may also be subject to losses or reputational damage as a result of illegal behaviour by its employees or third party service providers. These risks may often be difficult to assess or quantify and their existence and magnitude often remain unknown for substantial periods of time.

Should any legal proceedings or investigations be determined adversely to the Bank, the Bank could be required to pay damages and/or fines and be subject to future restrictions on its business activities, either of which could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

Iceland's national implementation of the EEA rules may not be comprehensive in all circumstances

As a member state of the EEA, Iceland is obligated to implement certain European Union legislation with EEA relevance, including legislation relating to financial markets. Where Iceland has failed to amend national law to conform to EEA rules, citizens may be unable to rely on them and the Icelandic courts barred from applying them, unless Icelandic legislation may be interpreted in conformity with the relevant EEA rules. In this respect, the Icelandic legislation on financial undertakings, securities transactions and other relevant fields are mostly implemented from EU law. There can be errors in such implementations which can result in a lack of uniformity between EU law and the corresponding Icelandic legislation. In such cases, Icelandic law will be deemed to prevail in the Icelandic courts. Such errors can cause confusion and debate as to precisely which rules the Bank is required to follow and can result in time-consuming and resource intensive discourse with regulators.

Delays in the full implementation of European directives and regulations into Icelandic legislation may also give rise to uncertainty as to the applicable requirements. Icelandic government authorities, as well as the Bank's counterparties, may seek to mitigate delays in formal implementation into national law by seeking to apply in practice requirements equivalent to those under EEA rules. As a result, the Bank may be unable to rely on the precise wording of statutes or draw guidance from legislative preparatory works. Complying with regulation that is in flux can be resource intensive and exposes the Bank to a risk of non-compliance.

The Capital Controls restrict to some extent the manner in which the Bank conducts its business and may result in abnormal pricing and financial bubbles in Iceland

In response to the financial crisis, the Parliament of Iceland approved certain amendments to Act No. 87/1992 on Foreign Exchange, as amended (the **Foreign Exchange Act**) that introduced the Capital Controls in 2008. See "*Capital Controls - Foreign Exchange Act*".

The Icelandic Central Bank has largely removed the Capital Controls, though has done so subject to continued satisfaction of three conditions: macroeconomic stability, an adequate level of foreign reserves and a sound financial system. Even since the most recent reforms in March 2017, certain transactions continue to be restricted, and as a result, there continues to be a certain degree of risk of abnormal pricing and financial bubbles. The reforms announced by the Icelandic Central Bank in March 2017 provide for general exemptions to most of the restrictions pursuant to the Foreign Exchange Act, with restrictions remaining on (i) derivatives trading for purposes other than hedging; (ii) foreign exchange transactions carried out between residents and non-residents without the intermediation of a financial undertaking; (iii) in certain instances, lending by residents to non-residents; and (iv) certain other restrictions in relation to special reserve requirements due to new inflows of foreign currency in further specified cases.

It is uncertain when and if the remaining restrictions of the Capital Controls will be lifted in full, and if economic circumstances in Iceland were to change, there can be no assurance that the Icelandic Central Bank would not re-impose elements of the Capital Controls which have already been lifted. Moreover, even if the Capital Controls were to be successfully lifted in full (i.e. with no direct, unintended negative consequences, such as a significant devaluation of Icelandic Krona, a consequential rise in inflation and flight of capital) and on a permanent basis, levels of foreign direct investment in Iceland may be affected by a market perception that capital restrictions could be reintroduced in the future, which could limit growth prospects for the Icelandic economy and ultimately for the Bank, any of which could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank may be unable to successfully maintain salary levels, and overrunning salaries and related expenses may give rise to reputational risk while heavy cost-cutting measures may have adverse effects on operations

Measures introduced by the Bank from time to time to cut or contain salaries and related expenses may not produce anticipated results. For example, total salary expenditure may increase, notwithstanding cost-cutting measures in the form of redundancies, in response to external factors such as general salary increases. When the general labour market is in a state of flux, including when significant wage increases have been introduced for specific groups such as Members of Parliament and government officials or the market is experiencing wage inflation more generally, the Bank may come under pressure to increase the salaries of its employees. Steep salary increases not only increase the Bank's expenditure but may also have reputational consequences in light of public sentiment. See "- *Public sentiment and political activity in Iceland could impair the Bank's operations*". In addition, failure to properly staff the various divisions of the Bank and to remunerate and incentivise employees adequately could lead to, among other things, an impairment in the level of service which the Bank provides to its customers or in regulatory and compliance functions and, consequently, impair its business operations. Any of the above could have a material adverse effect on the Group's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank may be unable to recruit or retain experienced and qualified personnel

The Bank's future success depends, in part, on its ability to attract, retain and motivate qualified and experienced banking and management personnel. Competition for personnel with relevant expertise can be significant, particularly given the limited pool of potential candidates in Iceland, as the Bank competes for talented people with both financial and non-financial services companies. In addition, the Bank may not have sufficient scale, or may be subject to additional limitations on compensation imposed by Icelandic law or public sentiment, which make it unable to offer employees rates of compensation comparable to its larger international competitors (or smaller domestic competitors which might be able to offer more flexible compensation structures), particularly at more senior levels. The loss of the services of any key employees with institutional and customer knowledge may significantly delay the Bank's achievement of its business objectives and could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank could experience credit rating downgrades

Rating agencies assess the creditworthiness of the Bank and its operating environment and they assign a rating to it and certain of the financial instruments it has issued for funding and capital management purposes. The Bank has been rated BBB+ by Standard & Poor's.

A rating agency assessment is based on various factors. While most of the factors are specific to the Bank and the relevant financial instruments it issues, some relate to general economic conditions and other circumstances outside the Bank's control, such as changes in the macroeconomic environment, sovereign credit rating of Iceland and prospective level of systemic support a government can provide. No assurance can be given that a rating agency will not revise downward a credit rating or change the outlook on any such credit rating. In addition, rating agencies have and may in the future change their methodology from time to time, which may also result in a downgrade or a change in the outlook on any credit rating of the Bank or the relevant financial instruments it issues, for example by reducing or removing the effect of systemic support.

Any downgrade or potential downgrade in the ratings of the Bank or of the relevant financial instruments it issues may limit the Bank's access to the capital markets and certain types of instruments (for example, in terms of seniority and maturity), reduce its prospective investor base, increase borrowing costs, require the Bank to replace funding lost due to the downgrade or potential downgrade (for example, customer deposits), limit the Bank's access to capital, funding and money markets and trigger requirements to post additional collateral in derivatives contracts and other secured funding arrangements. In addition, a rating downgrade or potential downgrade of the Bank could, among other things, limit its opportunities to operate in certain business lines and materially adversely affect certain other business activities, which in turn could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank is exposed to operational risks

The operational risks that the Bank faces include the possibility of inadequate or failed internal or external processes or systems failures, human error, regulatory breaches, employee misconduct or external events, such as fraud. The Bank's business inherently generates operational risks. The business depends on processing numerous complex transactions. The recording and processing of these transactions are potentially exposed to the risk of human and technological errors, including miscalculations, or a breakdown in internal controls relating to the due authorisation of transactions. Given the volume of transactions processed by the Bank, errors may be repeated or compounded before they are discovered and rectified, and no assurance can be given that risk assessments made in advance will adequately estimate the costs of these errors. Errors or misconduct can have a particularly significant impact with respect to funds and portfolios managed by the Bank or its wholly owned independent subsidiary Stefnir given the volume of assets under management in any particular fund or portfolio and the consequent magnitude of any errors or misconduct.

The Bank has implemented controls designed to detect, monitor and mitigate operational risks. However, these controls cannot completely eliminate such risks as some can be difficult to detect, recommendations and suggestions of surveillance units of the Bank (such as the compliance and internal audit functions) could be ignored, misunderstood or misapplied, and mitigation may fail to be effective. With respect to 2016 and 2017, the internal auditor's overall conclusion on the effectiveness of the Bank's internal controls and the Bank's risk and control culture was that they were unsatisfactory (Is. *ófullnægjandi*) and should be improved, particularly relating to controls and risk awareness in the Corporate Banking division (as evidenced by the matters relating to United Silicon) and anti-money laundering processes at the Bank generally. Although the Bank has been making improvements to its systems and controls in response to these conclusions, there is no assurance that these improvements will be successful. Failures in internal controls could subject the Bank to regulatory scrutiny and could ultimately lead to losses or impairments, as in the case of United Silicon. See "*—The Bank is exposed to credit risk and its customer loan portfolio contains certain problem and impaired loans*" and "*Management and Employees—Internal Audit*". Such events could harm the Bank's reputation and have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank relies on its reputation and brands and those of its subsidiaries

The success of the Bank's business depends significantly on the Bank's reputation with customers as well as the strength and appeal of the brand of the Bank. The Bank's reputation is one of its most important assets and its ability to attract and retain customers and staff and conduct business with its counterparties could be materially adversely affected to the extent that its reputation or the reputation of its brand is damaged. Failure to address, or a perception that the Bank has failed to address, various issues that could give rise to reputational risk could cause harm to the Bank and its business prospects. Reputational issues could include:

- poor customer service or IT failures or interruptions that impact customer services and accounts (see "*—The Bank is exposed to the risk of failure and breaches of its information technology systems*");
- failure, or allegations of having failed, to maintain appropriate standards of customer privacy, customer service and record keeping and disclosure of confidential information (see "*- Unauthorised disclosure of confidential information, whether through cyber security breaches, computer viruses or otherwise, could expose the Bank to liability, protracted and costly litigation and damage its reputation*");
- failure to appropriately address potential conflicts of interest and acting, or allegations of having acted, unethically in the conduct of its business;
- breaching, or allegations of having breached, legal and regulatory requirements, including anti-money laundering and anti-terrorism financing requirements (see "*- There are regulatory and legal risks inherent in the Bank's businesses*", "*- The Bank is involved in a number of ongoing legal proceedings and is subject to investigations by governmental authorities*" and "*- The Bank must comply with anti-money laundering and anti-bribery regulations, and the violation of such regulations may have severe consequences*");
- failure to properly identify legal, regulatory, compliance, reputational, credit, operational, liquidity and market risks inherent in the Bank's products and services (see "*- The Bank is exposed to a range of other typical financial institution market risks, including interest rate risk, equity price risk and inflation risk*" and "*- The Bank is exposed to operational risks*");
- third parties on whom the Bank relies for information, products and services failing to provide the required information, products and services;
- adverse impacts on customers of the Bank which had invested in or had exposures to companies whose loans are determined by the Bank to be problem loans, and experienced losses as a result;
- the fact that the Bank is privately owned, while its principal competitors Íslandsbanki and Landsbankinn are government owned; and
- generally poor business performance.

Failure to address these or any other relevant issues appropriately could damage the Bank's reputation and make customers, depositors and investors less willing to do business with the Bank, which may have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations.

In addition, the Bank believes that its brand and the brands of its subsidiaries Valitor, Stefnir and Vördur, are one of the key differentiators from competitors and provide a key competitive advantage. However, no assurance can be given that the Bank and its subsidiaries will be successful in further developing their respective brands and leveraging them into market share growth over competitors. Any circumstance that causes real or perceived damage to the Bank's brand or the brands of its subsidiaries, including the occurrence of any of the risks or events described in these "*Risk Factors*", could have a material adverse effect on the Bank's ability to retain existing customers and attract new customers. An inability by the Bank or its subsidiaries to manage the risks to their brands could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank's risk management methods may leave it exposed to unidentified, unanticipated or incorrectly quantified risks, which could lead to material losses or material increases in liabilities

The Bank's risk management strategies may fail under certain circumstances, particularly when confronted with risks that have not been identified or anticipated. Risk methodologies and techniques that the Bank adopts to assess credit risk, market risk, liquidity risk and operational risk may be flawed or may not take all risks into account, and it is possible that the methods for assessing these risks are not sound or are based on faulty information. They can also be misunderstood, not communicated properly to front-line staff, not implemented correctly or misapplied by the Bank's personnel, and supervision by management could also be insufficient. In addition, the Bank's risk management policies are constantly being re-evaluated and there may be a lag in implementation. Furthermore, some of the Bank's qualitative tools and metrics for managing risk are based upon the use of observed historical market behaviour. The Bank may apply statistical and other tools to these observations to arrive at quantifications of risk exposures. These tools and metrics may fail to predict future risk exposures.

The Bank's losses thus could be significantly greater than its risk management measures would indicate. In addition, the Bank's quantified modelling does not take all risks into account. Unanticipated or incorrectly quantified risk exposures could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Group relies on third party service providers

The Bank relies on the services, products and knowledge of third party service providers in the operation of its business. For example, the Bank relies on RB for deposit account and payment infrastructure. The Bank also relies on third party service providers in connection with its IT systems, including an outsourcing arrangement for elements of operations of the Bank's IT systems with Origo hf. (**Origo**), and it is considering other opportunities for IT outsourcing, and is currently in the process of outsourcing its cash centre operations in order to benefit from scale synergies with the other Icelandic banks. In addition, the Bank's subsidiary Valitor is subject to chargeback risk if Valitor or its bank sponsors are unable to collect the chargeback from its merchant's account or if the merchant refuses or is financially unable due to bankruptcy or other reasons to reimburse the merchant's bank for the chargeback. Accordingly, the Bank faces the risk that such third party service providers become insolvent, enter into default or fail to perform their contractual obligations in a timely manner or at all or fail to perform at an adequate and acceptable level. Any such failure could lead to interruptions in the Bank's operations or result in vulnerability of its IT systems, exposing the Bank to operational failures, additional costs or cyber-attacks. The Bank may need to replace a third party service provider on short notice to resolve any potential problems, and the search for and payment to a new third party service provider on short notice or any other measures to remedy such potential problems could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

In addition, no assurance can be given that the third party service providers selected by the Bank will be able to provide the products and services for which they have been contracted, for example, as a result of failing to have the relevant capabilities, products or services or due to changed regulatory requirements. Any failure of third party service providers to deliver the contracted products and services in a timely manner or at all or to deliver products and services in compliance with applicable laws and regulations and at an adequate and acceptable level could result in reputational damage, claims, losses and damages and have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank must comply with anti-money laundering and anti-bribery regulations, and the violation of such regulations may have severe consequences

The Bank is subject to laws regarding money laundering and the financing of terrorism as well as laws that prohibit the Bank or its employees or intermediaries from making improper payments or offers of payment to foreign governments and their officials and political parties for the purpose of obtaining or retaining business. Compliance with anti-money laundering and anti-bribery regulations can place a significant financial burden on banks and other financial institutions and requires significant technical capabilities. The Icelandic government is currently in the process of implementing the Fourth Money Laundering Directive (2015/849/EU), which is expected to come into force in Iceland later in 2018 and for which the Bank is currently making preparations. However, the Bank cannot predict the nature, scope or effect of future regulatory requirements to which it might be subject or the manner in which existing laws might be administered or interpreted. Although the Bank believes that its current policies and procedures are sufficient to comply with applicable anti-money laundering, anti-bribery and sanctions rules and regulations, it cannot guarantee that such policies completely prevent situations of money laundering or bribery, including actions by the Bank's employees, for which the Bank might be held responsible. Any such events may have severe consequences, including sanctions, fines and reputational consequences, which could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

Application of CRD IV could adversely affect the Bank's results

In 2013, the European Parliament and the European Council adopted a legislative package (**CRD IV**) for the implementation of the Basel III framework in the European Union, the implementation of which in Iceland has now been largely completed. Any failure by the Bank to maintain any increased regulatory capital requirements or to comply with any other requirements introduced by regulators could result in intervention by regulators or the imposition of sanctions, which could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes, and could have other effects on the Bank's financial performance, both with or without the intervention by regulators or the imposition of sanctions, and could also require raising additional capital.

The Bank and Valitor depend on both direct and sponsored membership in card schemes and compliance with card scheme rules

Valitor processes a significant majority of transactions through international credit and debit card schemes run by the two key card scheme operators, Visa and MasterCard. To access the international card schemes' networks to provide acquiring and processing services, merchant acquirers, including Valitor, and card issuers, including the Bank, must have the relevant geographically based operating licences or memberships. As part of its agreement and membership with card schemes, the Bank, Valitor and their customers are subject to, amongst other things, the card scheme membership fees and operating rules, including mandatory technology requirements promulgated by the card schemes, which could change, necessitating potentially significant capital expenditures to remain compliant, or could subject the Bank, Valitor and their customers to a variety of fines and penalties, as well as suspension and termination of membership or access. The Bank and Valitor may not be able to pass through the impact of any fees or fines to their customers, which could lead to lower margins in the future.

If a violation of any card scheme rules is sufficiently material, there is a risk of damaging the relationships the Bank and Valitor have with the card schemes to such an extent that any willingness the card schemes had to expand their business relationships in markets and sectors with the Bank or Valitor is restricted. Furthermore, failure to comply with the card scheme rules could also result in the restriction, suspension or termination of Valitor's licences to acquire payment transactions in various jurisdictions or the Bank's licences as issuer under the card schemes. If this were to occur, Valitor would be unable to process transactions using the relevant card scheme in the relevant jurisdiction and/or the Bank would be unable to issue cards under the relevant card scheme, which could have a material adverse effect on Valitor's and the

Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The asset management operations of the Bank may fail to sustain or increase their level of assets under management and is subject to pressure on fee margins

For the year ended 31 December 2017, the Bank generated ISK 4,011 million, or 7.5 per cent. of its operating income, from net fee and commission income of the Asset Management segment, comprising the Asset Management division of the Bank and its wholly owned independent subsidiary Stefnir. Stefnir manages open-ended funds, which allow investors to reduce the aggregate amount of their investment in open-ended funds, or to withdraw altogether from such funds, without notice. Similarly, portfolio management mandates and fiduciary mandates as well as discretionary and advisory mandates can typically be reduced or cancelled on short notice. Fee margins for asset management are generally under pressure as a result of competition in the market. If markets are declining, the investment performance of Stefnir's products and third party products provided by the Bank are seen as unsatisfactory and/or if customers are dissatisfied with the quality of the Bank's services or Stefnir's products (for instance, in respect of performance, reporting or compliance with customer instructions), this could lead to significant redemptions and withdrawals of assets under management. Funds provided by the Bank or managed by Stefnir could underperform the market or otherwise generate poor performance, undermining growth in assets under management, negatively affecting net fee and commission income as well as contributing to redemptions and withdrawals. In addition, reputational risk or potential conflicts of interest may result in a loss of key clients. Redemptions or withdrawals of assets under management would have an immediate impact on net fee and commission income and, therefore, operating income and, depending on the extent of such redemptions or withdrawals, could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes. Historical investment performance is not an indicator of the level of the Bank's future performance, and it may not be able to sustain successful performance over time. Results and performance levels in later periods may differ significantly from prior results and performance for various reasons, such as macroeconomic factors, performance of new funds compared with old funds, the departure of fund managers or other key staff members, loss of key clients, market conditions and a lack of investment opportunities.

Some of the pension funds that are fully managed by the Bank invested in the equity of United Silicon and consequently lost their investment following the bankruptcy of the company. There has been media coverage regarding the investment in light of the link between the pension funds and the Bank. The FME has investigated this investment and recommended some operational changes which the Bank and the relevant funds have complied with. The key changes are (i) to adjust the fund's investment processes in order to improve the assessment of potential conflicts of interest and reputational risk and (ii) to maintain more detailed documentation of the meetings and decisions of the fund's board of directors. This has also caused members of certain pension funds managed by the Bank to challenge the Bank's role in management of these funds, for example in terms of board representation by the Bank on the pension funds. The Bank believes that the potential for reputational risk involving possible or perceived conflicts of interest in respect of the operations of its Asset Management segment is increasing, and may have a negative impact on the Bank's relationships with its pension fund customers and their members or other clients and possibly result in loss of pension fund customers.

The Bank and Stefnir manage assets for retail and institutional investors, corporations and high net worth individuals in a broad range of asset classes. Certain of these asset classes may be viewed more or less favourably by potential customers at different times and in different markets with different regulatory and fiscal frameworks. Moreover, the overall proportion of customer assets across the asset management industry sector that is dedicated to actively managed funds of the type managed by the Bank and Stefnir is decreasing in favour of passively managed funds such as index funds, trackers and other similar low-fee alternatives, such as robo-advisers. In addition, new asset classes and categories of actively managed funds may be developed by competitors, some of which might not be among the principal products and services offered by the Bank and Stefnir. The entry into new products and services with potentially higher margins could also subject the Bank and Stefnir to potential losses, as a result of lack of experience with such products and services, greater inherent risk in the products and services or otherwise. The reduction in the number of pension funds in Iceland, and the recent trend on the part of certain Icelandic pension funds to bring asset management responsibilities back in-house rather than relying on third-party asset managers like the Bank, has had an impact on the fund management market in Iceland and is expected to have a negative effect on the fund management industry, especially in traditional funds, for the foreseeable future. Other imminent changes in the asset management industry include the arrival of new competition in the form of fintech companies, leading to more intense competition and putting pressure on commissions in various financial services. Responding to these changes will require the Bank to incur additional costs, hire employees with new expertise and change its business processes and services.

In addition, regulatory changes, in particular the adoption in Iceland of MiFID II and Regulation (600/2014) on Markets in Financial Instruments (**MiFIR**), which are intended to replace, extend and improve existing European rules on markets in financial instruments and strengthen investor protection by introducing additional organisational and conduct requirements, will give more extensive powers to regulators and introduce the possibility of imposing higher fines in case of infringement of the requirements of such regulations. As MiFID II and MiFIR will significantly extend not only the scope but also the detail of existing regulations, the Bank and Stefnir will have to review existing activities and, where necessary, may need to adjust the manner in which they operate. The Bank and Stefnir are also likely to have to provide more information to their customers, such as about the costs and charges involved in providing investment services and, as a result, could face significantly higher compliance costs and become subject to increasingly complex requirements, which could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

The Bank could incur unforeseen liabilities from prior and future acquisitions and disposals

During the last few years, the Bank has made various acquisitions (in particular, the acquisition of the insurance subsidiary Vördur and Valitor's acquisitions of AltaPay A/S for its e-commerce platform, IPS-International Payment Services Limited and Chip and PIN Solutions Ltd for their operations in the United Kingdom) and it has divested a number of assets, primarily non-core assets, which consist of legacy equity holdings of non-core subsidiaries and other assets, such as investment property, which it had acquired through restructuring processes following the financial crisis in 2008. See "*Description of Bank – History – 2010-2012: Restructuring of the Bank and its customers*". The Bank also acquired a majority interest in United Silicon as a result of its default. In the future, the Bank may make additional acquisitions and may decide to divest certain parts of its current businesses. The Bank may encounter difficulties integrating entities it has acquired into its operations or the combination of the businesses may not perform as well as anticipated. Failure to complete announced business combinations or failure to successfully integrate acquired businesses could lead to departures of key employees and have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

Acquisitions expose the Bank to the risk of unforeseen expenses, losses, tax liabilities or obligations with respect to employees, clients and business partners of acquired businesses, governmental authorities and other parties. Before making an investment in a company or business, the Bank assesses the value or potential value of such company or business and the potential return on such an investment. In making the assessment and otherwise conducting due diligence, the Bank relies on the resources available and, in some cases, an investigation by third parties. However, no assurance can be given that due diligence examinations carried out by the Bank or by third parties in connection with equity interests in companies or businesses that the Group has acquired or will acquire are sufficient or will reveal all of the risks associated with such companies and businesses or the full extent of such risks. In addition, acquired companies or businesses may have hidden liabilities that are not apparent at the time of acquisition. Although the Bank normally obtains certain warranties and indemnities from the seller, these warranties and indemnities may not cover all of the liabilities that may arise following the acquisition, and any indemnification may not fully compensate the Bank for any diminution in the value of its interest in such companies or businesses. The Bank may also encounter difficulties enforcing warranties or indemnities against a seller for various reasons, including the insolvency of the seller, legal technicalities, such as the relevant jurisdiction or evidence requirements, or expiry of claim periods for such warranties or indemnities.

When divesting businesses or assets, the Bank may not always be able to pass on the entire risk relating to the divested business or assets to the purchaser, which may lead to additional risks, such as liability related to legacy obligations. The Bank could also face reputational issues or negative public sentiment upon a disposal, whether as a result of a sale at a discount to perceived value or for other reasons.

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

The Bank maintains customary insurance policies for its operations, including insurance for its liquid assets, money transport and directors' and officers' liability, as well as insurance against computer crimes and for employee dishonesty and mistakes. Due to the nature of the Bank's operations and the nature of the risks that it faces, no assurance can be given that the coverage that the Bank maintains is adequate to cover the losses for which it believes it is insured and, in the event the Bank's insurance is not adequate, this could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Notes.

FACTORS WHICH ARE MATERIAL FOR THE PURPOSE OF ASSESSING THE MARKET RISKS ASSOCIATED WITH NOTES ISSUED UNDER THE PROGRAMME

Risks related to the structure of a particular issue of Notes

A range of Notes may be issued under the Programme. A number of these Notes may have features which contain particular risks for potential investors. Set out below is a description of the most common such features, distinguishing between factors which may occur in relation to any Notes:

Risks applicable to all Notes

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

An optional redemption feature (including any redemption of the Notes (i) for tax reasons pursuant to Condition 5.2 and (ii) upon the occurrence of a Capital Event pursuant to Condition 5.8 in the case of Subordinated Notes) may limit the market value of Notes. During any period when the Bank may elect to redeem Notes, or during which there is an actual or perceived increased likelihood that the Issuer may elect to redeem the Notes, the market value of those Notes generally will not rise substantially above the price at which they can be redeemed. This also may be true prior to any redemption period.

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

If the Notes include a feature to convert the interest basis from a fixed rate to a floating rate, or vice versa, this may affect the secondary market and the market value of the Notes concerned.

Fixed/Floating Rate Notes are Notes which bear interest at a rate that converts from a fixed rate to a floating rate, or from a floating rate to a fixed rate. Such a feature to convert the interest basis, and any conversion of the interest basis, may affect the secondary market in, and the market value of, such Notes as the change of interest basis may result in a lower interest return for Noteholders. Where the Notes convert from a fixed rate to a floating rate, the spread on the Fixed/Floating Rate Notes may be less favourable than then prevailing spreads on comparable Floating Rate Notes tied to the same reference rate. In addition, the new floating rate at any time may be lower than the rates on other Notes. Where the Notes convert from a floating rate to a fixed rate, the fixed rate may be lower than then prevailing rates on those Notes and could affect the market value of an investment in the relevant Notes.

The interest rate on Fixed Reset Notes will reset on each Reset Date, which can be expected to affect interest payments on an investment in Fixed Reset Notes and could affect the secondary market and the market value of the Fixed Reset Notes concerned

Fixed Reset Notes will initially bear interest at the Initial Interest Rate (as specified in the applicable Final Terms) until (but excluding) the Reset Date (as specified in the applicable Final Terms). On the Reset Date and each Subsequent Reset Date (as specified in the applicable Final Terms) (if any) thereafter, the interest rate will be reset to the sum of the applicable Mid-Swap Rate and the Reset Margin (each as specified in the applicable Final Terms) as determined by the Fiscal Agent, or the relevant Reset Determination Date (each such interest rate, a **Subsequent Reset Rate**). The Subsequent Reset Rate for any Reset Period could be less than the Initial Interest Rate or the Subsequent Reset Rate for prior Reset Periods and could affect the market value of an investment in the Fixed Reset Notes.

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

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

The claims of Noteholders will be subordinated to the claims of certain of the Bank's depositors in the event of a winding-up

The claims of holders of senior ranking unsecured debt instruments, such as the Unsubordinated Notes, together with any subordinated debt instruments such as the Subordinated Notes, issued in each case by a financial institution such as the Bank which holds bank deposits are subordinated under Article 102 of the Act on Financial Undertakings to the claims of certain depositors. Should the Bank therefore enter into winding-up proceedings, the claims of Noteholders would be subordinated to the claims of such depositors and there may not be sufficient assets in the resulting estate to pay the claims of these Noteholders after the claims of those depositors have been paid. In the case of Subordinated Notes, see also "*-There is a real risk that holders of Subordinated Notes will lose some or all of their investment should the issuer become insolvent or subject to resolution or at the point of non-viability of the Bank*".

The Council of the European Union has adopted the BRRD which provides for a range of actions to be taken in relation to credit institutions, investment firms, certain financial institutions and certain holding companies of those entities (each a* relevant entity*) considered to be at risk of failing. The implementation of the BRRD in Iceland and its impact on the Bank is currently unclear but the taking of any action under the BRRD following its implementation could materially affect the value of any Notes

On 2 July 2014, Directive 2014/59/EU providing for the establishment of an EU-wide framework for the recovery and resolution of credit institutions and investment firms (the **Bank Recovery and Resolution Directive** or **BRRD**) entered into force. Iceland, Liechtenstein, Norway and Switzerland are members of the EFTA and Iceland, together with Liechtenstein and Norway (the **EEA EFTA States**) is also a party to the EEA Agreement by which the EEA EFTA States participate in the internal market of the European Union (the **EU**). The BRRD was incorporated into the EEA Agreement on 9 February 2018 with Decision No 21/2018 of the EEA Joint Committee. A committee has been established, charged with the task of preparing new legislation implementing the BRRD in Iceland. The first bill for the implementation of the BRRD in Iceland was submitted to the Icelandic Parliament on 22 March 2018. This bill proposes to provide for the implementation of the BRRD provisions relating to recovery planning, early intervention and intra-group financial support. According to this first bill, the objective is to submit another bill during the next legislative parliament to provide for the further implementation of the BRRD in Iceland. The Notes may be subject to the exercise, in the future, of a bail-in power by the Relevant Resolution Authority (as defined in Condition 6 under "*Terms and Conditions of the Notes*"), and the Notes include a contractual consent to the application of any Statutory Loss Absorption Powers (as defined in Condition 18 under "*Terms and Conditions of the Notes*"), and consequently, investors may lose part or all of their investment in the Notes (see Condition 18 under "*Terms and Conditions of the Notes*").

The BRRD is designed to provide authorities with a credible set of tools to intervene sufficiently early and quickly in an unsound or failing relevant entity so as to ensure the continuity of the relevant entity's critical financial and economic functions, while minimising the impact of a relevant entity's failure on the economy and financial system. The BRRD was applied by Member States from 1 January 2015, except for the general bail-in tool (see below) which was applied from 1 January 2016.

The BRRD contains four resolution tools and powers which may be used alone or in combination where the relevant resolution authority considers that (a) a relevant entity is failing or likely to fail, (b) there is no reasonable prospect that any alternative private sector measures would prevent the failure of such relevant entity within a reasonable timeframe, and (c) a resolution action is in the public interest: (i) sale of business - which enables resolution authorities to direct the sale of the relevant entity or the whole or part of its business on commercial terms; (ii) bridge institution - which enables resolution authorities to transfer all or part of the business of the relevant entity to a "bridge institution" (an entity created for this purpose that is wholly or partially in public control), which may limit the capacity of the relevant entity to meet its repayment obligations; (iii) asset separation - which enables resolution authorities to transfer impaired or problem assets to one or more publicly owned asset management vehicles to allow them to be managed with a view to maximising their value through eventual sale or orderly wind-down (this can be used together with another resolution tool only); and (iv) bail-in - which gives resolution authorities the power to write down certain claims of unsecured creditors of a failing relevant entity (which write-down may result in the reduction of such claims to zero) and to convert certain unsecured debt claims (including Notes) to equity or other instruments of ownership (the **general bail-in tool**), which equity or other instruments could also be subject to any future cancellation, transfer or dilution.

The BRRD also provides for a Member State as a last resort, after having assessed and exploited the above resolution tools to the maximum extent possible whilst maintaining financial stability, to be able to provide extraordinary public financial support through additional financial stabilisation tools. These consist of the public equity support and temporary public ownership tools. Any such extraordinary financial support must be provided in accordance with the EU state aid framework.

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

In addition to the general bail-in tool, the BRRD provides for resolution authorities to have the further power to permanently write-down or convert into equity capital instruments such as the Subordinated Notes at the point of non-viability and before any other resolution action is taken (**non-viability loss absorption**). Any shares issued to holders of Subordinated Notes upon any such conversion into equity may also be subject to any future cancellation, transfer or dilution.

Prior to the implementation of the BRRD in Iceland, Subordinated Notes may further be subject as directed by the Relevant Resolution Authority to Write-Down upon the occurrence of a Non-Viability Event pursuant to Condition 6 (each of the capitalised terms has the meaning given in Condition 6).

Any application of the general bail-in tool under the BRRD shall be in accordance with the hierarchy of claims in normal insolvency proceedings. Accordingly, the impact of such application on holders of the Notes will depend on their ranking in accordance with such hierarchy, including any priority given to other creditors such as depositors.

To the extent any resulting treatment of holders of the Notes pursuant to the exercise of the general bail-in tool is less favourable than would have been the case under such hierarchy in normal insolvency proceedings, a holder has a right to compensation under the BRRD based on an independent valuation of the relevant entity (which is referred to as the "no creditor worse off safeguard" under the BRRD). Any such compensation is unlikely to compensate that holder for the losses it has actually incurred and there is likely to be a considerable delay in the recovery of such compensation. Compensation payments (if any) are also likely to be made considerably later than when amounts may otherwise have been due under the Notes. No such hierarchy of claims or compensation may apply in respect of any Write-Down of the Notes pursuant to Condition 6.

Under the BRRD, resolution authorities must set a minimum level of own funds and other eligible liabilities (**MREL**) for each bank (and/or group) based on criteria including systemic importance. Eligible liabilities may be senior or subordinated provided they have a remaining maturity of at least one year and must be able to be written-down or converted into equity upon application of the general bail-in tool. As Iceland has not yet implemented the BRRD it is currently unclear how such requirements may be applied to Icelandic banks such as the Bank in the future.

The powers currently set out in the BRRD and under Condition 6 will, in certain circumstances, impact the rights of creditors. Once the BRRD is implemented in Iceland (and before such implementation in the case of any Write-Down pursuant to Condition 6) holders of Notes may be subject to the application of the general bail-in tool and, in the case of Subordinated Notes, non-viability loss absorption or the Write-Down of such Subordinated Notes pursuant to Condition 6, as applicable, which may result in such holders losing some or all of their investment (in the case of Subordinated Notes, see further "*-There is a real risk that holders of Subordinated Notes will lose some or all of their investment should the issuer become insolvent or subject to resolution or at the point of non-viability of the Bank*"). Such application of the general bail-in tool could also involve modifications to or the disapplication of provisions in the conditions of the Notes, including alteration of the principal amount or any interest payable on the Notes, the maturity date or any other dates on which payments may be due, as well as the suspension of payments for a certain period. The exercise of any power under the BRRD pursuant to Condition 6 or any suggestion of such exercise could, therefore, materially adversely affect the rights of Noteholders, the price or value of their investment in any Notes and/or the ability of the Bank to satisfy its obligations under any Notes.

Under the terms of the Notes, investors will agree to be bound by and consent to the exercise of any Statutory Loss Absorption Powers by the Relevant Resolution Authority

By acquiring Notes, each Noteholder and each beneficial owner acknowledges, accepts, consents and agrees to be bound by (a) the effect of the exercise of Statutory Loss Absorption Powers by the Relevant Resolution Authority, that may include and result in any of the following, or some combination thereof: (i) the reduction of all, or a portion, of the principal amount of, or any interest on, the Notes or any other outstanding amounts due under, or in respect of, the Notes; (ii) the conversion of all, or a portion, of the principal amount of, or any interest on, the Notes or any other outstanding amounts due under, or in respect of, the Notes into shares, other securities or other obligations of the Bank or another person (and the issue to or conferral on the Noteholder of such shares, securities or obligations), including by means of an amendment, modification or variation of the terms of the Notes; (iii) the cancellation of the Notes; (iv) the amendment or alteration of the maturity of the Notes or amendment of the amount of interest payable on the Notes, or the date on which the interest becomes payable, including by suspending payment for a temporary period; and (b) the variation of the terms of the Notes as deemed necessary by the Relevant Resolution Authority, to give effect to the exercise of any Statutory Loss Absorption Powers by the Relevant Resolution Authority. See Condition 18 under "*Terms and Conditions of the Notes*".

The terms of the Notes contain provisions which may permit their modification without the consent of all investors

The terms of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.

In addition, pursuant to Condition 3.4, certain changes may be made to the interest calculation provisions of Floating Rate Notes or Fixed Reset Notes in the circumstances set out in Condition 3.4, without the requirement for consent of the Noteholders. See "—*Benchmark Discontinuation*" below.

The value of the Notes could be adversely affected by a change in English law or administrative practice

The terms of the Notes are based on English law (other than the subordination provisions in Condition 2.2 of the Subordinated Notes, which are based on Icelandic law), as in effect as at the date of this Base Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to English law, Icelandic law or administrative practice after the date of this Base Prospectus and any such change could materially adversely impact the value of any Notes affected by it.

Investors who hold less than the minimum Specified Denomination may be unable to sell their Notes and may be adversely affected if definitive Notes are subsequently required to be issued

In relation to any issue of Notes which have denominations consisting of a minimum Specified Denomination plus one or more higher integral multiples of another smaller amount, it is possible that such Notes may be traded in amounts in excess of the minimum Specified Denomination that are not integral multiples of such minimum Specified Denomination. In such a case a holder who, as a result of trading such amounts, holds an amount which is less than the minimum Specified Denomination in his account with the relevant clearing system would not be able to sell the remainder of such holding without first purchasing a principal amount of Notes at or in excess of the minimum Specified Denomination such that its holding amounts to a Specified Denomination. Further, a holder who, as a result of trading such amounts, holds an amount which is less than the minimum Specified Denomination in his account with the relevant clearing system at the relevant time may not receive a definitive Note in respect of such holding (should definitive Notes be printed) and would need to purchase a principal amount of Notes at or in excess of the minimum Specified Denomination such that its holding amounts to a Specified Denomination.

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

Tax exemptions from withholding may not be available if definitive Notes are required to be issued

The Icelandic statutory exemption from withholding only applies to Notes held through a securities depository in an OECD state, EU state, an EFTA state or the Faroe Islands. If Notes in definitive form are issued, holders should be aware that the tax exemption may not be available. However, the Bank will be required to pay the necessary additional amounts under Condition 7 in such circumstances to cover any resulting amounts deducted or withheld. See "*Taxation - Iceland - Non-Icelandic Tax Residents*".

Reliance on Euroclear and Clearstream, Luxembourg procedures

Notes issued under the Programme will be represented on issue by one or more Global Notes that may be delivered to a common depositary or common safekeeper for Euroclear and Clearstream, Luxembourg (each as defined under "*Form of the Notes*"). Except in the circumstances described in each Global Note, investors will not be entitled to receive Notes in definitive form. Each of Euroclear and Clearstream, Luxembourg and their respective direct and indirect participants will maintain records of the beneficial interests in each Global Note held through it. While the Notes are represented by a Global Note, investors will be able to trade their beneficial interests only through the relevant clearing systems and their respective participants.

While the Notes are represented by Global Notes, the Bank will discharge its payment obligation under the Notes by making payments through the relevant clearing systems. A holder of a beneficial interest in a Global Note must rely on the procedures of the relevant clearing system and its participants to receive payments under the Notes. The Bank has no responsibility or liability for the records relating to, or payments made in respect of, beneficial interests in any Global Note.

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

The Notes are unsecured and do not have the benefit of a negative pledge provision

The Notes will be unsecured and do not have the benefit of a negative pledge provision. If the Bank defaults on the Notes, or in the event of a bankruptcy, liquidation or reorganisation, then, to the extent that the Bank has granted security over its assets, the assets that secure those obligations will be used to satisfy the obligations thereunder before the Bank could sell or otherwise dispose of those assets in order to make any payment on the Notes. As a result of the granting of such security, there may only be limited assets available to make payments on the Notes in such circumstances. In addition, there is no restriction on the issue by the Bank of other similar securities that do have the benefit of security, which may impact on the market price of its securities, such as the Notes, that are unsecured.

Risks related to Subordinated Notes

There is a real risk that holders of Subordinated Notes will lose some or all of their investment should the Bank become insolvent or subject to resolution or at the point of non-viability of the Bank

The Bank's obligations under Subordinated Notes issued by it will be unsecured and subordinated. In the event of the liquidation or insolvency (in Icelandic: *slit eða gjaldþrot*) of the Bank, the rights of the Noteholders to payments on or in respect of the Subordinated Notes shall rank:

(i) *pari passu* without any preference among themselves;

(ii) at least *pari passu* with payments to holders of any other Tier 2 Instruments and claims of any other subordinated creditors the claims of which rank, or are expressed to rank, *pari passu* with the Subordinated Notes;

(iii) in priority to payments to holders of any outstanding Additional Tier 1 Instruments and all classes of share capital of the Bank in their capacity as such holders, and claims of any other subordinated creditors the claims of which rank, or are expressed to rank, junior to the Subordinated Notes; and

(iv) junior in right of payment to the payment of any present or future claims of (a) depositors of the Bank, (b) other unsubordinated creditors of the Bank and (c) claims of any other subordinated creditors the claims of which rank, or are expressed to rank, in priority to the Subordinated Notes.

Although Subordinated Notes may pay a higher rate of interest than comparable Notes which are not subordinated, there is a real risk that Noteholders will lose all or some of their investment should the Bank become insolvent or subject to resolution under the BRRD (as defined below) as implemented in Iceland or at the point of non-viability of the Bank – see further "*Subordinated Notes may be subject to loss absorption on any application of the general bail-in tool or at the point of non-viability of the Bank*" below. In the case of any application of the general bail-in tool under the BRRD, the sequence of any resulting write-down or conversion of the Subordinated Notes under Article 48 of the BRRD provides for the write-down or conversion of Subordinated Notes prior to Unsubordinated Notes, which write-down or conversion shall be implemented in accordance with the hierarchy of claims in normal insolvency proceedings.

Subordinated Notes may be subject to loss absorption on any application of the general bail-in tool or at the point of non-viability of the Bank

In addition to the application of the general bail-in tool to Subordinated Notes (see "*The Council of the European Union has adopted the BRRD which provides for a range of actions to be taken in relation to credit institutions, investment firms, certain financial institutions and certain holding companies of those entities (each a* relevant entity*) considered to be at risk of failing. The implementation of the BRRD in Iceland and its impact on the Bank is currently unclear but the taking of any action under the BRRD following its implementation could materially affect the value of any Notes*"), the BRRD and the terms of the Subordinated Notes contemplate that Subordinated Notes may be subject to non-viability loss absorption. As a result, resolution authorities may require the permanent write-down of capital instruments such as Subordinated Notes (which write-down may be in full) or the conversion of them into equity capital at the point of non-viability and before any other resolution action is taken. Prior to the implementation of the BRRD in Iceland, such non-viability loss absorption is provided for in Condition 6 of the Notes.

While any such write-down or conversion pursuant to non-viability loss absorption under the BRRD shall be in accordance with the hierarchy of claims in normal insolvency proceedings, even if grounds for compensation could be established, compensation may not be available under the BRRD to any holders of capital instruments subject to any write-down or conversion and even if available would only take the form of shares in the Bank.

For the purposes of the application of any non-viability loss absorption measure, the point of non-viability under the BRRD is the point at which (i) the relevant authority determines that the relevant entity meets the conditions for resolution or (ii) the relevant authority or authorities, as the case may be, determine(s) that the relevant entity or its group will no longer be viable unless the relevant capital instruments (such as the Subordinated Notes) are written-down or converted into equity or (iii) extraordinary public financial support is required by the relevant entity other than, where the entity is an institution, for the purposes of remedying a serious disturbance in the economy of an EEA member state and to preserve financial stability. This is further reflected in the definition of "Non-Viability Event" under Condition 6.

The occurrence of a Non-Viability Event or the application of the general bail-in tool or any non-viability loss absorption measure pursuant to any Applicable Statutory Loss Absorption Regime (including the BRRD) or Condition 6 of the Subordinated Notes may result in Noteholders losing some or all of their investment. The exercise of any such power or any suggestion of such exercise could, therefore, materially adversely affect the rights of Noteholders, the price or value of Subordinated Notes issued under the Programme and/or the ability of the Bank to satisfy its obligations under Subordinated Notes.

Noteholders may only declare the Subordinated Notes to be due and payable in certain very limited circumstances and may only claim for payment in respect of the Subordinated Notes in the liquidation (in Icelandic: slit eða gjaldþrot) of the Bank

Upon default being made in the payment of any principal or interest due in respect of the Subordinated Notes, a holder of the Subordinated Notes may upon the expiry of the applicable period, institute proceedings for the Bank to be declared insolvent or its liquidation (in Icelandic: *slit eða gjaldþrot*) and prove or claim in the liquidation of the Bank. It is only upon a declaration of insolvency by a court or agency or supervisory authority with the necessary jurisdiction and/or the liquidation of the Bank, that a holder of the Subordinated Notes may declare the Subordinated Notes to be due and payable and that holder may then only claim payment in respect of the Subordinated Notes in the liquidation of the Bank.

Holders of the Subordinated Notes may not otherwise institute any proceedings against the Bank and do not have any other remedies against the Bank, in each case to enforce any obligation for the payment of any principal or interest in respect of the Subordinated Notes. Accordingly, upon any default being made by the Bank in payment of any amount due in respect of the Subordinated Notes, a holder of the Subordinated Notes will only have the limited remedies above and will not have any other remedy against the Bank.

The maturity of Subordinated Notes may only be accelerated in limited circumstances and, if accelerated, holders may only claim payment in the bankruptcy or liquidation of the Bank

Holders of Subordinated Notes may only accelerate the maturity of their Subordinated Notes in limited circumstances and, if accelerated, may claim payment only in the bankruptcy or liquidation of the Bank. See Condition 2.3 under "*Terms and Conditions of the Notes*".

The terms of the Subordinated Notes contain a waiver of set-off rights

No holder of any Subordinated Notes may at any time exercise or claim any Set-Off Rights (as defined in Condition 2.3 under "*Terms and Conditions of the Notes*") against any right, claim or liability of the Bank or that the Bank may have or acquire against such holder, directly or indirectly and howsoever arising (and including all such rights, claims and liabilities arising under or in relation to any and all agreements or other instruments of any kind or any non-contractual obligation, whether or not relating to those Subordinated Notes).

The Terms and Conditions of the Notes provide that holders of Subordinated Notes shall be deemed to have waived all Set-Off Rights to the fullest extent permitted by applicable law in relation to all such actual and potential rights, claims and liabilities. As a result, those Noteholders will not at any time be entitled to set-off the Bank's obligations under such Subordinated Notes against obligations owed by them to the Bank.

Risks related to the market generally

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

An active secondary market in respect of the Notes may never be established or may be illiquid and this would adversely affect the value at which an investor could sell his Notes

Notes may have no established trading market when issued, and one may never develop. If a market for the Notes does develop, it may not be very liquid and may be sensitive to changes in financial markets. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. In addition, liquidity may be limited if the Bank makes large allocations to a limited number of investors.

If an investor holds Notes which are not denominated in the investor's home currency, the investor will be exposed to movements in exchange rates adversely affecting the value of its holding. In addition, the imposition of exchange controls in relation to any Notes could result in an investor not receiving payments on those Notes

The Bank will pay principal and interest on the Notes in the Specified Currency. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the **Investor's Currency**) other than the Specified Currency. These include the risk that exchange rates may significantly change (including changes due to devaluation of the Specified Currency or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to the Specified Currency would decrease (1) the Investor's Currency-equivalent yield on the Notes,

(2) the Investor's Currency-equivalent value of the principal payable on the Notes and (3) the Investor's Currency-equivalent market value of the Notes.

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

The value of Fixed Rate Notes may be adversely affected by movements in market interest rates

Investment in Fixed Rate Notes or Fixed Reset Notes involves the risk that if market interest rates subsequently increase above the rate paid on the Fixed Rate Notes or Fixed Reset Notes, this will adversely affect the value of the Fixed Rate Notes.

Future discontinuance of LIBOR may adversely affect the value of Floating Rate Notes or Fixed Reset Notes which reference LIBOR, and other regulation and reform of "benchmarks" may adversely affect the value of Notes linked to or referencing such "benchmarks"

On 27 July 2017, the Chief Executive of the Financial Conduct Authority in the United Kingdom, which regulates LIBOR, announced that it does not intend to continue to persuade, or use its powers to compel, panel banks to submit rates for the calculation of LIBOR to the administrator of LIBOR after 2021. The announcement indicates that the continuation of LIBOR on the current basis is not guaranteed after 2021. It is not possible to predict whether, and to what extent, panel banks will continue to provide LIBOR submissions to the administrator of LIBOR going forwards. This may cause LIBOR to perform differently than it did in the past and may have other consequences which cannot be predicted.

In addition to this announcement in relation to LIBOR, there have been other recent national and international regulatory guidance and proposals for reform of interest rates and indices which are deemed to be “benchmarks”, including LIBOR, EURIBOR, NIBOR, STIBOR, REIBOR and CIBOR. Some of these reforms are already effective whilst others are still to be implemented. These reforms could include, among other things, reforms to other “benchmarks” similar to those reforms announced in relation to LIBOR, and any such reforms may cause such “benchmarks” to perform differently than in the past, to disappear entirely, or have other consequences which cannot be predicted. Any such consequence could have a material adverse effect on the value or liquidity of, and return on, any Floating Rate Notes, Fixed Reset Notes or any other Notes which are linked to or reference a “benchmark”.

The Benchmarks Regulation was published in the Official Journal of the European Union on 29 June 2016 and applies from 1 January 2018. The Benchmarks Regulation applies to the provision of benchmarks, the contribution of input data to a benchmark and the use of a benchmark within the European Union. It will, among other things, (i) require benchmark administrators to be authorised or registered (or, if non-European Union based, to be subject to an equivalent regime or otherwise recognised or endorsed) and (ii) prevent certain uses by European Union supervised entities of "benchmarks" of administrators that are not authorised or registered (or, if non-European Union based, not deemed equivalent or recognised or endorsed).

The Benchmarks Regulation could have a material impact on any Notes linked to or referencing a “benchmarks”, in particular, if the methodology or other terms of the "benchmark" are changed in order to comply with the requirements of the Benchmarks Regulation. Such changes could, among other things, have the effect of reducing, increasing or otherwise affecting the volatility of the published rate or level of the “benchmarks”.

More broadly, any of the international or national reforms (including those announced in relation to LIBOR and the application of any similar reforms to other "benchmarks"), or the general increased regulatory scrutiny of "benchmarks", could increase the costs and risks of administering or otherwise participating in the setting of a "benchmark" and complying with any such regulations or requirements. Such factors may have the following effects on certain "benchmarks": (i) discourage market participants from continuing to administer or contribute to the "benchmark"; (ii) trigger changes in the rules or methodologies used in the "benchmark"; or (iii) lead to the disappearance of the "benchmark". Any of the above changes or any other consequential changes as a result of international or national reforms or other initiatives or investigations, could have a material adverse effect on the value of and return on any Notes linked to or referencing a "benchmark".

Investors should consult their own independent advisers and make their own assessment about the potential risks imposed by the Benchmarks Regulation reforms in making any investment decision with respect to any Notes linked to or referencing a "benchmark".

Investors should be aware that in the case of Floating Rate Notes and Fixed Reset Notes, the Conditions of the Notes provide for certain fallback arrangements in the event that a published Benchmark, including an inter-bank offered rate such as LIBOR, EURIBOR or other relevant reference rates ceases to exist or be published or another Benchmark Event occurs. These fallback arrangements include the possibility that the Rate of Interest could be determined by reference to a Successor Rate or an Alternative Rate and that an Adjustment Spread may be applied to such Successor Rate or Alternative Rate to reduce or eliminate, to the fullest extent reasonably practicable in the circumstances, any economic prejudice or benefit (as the case may be) to Noteholders as a result of the replacement of the relevant benchmark or screen rate (as applicable) originally specified with the Successor Rate or the Alternative Rate (as the case may be), together with the making of certain Benchmark Amendments to the Conditions of such Notes, which in the case of any Alternative Rate, any Adjustment Spread unless formally recommended or provided for and any Benchmark Amendments shall be determined by the Bank (acting in good faith, in a commercially reasonable manner and by reference to such sources as it deems appropriate, which may include consultation with an Independent Adviser).

In certain circumstances the ultimate fallback for the purposes of calculation of interest for a particular Interest Period or Reset Period (as the case may be) may result in the Rate of Interest for the last preceding Interest Period or Reset Period being used. This may result in the effective application of a fixed rate for Floating Rate Notes based on the rate which was last observed on the Relevant Screen Page or, in the case of Fixed Reset Notes, the application of the Reset Rate for a preceding Reset Period or the initial Rate of Interest applicable to such Notes on the Interest Commencement Date. In addition, due to the uncertainty concerning the availability of any Successor Rate or Alternative Rate, any determinations that may need to be made by the Bank and the involvement of any Independent Adviser, the relevant fallback provisions may not operate as intended at the relevant time.

Any such consequences could have a material adverse effect on the value or liquidity of and return on any such Notes. Moreover, any of the above matters or any other significant change to the setting or existence of any relevant reference rate could affect the ability of the Bank to meet its obligations under the Floating Rate Notes or Fixed Reset Notes or could have a material adverse effect on the value or liquidity of, and the amount payable under, the Floating Rate Notes or Fixed Reset Notes. Investors should consider these matters when making their investment decision with respect to the relevant Floating Rate Notes or Fixed Reset Notes.

Credit ratings assigned to the Bank or any Notes may not reflect all the risks associated with an investment in those Notes

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

In general, European regulated investors are restricted under the CRA Regulation from using credit ratings for regulatory purposes, unless such ratings are issued by a credit rating agency established in the European Union and registered under the CRA Regulation (and such registration has not been withdrawn or suspended), subject to transitional provisions that apply in certain circumstances. Such general restriction will also apply in the case of credit ratings issued by non-European Union credit rating agencies, unless the relevant credit ratings are endorsed by an European Union-registered credit rating agency or the relevant non-European Union rating agency is certified in accordance with the CRA Regulation (and such endorsement action or certification, as the case may be, has not been withdrawn or suspended, subject to transitional provisions that apply in certain circumstances). The list of registered and certified rating agencies published by ESMA on its website in accordance with the CRA Regulation is not conclusive evidence of the status of the relevant rating agency included in such list, as there may be delays between certain supervisory measures being taken against a relevant rating agency and the publication of the updated ESMA list. Certain information with respect to the credit rating agencies and ratings is set out on the cover of this Base Prospectus.

DOCUMENTS INCORPORATED BY REFERENCE

The following documents which have previously been published or are published simultaneously with this Base Prospectus and have been filed with the CSSF shall be incorporated by reference in, and form part of, this Base Prospectus:

(a) The Annual Financial Statements, including the information set out at the following pages of the 2017 Consolidated Financial Statements and the 2016 Consolidated Financial Statements, respectively, in particular:

	2017 Consolidated Financial Statements	**2016 Consolidated Financial Statements**
Consolidated Statement of Financial Position ………………………………..	Page 13	Page 13
Significant Accounting Policies …………	Pages 77 to 94	Pages 76 to 88
Consolidated Statement of Cash Flows….	Pages 15 to 16	Pages 15 to 16
Consolidated Statement of Comprehensive Income…………………………………..	Page 12	Page 12
Consolidated Statement of Changes in Equity…………………………………...	Page 14	Page 14
Notes……………………………………	Pages 17 to 94	Pages 17 to 88
Independent Auditors' Report ……………	Pages 9 to 11	Pages 9 to 11

Any other information incorporated by reference that is not included in the cross-reference list above is considered to be additional information to be disclosed to investors rather than information required by the relevant Annexes of the Prospectus Regulation.

(b) The Interim Financial Statements, in particular:

Interim Consolidated Statement of Comprehensive Income……………………………………………..	Page 7
Interim Consolidated Statement of Financial Position	Page 8
Interim Consolidated Statement of Changes in Equity	Page 9
Interim Consolidated Statement of Cash Flows…….	Pages 10 to 11
Significant Accounting Policies…………………….	Pages 67 to 74
Notes……………………………………………….	Pages 14 to 74

Any other information incorporated by reference that is not included in the cross-reference list above is considered to be additional information to be disclosed to investors rather than information required by the relevant Annexes of the Prospectus Regulation.

(c) the Terms and Conditions of the Notes contained in the previous Base Prospectus dated 23 April 2014, pages 47 to 70 (inclusive) prepared by the Bank in connection with the Programme.

(d) the Terms and Conditions of the Notes contained in the previous Base Prospectus dated 5 June 2015, pages 49 to 72 (inclusive) prepared by the Bank in connection with the Programme.

(e) the Terms and Conditions of the Notes contained in the previous Base Prospectus dated 7 June 2016, pages 48 to 71 (inclusive) prepared by the Bank in connection with the Programme.

(f) the Terms and Conditions of the Notes contained in the previous Base Prospectus dated 19 June 2017, pages 60 to 90 (inclusive) prepared by the Bank in connection with the Programme.

The non-incorporated parts of the documents referred to herein which, for the avoidance of doubt, are not included in the cross-reference lists above, are either deemed not relevant for an investor or are otherwise covered elsewhere in this Base Prospectus.

Following the publication of this Base Prospectus a supplement may be prepared by the Bank and approved by the CSSF in accordance with Article 16 of the Prospectus Directive. Statements contained in any such supplement (or contained in any document incorporated by reference therein) shall, to the extent applicable, be deemed to modify or supersede statements contained in this Base Prospectus or in a document which is incorporated by reference in this Base Prospectus. Any statement so modified or superseded shall not, except as so modified or superseded, constitute a part of this Base Prospectus.

Copies of documents incorporated by reference in this Base Prospectus can be obtained from the Luxembourg Stock Exchange's website at www.bourse.lu, from the registered office of the Bank and from the specified offices of the Paying Agents for the time being in London and can be viewed electronically free of charge at www.arionbanki.is/.

Any websites referenced in this Base Prospectus are referenced for information purposes only and the contents of any website referenced in this Base Prospectus do not form part of (and are not incorporated by reference into) this Base Prospectus.

Any documents themselves incorporated by reference in the documents incorporated by reference in this Base Prospectus shall not be incorporated by reference in this Base Prospectus as they are either deemed not relevant for an investor or are otherwise covered elsewhere in this Base Prospectus

The Bank will, in the event of any significant new factor, material mistake or inaccuracy relating to information included in this Base Prospectus which is capable of affecting the assessment of any Notes, prepare a supplement to this Base Prospectus or publish a new Base Prospectus for use in connection with any subsequent issue of Notes.

FORM OF THE NOTES

Each Tranche of Notes will be in bearer form and will initially be issued in the form of a temporary global note (a **Temporary Global Note**) or, if so specified in the applicable Final Terms, a permanent global note (a **Permanent Global Note**, and together with a Temporary Global Note, each a **Global Note**) which, in either case, will:

(i) if the Global Notes are intended to be issued in new global note (**NGN**) form, as stated in the applicable Final Terms, be delivered on or prior to the original issue date of the Tranche to a common safekeeper (the **Common Safekeeper**) for Euroclear Bank SA/NV (**Euroclear**) and Clearstream Banking S.A. (**Clearstream, Luxembourg**); and

(ii) if the Global Notes are not intended to be issued in NGN Form, be delivered on or prior to the original issue date of the Tranche to a common depositary (the **Common Depositary**) for Euroclear and Clearstream, Luxembourg.

Where the Global Notes issued in respect of any Tranche are in NGN form, the applicable Final Terms will also indicate/Euroclear and Clearstream, Luxembourg will be notified as to whether or not such Global Notes are intended to be held in a manner which would allow Eurosystem eligibility. Any indication that the Global Notes are to be so held does not necessarily mean that the Notes of the relevant Tranche will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any times during their life as such recognition depends upon satisfaction of the Eurosystem eligibility criteria. The Common Safekeeper for NGNs will either be Euroclear or Clearstream, Luxembourg or another entity approved by Euroclear and Clearstream, Luxembourg, as indicated in the applicable Final Terms.

Whilst any Note is represented by a Temporary Global Note, payments of principal, interest (if any) and any other amount payable in respect of the Notes due prior to the Exchange Date (as defined below) will be made (against presentation of the Temporary Global Note if the Temporary Global Note is not intended to be issued in NGN form) only to the extent that certification (in a form to be provided) to the effect that the beneficial owners of interests in the Temporary Global Note are not U.S. persons or persons who have purchased for resale to any U.S. person, as required by U.S. Treasury regulations, has been received by Euroclear and/or Clearstream, Luxembourg and Euroclear and/or Clearstream, Luxembourg, as applicable, has given a like certification (based on the certifications it has received) to the Fiscal Agent.

On and after the date (the **Exchange Date**) which is 40 days after a Temporary Global Note is issued, interests in such Temporary Global Note will be exchangeable (free of charge) upon a request as described therein either for (a) interests in a Permanent Global Note of the same Series or (b) definitive Note of the same Series with, where applicable, interest coupons and talons attached (as indicated in the applicable Final Terms), in each case against certification of beneficial ownership as described above unless such certification has already been given. The holder of a Temporary Global Note will not be entitled to collect any payment of interest, principal or other amount due on or after the Exchange Date unless, upon due certification, exchange of the Temporary Global Note for an interest in a Permanent Global Note or for definitive Notes is improperly withheld or refused.

Payments of principal, interest (if any) or any other amounts on a Permanent Global Note will be made through Euroclear and/or Clearstream, Luxembourg (against presentation or surrender (as the case may be) of the Permanent Global Note if the Permanent Global Note is not intended to be issued in NGN form) without any requirement for certification.

The applicable Final Terms will specify that a Permanent Global Note will be exchangeable (free of charge), in whole but not in part, for definitive Notes with, where applicable, interest coupons and talons attached upon the occurrence of an Exchange Event. For these purposes, **Exchange Event** means that (i) an Event of

Default (as defined in Condition 9) has occurred and is continuing, (ii) the Bank has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and no successor clearing system is available or (iii) the Bank has or will become subject to adverse tax consequences which would not be suffered were the Notes represented by the Permanent Global Note in definitive form. The Bank will promptly give notice to Noteholders in accordance with Condition 13 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Global Note) may give notice to the Fiscal Agent requesting exchange and, in the event of the occurrence of an Exchange Event as described in (iii) above, the Bank may also give notice to the Fiscal Agent requesting exchange. Any such exchange shall occur not later than 45 days after the date of receipt of the first relevant notice by the Fiscal Agent.

The following legend will appear on all Notes (other than Temporary Global Notes), and on all interest coupons relating to such Notes where TEFRA D is specified in the applicable Final Terms:

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

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

Notes which are represented by a Global Note will only be transferable in accordance with the rules and procedures for the time being of Euroclear or Clearstream, Luxembourg, as the case may be.

Pursuant to the Agency Agreement (as defined under "*Terms and Conditions of the Notes*"), the Fiscal Agent shall arrange that, where a further Tranche of Notes is issued which is intended to form a single Series with an existing Tranche of Notes at a point after the Issue Date of the further Tranche, the Notes of such further Tranche shall be assigned a common code and ISIN which are different from the common code and ISIN assigned to Notes of any other Tranche of the same Series until such time as the Tranches are consolidated and form a single Series, which shall not be prior to the expiry of the distribution compliance period (as defined in Regulation S under the Securities Act) applicable to the Notes of such Tranche.

Any reference herein to Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system specified in the applicable Final Terms.

A Note may be accelerated by the holder thereof in certain circumstances described in Condition 9. In such circumstances, where any Note is still represented by a Global Note and the Global Note (or any part thereof) has become due and repayable in accordance with the Terms and Conditions of such Notes and payment in full of the amount due has not been made in accordance with the provisions of the Global Note then from 8.00 p.m. (London time) on such day holders of interests in such Global Note credited to their accounts with Euroclear and/or Clearstream, Luxembourg, as the case may be, will become entitled to proceed directly against the Bank on the basis of statements of account provided by Euroclear and/or Clearstream, Luxembourg on and subject to the terms of a deed of covenant (the **Deed of Covenant**) dated 19 June 2017 and executed by the Bank.

The Bank may agree with any Dealer that Notes may be issued in a form not contemplated by the Terms and Conditions of the Notes, in which event a supplement to this Base Prospectus or a new Base Prospectus will be made available which will describe the effect of the agreement reached in relation to such Notes.

[PROHIBITION OF SALES TO EEA RETAIL INVESTORS – The Notes are not intended to be offered, sold or otherwise made available to and should not be offered, sold or otherwise made available to any retail investor in the European Economic Area (**EEA**). For these purposes, a retail investor means a person who is one (or more) of: (i) a retail client as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, **MiFID II**); or (ii) a customer within the meaning of Directive 2002/92/EC (as amended, the Insurance Mediation Directive), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or (iii) not a qualified investor as defined in the Prospectus Directive. Consequently no key information document required by Regulation (EU) No 1286/2014 (as amended, the **PRIIPs Regulation**) for offering or selling the Notes or otherwise making them available to retail investors in the EEA has been prepared and therefore offering or selling the Notes or otherwise making them available to any retail investor in the EEA may be unlawful under the PRIIPs Regulation.][1]

[[2]**MIFID II product governance/Professional investors and ECPs only target market** – Solely for the purposes of [the/each] manufacturer's product approval process, the target market assessment in respect of the Notes has led to the conclusion that: (i) the target market for the Notes is eligible counterparties and professional clients only, each as defined in [Directive 2014/65/EU (as amended, **MiFID II**)][MiFID II]; and (ii) all channels for distribution of the Notes to eligible counterparties and professional clients are appropriate. [*Consider any negative target market*][3]. Any person subsequently offering, selling or recommending the Notes (a **distributor**) should take into consideration the manufacturer['s/s'] target market assessment; however, a distributor subject to MiFID II is responsible for undertaking its own target market assessment in respect of the Notes (by either adopting or refining the manufacturer['s/s'] target market assessment) and determining appropriate distribution channels.]

APPLICABLE FINAL TERMS

Set out below is the form of Final Terms which will be completed for each Tranche of Notes which have a denomination of €100,000 (or its equivalent in any other currency) or more issued under the Programme.

[*Date*]

ARION BANK HF

Legal Entity Identifier (LEI): RIL4VBPDB0M7Z3KXSF19

Issue of [Aggregate Nominal Amount of Tranche] [Title of Notes]
under the €3,000,000,000
Euro Medium Term Note Programme

PART A – CONTRACTUAL TERMS

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions set forth in the Base Prospectus dated 10 July 2018 [and the supplement[s] to it dated [*date*] [and [*date*]] which [together] constitute[s] a base prospectus for the purposes of the Prospectus Directive (the **Base Prospectus**). This document constitutes the Final Terms of the Notes described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with the Base Prospectus. Full information on the Bank and the offer of the Notes is only available on the basis of the combination of these Final Terms and

[1] Legend to be included on front of the Final Terms if the Notes potentially constitute "packaged" products and no key information document will be prepared or the issuer wishes to prohibit offers to EEA retail investors for any other reason, in which case the selling restriction should be specified to be "Applicable".
[2] Legend to be included on front of the Final Terms if following the ICMA 1 "all bonds to all professionals" target market approach.
[3] To be considered on a case-by-case basis. If a negative target market is deemed necessary, wording along the following lines could be included: "The target market assessment indicates that Notes are incompatible with the needs, characteristics and objectives of clients which are [*details to be inserted*].

the Base Prospectus. The Base Prospectus has been published on the Luxembourg Stock Exchange's website (www.bourse.lu).

[The following alternative language applies if the first tranche of an issue which is being *increased* was issued under a *Base Prospectus* with an earlier date.]

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions (the **Conditions**) set forth in the Base Prospectus dated [23 April 2014/5 June 2015/7 June 2016/19 June 2017]. This document constitutes the Final Terms of the Notes described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with the Base Prospectus dated 10 July 2018 [and the supplement[s] to it dated [*date*] [and [*date*]]] which [together] constitute[s] a base prospectus for the purposes of the Prospectus Directive (the **Base Prospectus**), including the Conditions incorporated by reference in the Base Prospectus. Full information on the Bank and the offer of the Notes is only available on the basis of the combination of these Final Terms and the Base Prospectus. The Base Prospectus has been published on the Luxembourg Stock Exchange's website (www.bourse.lu).

1.	(a)	Series Number:	[ ]
	(b)	Tranche Number:	[ ]
	(c)	Date on which the Notes will be consolidated and form a single Series:	The Notes will be consolidated and form a single Series with [*provide issue amount/ISIN/maturity date/issue date of earlier Tranches*] on [the Issue Date/exchange of the Temporary Global Note for interests in the Permanent Global Note, as referred to in paragraph 20 below, which is expected to occur on or about [*date*]][Not Applicable]
2.	Specified Currency or Currencies:		[ ]
3.	Aggregate Nominal Amount:		
	(a)	Series:	[ ]
	(b)	Tranche:	[ ]
4.	Issue Price:		[ ] per cent. of the Aggregate Nominal Amount [plus accrued interest from [*insert date*] (*if applicable*)]
5.	(a)	Specified Denominations:	[ ] *(N.B. Notes must have a minimum denomination of €100,000 (or equivalent)* *(Note – where multiple denominations above [€100,000] or equivalent are being used the following sample wording should be followed:* *"[€100,000] and integral multiples of [€1,000] in excess thereof up to and including [€199,000]. No Notes in definitive form will be issued with a denomination above [€199,000].")*
	(b)	Calculation Amount (in relation	[ ]

		to calculation of interest in global form see Conditions):	(*If only one Specified Denomination, insert the Specified Denomination. If more than one Specified Denomination, insert the highest common factor. Note: There must be a common factor in the case of two or more Specified Denominations*.)
6.	(a)	Issue Date:	[ ]
	(b)	Interest Commencement Date:	[*specify*/Issue Date/Not Applicable] (*N.B. An Interest Commencement Date will not be relevant for certain Notes, for example Zero Coupon Notes*.)
7.	Maturity Date:		[*Specify date or for Floating Rate Notes* Interest Payment Date falling in or nearest to [*specify month and year*]]
8.	Interest Basis:		[[ ] per cent. Fixed Rate] [Fixed Reset] [[[ ] month [LIBOR/EURIBOR/NIBOR/STIBOR/REIBOR/CIBOR]] +/- [ ] per cent. Floating Rate] [Zero coupon] (see paragraph [13]/[14]/[15]/[16]below)
9.	Redemption/Payment Basis:		Subject to any purchase and cancellation or early redemption, the Notes will be redeemed on the Maturity Date at [100]/[ ] per cent. of their nominal amount (*N.B. On the Maturity Date the Notes must be redeemed at an amount that is at least 100 per cent. of their nominal amount*)
10.	Change of Interest Basis:		[For the period from (and including) the Interest Commencement Date, up to (but excluding) [*date*] paragraph [13/15] applies and for the period from (and including) [*date*], up to (and including) the Maturity Date, paragraph [13/15] applies][Not Applicable]
11.	Call Options:		[Issuer Call] [Not Applicable] [(see paragraph [17]/[18] below)]
12.	Status of Notes		[Unsubordinated/Subordinated]

PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE

13.	Fixed Rate Note Provisions		[Applicable/Not Applicable] (*If not applicable, delete the remaining subparagraphs of this paragraph*)
	(a)	Rate(s) of Interest:	[ ] per cent. per annum payable in arrear on each Interest Payment Date
	(b)	Interest Payment Date(s):	[ ] in each year up to and including the Maturity

			Date (*Amend appropriately in the case of irregular coupons*)
	(c)	Fixed Coupon Amount(s) for Notes in definitive form. (and in relation to Notes in global form see Conditions)	[ ] per Calculation Amount
	(d)	Broken Amount(s) for Notes in definitive form. (and in relation to Notes in global form see Conditions)	[[ ] per Calculation Amount, payable on the Interest Payment Date falling [in/on] [ ]][Not Applicable]
	(e)	Day Count Fraction:	[30/360] [Actual/Actual (ICMA)]
	(f)	Determination Date(s):	[[ ] in each year][Not Applicable] (*Only relevant where Day Count Fraction is Actual/Actual (ICMA). In such a case, insert regular interest payment dates, ignoring issue date or maturity date in the case of a long or short first or last coupon)*
14.	Fixed Reset Provisions:		[Applicable/Not Applicable] (*If not applicable, delete the remaining subparagraphs of this paragraph*)
	(a)	Initial Interest Rate:	[ ] per cent. per annum [payable [annually/semi-annually/quarterly] in arrear on each Interest Payment Date]
	(b)	Interest Payment Date(s):	[[ ] in each year up to and including the Maturity Date]
	(c)	Fixed Coupon Amount to (but excluding) the First Reset Date for Notes in definitive form (and in relation to Notes in global form see Conditions):	[[ ] per Calculation Amount/Not Applicable]
	(d)	Broken Amount(s) for Notes in definitive form (and in relation to Notes in global form see Conditions):	[[ ] per Calculation Amount payable on the Interest Payment Date falling [in/on] [ ]][Not Applicable]
	(e)	Day Count Fraction:	[30/360 or Actual/Actual (ICMA)]
	(f)	Determination Date(s):	[[ ] in each year][Not Applicable] [*Insert interest payment dates except where there are long or short periods. In these cases, insert regular interest payment dates*] (*NB: Only relevant where Day Count Fraction is Actual/Actual* (*ICMA*))
	(g)	Reset Date:	[ ]

(h)	Subsequent Reset Date(s):	[●] [and [●]]
(i)	Reset Margin:	[+/-][●] per cent. per annum
(j)	Relevant Screen Page:	[ ]
(k)	Floating Leg Reference Rate:	[ ]
(l)	Floating Leg Screen Page:	[ ]
(m)	Initial Mid-Swap Rate:	[ ] per cent. per annum (quoted on a[n annual/semi-annual basis])

15.	Floating Rate Note Provisions		[Applicable/Not Applicable] (*If not applicable, delete the remaining subparagraphs of this paragraph*)
	(a)	Specified Period(s)/Specified Interest Payment Dates:	[ ][, subject to adjustment in accordance with the Business Day Convention set out in (b) below/, not subject to adjustment, as the Business Day Convention in (b) below is specified to be Not Applicable]
	(b)	Business Day Convention:	[Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/[*specify other*]][Not Applicable]
	(c)	Additional Business Centre(s):	[ ]
	(d)	Manner in which the Rate of Interest and Interest Amount is to be determined:	[Screen Rate Determination/ISDA Determination]
	(e)	Party responsible for calculating the Rate of Interest and Interest Amount (if not the Fiscal Agent):	[ ]
	(f)	Screen Rate Determination:	
		(i) Reference Rate:	[*currency*][ ] month [LIBOR/EURIBOR/NIBOR/STIBOR/REIBOR/CIBOR].
		(ii) Interest Determination Date(s):	[ ] *(Second London business day prior to the start of each Interest Period if LIBOR (other than Sterling or euro LIBOR), first day of each Interest Period if Sterling LIBOR and the second day on which the TARGET2 System is open prior to the start of each Interest Period if EURIBOR or euro LIBOR. Second Oslo, Stockholm, Reykjavík or Copenhagen (as the case may be) business day prior to the start of each Interest Period if NIBOR, STIBOR, REIBOR or CIBOR)*

	(iii)	Relevant Screen Page:	[ ] (*In the case of EURIBOR, if not Reuters EURIBOR01 ensure it is a page which shows a composite rate or amend the fallback provisions appropriately*)
(g)	ISDA Determination:		
	(i)	Floating Rate Option:	[ ]
	(ii)	Designated Maturity:	[ ]
	(iii)	Reset Date:	[ ] (*In the case of a LIBOR or EURIBOR based option, the first day of the Interest Period*) (*N.B. The fall-back provisions applicable to ISDA Determination under the 2006 ISDA Definitions are reliant upon the provision by reference banks of offered quotations for LIBOR and/or EURIBOR which, depending on market circumstances, may not be available at the relevant time*)
(h)	Linear Interpolation:		[Not Applicable/Applicable – the Rate of interest for the [long/short] [first/last] Interest Period shall be calculated using Linear Interpolation (*specify for each short or long interest period*)]
(i)	Margin(s):		[+/-][ ] per cent. per annum
(j)	Minimum Rate of Interest:		[ ] per cent. per annum
(k)	Maximum Rate of Interest:		[ ] per cent. per annum
(l)	Day Count Fraction:		[Actual/Actual (ISDA)][Actual/Actual] Actual/365 (Fixed) Actual/365 (Sterling) Actual/360 [30/360][360/360][Note Basis] [30E/360][Eurobond Basis] 30E/360 (ISDA)]

16.	Zero Coupon Note Provisions		[Applicable/Not Applicable] (*If not applicable, delete the remaining subparagraphs of this paragraph*)
	(a)	Accrual Yield:	[ ] per cent. per annum
	(b)	Reference Price:	[ ]
	(c)	Day Count Fraction in relation to Early Redemption Amounts:	[30/360] [Actual/360] [Actual/365]

PROVISIONS RELATING TO REDEMPTION

17.	Issuer Call:		[Applicable/Not Applicable] (*If not applicable, delete the remaining subparagraphs of this paragraph*)
	(a)	Optional Redemption Date(s):	[ ]
	(b)	Optional Redemption Amount:	[[ ] per Calculation Amount] [*Set out appropriate variable details in this pro forma, for example reference obligation*]
	(c)	If redeemable in part:	
		(i) Minimum Redemption Amount:	[ ]
		(ii) Maximum Redemption Amount:	[ ]
	(d)	Notice periods:	Minimum period: [ ] days Maximum period: [ ] days (*N.B. When setting notice periods, the Bank is advised to consider the practicalities of distribution of information through intermediaries, for example, clearing systems* (*which require a minimum of 5 clearing system business days' notice for a call*) *and custodians, as well as any other notice requirements which may apply, for example, as between the Bank and the Fiscal Agent*)
18.	Final Redemption Amount:		[ ] per Calculation Amount (*N.B. Except in the case of Zero Coupon Notes where a Redemption/Payment Basis of more than 100 per cent. of the nominal amount has been specified, the Final Redemption Amount shall be equal to 100 per cent. of the Calculation Amount per Calculation Amount*)
19.	Early Redemption Amount payable on redemption for taxation reasons, upon the occurrence of a Capital Event or on an event of default:		[ ] per Calculation Amount (*N.B. If the Final Redemption Amount is 100 per cent. of the nominal value (i.e. par), the Early Redemption Amount is likely to be par (but consider). If, however, the Final Redemption Amount is other than 100 per cent. of the nominal value, consideration should be given as to what the Early Redemption Amount should be.*)

GENERAL PROVISIONS APPLICABLE TO THE NOTES

20.	Form of Notes:		
	(a)	Form:	[Temporary Global Note exchangeable for a Permanent

		Global Note which is exchangeable for Definitive Notes upon an Exchange Event] [Temporary Global Note exchangeable for Definitive Notes on and after the Exchange Date] [Permanent Global Note exchangeable for Definitive Notes only upon an Exchange Event] [Notes shall not be physically delivered in Belgium, except to a clearing system, a depository or other institution for the purpose of their immobilisation in accordance with article 4 of the Belgian Law of 14 December 2005.[4]] (*N.B. The option for an issue of Notes to be represented on issue by a Temporary Global Note exchangeable for Definitive Notes should not be expressed to be applicable if the Specified Denomination of the Notes in paragraph 5 includes language substantially to the following effect: "[€100,000] and integral multiples of [€1,000] in excess thereof up to and including [€199,000]."*)
	(b) New Global Note:	[Yes][No]
21.	Additional Financial Centre(s):	[Not Applicable/*give details*] (*Note that this paragraph relates to the date of payment and not the end dates of Interest Periods for the purposes of calculating the amount of interest, to which sub-paragraph 15(c) relates*)
22.	Talons for future Coupons to be attached to Definitive Notes:	[Yes, as the Notes have more than 27 coupon payments, Talons may be required if, on exchange into definitive form, more than 27 coupon payments are still to be made/No]

THIRD PARTY INFORMATION

[*Relevant third party information*] has been extracted from [*specify source*]. The Bank confirms that such information has been accurately reproduced and that, so far as it is aware and is able to ascertain from information published by [*specify source*], no facts have been omitted which would render the reproduced information inaccurate or misleading.

Signed on behalf of **ARION BANK HF.**:

By:	By:
Duly authorised	*Duly authorised*

[4] Include for Notes that are to be offered in Belgium.

PART B – OTHER INFORMATION

1. LISTING AND ADMISSION TO TRADING

(i)	Listing and Admission to trading	[Application has been made by the Bank (or on its behalf) for the Notes to be admitted to trading on [the Luxembourg Stock Exchange's regulated market/] and listed on the Official List of [the Luxembourg Stock Exchange/] with effect from [ ].] [Application is expected to be made by the Bank (or on its behalf) for the Notes to be admitted to trading on the Luxembourg Stock Exchange/] and listed on the Official List of [the Luxembourg Stock Exchange/] with effect from [ ].] (*Where documenting a fungible issue need to indicate that original Notes are already admitted to trading*.)
(ii)	Estimate of total expenses related to admission to trading:	[ ]

2. RATINGS

Ratings:	[The Notes to be issued will not be rated]/[The Notes to be issued [[have been]/[are expected to be]] rated]/[The following ratings reflect ratings assigned to Notes of this type issued under the Programme generally]: [*insert details*] by [*insert the legal name of the relevant credit rating agency entity(ies) and associated defined terms*]. Each of [*defined terms*] is established in the European Union and is registered under Regulation (EC) No. 1060/2009 (as amended).] *(The above disclosure should reflect the rating allocated to Notes of the type being issued under the Programme generally or, where the issue has been specifically rated, that rating*.)

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

[Save for any fees payable to the [Managers/Dealers], so far as the Bank is aware, no person involved in the issue of the Notes has an interest material to the offer. The [Managers/Dealers] and their affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform other services for, the Bank and its affiliates in the ordinary course of business – *Amend as appropriate if there are other interests*]

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

4. YIELD (*Fixed Rate Notes and Fixed Reset Notes only*)

Indication of yield:	[ ][Not Applicable]

5. OPERATIONAL INFORMATION

(i)	ISIN:	[ ]
(ii)	Common Code:	[ ]
(iii)	CFI:	[ ][Not Applicable]
(iv)	FISN	[ ][Not Applicable] (*If the CFI and/or FISN is not required, requested or available, it/they should be specified to be "Not Applicable"*)
(v)	Any clearing system(s) other than Euroclear and Clearstream, Luxembourg and the relevant identification number(s):	[Not Applicable/*give name(s), address(es) and number(s)*]
(vi)	Delivery:	Delivery [against/free of] payment
(vii)	Names and addresses of additional Paying Agent(s) (if any):	[ ]
[(viii)	Intended to be held in a manner which would allow Eurosystem eligibility:	[Yes. Note that the designation "yes" simply means that the Notes are intended upon issue to be deposited with one of the ICSDs as common safekeeper and does not necessarily mean that the Notes will be recognised as eligible collateral for Eurosystem monetary policy and intra day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon the ECB being satisfied that Eurosystem eligibility criteria have been met.]/ [No. Whilst the designation is specified as "no" at the date of these Final Terms, should the Eurosystem eligibility criteria be amended in the future such that the Notes are capable of meeting them the Notes may then be deposited with one of the ICSDs as common safekeeper. Note that this does not necessarily mean that the Notes will then be recognised as eligible collateral for Eurosystem monetary policy and intra day credit operations by the Eurosystem at any time during their life. Such recognition will depend upon the ECB

being satisfied that Eurosystem eligibility criteria have been met.]]

6. DISTRIBUTION

(i)	Method of distribution:	[Syndicated/Non-syndicated]
(ii)	If syndicated, names of Managers:	[Not Applicable/*give names*]
(iii)	Date of [Subscription] Agreement:	[ ]
(iv)	Stabilisation Manager(s) (if any):	[Not Applicable/*give name*]
(v)	If non-syndicated, name of relevant Dealer:	[Not Applicable/*give name*]
(vi)	U.S. Selling Restrictions:	[Reg. S Compliance Category 2; TEFRA D/TEFRA C/TEFRA not applicable]]
(vii)	Prohibition of Sales to EEA Retail Investors:	[Applicable/Not Applicable] (*If the Notes clearly do not constitute "packaged" products, "Not Applicable" should be specified. If the Notes may constitute "packaged" products and no key information document will be prepared, "Applicable" should be specified.*)
(viii)	Prohibition of Sales to Belgian Consumers:	[Applicable/Not Applicable] (*N.B. advice should be taken from Belgian counsel before disapplying this selling restriction*)
(ix)	Relevant Benchmark:	[[LIBOR/EURIBOR/NIBOR/STIBOR/REIBOR/CIBOR/[ ]] is provided by [ICE Benchmark Administration Limited/European Money Markets Institute/Norske Finansielle Referanser AS/Swedish Bankers' Association/Central Bank of Iceland/Finance Denmark/[ ]]. As at the date hereof, [[LIBOR/EURIBOR/NIBOR/STIBOR/REIBOR/CIBOR/[ ]] [[appears]/[does not appear]] in the register of administrators and benchmarks established and maintained by the European Securities and Markets Authority pursuant to Article 36 of Regulation (EU) No. 2016/1011 (the **Benchmarks Regulation**).] [[As far as the Bank is aware, as at the date hereof, the transitional provisions in Article 51 of the Benchmarks Regulation apply, such that [European Money Markets Institute/Norske Finansielle Referanser AS/Swedish Bankers' Association/Finance Denmark/[ ]] is not currently required to obtain authorisation/registration (or, if located outside the European Union, recognition, endorsement or equivalence)] OR [[Central Bank of Iceland/[ ]] does not fall within the scope of the Benchmarks Regulation]]/[Not Applicable]

TERMS AND CONDITIONS OF THE NOTES

The following are the Terms and Conditions of the Notes which will be incorporated by reference into each Global Note (as defined below) and each definitive Note, in the latter case only if permitted by the relevant stock exchange or other relevant authority (if any) and agreed by the Bank and the relevant Dealer at the time of issue but, if not so permitted and agreed, such definitive Note will have endorsed thereon or attached thereto such Terms and Conditions. The applicable Final Terms (or the relevant provisions thereof) will be endorsed upon, or attached to, each Global Note and definitive Note. Reference should be made to "Applicable Final Terms" for a description of the content of Final Terms which will specify which of such terms are to apply in relation to the relevant Notes.

This Note is one of a Series (as defined below) of Notes issued by Arion Bank hf. (the **Bank**) pursuant to the Agency Agreement (as defined below).

References herein to the **Notes** shall be references to the Notes of this Series and shall mean:

(a) in relation to any Notes represented by a global Note (a **Global Note**), units of each Specified Denomination in the Specified Currency;

(b) any Global Note; and

(c) any definitive Notes issued in exchange for a Global Note.

The Notes and the Coupons (as defined below) have the benefit of an Agency Agreement dated 19 June 2017 as supplemented by a Supplemental Agency Agreement dated 10 July 2018 (as further amended and/or supplemented and/or restated from time to time, the **Agency Agreement**) each as made between the Bank and Citibank N.A., London Branch as fiscal agent (the **Fiscal Agent**, which expression shall include any successor agent) and the other paying agents named therein (together with the Fiscal Agent, the **Paying Agents**, which expression shall include any additional or successor paying agents).

The final terms for this Note (or the relevant provisions thereof) are set out in Part A of the Final Terms attached to or endorsed on this Note which complete these Terms and Conditions (the **Conditions**). References to the **applicable Final Terms** are, unless otherwise stated, to Part A of the Final Terms (or the relevant provisions thereof) attached to or endorsed on this Note. The expression **Prospectus Directive** means Directive 2003/71/EC (as amended), and includes any relevant implementing measure in a relevant Member State of the European Economic Area (the **EEA**).

Interest bearing definitive Notes have interest coupons (**Coupons**) and, in the case of Notes which, when issued in definitive form, have more than 27 interest payments remaining, talons for further Coupons (**Talons**) attached on issue. Any reference herein to Coupons or coupons shall, unless the context otherwise requires, be deemed to include a reference to Talons or talons. Global Notes do not have Coupons or Talons attached on issue.

Any reference to **Noteholders** or **holders** in relation to any Notes shall mean the holders of the Notes and shall, in relation to any Notes represented by a Global Note, be construed as provided below. Any reference herein to **Couponholders** shall mean the holders of the Coupons and shall, unless the context otherwise requires, include the holders of the Talons.

As used herein, **Tranche** means Notes which are identical in all respects (including as to listing and admission to trading) and **Series** means a Tranche of Notes together with any further Tranche or Tranches of Notes which (a) are expressed to be consolidated and form a single series and (b) have the same terms and conditions or terms and conditions which are the same in all respects save for the amount and date of the first payment of interest thereon and the date from which interest starts to accrue.

The Noteholders and the Couponholders are entitled to the benefit of the Deed of Covenant (such Deed of Covenant as amended and/or supplemented and/or restated from time to time, the **Deed of Covenant**) dated 19 June 2017 and made by the Bank. The original of the Deed of Covenant is held by the common depositary for Euroclear (as defined below) and Clearstream, Luxembourg (as defined below).

Copies of the Agency Agreement and the Deed of Covenant are available for inspection during normal business hours at the specified office of each of the Paying Agents. If the Notes are to be admitted to trading on the regulated market of the Luxembourg Stock Exchange the applicable Final Terms will be published on the website of the Luxembourg Stock Exchange (www.bourse.lu). The Noteholders and the Couponholders are deemed to have notice of, and are entitled to the benefit of, all the provisions of the Agency Agreement, the Deed of Covenant and the applicable Final Terms which are applicable to them. The statements in the Conditions include summaries of, and are subject to, the detailed provisions of the Agency Agreement.

Words and expressions defined in the Agency Agreement or used in the applicable Final Terms shall have the same meanings where used in the Conditions unless the context otherwise requires or unless otherwise stated and provided that, in the event of inconsistency between the Agency Agreement and the applicable Final Terms, the applicable Final Terms will prevail.

In the Conditions, **euro** means the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty on the Functioning of the European Union, as amended.

1. FORM, DENOMINATION AND TITLE

The Notes are in bearer form and, in the case of definitive Notes, serially numbered, in the currency (the **Specified Currency**) and the denominations (the **Specified Denomination(s)**) specified in the applicable Final Terms. Notes of one Specified Denomination may not be exchanged for Notes of another Specified Denomination.

This Note may be a Fixed Rate Note, a Fixed Reset Note, a Floating Rate Note or a Zero Coupon Note, or a combination of any of the foregoing, depending upon the Interest Basis shown in the applicable Final Terms.

This Note may be an Unsubordinated Note or a Subordinated Note, depending on the Status shown in the applicable Final Terms.

Definitive Notes are issued with Coupons attached, unless they are Zero Coupon Notes in which case references to Coupons and Couponholders in these Conditions are not applicable.

Subject as set out below, title to the Notes and Coupons will pass by delivery. The Bank and the Paying Agents will (except as otherwise required by law) deem and treat the bearer of any Note or Coupon as the absolute owner thereof (whether or not overdue and notwithstanding any notice of ownership or writing thereon or notice of any previous loss or theft thereof) for all purposes but, in the case of any Global Note, without prejudice to the provisions set out in the next succeeding paragraph.

For so long as any of the Notes is represented by a Global Note held on behalf of Euroclear Bank SA/NV (**Euroclear**) and/or Clearstream Banking S.A. (**Clearstream, Luxembourg**), each person (other than Euroclear or Clearstream, Luxembourg) who is for the time being shown in the records of Euroclear or of Clearstream, Luxembourg as the holder of a particular nominal amount of such Notes (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the nominal amount of such Notes standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Bank and the Paying Agents as the holder of such nominal amount of such Notes for all purposes other than with respect to the payment of principal or interest on such nominal amount of such

Notes, for which purpose the bearer of the relevant Global Note shall be treated by the Bank and any Paying Agent as the holder of such nominal amount of such Notes in accordance with and subject to the terms of the relevant Global Note and the expressions **Noteholder** and **holder of Notes** and related expressions shall be construed accordingly.

Notes which are represented by a Global Note will be transferable only in accordance with the rules and procedures for the time being of Euroclear and Clearstream, Luxembourg, as the case may be. References to Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system specified in Part B of the applicable Final Terms.

2. STATUS OF THE NOTES

2.1 Status of the Unsubordinated Notes

This Condition 2.1 is applicable in relation to Notes specified in the applicable Final Terms as being Unsubordinated Notes. The Notes and any relative Coupons are direct, unconditional, unsubordinated and unsecured obligations of the Bank and rank *pari passu* among themselves and (save for certain obligations required to be preferred by law) equally with all other unsecured obligations (other than subordinated obligations, if any) of the Bank, from time to time outstanding.

2.2 Status of the Subordinated Notes

This Condition 2.2 is applicable in relation to Notes specified in the applicable Final Terms as being Subordinated Notes. In such case, the Notes constitute unsecured, subordinated obligations of the Bank.

In the event of the liquidation or insolvency (in Icelandic: *slit eða gjaldþrot*) of the Bank, the rights of the Noteholders to payments on or in respect of the Notes shall rank:

(a) *pari passu* without any preference among themselves;

(b) at least *pari passu* with payments to holders of any other Tier 2 Instruments and claims of any other subordinated creditors the claims of which rank, or are expressed to rank, *pari passu* with the Notes;

(c) in priority to payments to holders of any Additional Tier 1 Instruments and all classes of share capital of the Bank in their capacity as such holders, and claims of any other subordinated creditors the claims of which rank, or are expressed to rank, junior to the Notes; and

(d) junior in right of payment to the payment of any present or future claims of (a) depositors of the Bank, (b) other unsubordinated creditors of the Bank and (c) claims of any other subordinated creditors the claims of which rank, or are expressed to rank, in priority to the Notes.

In these Conditions:

Additional Tier 1 capital means Additional Tier 1 capital, as defined in article 84. b. of the Act on Financial Undertakings No. 161/2002, and as defined in Applicable Banking Regulations

Additional Tier 1 Instruments means any debt instruments of the Bank that at the time of issuance comply with the then current requirements under Applicable Banking Regulations in relation to Additional Tier 1 capital.

Applicable Banking Regulations means at any time the laws, regulations, requirements, guidelines and policies relating to capital adequacy or resolution then in effect in Iceland and applicable to the Bank, including, without limitation to the generality of the foregoing, those regulations, requirements, guidelines and policies relating to capital adequacy or resolution of the FME or the Relevant Resolution Authority (as defined in Condition 6), respectively, in each case to the extent then in effect in Iceland (whether or not such requirements, guidelines or policies have the force of law and whether or not they are applied generally or specifically to the Bank);

FME means the Financial Supervisory Authority of Iceland (*Fjármálaeftirlitið*) or such other or successor authority in Iceland having primary bank supervisory authority with respect to the Bank**;**

Tier 2 capital means Tier 2 capital, as defined in article 84. c of the Act on Financial Undertakings No 161/2002, and as defined in Applicable Banking Regulations; and

Tier 2 Instruments means any debt instruments of the Bank that at the time of issuance comply with the then current requirements under Applicable Banking Regulations in relation to Tier 2 capital.

2.3 Waiver of all Set-Off Rights

No holder of a Subordinated Note may at any time exercise or claim any Set-Off Rights against any right, claim or liability of the Bank or that the Bank may have or acquire against such holder, directly or indirectly and howsoever arising (and including all such rights, claims and liabilities arising under or in relation to any and all agreements or other instruments of any kind or any non-contractual obligation, whether or not relating to that Subordinated Note) and each holder of any Subordinated Note shall be deemed to have waived all Set-Off Rights to the fullest extent permitted by applicable law in relation to all such actual and potential rights, claims and liabilities. Notwithstanding the preceding sentence, if any amount payable by the Bank in respect of, or arising under or in connection with, any Subordinated Note to any holder of such Subordinated Note is discharged by set-off or any netting, such holder shall, subject to applicable law, immediately pay an amount equal to the amount of such discharge to the Bank and, until such time as payment is made, shall hold an amount equal to such amount in trust for the Bank and, accordingly, any such discharge shall be deemed not to have taken place.

Nothing in this Condition 2.3 is intended to provide, or shall be construed as acknowledging, any Set-Off Rights or that any such Set-Off Right is or would be available to any holder of any Subordinated Note but for this Condition 2.3.

In this Condition 2.3, **Set-Off Rights** means any and all rights or claims of any holder of a Subordinated Note against the Bank for deduction, set-off, netting, compensation, retention or counterclaim arising directly or indirectly under or in connection with any Subordinated Note.

3. INTEREST

3.1 Interest on Fixed Rate Notes

Each Fixed Rate Note bears interest from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest. Interest will be payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Maturity Date.

If the Notes are in definitive form, except as provided in the applicable Final Terms, the amount of interest payable on each Interest Payment Date in respect of the Fixed Interest Period ending on (but excluding) such date will amount to the Fixed Coupon Amount. Payments of interest on any Interest

Payment Date will, if so specified in the applicable Final Terms, amount to the Broken Amount so specified.

As used in the Conditions, **Fixed Interest Period** means the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.

Except in the case of Notes in definitive form where an applicable Fixed Coupon Amount or Broken Amount is specified in the applicable Final Terms, interest shall be calculated in respect of any period by applying the Rate of Interest to:

(a) in the case of Fixed Rate Notes which are represented by a Global Note, the aggregate outstanding nominal amount of the Fixed Rate Notes represented by such Global Note; or

(b) in the case of Fixed Rate Notes in definitive form, the Calculation Amount;

and, in each case, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention. Where the Specified Denomination of a Fixed Rate Note in definitive form is a multiple of the Calculation Amount, the amount of interest payable in respect of such Fixed Rate Note shall be the product of the amount (determined in the manner provided above) for the Calculation Amount and the amount by which the Calculation Amount is multiplied to reach the Specified Denomination, without any further rounding.

Day Count Fraction means, in respect of the calculation of an amount of interest in accordance with this Condition 3.1:

(a) if "Actual/Actual (ICMA)" is specified in the applicable Final Terms:

  (i) in the case of Notes where the number of days in the relevant period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (the **Accrual Period**) is equal to or shorter than the Determination Period during which the Accrual Period ends, the number of days in such Accrual Period divided by the product of (I) the number of days in such Determination Period and (II) the number of Determination Dates (as specified in the applicable Final Terms) that would occur in one calendar year; or

  (ii) in the case of Notes where the Accrual Period is longer than the Determination Period during which the Accrual Period ends, the sum of:

    (A) the number of days in such Accrual Period falling in the Determination Period in which the Accrual Period begins divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and

    (B) the number of days in such Accrual Period falling in the next Determination Period divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and

(b) if "30/360" is specified in the applicable Final Terms, the number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Interest

Commencement Date) to (but excluding) the relevant payment date (such number of days being calculated on the basis of a year of 360 days with 12 30-day months) divided by 360.

(c) In these Conditions:

Determination Period means each period from (and including) a Determination Date to (but excluding) the next Determination Date (including, where either the Interest Commencement Date or the final Interest Payment Date is not a Determination Date, the period commencing on the first Determination Date prior to, and ending on the first Determination Date falling after, such date); and

sub-unit means, with respect to any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, with respect to euro, one cent.

3.2 Interest on Fixed Reset Notes

(a) The applicable Final Terms contains provisions applicable to the determination of the resetting of the Rate of Interest for Fixed Reset Notes and must be read in conjunction with this Condition 3.2 for full information on the manner in which interest is calculated on Fixed Reset Notes. In particular, the applicable Final Terms will specify the Interest Commencement Date, the Reset Date, any Subsequent Reset Date(s), the Reset Margin, the Specified Currency, the Relevant Screen Page, the Floating Leg Reference Rate, the Floating Leg Screen Page and the Initial Mid-Swap Rate.

(b) If the Notes are specified in the applicable Final Terms as being Fixed Reset Notes, the Notes shall bear interest:

(i) from (and including) the Interest Commencement Date to (but excluding) the Reset Date at the rate per annum equal to the Initial Interest Rate; and

(ii) from (and including) the Reset Date to (but excluding) either (a) the Maturity Date or (b) if applicable, the first Subsequent Reset Date and each successive period from (and including) any Subsequent Reset Date to (but excluding) the next succeeding Subsequent Reset Date (if any) (each period in (a) and (b) being a **Reset Period**), in each case at the rate per annum equal to the relevant Reset Rate,

(in each case rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) (each a **Rate of Interest**) payable, in each case, in arrear on the Interest Payment Date(s) in each year up to and including the Maturity Date or, if none, the redemption, or purchase and cancellation, of the Notes.

The provisions of this Condition 3.2 shall apply, as applicable, in respect of any determination by the Fiscal Agent of the Rate of Interest for a Reset Period in accordance with this Condition 3.2 as if the Fixed Reset Notes were Floating Rate Notes. The Rate of Interest for each Reset Period shall otherwise be determined by the Fiscal Agent on the relevant Reset Determination Date in accordance with the provisions of this Condition 3.2. Once the Rate of Interest is determined for a Reset Period, the provisions of Condition 3.1 shall apply to Fixed Reset Notes, as applicable, as if the Fixed Reset Notes were Fixed Rate Notes.

In these Conditions:

Mid-Swap Rate means, in relation to the Reset Date or relevant Subsequent Reset Date, as the case may be, and the Reset Period commencing on the Reset Date or that Subsequent Reset Date, the rate for the Reset Date or that Subsequent Reset Date of, in the case of semi-annual or annual Interest Payment Dates, the semi-annual or annual swap rate, respectively (with such semi-annual swap rate to be converted to a quarterly rate in accordance with market convention, in the case of quarterly

Interest Payment Dates) for swap transactions in the Specified Currency maturing on the last day of such Reset Period, expressed as a percentage, which appears on the Relevant Screen Page as of approximately 11.00 a.m. in the principal financial centre of the Specified Currency on such Reset Determination Date. If such rate does not appear on the Relevant Screen Page, the Mid-Swap Rate for the Reset Date or relevant Subsequent Reset Date, as the case may be, will be the Reset Reference Bank Rate for the Reset Period;

Relevant Screen Page means the display page on the relevant service as specified in the applicable Final Terms or such other page as may replace it on that information service, or on such other equivalent information service as determined by the Fiscal Agent for the purpose of displaying equivalent or comparable rates to the relevant swap rates for swap transactions in the Specified Currency with an equivalent maturity to the Reset Period;

Representative Amount means an amount that is representative for a single transaction in the relevant market at the relevant time;

Reset Determination Date means the second Business Day immediately preceding the Reset Date or relevant Subsequent Reset Date, as the case may be;

Reset Period Mid-Swap Rate Quotations means the bid and offered rates for the semi-annual or annual, as applicable, fixed leg (calculated on the day count basis customary for fixed rate payments in the Specified Currency), of a fixed-for-floating interest rate swap transaction in the Specified Currency with a term equal to the Reset Period commencing on the Reset Date or relevant Subsequent Reset Date, as the case may be, and in a Representative Amount with an acknowledged dealer of good credit in the swap market, where the floating leg (in each case calculated on the day count basis customary for floating rate payments in the Specified Currency), is equivalent to the Rate of Interest that would apply in respect of the Notes if (a) Screen Rate Determination was specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, (b) the Reference Rate was the Floating Leg Reference Rate and (c) the Relevant Screen Page was the Floating Leg Screen Page;

Reset Rate means the sum of the Reset Margin and the Mid-Swap Rate for the relevant Reset Period;

Reset Reference Bank Rate means, in relation to the Reset Date or relevant Subsequent Reset Date, as the case may be, and the Reset Period commencing on the Reset Date or that Subsequent Reset Date, the percentage determined on the basis of the arithmetic mean of the Reset Period Mid-Swap Rate Quotations provided by the Reset Reference Banks at approximately 11.00 in the principal financial centre of the Specified Currency on the Reset Determination Date. The Fiscal Agent will request the principal office of each of the Reset Reference Banks to provide a quotation of its rate. If at least three quotations are provided, the rate for the Reset Date or relevant Subsequent Reset Date, as the case may be, will be the arithmetic mean of the quotations, eliminating the highest quotation (or, in the event of equality, one of the highest) and the lowest quotation (or, in the event of equality, one of the lowest). If only two quotations are provided, it will be the arithmetic mean of the quotations provided. If only one quotation is provided, it will be the quotation provided. If no quotations are provided, the Mid-Swap Rate will be the Mid-Swap Rate for the immediately preceding Reset Period or, if none, the Initial Mid-Swap Rate; and

Reset Reference Banks means five leading swap dealers in the interbank market for swap transactions in the Specified Currency with an equivalent maturity to the Reset Period as selected by the Bank.

3.3 Interest on Floating Rate Notes

(a) Interest Payment Dates

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

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

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

Such interest will be payable in respect of each Interest Period. In the Conditions, **Interest Period** means the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.

If a Business Day Convention is specified in the applicable Final Terms and (x) if there is no numerically corresponding day in the calendar month in which an Interest Payment Date should occur or (y) if any Interest Payment Date would otherwise fall on a day which is not a Business Day, then, if the Business Day Convention specified is:

(a) in any case where Specified Periods are specified in accordance with Condition 3.2(a)(ii) above, the Floating Rate Convention, such Interest Payment Date (a) in the case of (x) above, shall be the last day that is a Business Day in the relevant month and the provisions of (ii) below shall apply *mutatis mutandis* or (b) in the case of (y) above, shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event (i) such Interest Payment Date shall be brought forward to the immediately preceding Business Day and (ii) each subsequent Interest Payment Date shall be the last Business Day in the month which falls the Specified Period after the preceding applicable Interest Payment Date occurred; or

(b) the Following Business Day Convention, such Interest Payment Date shall be postponed to the next day which is a Business Day; or

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

(d) the Preceding Business Day Convention, such Interest Payment Date shall be brought forward to the immediately preceding Business Day.

In the Conditions, **Business Day** means:

(a) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in London and each Additional Business Centre (other than TARGET2 System) specified in the applicable Final Terms;

(b) if TARGET2 System is specified as an Additional Business Centre in the applicable Final Terms, a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET2) System (the **TARGET2 System**) is open; and

(c) either (i) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney and Auckland, respectively) or (ii) in relation to any sum payable in euro, a day on which the TARGET2 System is open.

(b) **Rate of Interest**

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

(i) ISDA Determination for Floating Rate Notes

Where ISDA Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will be the relevant ISDA Rate plus or minus (as indicated in the applicable Final Terms) the Margin (if any). For the purposes of this subparagraph (i), **ISDA Rate** for an Interest Period means a rate equal to the Floating Rate that would be determined by the Fiscal Agent under an interest rate swap transaction if the Fiscal Agent were acting as Calculation Agent for that swap transaction under the terms of an agreement incorporating the 2006 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc. and as amended and updated as at the Issue Date of the first Tranche of the Notes (the **ISDA Definitions**) and under which:

(A) the Floating Rate Option is as specified in the applicable Final Terms;

(B) the Designated Maturity is a period specified in the applicable Final Terms; and

(C) the relevant Reset Date is the day specified in the applicable Final Terms.

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

(ii) Screen Rate Determination for Floating Rate Notes

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

(A) the offered quotation; or

(B) the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) of the offered quotations,

(expressed as a percentage rate per annum) for the Reference Rate (being LIBOR, EURIBOR, NIBOR, STIBOR, REIBOR or CIBOR, as specified in the applicable Final

Terms) which appears or appear, as the case may be, on the Relevant Screen Page (or such replacement page on that service which displays the information) as at 11.00 a.m. (London time in the case of LIBOR, Brussels time, in the case of EURIBOR, Oslo time, in the case of NIBOR, Stockholm time, in the case of STIBOR, Reykjavik time, in the case of REIBOR and Copenhagen time, in the case of CIBOR) on the Interest Determination Date in question plus or minus (as indicated in the applicable Final Terms) the Margin (if any), all as determined by the Fiscal Agent. If five or more of such offered quotations are available on the Relevant Screen Page, the highest (or, if there is more than one such highest quotation, one only of such quotations) and the lowest (or, if there is more than one such lowest quotation, one only of such quotations) shall be disregarded by the Fiscal Agent for the purpose of determining the arithmetic mean (rounded as provided above) of such offered quotations.

If the Relevant Screen Page is not available or if, in the case of (A) above, no offered quotation appears or, in the case of (B) above, fewer than three offered quotations appear, in each case as at 11.00 a.m. (London time in the case of LIBOR, Brussels time, in the case of EURIBOR, Oslo time, in the case of NIBOR, Stockholm time, in the case of STIBOR, Reykjavik time, in the case of REIBOR or Copenhagen time, in the case of CIBOR), the Fiscal Agent shall request each of the Reference Banks to provide the Fiscal Agent with its offered quotation (expressed as a percentage rate per annum) for the Reference Rate at approximately 11.00 a.m. (London time in the case of LIBOR, Brussels time, in the case of EURIBOR, Oslo time, in the case of NIBOR, Stockholm time, in the case of STIBOR, Reykjavik time, in the case of REIBOR or Copenhagen time, in the case of CIBOR) on the Interest Determination Date in question. If two or more of the Reference Banks provide the Fiscal Agent with offered quotations, the Rate of Interest for the Interest Period shall be the arithmetic mean (rounded if necessary to the fifth decimal place with 0.000005 being rounded upwards) of the offered quotations plus or minus (as appropriate) the Margin (if any), all as determined by the Fiscal Agent.

If on any Interest Determination Date one only or none of the Reference Banks provides the Fiscal Agent with an offered quotation as provided in the preceding paragraph, the Rate of Interest for the relevant Interest Period shall be the rate per annum which the Fiscal Agent determines as being the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) of the rates, as communicated to (and at the request of) the Fiscal Agent by the Reference Banks or any two or more of them, at which such banks were offered, at approximately 11.00 a.m. (London time in the case of LIBOR, Brussels time, in the case of EURIBOR, Oslo time, in the case of NIBOR, Stockholm time, in the case of STIBOR, Reykjavik time, in the case of REIBOR or Copenhagen time, in the case of CIBOR) on the relevant Interest Determination Date, deposits in the Specified Currency for a period equal to that which would have been used for the Reference Rate by leading banks in the London inter-bank market (if the Reference Rate is LIBOR), the Euro-zone inter-bank market (if the Reference Rate is EURIBOR), the Norwegian inter-bank market (if the Reference Rate is NIBOR), the Swedish inter-bank market (if the Reference Rate is STIBOR), the Icelandic inter-bank market (if the Reference Rate is REIBOR) or the Danish inter-bank market (if the Reference Rate is CIBOR) plus or minus (as appropriate) the Margin (if any) or, if fewer than two of the Reference Banks provide the Fiscal Agent with offered rates, the offered rate for deposits in the Specified Currency for a period equal to that which would have been used for the Reference Rate, or the arithmetic mean (rounded as provided above) of the offered rates for deposits in the Specified Currency for a period equal to that which would have been used for the Reference Rate, at which, at approximately 11.00 a.m. (London time in the case of LIBOR, Brussels time, in the case of EURIBOR, Oslo time, in the case of NIBOR, Stockholm time, in the case of STIBOR, Reykjavik time, in the case of REIBOR or Copenhagen time, in the case of CIBOR) on the relevant Interest

Determination Date, any one or more banks (which bank or banks is or are in the opinion of the Bank suitable for the purpose) informs the Fiscal Agent it is quoting to leading banks in the London inter-bank market (if the Reference Rate is LIBOR), the Euro-zone inter-bank market (if the Reference Rate is EURIBOR), the Norwegian inter-bank market (if the Reference Rate is NIBOR), the Swedish inter-bank market (if the Reference Rate is STIBOR), the Icelandic inter-bank market (if the Reference Rate is REIBOR) or the Danish inter-bank market (if the Reference Rate is CIBOR) plus or minus (as appropriate) the Margin (if any), provided that, if the Rate of Interest cannot be determined in accordance with the foregoing provisions of this paragraph, the Rate of Interest shall be determined as at the last preceding Interest Determination Date (though substituting, where a different Margin is to be applied to the relevant Interest Period from that which applied to the last preceding Interest Period, the Margin relating to the relevant Interest Period in place of the Margin relating to that last preceding Interest Period).

As used herein, **Reference Banks** means, in the case of a determination of LIBOR, the principal London office of four major banks in the London inter-bank market, in the case of a determination of EURIBOR, the principal Euro-zone office of four major banks in the Euro-zone inter-bank market, in the case of a determination of NIBOR, the principal Oslo office of four major banks in the Norwegian inter-bank market, in the case of a determination of STIBOR, the principal Stockholm office of four major banks in the Swedish inter-bank market, in the case of a determination of REIBOR, the principal Reykjavik office of four major banks in the Icelandic inter-bank market and, in the case of a determination of CIBOR, the principal Copenhagen office of four major banks in the Danish inter-bank market, in each case selected by the Fiscal Agent in consultation with the Bank.

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

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

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

Unless otherwise stated in the applicable Final Terms, the Minimum Rate of Interest shall be deemed to be zero.

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

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

The Fiscal Agent will calculate the amount of interest (the **Interest Amount**) payable on the Floating Rate Notes for the relevant Interest Period by applying the Rate of Interest to:

(A) in the case of Floating Rate Notes which are represented by a Global Note, the aggregate outstanding nominal amount of the Notes represented by such Global Note; or

(B) in the case of Floating Rate Notes in definitive form, the Calculation Amount, and, in each case, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention. Where the Specified Denomination of a Floating Rate Note in definitive form is a multiple of the Calculation Amount, the Interest Amount payable in respect of such Note shall be the product of the amount (determined in the manner provided above) for the Calculation Amount and the amount by which the Calculation Amount is multiplied to reach the Specified Denomination, without any further rounding.

Day Count Fraction means, in respect of the calculation of an amount of interest in accordance with this Condition 3.2:

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

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

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

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

(v) if "30/360", "360/360" or "Note Basis" is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \text{ x } (Y_2 - Y_1)] + [30 \text{ x } (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

"Y_1" is the year, expressed as a number, in which the first day of the Interest Period falls;

"Y_2" is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"M_1" is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

"M_2" is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"D_1" is the first calendar day, expressed as a number, of the Interest Period, unless such number is 31, in which case D_1 will be 30; and

"D_2" is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless such number would be 31 and D_1 is greater than 29, in which case D_2 will be 30;

(vi) if "30E/360" or "Eurobond Basis" is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \text{ x } (Y_2 - Y_1)] + [30 \text{ x } (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

"Y_1" is the year, expressed as a number, in which the first day of the Interest Period falls;

"Y_2" is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"M_1" is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

"M_2" is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"D_1" is the first calendar day, expressed as a number, of the Interest Period, unless such number would be 31, in which case D_1 will be 30; and

"D_2" is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless such number would be 31, in which case D_2 will be 30;

(vii) if "30E/360 (ISDA)" is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \text{ x } (Y_2 - Y_1)] + [30 \text{ x } (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

"Y_1" is the year, expressed as a number, in which the first day of the Interest Period falls;

"Y_2" is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"M_1" is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

"M_2" is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"D_1" is the first calendar day, expressed as a number, of the Interest Period, unless (i) that day is the last day of February or (ii) such number would be 31, in which case D_1 will be 30; and

"D_2" is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless (i) that day is the last day of February but not the Maturity Date or (ii) such number would be 31, in which case D_2 will be 30.

(e) **Linear Interpolation**

Where Linear Interpolation is specified as applicable in respect of an Interest Period in the applicable Final Terms, the Rate of Interest for such Interest Period shall be calculated by the Fiscal Agent by straight line linear interpolation by reference to two rates based on the relevant Reference Rate (where Screen Rate Determination is specified as applicable in the applicable Final Terms) or the relevant Floating Rate Option (where ISDA Determination is specified as applicable in the applicable Final Terms), one of which shall be determined as if the Designated Maturity were the period of time for which rates are available next shorter than the length of the relevant Interest Period and the other of which shall be determined as if the Designated Maturity were the period of time for which rates are available next longer than the length of the relevant Interest Period provided however that if there is no rate available for a period of time next shorter or, as the case may be, next longer, then the Fiscal Agent shall determine such rate at such time and by reference to such sources as it determines appropriate.

Designated Maturity means, in relation to Screen Rate Determination, the period of time designated in the Reference Rate.

(f) **Notification of Rate of Interest and Interest Amounts**

The Fiscal Agent will cause the Rate of Interest and each Interest Amount for each Interest Period and the relevant Interest Payment Date to be notified to the Bank and any stock exchange on which the relevant Floating Rate Notes are for the time being listed (by no later than the first day of each Interest Period) and notice thereof to be published in accordance with Condition 13 as soon as possible after their determination but in no event later than the fourth London Business Day thereafter. Each Interest Amount and Interest Payment Date so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without prior notice in the event of an extension or shortening of the Interest Period. Any such amendment will promptly be notified to each stock exchange on which the relevant Floating Rate Notes are for the time being listed and to the Noteholders in accordance with Condition 13. For the purposes of this paragraph, the expression **London Business Day** means a day (other than a Saturday or a Sunday) on which banks and foreign exchange markets are open for general business in London.

(g) **Certificates to be final**

All certificates, communications, opinions, determinations, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition 3.2 by the Fiscal Agent shall (in the absence of wilful default, bad faith or manifest error) be binding on the Bank, the Fiscal Agent, the other Paying Agents and all Noteholders and Couponholders and (in the absence of wilful default or bad faith) no liability to the Bank, the Noteholders or the Couponholders shall attach to the Fiscal Agent in connection with the exercise or non-exercise by it of its powers, duties and discretions pursuant to such provisions.

3.4 Benchmark Discontinuation

Notwithstanding the provisions in Conditions 3.2 or 3.3, as the case may be, above, if the Bank determines that a Benchmark Event has occurred in relation to an Original Reference Rate when any Rate of Interest (or any component part thereof) remains to be determined by reference to that Original Reference Rate, then the following provisions of this Condition 3.4 shall apply.

(a) **Successor Rate or Alternative Rate**

If there is a Successor Rate, then the Bank shall promptly notify the Fiscal Agent and, in accordance with Condition 13, the Noteholders of such Successor Rate and that Successor

Rate shall (subject to adjustment as provided in Condition 3.4(b)) subsequently be used by the Fiscal Agent in place of the Original Reference Rate to determine the relevant Rate(s) of Interest (or the relevant component part(s) thereof) for all relevant future payments of interest on the Notes (subject to the further operation of this Condition 3.4).

If there is no Successor Rate but the Bank, acting in good faith, in a commercially reasonable manner and by reference to such sources as it deems appropriate, which may include consultation with an Independent Adviser, determines that there is an Alternative Rate, then the Bank shall promptly notify the Fiscal Agent and, in accordance with Condition 13, the Noteholders of such Alternative Rate and that Alternative Rate shall (subject to adjustment as provided in Condition 3.4(b)) subsequently be used in place of the Original Reference Rate to determine the relevant Rate(s) of Interest (or the relevant component part(s) thereof) for all relevant future payments of interest on the Notes (subject to the further operation of this Condition 3.4).

(b) **Adjustment Spread**

If, in the case of a Successor Rate, an Adjustment Spread is formally recommended, or formally provided as an option for parties to adopt, in relation to the replacement of the Original Reference Rate with the Successor Rate by any Relevant Nominating Body, then the Bank shall promptly notify the Fiscal Agent and, in accordance with Condition 13, the Noteholders of such Adjustment Spread and the Fiscal Agent shall apply such Adjustment Spread to the Successor Rate for each subsequent determination of a relevant Rate of Interest (or a component part thereof) by reference to such Successor Rate.

If, in the case of a Successor Rate where no such Adjustment Spread is formally recommended or provided as an option by any Relevant Nominating Body, or in the case of an Alternative Rate, the Bank, acting in good faith, in a commercially reasonable manner and by reference to such sources as it deems appropriate, which may include consultation with an Independent Adviser, determines that there is an Adjustment Spread in customary market usage in the international debt capital markets for transactions which reference the Original Reference Rate, where such rate has been replaced by the Successor Rate or the Alternative Rate (as the case may be), then the Bank shall promptly notify the Fiscal Agent and, in accordance with Condition 13, the Noteholders of such Adjustment Spread and the Fiscal Agent shall apply such Adjustment Spread to the Successor Rate and the Alternative Rate (as the case may be) for each subsequent determination of a relevant Rate of Interest (or a component part thereof) by reference to such Successor Rate or Alternative Rate (as applicable).

If no such recommendation or option has been made (or made available) by any Relevant Nominating Body, or the Bank so determines that there is no such Adjustment Spread in customary market usage in the international debt capital markets and the Bank further determines, acting in good faith, in a commercially reasonable manner and following consultation with an Independent Adviser, that an Adjustment Spread is required to be applied to the Successor Rate or the Alternative Rate (as the case may be), then the Adjustment Spread shall be:

(i) the Adjustment Spread determined by the Bank, acting in good faith, in a commercially reasonable manner and following consultation with an Independent Adviser, as being the Adjustment Spread recognised or acknowledged as being the industry standard for over-the-counter derivative transactions which reference the Original Reference Rate, where such rate has been replaced by the Successor Rate or the Alternative Rate (as the case may be); or

(ii) if there is no such industry standard recognised or acknowledged, such Adjustment Spread as the Bank, acting in good faith, in a commercially reasonable manner and following consultation with an Independent Adviser, determines to be appropriate.

Following any such determination of the Adjustment Spread, the Bank shall promptly notify the Fiscal Agent and, in accordance with Condition 13, the Noteholders of such Adjustment Spread and the Fiscal Agent shall apply such Adjustment Spread to the Successor Rate or the Alternative Rate (as the case may be) for each subsequent determination of a relevant Rate of Interest (or a component part thereof) by reference to such Successor Rate or Alternative Rate (as applicable).

(c) **Benchmark Amendments**

If any Successor Rate, Alternative Rate or Adjustment Spread is determined in accordance with this Condition 3.4 and the Bank, acting in good faith, in a commercially reasonable manner and by reference to such sources as it deems appropriate, which may include consultation with an Independent Adviser, determines in its discretion (A) that amendments to these Conditions and/or the Agency Agreement are necessary to ensure the proper operation of such Successor Rate, Alternative Rate and/or Adjustment Spread (such amendments, the **Benchmark Amendments**) and (B) the terms of the Benchmark Amendments, then the Bank and the Fiscal Agent shall, subject to the Bank having to give notice thereof to the Noteholders in accordance with Condition 13, without any requirement for the consent or approval of Noteholders, agree to the necessary modifications to these Conditions and/or the Agency Agreement to give effect to such Benchmark Amendments with effect from the date specified in such notice.

In connection with any such modifications in accordance with this Condition 3.4(c), the Bank shall comply with the rules of any stock exchange on which the Notes are for the time being listed or admitted to trading. Notwithstanding any other provision of this Condition 3.4, no Successor Rate, Alternative Rate or Adjustment Spread will be adopted, nor will any other amendment to the terms and conditions of any Series of Notes be made to effect the Benchmark Amendments, if and to the extent that, in the determination of the Bank, the same could reasonably be expected to prejudice the treatment of any relevant Series of Subordinated Notes as Tier 2 capital.

Any Benchmark Amendments determined under this Condition 3.4(c) shall be notified promptly by the Bank to the Fiscal Agent and, in accordance with Condition 13, the Noteholders. Such notice shall be irrevocable and shall specify the effective date of such Benchmark Amendments.

(d) **Independent Adviser**

In the event the Bank is to consult with an Independent Adviser in connection with any determination to be made by the Bank pursuant to this Condition 3.4, the Bank shall use its reasonable endeavours to appoint an Independent Adviser, as soon as reasonably practicable, for the purposes of any such consultation.

An Independent Adviser appointed pursuant to this Condition 3.4 shall act in good faith, in a commercially reasonable manner and (in the absence of fraud or wilful default) shall have no liability whatsoever to the Bank or the Noteholders for any determination made by it or for any advice given to the Bank in connection with any determination made by the Bank pursuant to this Condition 3.4 or otherwise in connection with the Notes.

If the Bank is in any doubt as to whether there is an Alternative Rate and/or any Adjustment Spread is required to be applied and/or in relation to the quantum of, or any formula or methodology for determining such Adjustment Spread and/or whether any Benchmark Amendments are necessary and/or in relation to the terms of any such Benchmark Amendments, a written determination of an Independent Adviser in respect thereof shall be conclusive and binding on all parties, save in the case of manifest error, and (in the absence of fraud or wilful default) the Bank shall have no liability whatsoever to the Noteholders in respect of anything done, or omitted to be done, in relation to that matter in accordance with any such written determination.

No Independent Adviser appointed in connection with the Notes (acting in such capacity), shall have any relationship of agency or trust with the Noteholders.

(e) **Survival of Original Reference Rate Provisions**

(f) Without prejudice to the obligations of the Bank under this Condition 3.4, the Original Reference Rate and the fallback provisions provided for in Conditions 3.2, 3.3, the Agency Agreement and the applicable Final Terms, as the case may be, will continue to apply unless and until the Bank has determined the Successor Rate or the Alternative Rate (as the case may be), and any Adjustment Spread and Benchmark Amendments, in accordance with the relevant provisions of this Condition 3.4.

(g) **Definitions**

In this Condition 3.4:

Adjustment Spread means either a spread, or the formula or methodology for calculating a spread and the spread resulting from such calculation, which spread may in either case be positive or negative and is to be applied to the Successor Rate or the Alternative Rate (as the case may be) to reduce or eliminate, to the fullest extent reasonably practicable in the circumstances, any economic prejudice or benefit (as the case may be) to Noteholders as a result of the replacement of the Original Reference Rate with the Successor Rate or the Alternative Rate (as the case may be);

Alternative Rate means an alternative benchmark or screen rate which the Bank determines in accordance with this Condition 3.4 is used in place of the Original Reference Rate in customary market usage in the international debt capital markets for the purposes of determining rates of interest (or the relevant component part thereof) for a commensurate interest period and in the same Specified Currency as the Notes;

Benchmark Event means:

(i) the Original Reference Rate ceasing to exist or be published;

(ii) the later of (A) the making of a public statement by the administrator of the Original Reference Rate that it will, by a specified date, cease publishing the Original Reference Rate permanently or indefinitely (in circumstances where no successor administrator has been appointed that will continue publication of the Original Reference Rate) and (B) the date falling six months prior to such specified date;

(iii) the making of a public statement by the supervisor of the administrator of the Original Reference Rate that the Original Reference Rate has been permanently or indefinitely discontinued or is prohibited from being used or that its use is subject to restrictions or adverse consequences or, where such discontinuation, prohibition, restrictions or adverse consequences are to apply from a specified date after the making of any public statement to such effect, the later of the date of the making of such public statement and the date falling six months prior to such specified date; or

(iv) it has or will prior to the next Interest Determination Date or Reset Determination Date, as applicable, become unlawful for the Calculation Agent, any Paying Agent or the Bank to determine any Rate of Interest and/or calculate any Interest Amount using the Original Reference Rate (including, without limitation, under Regulation (EU) No. 2016/1011, if applicable).

Independent Adviser means an independent financial institution of international repute or other independent adviser of recognised standing with appropriate expertise appointed by the Bank at its own expense;

Original Reference Rate means the benchmark or screen rate (as applicable) originally specified in the applicable Final Terms for the purposes of determining the relevant Rate of Interest (or any component part thereof) in respect of the Notes;

Relevant Nominating Body means, in respect of a benchmark or screen rate (as applicable):

(i) the central bank for the currency to which the benchmark or screen rate (as applicable) relates, or any central bank or other supervisory authority which is responsible for supervising the administrator of the benchmark or screen rate (as applicable); or

(ii) any working group or committee sponsored by, chaired or co-chaired by or constituted at the request of (A) the central bank for the currency to which the benchmark or screen rate (as applicable) relates, (B) any central bank or other supervisory authority which is responsible for supervising the administrator of the benchmark or screen rate (as applicable), (C) a group of the aforementioned central banks or other supervisory authorities, or (D) the Financial Stability Board or any part thereof; and

Successor Rate means a successor to or replacement of the Original Reference Rate which is formally recommended by any Relevant Nominating Body.

3.5 Accrual of interest

Each Note (or in the case of the redemption of part only of a Note, that part only of such Note) will cease to bear interest (if any) from the date for its redemption unless payment of principal is improperly withheld or refused. In such event, interest will continue to accrue until whichever is the earlier of:

(a) the date on which all amounts due in respect of such Note have been paid; and

(b) five days after the date on which the full amount of the moneys payable in respect of such Note has been received by the Fiscal Agent and notice to that effect has been given to the Noteholders in accordance with Condition 13.

3.6 Interest on any Write-Down of Subordinated Notes

In the case of any Write-Down (as defined in Condition 6) of Subordinated Notes, interest accrued and unpaid on the Subordinated Notes to (but excluding) the date of the Write-Down (the **Write-Down Date**) shall be cancelled in accordance with Condition 6 and:

(a) if the Subordinated Notes are Written-Down in full, no further interest shall accrue or be paid in respect of the Subordinated Notes; and

(b) if the Subordinated Notes are not Written-Down in full, interest will again start to accrue on the Subordinated Notes from (and including) the Write-Down Date and for the purposes of the payment of interest on the Subordinated Notes on the Interest Payment Date immediately following the Write-Down Date (the **Partial Write-Down Interest Payment Date**), the amount of interest payable on the Subordinated Notes shall be calculated in respect of the period from (and including) the Write-Down Date to (but excluding) the Partial Write-Down Interest Payment Date and by reference to the Prevailing Principal Amount(s) of the outstanding Notes immediately following such Write-Down.

Following any Write-Down and the cancellation of any accrued and unpaid interest on the Subordinated Notes, the right of holders of the Subordinated Notes to receive any amount in respect of such interest will be extinguished and the Bank will have no obligation to pay any such amount or to pay any interest thereon.

3.7 In these Conditions, **Prevailing Principal Amount** means, in respect of a Subordinated Note at any time, the principal or nominal amount of that Subordinated Note as of the Issue Date as reduced (on one or more occasions) by any Write-Down at or prior to such time and references in these Conditions to any principal or nominal amount of a Subordinated Note shall be construed accordingly as a reference to the Prevailing Principal Amount of that Subordinated Note.

4. PAYMENTS

4.1 Method of payment

Subject as provided below:

(a) payments in a Specified Currency other than euro will be made by credit or transfer to an account in the relevant Specified Currency maintained by the payee with a bank in the principal financial centre of the country of such Specified Currency (which, if the Specified Currency is Australian dollars or New Zealand dollars, shall be Sydney and Auckland, respectively); and

(b) payments will be made in euro by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee.

Payments will be subject in all cases to (i) any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 7 and (ii) any withholding or deduction required pursuant to an agreement described in Section 1471(b) of the U.S. Internal Revenue Code of 1986 (the **Code**) or otherwise imposed pursuant to Sections 1471 through 1474 of the Code, any regulations or agreements thereunder, any official interpretations thereof, or any law implementing an intergovernmental approach thereto.

4.2 Presentation of definitive Notes and Coupons

Payments of principal in respect of definitive Notes will (subject as provided below) be made in the manner provided in Condition 4.1 above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of definitive Notes, and payments of interest in respect of definitive Notes will (subject as provided below) be made as aforesaid only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of Coupons, in each case at the specified office of any Paying Agent outside the United States (which expression, as used herein, means the United States of America (including the States and the District of Columbia and its possessions)).

Fixed Rate Notes in definitive form (other than Long Maturity Notes (as defined below)) should be presented for payment together with all unmatured Coupons appertaining thereto (which expression shall for this purpose include Coupons falling to be issued on exchange of matured Talons), failing which the amount of any missing unmatured Coupon (or, in the case of payment not being made in full, the same proportion of the amount of such missing unmatured Coupon as the sum so paid bears to the sum due) will be deducted from the sum due for payment. Each amount of principal so deducted will be paid in the manner mentioned above against surrender of the relative missing Coupon at any time before the expiry of 10 years after the Relevant Date (as defined in Condition 7) in respect of such principal (whether or not such Coupon would otherwise have become void under Condition 8) or, if later, five years from the date on which such Coupon would otherwise have become due, but in no event thereafter.

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

Upon the date on which any Floating Rate Note or Long Maturity Note in definitive form becomes due and repayable, unmatured Coupons and Talons (if any) relating thereto (whether or not attached) shall become void and no payment or, as the case may be, exchange for further Coupons shall be made in respect thereof. A **Long Maturity Note** is a Fixed Rate Note (other than a Fixed Rate Note which on issue had a Talon attached) whose nominal amount on issue is less than the aggregate interest payable thereon provided that such Note shall cease to be a Long Maturity Note on the Interest Payment Date on which the aggregate amount of interest remaining to be paid after that date is less than the nominal amount of such Note.

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

4.3 Payments in respect of Global Notes

Payments of principal and interest (if any) in respect of Notes represented by any Global Note will (subject as provided below) be made in the manner specified above in relation to definitive Notes or otherwise in the manner specified in the relevant Global Note, where applicable against presentation or surrender, as the case may be, of such Global Note at the specified office of any Paying Agent outside the United States. A record of each payment made, distinguishing between any payment of principal and any payment of interest, will be made either on such Global Note by the Paying Agent to which it was presented or in the records of Euroclear and Clearstream, Luxembourg, as applicable.

4.4 General provisions applicable to payments

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

Notwithstanding the foregoing provisions of this Condition, if any amount of principal and/or interest in respect of Notes is payable in U.S. dollars, such U.S. dollar payments of principal and/or interest in respect of such Notes will be made at the specified office of a Paying Agent in the United States if:

(a) the Bank has appointed Paying Agents with specified offices outside the United States with the reasonable expectation that such Paying Agents would be able to make payment in U.S. dollars at such specified offices outside the United States of the full amount of principal and interest on the Notes in the manner provided above when due;

(b) payment of the full amount of such principal and interest at all such specified offices outside the United States is illegal or effectively precluded by exchange controls or other similar restrictions on the full payment or receipt of principal and interest in U.S. dollars; and

(c) such payment is then permitted under United States law without involving, in the opinion of the Bank, adverse tax consequences to the Bank.

4.5 Payment Day

If the date for payment of any amount in respect of any Note or Coupon is not a Payment Day, the holder thereof shall not be entitled to payment until the next following Payment Day in the relevant place and shall not be entitled to further interest or other payment in respect of such delay. For these purposes, **Payment Day** means any day which (subject to Condition 8) is:

(a) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in:

  (i) in the case of Notes in definitive form only, in the relevant place of presentation; and

  (ii) in each Additional Financial Centre (other than TARGET2 System) specified in the applicable Final Terms;

(b) if TARGET2 System is specified as an Additional Financial Centre in the applicable Final Terms, a day on which the TARGET2 System is open, and

(c) either (A) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney and Auckland, respectively) or (B) in relation to any sum payable in euro, a day on which the TARGET2 System is open.

4.6 Interpretation of principal and interest

Any reference in the Conditions to principal in respect of the Notes shall be deemed to include, as applicable:

(a) any additional amounts which may be payable with respect to principal under Condition 7;

(b) the Final Redemption Amount of the Notes;

(c) the Early Redemption Amount of the Notes;

(d) the Optional Redemption Amount(s) (if any) of the Notes;

(e) in relation to Zero Coupon Notes, the Amortised Face Amount (as defined in Condition 5.4); and

(f) any premium and any other amounts (other than interest) which may be payable by the Bank under or in respect of the Notes.

Any reference in the Conditions to interest in respect of the Notes shall be deemed to include, as applicable, any additional amounts which may be payable with respect to interest under Condition 7.

5. REDEMPTION AND PURCHASE

5.1 Redemption at maturity

Subject to Condition 6, unless previously redeemed or purchased and cancelled as specified below, each Note will be redeemed by the Bank at its Final Redemption Amount of 100 per cent. or more of its nominal amount calculated as follows:

(a) in the case of a Note (other than a Zero Coupon Note where a Redemption/Payment Basis of more than 100 per cent. of the nominal amount has been specified in the applicable Final Terms), at 100 per cent. of the Calculation Amount per Calculation Amount as specified in the applicable Final Terms; or

(b) in the case of a Zero Coupon Note where a Redemption/Payment Basis of more than 100 per cent. of the nominal amount has been specified in the applicable Final Terms, at the amount specified in the applicable Final Terms,

in each case in the relevant Specified Currency on the Maturity Date specified in the applicable Final Terms.

5.2 Redemption for tax reasons

Subject to Condition 5.4 and, in the case of Subordinated Notes, to the provisions of Condition 5.9 below, the Notes may be redeemed at the option of the Bank in whole, but not in part, at any time (if this Note is not a Floating Rate Note) or on any Interest Payment Date (if this Note is a Floating Rate Note), on giving not less than 30 and not more than 60 days' notice to the Fiscal Agent and, in accordance with Condition 13, the Noteholders (which notice shall be irrevocable), if:

(a) either (i) on the occasion of the next payment due under the Notes, the Bank has or will become obliged to pay additional amounts as provided or referred to in Condition 7 or (ii) in the case of Subordinated Notes only, the Bank would not be entitled to claim a deduction in computing its taxation liabilities in any Tax Jurisdiction (as defined in Condition 7) in respect of any payment of interest to be made on the Notes on the occasion of the next payment due under the Notes (or the amount of such deduction would be materially reduced), in each case as a result of any change in, or amendment to, the laws or regulations of a Tax Jurisdiction or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after (a) (in the case of Unsubordinated Notes) the date on which agreement is reached to issue the last Tranche of the Notes; or (b) (in the case of Subordinated Notes) the Issue Date; and

(b) such obligation, loss of entitlement (or reduction) cannot be avoided by the Bank taking reasonable measures available to it, provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date (i) on which the Bank would be obliged to pay such additional amounts, or (ii) on which the Bank would not be entitled to claim such a deduction (or the amount of such deduction would be materially reduced) in respect of such payment (as applicable), were a payment in respect of the Notes then due.

Prior to the publication of any notice of redemption pursuant to this Condition, the Bank shall deliver to the Fiscal Agent to make available at its specified office to the Noteholders (i) a certificate signed by two Directors of the Bank stating that the Bank is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Bank so to redeem have occurred and (ii) an opinion of independent legal or tax advisers of recognised standing to the effect that the Bank has or will become obliged to pay such additional amounts or, as the case may be, that the Bank will not be entitled to claim such deduction or the amount of such deduction will be reduced, in each case, as a result of such change or amendment.

Notes redeemed pursuant to this Condition 5.2 will be redeemed at their Early Redemption Amount referred to in Condition 5.4 below together (if appropriate) with interest accrued to (but excluding) the date of redemption.

5.3 Redemption at the option of the Bank (Issuer Call)

Subject to, in the case of Subordinated Notes, the provisions of Condition 5.9 below, if Issuer Call is specified as being applicable in the applicable Final Terms, the Bank may, having given not less than the minimum period nor more than the maximum period of notice specified in applicable Final Terms to the Noteholders in accordance with Condition 13 (which notice shall be irrevocable and shall specify the date fixed for redemption), redeem all or some only of the Notes then outstanding on any Optional Redemption Date and at the Optional Redemption Amount(s) specified in the applicable Final Terms together, if appropriate, with interest accrued to (but excluding) the relevant Optional Redemption Date. Any such redemption must be of a nominal amount not less than the Minimum Redemption Amount and not more than the Maximum Redemption Amount, in each case as may be specified in the applicable Final Terms. In the case of a partial redemption of Notes, the Notes to be redeemed (**Redeemed Notes**) will (i) in the case of Redeemed Notes represented by definitive Notes, be selected individually by lot, not more than 30 days prior to the date fixed for redemption and (ii) in the case of Redeemed Notes represented by a Global Note, be selected in accordance with the rules of Euroclear and/or Clearstream, Luxembourg, (to be reflected in the records of Euroclear and Clearstream, Luxembourg as either a pool factor or a reduction in nominal amount, at their discretion). In the case of Redeemed Notes represented by definitive Notes, a list of the serial numbers of such Redeemed Notes will be published in accordance with Condition 13 not less than 15 days prior to the date fixed for redemption.

5.4 Early Redemption Amounts

For the purpose of Condition 5.2 above, Condition 5.8 below and Condition 9 below:

(a) subject to Condition 6, each Note (other than a Zero Coupon Note) will be redeemed at its Early Redemption Amount; and

(b) each Zero Coupon Note will be redeemed at an amount (the **Amortised Face Amount**) calculated in accordance with the following formula:

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

where:

RP means the Reference Price;

AY means the Accrual Yield expressed as a decimal; and

y is the Day Count Fraction specified in the applicable Final Terms which will be either (i) 30/360 (in which case the numerator will be equal to the number of days (calculated on the basis of a 360-day year consisting of 12 months of 30 days each) from (and including) the Issue Date of the first Tranche of the Notes to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Note becomes due and repayable and the denominator will be 360) or (ii) Actual/360 (in which case the numerator will be equal to the actual number of days from (and including) the Issue Date of the first Tranche of the Notes to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Note becomes due and repayable and the denominator will be 360) or (iii) Actual/365 (in which case the numerator will be equal to the actual number of days from (and including) the Issue Date of the first Tranche of the Notes to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Note becomes due and repayable and the denominator will be 365)

5.5 Purchases

Subject, in the case of Subordinated Notes, to the provisions of Condition 5.9 below, the Bank or any Subsidiary of the Bank may at any time purchase Notes (provided that, in the case of definitive Notes, all unmatured Coupons and Talons appertaining thereto are purchased therewith) at any price in the open market or otherwise. Such Notes may be held, reissued, resold or, at the option of the Bank, surrendered to any Paying Agent for cancellation.

5.6 Cancellation

All Notes which are redeemed will forthwith be cancelled (together with all unmatured Coupons and Talons attached thereto or surrendered therewith at the time of redemption). All Notes so cancelled and any Notes purchased and cancelled pursuant to Condition 5.5 above (together with all unmatured Coupons and Talons cancelled therewith) shall be forwarded to the Fiscal Agent and cannot be reissued or resold.

5.7 Late payment on Zero Coupon Notes

If the amount payable in respect of any Zero Coupon Note upon redemption of such Zero Coupon Note pursuant to Condition 5.1, 5.2 or 5.3 above or upon its becoming due and repayable as provided in Condition 9 is improperly withheld or refused, the amount due and repayable in respect of such Zero Coupon Note shall be the amount calculated as provided in Condition 5.4(b) above as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon Note becomes due and payable were replaced by references to the date which is the earlier of:

(a) the date on which all amounts due in respect of such Zero Coupon Note have been paid; and

(b) five days after the date on which the full amount of the moneys payable in respect of such Zero Coupon Notes has been received by the Fiscal Agent and notice to that effect has been given to the Noteholders in accordance with Condition 13.

5.8 Redemption upon a Capital Event – Subordinated Notes

If the Notes are Subordinated Notes, then upon the occurrence of a Capital Event, the Bank may, at its option, having given not less than 30 days' nor more than 60 days' notice to the Fiscal Agent and the Noteholders in accordance with Condition 13 (which notice shall be irrevocable and shall specify the date fixed for such redemption), at any time (if this Note is not a Floating Rate Note) or on any Interest Payment Date (if this Note is not a Floating Rate Note) redeem all (but not some only) of the Subordinated Notes then outstanding at the Early Redemption Amount specified in the applicable Final Terms, together, if appropriate, with interest accrued to (but excluding) the date of redemption.

Prior to the publication of any notice of redemption pursuant to this Condition, the Bank shall deliver to the Fiscal Agent, a certificate signed by two Directors of the Bank stating that the Bank is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Bank so to redeem have occurred.

For this purpose, a **Capital Event** means the determination by the Bank after consultation with the FME that, as a result of a change in Icelandic law or Applicable Banking Regulations or any change in the official application or interpretation thereof becoming effective on or after the Issue Date, the aggregate outstanding nominal amount of the Subordinated Notes is excluded in whole or in part from inclusion in the Tier 2 capital of the Bank.

5.9 FME approval

Any redemption or purchase of Subordinated Notes pursuant to Conditions 5.2, 5.3, 5.5 and 5.8 is subject to the prior approval of the FME (if, and to the extent then required, by the FME).

6. POINT OF NON-VIABILITY LOSS ABSORPTION

6.1 This Condition 6 applies only to Subordinated Notes and prior to the date on which any Applicable Statutory Loss Absorption Regime becomes effective in respect of the Notes.

6.2 If a Non-Viability Event occurs at any time on or after the Issue Date and prior to the date on which any Applicable Statutory Loss Absorption Regime becomes effective in respect of the Notes, the Bank will:

(a) promptly notify Noteholders thereof in accordance with Condition 13 (a **Non-Viability Event Notice**); and

(b) irrevocably and mandatorily (and without any requirement for the consent or approval of Noteholders) cancel any interest accrued and unpaid on the Subordinated Notes to (but excluding) the Write-Down Date, and write-down the Prevailing Principal Amount of the Subordinated Notes in full or to the extent required in order for the Bank no longer to be considered Non-Viable by the Relevant Resolution Authority and in order that such Non-Viability Event is no longer continuing, whichever is lower (a **Write-Down** and **Written-Down** shall be construed accordingly), which Non-Viability Write-Down shall take place as directed by the Relevant Resolution Authority in accordance with the priority of claims under normal insolvency proceedings and may be effected before any public provision of capital to the Bank or any other equivalent measure of extraordinary financial support without which, in the determination of the Relevant Resolution Authority, the Bank would be Non-Viable.

With effect on and from the date on which an Applicable Statutory Loss Absorption Regime becomes effective in respect of the Notes, the foregoing provisions of this Condition 6 will lapse and cease to have any effect (and without any requirement for the consent or approval of Noteholders or any notice to be given to Noteholders), except to the extent such provisions are required by the Applicable Statutory Loss Absorption Regime. If a Non-Viability Event occurs on or after such date, the Relevant Resolution Authority (or the Bank following instructions from the Relevant Resolution Authority) may (without any requirement for the consent or approval of Noteholders or any notice to be given to Noteholders) take such action in respect of the Notes as is required or permitted by such Applicable Statutory Loss Absorption Regime.

Noteholders shall have no claim against the Bank in respect of any accrued and unpaid interest on and Prevailing Principal Amount of the Subordinated Notes that is cancelled and Written-Down, respectively, in accordance with the provisions of this Condition 6 or otherwise pursuant to any Applicable Statutory Loss Absorption Regime.

In these Conditions, the following expressions have the following meanings:

Applicable Statutory Loss Absorption Regime means a Statutory Loss Absorption Regime that is applicable to the Notes;

Non-Viability Event means the occurrence of any of the following events:

(a) the Relevant Resolution Authority determines that the Bank is or will be Non-Viable without a Non-Viability Write-Down;

(b) the Relevant Resolution Authority decides to inject capital into the Bank or provide any other equivalent extraordinary measure of financial support without which, the Bank would become Non-Viable; or

(c) any other event or circumstance specified in Applicable Banking Regulations or any Applicable Statutory Loss Absorption Regime that leads to a determination by the Relevant Resolution Authority that the Bank is Non-Viable;

Non-Viable means the liquidation or insolvency (in Icelandic: *slit eða gjaldþrot*) of the Bank or if the Bank is, unable to pay a material part of its debts as they fall due or unable to carry on its business or is subject to restructuring or resolution under the Act on Financial Undertakings, No. 161/2002 and Act on Bankruptcy, etc. No. 21/1991 or any other event or circumstance specified as such in Applicable Banking Regulations or any Applicable Statutory Loss Absorption Regime;

Relevant Resolution Authority means the FME or any successor authority that is responsible for the determination of any Non-Viability Event in respect of the Bank or that otherwise has the power to implement loss absorption measures with respect to the Bank under any Applicable Statutory Loss Absorption Regime; and

Statutory Loss Absorption Regime means any statutory regime implemented or directly effective in Iceland which provides any Relevant Resolution Authority with the powers to implement loss absorption measures in respect of capital instruments (such as the Notes), including, but not limited to, any regime resulting from the implementation in Iceland of, or which otherwise contains provisions analogous to, Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms, as amended or replaced from time to time.

7. TAXATION

All payments of principal and interest in respect of the Notes and Coupons by or on behalf of the Bank will be made without withholding or deduction for or on account of any present or future taxes or duties of whatever nature imposed or levied by or on behalf of any Tax Jurisdiction unless such withholding or deduction is required by law. In such event, the Bank will pay such additional amounts as shall be necessary in order that the net amounts received by the holders of the Notes or Coupons after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Notes or Coupons, as the case may be, in the absence of such withholding or deduction; except that no such additional amounts shall be payable with respect to any Note or Coupon:

(a) presented for payment in Iceland; or

(b) the holder of which is liable for such taxes or duties in respect of such Note or Coupon by reason of his having some connection with a Tax Jurisdiction other than the mere holding of such Note or Coupon; or

(c) presented for payment more than 30 days after the Relevant Date (as defined below) except to the extent that the holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day assuming that day to have been a Payment Day (as defined in Condition 4.5).

Notwithstanding any other provision of these Conditions, in no event will the Bank be required to pay any additional amounts in respect of the Notes and Coupons for, or on account of, any withholding or deduction required pursuant to an agreement described in Section 1471(b) of the Code or otherwise imposed pursuant to Sections 1471 through 1474 of the Code, any regulations or agreements thereunder, or any official interpretations thereof, or any law implementing an intergovernmental approach thereto.

As used herein:

(i) **Tax Jurisdiction** means Iceland or any political subdivision or any authority thereof or therein having power to tax; and

(ii) the **Relevant Date** means the date on which such payment first becomes due, except that, if the full amount of the moneys payable has not been duly received by the Fiscal Agent on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Noteholders in accordance with Condition 13.

In the case of Subordinated Notes only and notwithstanding the foregoing, the payment of any additional amounts by the Bank pursuant to this Condition 7 shall be limited to such payments in respect of payments of interest only and no such payments shall be made in respect of any payments of principal.

8. PRESCRIPTION

The Notes and Coupons will become void unless claims in respect of principal and/or interest are made within a period of 10 years (in the case of principal) and five years (in the case of interest) after the Relevant Date (as defined in Condition 7) therefor.

There shall not be included in any Coupon sheet issued on exchange of a Talon any Coupon the claim for payment in respect of which would be void pursuant to this Condition or Condition 4.2 or any Talon which would be void pursuant to Condition 4.2.

9. EVENTS OF DEFAULT

9.1 Events of Default – Unsubordinated Notes

This Condition 9.1 is applicable in relation to Notes specified in the applicable Final Terms as being Unsubordinated Notes. If any one or more of the following events (each an **Event of Default**) shall occur and be continuing:

(a) if default is made in the payment in the Specified Currency of any principal or interest due in respect of the Notes or any of them and the default continues for a period of five days in the case of principal and 10 days in the case of interest; or

(b) if the Bank fails to perform or observe any of its other obligations under the Conditions and (except in any case where the failure is incapable of remedy when no such continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 30 days next following the service by a Noteholder on the Bank of notice requiring the same to be remedied; or

(c) if (i) any Financial Indebtedness (as defined below) of the Bank or any of its Principal Subsidiaries becomes due and repayable prematurely by reason of an event of default (however described); (ii) the Bank or any of its Principal Subsidiaries fails to make any payment in respect of any Financial Indebtedness on the due date for payment as extended by any originally applicable grace period; (iii) any security given by the Bank or any of its Principal Subsidiaries for any Financial Indebtedness becomes enforceable; or (iv) default is made by the Bank or any of its Principal Subsidiaries in making any payment due under any guarantee and/or indemnity given by it in relation to any Financial Indebtedness of any other person, provided that the aggregate nominal amount of any such Financial Indebtedness of the Bank or such Principal Subsidiary in the case of (i), (ii) and/or (iii) above, and/or amount of Financial Indebtedness in relation to which such guarantee and/or indemnity of the Bank or such Principal Subsidiary has been given in the case of (iv) above, is at least €25,000,000 (or its equivalent in any other currency);

(d) if any order is made by any competent court or resolution passed for the winding-up or dissolution of the Bank or any of its Principal Subsidiaries, save for the purposes of reorganisation on terms previously approved by an Extraordinary Resolution; or

(e) if the Bank or any of its Principal Subsidiaries ceases or threatens to cease to carry on (in the case of the Bank) the whole or a substantial part of its business or (in the case of a Principal Subsidiary) the whole or substantially the whole of its business, save (i) in the case of the Bank for the purposes of any sale or other disposal of Valitor Holding hf. and (ii) in each case for the purposes of reorganisation on terms previously approved by an Extraordinary Resolution, or the Bank or any of its Principal Subsidiaries stops or threatens to stop payment of, or is unable to, or admits inability to, pay, its debts (or any class of its debts) as they fall due, or is deemed unable to pay its debts pursuant to or for the purposes of any applicable law, or is adjudicated or found bankrupt or insolvent; or

(f) if (A) proceedings are initiated against the Bank or any of its Principal Subsidiaries under any applicable liquidation, insolvency, composition, reorganisation or other similar laws, or an application is made (or documents filed with a court) for the appointment of an administrative or other receiver, manager, administrator or other similar official, or an administrative or other receiver, manager, administrator or other similar official is appointed, in relation to the Bank or any of its Principal Subsidiaries or, as the case may be, in relation to all or substantially all of the undertaking or assets of any of them, or an encumbrance takes possession of all or substantially all of the undertaking or assets of any of them, or a distress, execution, attachment, sequestration or other process is levied, enforced upon, sued out or put in force against all or substantially all of the undertaking or assets of any of them and (B) in any case (other than the appointment of an administrator) is not discharged within 14 days; or

(g) if the Bank or any of its Principal Subsidiaries initiates or consents to judicial proceedings relating to itself under any applicable liquidation, insolvency, composition, reorganisation or other similar laws (including the obtaining of a moratorium) or makes a conveyance or assignment for the benefit of, or enters into any composition or other arrangement with, its creditors generally (or any class of its creditors) or any meeting is convened to consider a proposal for an arrangement or composition with its creditors generally (or any class of its creditors),

then any holder of a Note may, by written notice to the Bank at the specified office of the Fiscal Agent, effective upon the date of receipt thereof by the Fiscal Agent, declare any Note held by it to be forthwith due and payable whereupon the same shall become forthwith due and payable at its Early Redemption Amount, together with accrued interest (if any) to the date of repayment, without presentment, demand, protest or other notice of any kind.

9.2 Events of Default – Subordinated Notes

(a) This Condition 9.2 is applicable in relation to Notes specified in the applicable Final Terms as being Subordinated Notes. If:

(i) default is made in the payment of any principal or interest due in respect of the Subordinated Notes or any of them and the default continues for a period of five days in the case of principal and ten days in the case of interest; or

(ii) an order is made or an effective resolution is passed for the liquidation of the Bank (except for the purposes of a merger, reconstruction or amalgamation under which the continuing entity effectively assumes the entire obligations of the Bank under the Subordinated Notes) or the Bank is otherwise declared insolvent or put into liquidation, in each case by a court or agency or supervisory authority in Iceland having jurisdiction in respect of the same under the Act on Financial Undertakings, No. 161/2002 and Act on Bankruptcy, etc. No. 21/1991,

any holder of a Subordinated Note may:

(A) (in the case of (i) above) institute proceedings for the Bank to be declared insolvent or its liquidation, in each case in Iceland and not elsewhere, and prove or claim in the liquidation of the Bank; and/or

(B) (in the case of (ii) above), prove or claim in the liquidation of the Bank, whether in Iceland or elsewhere and instituted by the Bank itself or by a third party,

but (in either case) the holder of such Subordinated Note may claim payment in respect of the Subordinated Note only in the liquidation of the Bank.

(b) In any of the events or circumstances described in Condition 9.2(a)(ii) above, the holder of any Subordinated Note may, by notice to the Bank, declare such Subordinated Note to be due and payable, and such Subordinated Note shall accordingly become due and payable at its then Prevailing Principal Amount together with accrued interest to the date of payment but subject to such Noteholder only being able to claim payment in respect of the Subordinated Note in the liquidation of the Bank.

(c) The holder of any Subordinated Note may at its discretion institute such proceedings against the Bank as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Bank under the Subordinated Notes (other than, without prejudice to Conditions 9.2(a) or 9.2(b) above, any obligation for the payment of any principal or interest in respect of the Subordinated Notes) provided that the Bank shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it, except with the prior approval of the FME.

(d) No remedy against the Bank, other than as provided in Conditions 9.2(a), 9.2(b) and 9.2(c) above shall be available to the Noteholders, whether for the recovery of amounts owing in respect of the Subordinated Notes or in respect of any breach by the Bank of any of its obligations or undertakings under the Subordinated Notes.

9.3 Definitions

For the purposes of the Conditions:

Financial Indebtedness means any indebtedness for or in respect of:

(a) borrowed money;

(b) any amount raised by acceptance under any acceptance credit facility or any dematerialised equivalent;

(c) any amount raised pursuant to any note purchase facility or the issue of any debenture, bond, note or loan stock or other similar instrument (with the exception of any loan stock issued by a member of the Group which is cash collateralised);

(d) the amount of any liability in respect of any lease or hire purchase contract which would, in accordance with IFRS, be treated as a finance or capital lease;

(e) receivables sold or discounted (otherwise than on a non-recourse basis);

(f) any amount raised under any other transaction (including any forward sale or purchase agreement) having the commercial or economic effect of a borrowing and which, for the avoidance of doubt, includes any transaction that is required to be classified and accounted for as borrowings, for financial reporting purposes in accordance with IFRS;

(g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price (and, when calculating the value of any derivative transaction, only the marked to market value shall be taken into account); or

(h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, standby or documentary letter of credit or any other instrument issued by a bank or financial institution;

Group means the Bank and its consolidated subsidiaries, taken as a whole;

IFRS means International Financial Reporting Standards; and

Principal Subsidiary means at any time a Subsidiary of the Bank:

(a) whose gross revenues (consolidated in the case of a Subsidiary which itself has Subsidiaries) or whose total assets (consolidated in the case of a Subsidiary which itself has Subsidiaries) represent in each case (or, in the case of a Subsidiary acquired after the end of the financial period to which the then latest audited consolidated accounts of the Bank and its Subsidiaries relate, are equal to) not less than 10 per cent. of the consolidated gross revenues, or, as the case may be, consolidated total assets, of the Bank and its Subsidiaries taken as a whole, all as calculated respectively by reference to the then latest audited accounts (consolidated or, as the case may be, non-consolidated) of such Subsidiary and the then latest audited consolidated accounts of the Bank and its Subsidiaries, provided that in the case of a Subsidiary of the Bank acquired after the end of the financial period to which the then latest audited consolidated accounts of the Bank and its Subsidiaries relate, the reference to the then latest audited consolidated accounts of the Bank and its Subsidiaries for the purposes of the calculation above shall, until consolidated accounts for the financial period in which the acquisition is made have been prepared and audited as aforesaid, be deemed to be a reference to such first-mentioned accounts as if such Subsidiary had been shown in such accounts by reference to its then latest relevant audited accounts, adjusted as deemed appropriate by the Bank;

(b) to which is transferred the whole or substantially the whole of the undertaking and assets of a Subsidiary of the Bank which immediately prior to such transfer is a Principal Subsidiary, provided that the transferor Subsidiary shall upon such transfer forthwith cease to be a Principal Subsidiary and the transferee Subsidiary shall cease to be a Principal Subsidiary pursuant to this subparagraph (b) on the date on which the consolidated accounts of the Bank and its Subsidiaries for the financial period current at the date of such transfer have been prepared and audited as aforesaid but so that such transferor Subsidiary or such transferee Subsidiary may be a Principal Subsidiary on or at any time after the date on which such consolidated accounts have been prepared and audited as aforesaid by virtue of the provisions of subparagraph (a) above or, prior to or after such date, by virtue of any other applicable provision of this definition; or

(c) to which is transferred an undertaking or assets which, taken together with the undertaking or assets of the transferee Subsidiary, generated (or, in the case of the transferee Subsidiary being acquired after the end of the financial period to which the then latest audited consolidated accounts of the Bank and its Subsidiaries relate, generate gross revenues equal to) not less than 10 per cent. of the consolidated gross revenues, or represent (or, in the case aforesaid, are equal to) not less than 10 per cent. of the consolidated total assets, of the Bank and its Subsidiaries taken as a whole, all as calculated as referred to in subparagraph (a) above, provided that the transferor Subsidiary (if a Principal Subsidiary) shall upon such transfer forthwith cease to be a Principal Subsidiary unless immediately following such transfer its undertaking and assets generate (or, in the case aforesaid, generate gross revenues equal to) not less than 10 per cent. of the consolidated total gross revenues, or its assets represent (or, in the case aforesaid, are equal to) not less than 10 per cent. of the consolidated total assets, of the Bank and its Subsidiaries taken as a whole, all as calculated as referred to in subparagraph (a) above, and the transferee Subsidiary shall cease to be a Principal Subsidiary pursuant to this subparagraph (c) on the date on which the consolidated accounts of the Bank and its Subsidiaries for the financial period current at the date of such transfer have been prepared and audited but so that such transferor Subsidiary or such transferee Subsidiary may be a Principal Subsidiary on or at any time after the date on which such consolidated accounts have been prepared and audited as aforesaid by virtue of the provisions of subparagraph (a) above or, prior to or after such date, by virtue of any other applicable provision of this definition,

all as more particularly defined in the Agency Agreement.

A report by two Authorised Signatories of the Bank that in their opinion a Subsidiary of the Bank is or is not or was or was not at any particular time or throughout any specified period a Principal Subsidiary, shall, in the absence of manifest error, be conclusive and binding on all parties.

10. REPLACEMENT OF NOTES, COUPONS AND TALONS

Should any Note, Coupon or Talon be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Fiscal Agent upon payment by the claimant of such costs and expenses as may be incurred in connection therewith and on such terms as to evidence and indemnity as the Bank may reasonably require. Mutilated or defaced Notes, Coupons or Talons must be surrendered before replacements will be issued.

11. PAYING AGENTS

The initial Paying Agents are set out below. If any additional Paying Agents are appointed in connection with any Series, the names of such Paying Agents will be specified in Part B of the applicable Final Terms.

The Bank is entitled to vary or terminate the appointment of any Paying Agent and/or appoint additional or other Paying Agents and/or approve any change in the specified office through which any Paying Agent acts, provided that:

(a) there will at all times be a Fiscal Agent;

(b) so long as the Notes are listed on any stock exchange or admitted to listing by any other relevant authority, there will at all times be a Paying Agent with a specified office in such place as may be required by the rules and regulations of the relevant stock exchange or other relevant authority; and

(c) there will at all times be a Paying Agent in a jurisdiction within Europe, other than the jurisdiction in which the Bank is incorporated.

In addition, the Bank shall forthwith appoint a Paying Agent having a specified office in New York City in the circumstances described in Condition 4.4. Notice of any variation, termination, appointment or change in Paying Agents will be given to the Noteholders promptly by the Bank in accordance with Condition 13.

In acting under the Agency Agreement, the Paying Agents act solely as agents of the Bank and do not assume any obligation to, or relationship of agency or trust with, any Noteholders or Couponholders. The Agency Agreement contains provisions permitting any entity into which any Paying Agent is merged or converted or with which it is consolidated or to which it transfers all or substantially all of its assets to become the successor paying agent.

12. EXCHANGE OF TALONS

On and after the Interest Payment Date on which the final Coupon comprised in any Coupon sheet matures, the Talon (if any) forming part of such Coupon sheet may be surrendered at the specified office of the Fiscal Agent or any other Paying Agent in exchange for a further Coupon sheet including (if such further Coupon sheet does not include Coupons to (and including) the final date for the payment of interest due in respect of the Note to which it appertains) a further Talon, subject to the provisions of Condition 8.

13. NOTICES

All notices regarding the Notes will be deemed to be validly given if published (a) in a leading English language daily newspaper of general circulation in London, and (b) if and for so long as the Notes are admitted to trading on, and listed on the Official List of the Luxembourg Stock Exchange, a daily newspaper of general circulation in Luxembourg or the Luxembourg Stock Exchange's website, www.bourse.lu. It is expected that any such publication in a newspaper will be made in the *Financial Times* in London and the *Luxemburger Wort* or the *Tageblatt* in Luxembourg. The Bank shall also ensure that notices are duly published in a manner which complies with the rules of any stock exchange or other relevant authority on which the Notes are for the time being listed or by which they have been admitted to trading including publication on the website of the relevant stock exchange or relevant authority if required by those rules. Any such notice will be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers. Until such time as any definitive Notes are issued, there may, so long as any Global Notes representing the Notes are held in their entirety on behalf of Euroclear and/or Clearstream, Luxembourg, be substituted for such publication in such newspaper(s) or such websites the delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg for communication by them to the holders of the Notes and, in addition, for so long as any Notes are listed on a stock exchange or are admitted to trading by another relevant authority and the rules of that stock exchange or relevant authority so require, such notice will be published on the website of the relevant stock exchange or relevant authority and/or in a daily newspaper of general circulation in the place or places required by those rules. Any such notice shall be deemed to have been given to the holders of the Notes on the second day after the day on which the said notice was given to Euroclear and/or Clearstream, Luxembourg.

Notices to be given by any Noteholder shall be in writing and given by lodging the same, together (in the case of any Note in definitive form) with the relative Note or Notes, with the Fiscal Agent. Whilst any of the Notes are represented by a Global Note, such notice may be given by any holder of a Note to the Fiscal Agent through Euroclear and/or Clearstream, Luxembourg, as the case may be, in such manner as the Fiscal Agent and Euroclear and/or Clearstream, Luxembourg, as the case may be, may approve for this purpose.

14. MEETINGS OF NOTEHOLDERS AND MODIFICATION

The Agency Agreement contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of the Notes, the Coupons or any of the provisions of the Agency Agreement. Such a meeting may be convened by the Bank and shall be convened by the Bank if required in writing by Noteholders holding not less than five per cent. in nominal amount of the Notes for the time being remaining outstanding. The quorum at any such meeting for passing an Extraordinary Resolution is one or more persons holding or representing not less than 50 per cent. in nominal amount of the Notes for the time being outstanding, or at any adjourned meeting one or more persons being or representing Noteholders whatever the nominal amount of the Notes so held or represented, except that at any meeting the business of which includes the modification of certain provisions of the Notes or the Coupons (including modifying the date of maturity of the Notes or any date for payment of interest thereon, reducing or cancelling the amount of principal or the rate of interest payable in respect of the Notes or altering the currency of payment of the Notes or the Coupons), the quorum shall be one or more persons holding or representing not less than two-thirds in nominal amount of the Notes for the time being outstanding, or at any adjourned such meeting one or more persons holding or representing not less than one-third in nominal amount of the Notes for the time being outstanding. The Agency Agreement provides that (i) a resolution passed at a meeting duly convened and held in accordance with the Agency Agreement by a majority consisting of not less than three-fourths of the votes cast on such resolution, (ii) a resolution in writing signed by or on behalf of the holders of not less than three-fourths in nominal amount of the Notes for the time being outstanding or (iii) consent given by way of electronic consents through the relevant clearing system(s) (in a form satisfactory to the Fiscal Agent) by or on behalf of the holders of not less than three-fourths in nominal amount of the Notes for the time being outstanding, shall, in each case, be effective as an Extraordinary Resolution of the Noteholders. An Extraordinary Resolution passed by the Noteholders will be binding on all the Noteholders, whether or not they are present at any meeting and whether or not they voted on the resolution, and on all Couponholders.

The Fiscal Agent and the Bank may agree, without the consent of the Noteholders or Couponholders, to:

(a) any modification (except such modifications in respect of which an increased quorum is required as mentioned above) of the Notes, the Coupons or the Agency Agreement which is not prejudicial to the interests of the Noteholders; or

(b) any modification of the Notes, the Coupons or the Agency Agreement which is of a formal, minor or technical nature or is made to correct a manifest error or to comply with mandatory provisions of the law.

Any such modification shall be binding on the Noteholders and the Couponholders and any such modification shall be notified to the Noteholders in accordance with Condition 13 as soon as practicable thereafter.

15. FURTHER ISSUES

The Bank shall be at liberty from time to time without the consent of the Noteholders or the Couponholders to create and issue further notes having terms and conditions the same as the Notes or the same in all respects save for the amount and date of the first payment of interest thereon and the date from which interest starts to accrue and so that the same shall be consolidated and form a single Series with the outstanding Notes.

16. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

No person shall have any right to enforce any term or condition of this Note under the Contracts (Rights of Third Parties) Act 1999, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

17. GOVERNING LAW AND SUBMISSION TO JURISDICTION

17.1 Governing law

The Agency Agreement, the Deed of Covenant, the Notes, the Coupons and any non-contractual obligations arising out of or in connection with the Agency Agreement, the Deed of Covenant, the Notes and the Coupons are governed by, and construed in accordance with, English law, except for the subordination provisions in Condition 2.2 of the Subordinated Notes, which will be governed by, and construed in accordance with, Icelandic law.

17.2 Submission to jurisdiction

(a) Subject to Condition 17.2(c) below, the English courts have exclusive jurisdiction to settle any dispute arising out of or in connection with the Notes and/or the Coupons, including any dispute as to their existence, validity, interpretation, performance, breach or termination or the consequences of their nullity and any dispute relating to any non-contractual obligations arising out of or in connection with the Notes and/or the Coupons (a **Dispute**) and accordingly each of the Bank and any Noteholders or Couponholders in relation to any Dispute submits to the exclusive jurisdiction of the English courts.

(b) For the purposes of this Condition 17.2, the Bank waives any objection to the English courts on the grounds that they are an inconvenient or inappropriate forum to settle any Dispute.

(c) To the extent allowed by law, the Noteholders and the Couponholders may, in respect of any Dispute or Disputes, take (i) proceedings in any other court with jurisdiction; and (ii) concurrent proceedings in any number of jurisdictions.

17.3 Appointment of Process Agent

The Bank irrevocably appoints Law Debenture Corporate Services Limited at its registered office at Fifth Floor, 100 Wood Street, London EC2V 7EX as its agent for service of process in any proceedings before the English courts in relation to any Dispute, and agrees that, in the event of Law Debenture Corporate Services Limited being unable or unwilling for any reason so to act, it will immediately appoint another person as its agent for service of process in England in respect of any Dispute. The Bank agrees that failure by a process agent to notify it of any process will not invalidate service. Nothing herein shall affect the right to serve process in any other manner permitted by law.

17.4 Waiver of immunity

The Bank irrevocably and unconditionally with respect to any Dispute (i) waives any right to claim sovereign or other immunity from jurisdiction, recognition or enforcement and any similar argument in any jurisdiction, (ii) submits to the jurisdiction of the English courts and the courts of any other jurisdiction in relation to the recognition of any judgment or order of the English courts or the courts of any competent jurisdiction in relation to any Dispute and (iii) consents to the giving of any relief (whether by way of injunction, attachment, specific performance or other relief) or the issue of any related process, in any jurisdiction, whether before or after final judgment, including without limitation, the making, enforcement or execution against any property whatsoever (irrespective of its use or intended use) of any order or judgment made or given in connection with any Dispute.

17.5 Other documents

The Bank has in the Agency Agreement and the Deed of Covenant submitted to the jurisdiction of the English courts and appointed an agent for service of process in terms substantially similar to those set out above.

18. ACKNOWLEDGEMENT OF STATUTORY LOSS ABSORPTION POWERS

18.1 Notwithstanding and to the exclusion of any other term of the Notes, or any other agreements, arrangements or understandings between any of the parties thereto or between the Bank and any Noteholder (which, for the purposes of this Condition 18, includes each holder of a beneficial interest in the Notes), each Noteholder by its acquisition of the Notes will be deemed to acknowledge, accept, and agree, that any liability of the Bank in respect of the Notes may be subject to the exercise of Statutory Loss Absorption Powers by the Relevant Resolution Authority and acknowledges, accepts, consents to and agrees to be bound by:

(a) the effect of the exercise of any Statutory Loss Absorption Powers by the Relevant Resolution Authority, which exercise may include and result in (without limitation) any of the following, or a combination thereof:

(i) the reduction of all, or a portion, of the principal amount of, or any interest on, the Notes or any other outstanding amounts due under or in respect of the Notes;

(ii) the conversion of all, or a portion, of the principal amount of, or any interest on, the Notes or any other outstanding amounts due under or in respect of the Notes into shares, other securities or other obligations of the Bank or another person, and the issue to or conferral on the Noteholder of such shares, securities or obligations, including by means of an amendment, modification or variation of the terms of the Notes;

(iii) the cancellation of the Notes; and

(iv) the amendment or alteration of the maturity of the Notes or amendment of the amount of interest payable on the Notes, or the date on which interest becomes payable, including by suspending payment for a temporary period; and

(b) the variation of the terms of the Notes, as deemed necessary by the Relevant Resolution Authority, to give effect to the exercise of any Statutory Loss Absorption Powers by the Relevant Resolution Authority.

In this Condition 18, **Statutory Loss Absorption Powers** mean any write-down, conversion, transfer, modification, suspension or similar or related powers existing from time to time under, and exercised in compliance with, any Statutory Loss Absorption Regime.

18.2 By its acquisition of the Notes, each Noteholder (including, for these purposes, each holder of a beneficial interest in the Notes): (a) acknowledges, accepts, consents and agrees to be bound by the exercise of any Statutory Loss Absorption Powers as they may be exercised without any prior notice by the Relevant Resolution Authority of its decision to exercise such powers with respect to such Notes and (b) shall be deemed to have authorised, directed and requested Euroclear, Clearstream, Luxembourg, any accountholder in Euroclear or Clearstream, Luxembourg and any other intermediary through which it holds such Notes to take any and all necessary action, if required, to implement the exercise of any Statutory Loss Absorption Powers with respect to such Notes as it may be exercised, without any further action or direction on the part of such Noteholder, the Fiscal Agent or any Paying Agent.

18.3 Upon the exercise of any Statutory Loss Absorption Powers by the Relevant Resolution Authority with respect to the Notes, the Bank will provide written notice to the Noteholders in accordance with Condition 13 as soon as practicable regarding such exercise of the Statutory Loss Absorption Powers for the purpose of notifying Noteholders of such occurrence. The Bank will also deliver a copy of such notice to the Fiscal Agent and the Paying Agents for information purposes.

USE OF PROCEEDS

The net proceeds from each issue of Notes will be applied by the Bank for its general corporate purposes, which include making a profit.

FINANCIAL MARKETS IN ICELAND

General

Towards the end of 2008, Iceland suffered a currency and banking crisis. The Icelandic government was forced to step in and take control of the three major Icelandic banks Kaupthing, Landsbanki and Glitnir, all of which had been very active in the international financial markets, to shore up confidence in the financial sector, protect domestic deposits and maintain the orderly functioning of the payment system. Following this, certain assets and liabilities were transferred from the banks into three new entities, including the Bank, which have operated as commercial banks from that time.

The establishment of the new banks

After the Icelandic government took control of Kaupthing, Glitnir and Landsbanki in October 2008, certain assets and liabilities were transferred from the banks into new entities, which have now become the Bank, Íslandsbanki and Landsbankinn. Following an agreement between the Icelandic government and the resolution committee of Kaupthing (the **Kaupthing Resolution Committee**) in July 2009, the Kaupthing Resolution Committee announced that it intended to exercise its option to purchase 87 per cent. of the Bank's equity, and a subsequent capital injection took place on 8 January 2010.

From January 2010 until March 2017, the Bank had two shareholders, Kaupthing, through its subsidiary Kaupskil, and the National Treasury of Iceland. Following private placements in March 2017 and in February 2018, the exercise of certain options in September 2017 and in February 2018, the buy-back of shares in March 2018 and the initial public offering of the shares in the Bank on 31 May 2018 and the subsequent listing of the Bank's shares in Iceland and Sweden in June 2018, the Bank has expanded its shareholder base. As of the date of this Base Prospectus, Kaupthing, through its subsidiary Kaupskil, remains the largest shareholder in the Bank and holds a 32.67 per cent. stake. The National Treasury of Iceland no longer holds a stake in the Bank.

A similar agreement was reached between the Icelandic government and Íslandsbanki, and Glitnir's resolution committee, through ISB Holding, held 95 per cent. of the shares in Íslandsbanki and the Ministry of Finance and Economic Affairs held the remaining 5 per cent. However, as part of the Glitnir composition agreement, Íslandsbanki is now fully state-owned. Landsbankinn is 98.2 per cent. state-owned (with the shares held by Icelandic State Financial Investments on behalf of the National Treasury of Iceland), while the Bank holds 0.91 per cent. and employees and other investors hold the remaining 0.89 per cent.

The Icelandic financial sector before 2008

Prior to the collapse of the banking system in Iceland, the financial sector and the legislative environment in Iceland had undergone much transition. For example, in connection with the EEA Agreement, Icelandic legislation and regulations regarding commercial banks and other financial undertakings and the financial market had been adopted to implement various regulations and directives of the European Union.

Before 2000 the Icelandic banking system mostly consisted of three investment banks, four commercial banks and 26 savings banks. By 2008, however, the financial market mainly consisted of three major international banks (Kaupthing, Glitnir and Landsbanki), while the number of savings banks had been reduced to 21. The total assets of the Icelandic banking system amounted to around ISK 9,739 billion at the end of December 2007.[1]

Other relevant institutions

[1] http://sedlabanki.is/lisalib/getfile.aspx?itemid=848

A new Housing Financing Fund (www.ils.is) was established at the beginning of 1999. The fund is based on legislation approved by the Icelandic Parliament in June 1998, which was aimed at rationalising the existing state financing system for housing. The Housing Financing Fund used to be by far the largest provider of financing for residential housing in Iceland but with the competition from the three major banks over the years leading up to 2008 its market share shrunk significantly. After the collapse of the banking system, the importance of the Housing Financing Fund grew. However, the three major banks have been strengthening their position in the market for the financing of residential housing over the past four years, partly due to Icelandic banks starting to offer non-inflation-linked mortgage loans from 2011 onwards.

Several domestic securities houses are currently operating in Iceland. However, the operations of these securities houses have been greatly limited since the banking collapse, but before 2008, many of them operated mutual funds of various kinds.

In addition, there are several insurance companies licensed to operate in Iceland. Insurance companies have been active in the financial market through their investment activities especially before 2008.

Furthermore, pension funds receive payments from employers and employees and are an important source of long term finance in the country. Membership in a pension fund is obligatory for wage earners and self-employed people, in accordance with Act No. 129/1997, on Mandatory Pension Insurance and on the Activities of Pension Funds. The pension funds are independent non-government entities. They invest mainly in domestic bond issues, equity capital and foreign securities and are a source of financing for residential and commercial property. Since July 2015, pension funds have been granted limited exemptions from Iceland's capital controls allowing, as expanded in January 2016, such funds to engage in foreign currency investments within a capped amount.

The Financial Supervisory Authority, the European Financial Surveillance System, the Icelandic Central Bank and the Iceland Stock Exchange

At the beginning of 1999, the Bank Inspectorate of the Icelandic Central Bank and the Insurance Supervisory Authority were merged into a new independent entity, the FME (www.fme.is). The field of supervision covered by the new entity is the whole range of financial institutions as well as insurance companies and pension funds. The activities of FME are primarily governed by Act No. 87/1998, on the Official Supervision of Financial Operations, and Act No. 98/1999, on the Payment of Cost Due to the Official Supervision of Financial Activities.

Pursuant to the introduction of the act on the European Financial Markets Surveillance System, with effect from 9 May 2017, Iceland has adopted regulation no 1093/2010 of the European Parliament and of the Council dated 24 November 2010 establishing the European Banking Authority, amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC; EU regulation No 1094/2010 of the European Parliament and of the Council dated 24 November 2010 establishing the European Insurance and Occupational Pensions Authority, amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC; EU regulation No. 1095/2010 of the European Parliament and of the Council dated 24 November 2010 establishing the European Securities and Markets Authority, amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC and EU regulation No 1092/2010 of the European Parliament and of the Council dated 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board. Hence the European Banking Authority, European Insurance and Occupational Pensions Authority, European Securities and Markets Authority and European Systemic Risk Board have been given certain surveillance powers in Iceland as per the aforementioned regulations.

The Icelandic Central Bank (www.sedlabanki.is) is responsible for implementing monetary policy consistent with the goal of maintaining price stability. The activities of the Icelandic Central Bank are primarily governed by Act No. 36/2001, on The Icelandic Central Bank. The Icelandic Central Bank imposes a reserve requirement on all commercial banks and savings banks. The purpose of this requirement is to ensure these credit institutions are able to meet fluctuations in their liquidity positions. The Icelandic Central Bank also oversees surveillance of the rules on foreign exchange. See "*Capital Controls*").

The Iceland Stock Exchange (Nasdaq Iceland) (http://www.nasdaqomxnordic.com/nordic/Nordic.aspx) operates under Act No. 110/2007, on Stock Exchanges. In the autumn of 2000, the Iceland Stock Exchange joined NOREX, a joint project of the Nordic stock exchanges. One of the main benefits from the NOREX Alliance is the SAXESS trading system, which is used by all NOREX participants. In September 2006, the Iceland Stock Exchange joined the OMX Nordic Exchange.

CAPITAL CONTROLS

Foreign Exchange Act

In response to the financial crisis, the Parliament of Iceland passed Act No. 134/2008 on 28 November 2008 relating to amendments to the Foreign Exchange Act, which granted the Icelandic Central Bank powers to intervene in the currency-market with the intent of stabilising the foreign exchange rate of Icelandic Krona. The Icelandic Central Bank introduced the Capital Controls by implementing Rules No. 1082/2008, which were amended several times before the Capital Controls were enacted into primary legislation with the adoption of Act No. 127/2011, which amended the Foreign Exchange Act.

In March 2017, the Icelandic Central Bank announced new rules which provide for general exemptions to the majority of the Capital Controls, with restrictions remaining on (i) derivatives trading for purposes other than hedging; (ii) foreign exchange transactions carried out between residents and non-residents without the intermediation of a financial undertaking; (iii) in certain instances, lending by residents to non-residents; and (iv) certain other restrictions in relation to special reserve requirements due to new inflows of foreign currency in further specified cases. However, it is uncertain when and if the Capital Controls will be lifted in full, and if economic circumstances in Iceland were to change, there can be no assurance that the Icelandic Central Bank would not re-impose elements of the Capital Controls which have already been lifted.

Before the entry into force of the general exemption, the Capital Controls effectively prohibited the cross-border transfer of funds, except in the case of a payment for goods or services and transfers permitted under applicable statutory exemptions. As a result, all financial transactions leading to cross-border currency transactions, including lending and borrowing between resident and non-resident parties as well as currency-derivatives of any kind and the acquisition by domestic parties of financial instruments denominated in foreign currency, were prohibited unless expressly permitted. Furthermore, the Capital Controls made it compulsory for Icelanders and Icelandic companies to repatriate all of their foreign currency not subject to statutory exemptions.

The Bank is subject to the Capital Controls as an Icelandic resident entity but currently benefits from both general and specific exemptions. Accordingly, the Bank is subject to the restrictions on the cross-border transfer of currency and Icelandic Krona unless exemptions apply. The Capital Controls, if the exemptions no longer applied, could have a different impact on the Bank's operations depending on the type of cross-border activities the Bank engages in. Furthermore, the Capital Controls contain limitations on domestic transactions, such as currency transactions, derivatives transactions and lending in foreign exchange. Currently, financial institutions, including the Bank, enjoy a specific statutory exemption from the Capital Controls allowing unrestricted domestic interbank market trade in currencies when settled on a trade, using futures and swaps. The exemption also exempts financial institutions, including the Bank, from restrictions on cross-border borrowing and lending, provision of cross-border guarantees and obligation to remit foreign currency to Iceland. However, although specific terms of transactions may fall within exemptions, the overall transaction may nevertheless be restricted by the Capital Controls if it were not for the general exemption from March 2017. Finally, the exemption allows financial institutions, including the Bank, to accept money market deposits denominated in Icelandic Krona from non-resident entities.

Statutory Exemptions and Amendments

The Foreign Exchange Act provides for several statutory exemptions. For example, certain financial institutions are provided with an exemption from certain provisions of the Capital Controls. Accordingly, commercial banks, savings banks and credit institutions operating under a licence issued by the FME are, among other things, exempt from restrictions on borrowing and lending between resident and non-resident parties, the restriction on assuming liability for payments between resident and non-resident parties and the requirement to repatriate all foreign currency. In addition to the statutory exemptions, the Foreign Exchange

Act sets forth the mechanics for obtaining specific exemptions from the Capital Controls, upon application to, and subject to the approval of, the Icelandic Central Bank.

However, in the case of the winding-up, bankruptcy or insolvency of a financial institution, the exemptions from the Capital Controls may not apply and, therefore, restrictions will be effected in respect of payments in foreign currency and cross-border transfer of funds, whether by reason of the Foreign Exchange Act, the Act on Bankruptcy No. 21/1991, as amended, or applicable provisions under the Financial Undertakings Act.

The amendments, implemented in March 2012 by Act No. 17/2012, imposed further restrictions on the outflow of foreign currency with respect to, among other things, the Capital Controls in response to a perceived increase in circumvention of the Capital Controls. Before such amendments were implemented, an investor could change its interests in the principal amortisation and indexation payments under a CPI-indexed annuity bond into foreign currency and transfer such payments out of Iceland. The amendments removed the previous exemption provided for such payments, with the result that such payments became subject to the Capital Controls, meaning that only interest payments remained within the exemption. Furthermore, the wide exemptions for payments by the winding-up committees of Kaupthing, Glitnir and Landsbanki to creditors were removed and became subject to approval by the Icelandic Central Bank.

Two additional amendments were made to the Foreign Exchange Act in March 2013. First, on 9 March 2013, Act No. 16/2013 was adopted, implementing certain changes to the currency control regime, including the removal of the expiration date from the Foreign Exchange Act. Such amendments also imposed limits on the exemptions which the Icelandic Central Bank can apply and the extent to which the exemptions may be subject to prior consultation with the relevant ministry. These limits primarily relate to financial institutions or legal entities under the control of the FME through winding-up proceedings or legal entities with a balance sheet exceeding ISK 400 billion and where the transaction may have a substantial effect on Iceland's debt position or affect ownership of a commercial bank. Second, on 26 March 2013, further amendments were adopted with Act No. 35/2013, primarily relating to general exemptions and enhanced authorisations for the Icelandic Central Bank. Such amendments enhanced the Icelandic Central Bank's surveillance of foreign exchanges, including in relation to payments of interest, indexation, dividends and contractual maturities. The Icelandic Central Bank also received authorisation to collect certain information, which may extend to any relevant third party, and to impose fines.

In May 2014, additional amendments to the Foreign Exchange Act were implemented with the adoption of Act No. 67/2014. The amendments sought to clarify Article 13 j. of the Foreign Exchange Act by further elaborating on what payments are classified as dividends under Article 13 j. (1). Article 16 a. of the Foreign Exchange Act was also amended to provide that fines may be imposed on institutions pursuant to the Foreign Exchange Act or applicable rules thereunder, irrespective of whether the relevant violation can be linked to the actions of such institution's representative or its employees.

Additional amendments to the Foreign Exchange Act were implemented in June 2015 and July 2015, primarily in connection with the conclusion of the winding-up proceedings of the estates of Glitnir, Landsbanki, Kaupthing and other smaller failed banks. With the adoption of Act No. 27/2015 in June 2015, several amendments were made restricting the operations of entities undergoing winding-up proceedings, entities that have concluded winding-up proceedings and entities that have been established in connection with the implementation of a composition agreement, and withdrawing the general exemption that previously applied. As a result of such amendments, the estates are prohibited from (a) purchasing foreign currency other than from domestic banks, (b) intra-group lending and borrowing and (c) granting intra-group guarantees unless the guarantee is granted in connection with the purchase and sale of goods and services or if the loan for which the guarantee is granted is otherwise exempt. Restrictions were also placed on repayments of loans. Investments in derivative contracts or in claims against the estates no longer qualify as new investments under the Icelandic Central Bank's new investment regime. Restrictions were also adopted on borrowing by domestic parties from non-domestic parties and purchase of foreign currency for repayment of loans advanced by domestic lenders. Further amendments were adopted with Act No. 60/2015 in July

2015 in relation to the levying of a so-called "stability-tax", which grants the estates exemption from some of the restrictions of the Foreign Exchange Act.

Easing of Capital Controls

On 25 March 2011, the Icelandic Central Bank announced a new strategy for the gradual easing of the remaining Capital Controls in phases, each of which is subject to certain conditions. The Icelandic government and the Icelandic Central Bank implemented further easing of the Capital Controls, which was aimed at individuals and the investments of legal entities, with the most recent changes occurring in October 2016, as described in greater detail below. No further announcements have been made by the Icelandic government or the Icelandic Central Bank regarding the easing of the remainder of the Capital Controls.

The Capital Controls constitute protective measures under Article 44 of the EEA Agreement and have as such been notified to the Standing Committee of the EFTA under the procedures provided for in Protocol 18 of the EEA Agreement as well as Protocol 2 of the Agreement between the EEA EFTA states on the Establishment of a Surveillance Authority and a Court of Justice (the **Surveillance and Court Agreement**). Following a referral by the District Court of Reykjavík, the Court of Justice of the EEA EFTA states (the **EFTA Court**) issued a reasoned opinion on 14 December 2011, whereby the EFTA Court ruled that it had competence under the Capital Controls and the Surveillance and Court Agreement to review the Capital Controls, among other things, in light of the general principle of proportionality. The EFTA Court further declared that at the time in question the Capital Controls were proportionate. However, this ruling of the EFTA Court does not preclude further scrutiny of the Capital Controls by the relevant institutions of the EEA at any time.

In June 2015, the Icelandic government announced a plan towards easing of the Capital Controls. The plan was threefold: *first*, the estates of Glitnir, Landsbanki, Kaupthing and other smaller failed banks agreed to certain stability conditions, which have since been fulfilled by making contributions to the Icelandic Central Bank, after completing their respective winding-up proceedings by reaching composition agreements with their respective creditors, all of which have been confirmed by the District Court of Reykjavík; *second*, offshore holders of ISK-denominated deposits or government bonds will be offered a currency auction held by the Icelandic Central Bank; and, *third*, the Capital Controls will be gradually eased on the domestic market when conditions allow.

As of the date of this Base Prospectus, the first part of the plan has been completed. Each of the estates of Glitnir, Landsbanki and Kaupthing reached formal composition agreements approving a composition proposal through which they would exit winding-up proceedings with their creditors at creditors' meetings held in 2015. All composition agreements were approved by the District Court of Reykjavík before the year ended 31 December 2015. To allow each of Glitnir, Landsbanki and Kaupthing to implement their respective composition agreements, the Icelandic Central Bank has granted them certain exemptions from the Capital Controls on the basis that Glitnir, Landsbanki and Kaupthing, have, among other things, made a "stability contribution" to the Icelandic Central Bank. This stability contribution is intended to assist in maintaining stability in the Icelandic economy following the assumed negative impact of the composition agreements on the balance of payments and economic recovery programme for Iceland. The stability contribution varies between the estates, with the largest payment made by Glitnir, including the transfer of its shares in Íslandsbanki, and smaller payments made by Kaupthing and Landsbanki. Following the completion of the Kaupthing Composition Agreement, Kaupthing continued to hold 87 per cent. of the Bank's shares through its wholly owned subsidiary Kaupskil until March 2017. Kaupthing's shareholding has since decreased to 57.9 per cent., with the sale of a 29.1 per cent. stake in the Bank through a private placement in March 2017, to 57.4 per cent. upon the exercise of certain options in September 2017 and to 55.6 per cent. through a further private placement in February 2018. Kaupthing's shareholding in the Bank further decreased to 32.67 per cent. following the initial public offering of shares in the Bank on 31 May 2018 and the subsequent listing of the Bank's shares in Iceland and Sweden in June 2018. A profit-sharing agreement is in place whereby the proceeds from any sale of Kaupthing's shares in the Bank will be divided between Kaupthing and the Icelandic government, in proportions which will vary depending on the proceeds of any such sale, and will form part of Kaupthing's stability contribution.

As part of the implementation of the second part of the plan, Act No. 37/2016 on the Treatment of Krona-denominated Assets Subject to Special Restrictions (the **Krona Asset Act**) was enacted on 23 May 2016. The Krona Asset Act seeks to address the treatment of specified assets denominated in Icelandic Krona, defined as Offshore Krona Assets in article 2(1) of the Krona Asset Act. Offshore Krona Assets, which are currently subject to the Capital Controls and total over ISK 300 billion, include various assets and funds denominated in Icelandic Krona, owned or held by non-resident parties (as defined in the Foreign Exchange Act). They are considered by the Minister of Finance and Economic Affairs as assets likely to leave the Icelandic economy, with potentially negative consequences for financial stability. The aim of the Krona Asset Act, therefore, was for the Icelandic Central Bank to hold a foreign currency auction in which all owners of Offshore Krona Assets were given the option of exchanging these assets for euros at a particular exchange rate. Any Offshore Krona Assets not exchanged in the foreign currency auction held are subject to restrictions, as further set out in the Krona Asset Act.

In October 2016, in the adoption of Act No. 105/2016, which took effect on 1 January 2017, further amendments were made to begin to implement the third part in the plan for easing of the Capital Controls.

Most recently, in March 2017, the Icelandic Central Bank announced new rules which provide for general exemptions to nearly all of the restrictions pursuant to the Foreign Exchange Act, with restrictions remaining on i) derivatives trading for purposes other than hedging; ii) foreign exchange transactions carried out between residents and non-residents without the intermediation of a financial undertaking; iii) in certain instances, lending by residents to non-residents; and iv) certain other restrictions in relation to special reserve requirements due to new inflows of foreign currency in further specified cases. However, it is uncertain when and if the Capital Controls will be lifted in full, and if economic circumstances in Iceland were to change, there can be no assurance that the Icelandic Central Bank would not re-impose elements of the Capital Controls which have already been lifted.

DESCRIPTION OF THE BANK

OVERVIEW

The Bank was established on 18 October 2008 and is incorporated in Reykjavik and domiciled in Iceland. It is a public limited company established and operating under Act No. 2/1995 regarding Public Limited Companies, under the laws of the Republic of Iceland with ID number 581008-0150 in the Icelandic Register of Enterprises. The Bank was initially named New Kaupthing banki hf. and, on 21 November 2009, its name was changed to Arion banki hf., with foreign trading name Arion Bank hf.

The Bank is a leading, privately owned universal relationship bank in Iceland with a differentiated and innovative approach. The Bank has established itself as a broad and well-balanced bank that provides products and services which meet the needs of Icelandic households and companies. To ensure it is well-balanced and diversified in its product and services offering and expertise, the Bank has organised itself across four dedicated divisions and operates strategic subsidiaries that add valuable products and services to the business, such as payment processing and insurance. The Bank's diversified and balanced approach to its business also means that it has a broad revenue base and a balanced and diverse loan portfolio with a moderate risk profile serving individuals and companies. As a result, the Bank enjoys a strong position within domestic financial markets in terms of its return on equity, operational efficiency and product and services offering.

The Bank's focus is on building and strengthening long-term customer relationships by delivering excellent products and services and tailored solutions. Its main customers are corporations and individuals, who seek a wide variety of financial solutions and, as a universal relationship bank with a wide product and services offering (including a leading digital offering), the Bank seeks to meet those needs whatever they may be. While the Bank considers itself to be an Icelandic bank first, it is also increasingly but selectively providing financial services outside of Iceland, mainly to companies related to the seafood industry in Europe and North America. As the only privately owned major bank in Iceland, the Bank has the freedom to manage its business in accordance with this strategy and adapt to the changing needs of its customers.

The Bank's core values (the **Cornerstones**) were introduced in 2012 and are:

- We make a difference.
- We say what we mean.
- We get things done.

The Cornerstones guide the Bank in everything it says and does, particularly in its interaction with its main stakeholders: customers, employees, society and investors.

For the years ended 31 December 2017 and 2016 respectively, the Bank's net interest income was ISK 29,835 million and ISK 29,900 million, its net fee and commission income was ISK 15,357 million and ISK 13,978 million, its operating income was ISK 53,378 million and ISK 54,546 million, and its net earnings were ISK 14,419 million and ISK 21,739 million. As of 31 March 2018, the Bank's total assets were ISK 1,131,769 million.

The Bank's registered address is Borgartún 19, 105 Reykjavík and its telephone number is +354 444 7000.

HISTORY

The Bank's predecessor, Kaupthing, was the product of a merger in May 2003 of two leading Icelandic banks, Kaupthing Bank hf. and Bunadarbanki Islands hf. (the **Agricultural Bank of Iceland**). The

Agricultural Bank of Iceland was established in 1929 by a law passed by the Parliament of Iceland and began operations in 1930. At the beginning of 1998, the Agricultural Bank of Iceland became a limited liability company and was privatised in stages up to the beginning of 2003. Kaupthing hf. was established in Reykjavík in 1982, coinciding with the launch of the free capital markets in Iceland. Kaupthing hf. later became an investment bank before its merger with the Agricultural Bank of Iceland in 2003. The branch network of the Agricultural Bank of Iceland became the backbone of the Bank's retail branch network.

2010-2012: Restructuring of the Bank and its customers

The Bank was established in October 2008 as the entity to which certain assets and liabilities of Kaupthing were transferred following the assumption of control of Kaupthing by the FME. The transfer of these assets and liabilities posed a significant challenge. In March 2010, a new Board of Directors was appointed at the Annual General Meeting and, in June 2010, the Board of Directors appointed a new CEO. In addition, a strategic plan was adopted in October 2010, which aimed to position the Bank as a universal relationship bank, providing a range of quality financial products and services and focused on improving the Bank's competitiveness. From 2010 onward, under its new leadership and in accordance with its strategy, the Bank has systematically restructured and improved the credit quality of its customer loan portfolio. Immediately following the financial crisis in 2008, the Bank emerged from restructuring with a newly valued balance sheet, reflecting a loan portfolio transferred from Kaupthing at fair value, which in most cases was a discount on the face value of the loans. As a result of the Bank's restructuring and refinancing efforts, the discounts on these legacy loans have been progressively released as the restructuring of the customer loan portfolio continued, whether as a result of prepayments, write-offs or otherwise. During this period, the Bank also began reducing its number of problem loans, defined as loans more than 90 days past due but not impaired and other problem (i.e. individually impaired) loans. The Bank also took an innovative approach to mortgage loan products, being the first Icelandic bank to introduce the fixed rate non-CPI-linked mortgage loans, a strategy which it supported through selective portfolio acquisitions.

In January 2012, the Bank acquired the mortgage portfolio managed in a special fund (the **Fund**) owned by the estate of Kaupthing. The Fund had guaranteed the covered bonds issued from 2006 to 2008 by Kaupthing to finance its mortgage loans (the **Kaupthing Covered Notes**) under the covered bond programme established by Kaupthing on 30 March 2006. As a part of this acquisition, the Bank was substituted for, and assumed all liabilities and obligations (past, present and future, other than Kaupthing's liabilities and obligations relating to withholding tax payments) of, Kaupthing in respect of each of the six series of outstanding Kaupthing Covered Notes. The Kaupthing Covered Notes series have all been prepaid except for one outstanding series. The outstanding series is not rated, CPI-linked, has a final maturity date of 2048 and had an aggregate face value of ISK 78.3 million as of 31 December 2017, and which is included as borrowings in the Bank's consolidated statement of financial position.

2013-2014: Streamlining and building of the business

Following the success of its restructuring efforts, the Bank was in a position to begin building up its business. In 2013, the Bank launched its "lean banking initiative" and undertook a number of changes to its core banking operations, including the optimisation of its branch network by reducing total branch size and focusing on increased self-service opportunities for customers. The Bank also launched its digitalisation initiative to further drive efficiency, including the implementation of an extensive CRM system to provide better services and increase staff productivity. Digitalisation also allowed the Bank to strengthen its customer focus and decentralise credit decisions.

During this period, the Bank began to build up its Icelandic market leadership in its core products. The Investment Banking division also established itself as an innovator in the Icelandic capital markets through its involvement in three out of five initial public offerings during 2013 and 2014. The Bank adopted a first mover approach as exemplified by its early adoption of next generation personal banking technology, which led to the Bank becoming a market leader in personal online and mobile banking.

During this period, the Bank also continued to improve its underlying asset quality and reduce the number of problem loans as part of the restructuring process of its customer loan portfolio.

2015 to present: Strengthening market leadership and harvesting full value potential

Since 2015, the Bank has been able to focus on growing and improving its business by strengthening its presence and leadership in key markets, including capital markets, project financing and asset management. The Bank managed all four initial public offerings listed on the Main Market of NASDAQ Iceland in 2015 and 2016, managed the only listing on NASDAQ Iceland First North in 2017, and provided the project financing for a new five star hotel in Reykjavík, a deal worth over USD 125 million. The Bank is also in the process of optimising its capital structure and improving its risk-weighted assets profile. It continued with its first mover approach in 2015, being the first Icelandic bank to issue a benchmark eurobond since 2008. In its business divisions, the Bank has continued to drive commercial excellence in its markets and is actively exploring new business opportunities. In addition, the Bank acquired Vördur, a universal insurance company, in 2016.

The Bank has also worked to improve its operational efficiency. For example, the Bank has scaled its digitalisation initiatives and continues to invest in its IT infrastructure as well as applying the project delivery model, which originated in the IT division, across the Bank's other divisions, in order to promote speed and efficiency of project implementations. In March 2018, the Bank announced plans to merge certain branches and focus on optimising its branch network by reducing square metres occupied and to have digital branches, resulting in closing three branches.

KAUPTHING

In October 2008, Kaupthing was taken into a special resolution regime. Under this regime, Kaupthing entered into moratorium on 24 November 2008, which ended following a ruling of the District Court, on 22 November 2010, after which it entered into a winding-up process.

Prior to its dissolution, the Kaupthing Resolution Committee represented Kaupthing in all matters and safeguarded its interest. The Kaupthing Resolution Committee had a legal obligation to maximise the value of Kaupthing's assets and preserve the interests of its creditors as a whole. In addition, the Kaupthing Resolution Committee was responsible for managing Kaupthing's daily operations.

In May 2009, the District Court approved a request from the Kaupthing Resolution Committee and appointed a winding-up committee (the **Winding-up Committee**) for Kaupthing, to administer the processing of claims against Kaupthing. Prior to the dissolution of the Kaupthing Resolution Committee, the Winding-up Committee worked alongside the Kaupthing Resolution Committee and administered the formal process of filing and handling all claims against Kaupthing.

Under the winding-up proceedings, agreements and obligations of the financial undertaking continued to exist and Kaupthing was protected against petitions for insolvent liquidation. Its assets could not become subject to an attachment, execution or forced sale. No law suit could be filed against Kaupthing in Iceland while it was in winding-up proceedings, unless in accordance with a provision of law (primarily concerning disputes as to the processing of claims against Kaupthing) or through criminal proceedings.

The Kaupthing Resolution Committee was dissolved on 1 January 2012 and the Winding-up Committee assumed all responsibility for managing the Kaupthing estate. On 16 March 2016, a new board of directors was appointed to replace the Winding-up Committee.

On 24 November 2015, the requisite majority of Kaupthing's unsecured creditors voted at a creditors' meeting held to approve a composition proposal (at which point it became a composition agreement, the **Composition Agreement**), through which Kaupthing would exit the winding-up proceedings. The Composition Agreement was approved by the District Court on 15 December 2015 and became final and binding on 23 December 2015. In order to allow Kaupthing to implement the Composition Agreement, the Icelandic Central Bank has granted Kaupthing certain exemptions from Icelandic foreign capital controls on the basis that Kaupthing, among other things, has made a "stability contribution" to the Icelandic Central Bank.

As part of a refinancing of the Bank's debt position undertaken in connection with the "stability contribution", on 11 January 2016 the Bank issued USD747,481,000 Resettable Notes due 2023 (the **Resettable Notes**) under the Programme to Kaupthing. The Bank and Kaupthing agreed to set off Kaupthing's obligation to pay the purchase price in respect of the Resettable Notes against the Bank's obligation to make payment of all amounts outstanding under a foreign currency loan provided to the Bank by the Icelandic Central Bank on 22 January 2010 (such loan having been purchased by Kaupthing from the Icelandic Central Bank) and to return certain foreign currency deposits held by the Bank for Kaupthing. The Resettable Notes were repaid in full as of 30 June 2017.

SHAREHOLDERS OF THE BANK

Kaupthing's shareholding in the Bank is held through its wholly owned subsidiary Kaupskil, a private limited liability company, ID no. 580609-0150, Borgartún 26, Reykjavik.

Prior to March 2017, Kaupthing, together with the National Treasury of Iceland, were the Bank's main shareholders. Following completion of the Composition Agreement and the sale by Kaupthing of 29.2 per cent. of the shares in the Bank through a private placement in March 2017, the exercise of certain options in September 2017, a further private placement in February 2018 and the initial public offering of the shares in the Bank on 31 May 2018, Kaupthing, through its subsidiary Kaupskil, remains the largest shareholder in the Bank and holds a 32.67 per cent. stake. Taconic Capital Advisors is the next largest shareholder in the Bank with a stake of 10.00 per cent. Attestor Capital and Och-Ziff Capital Management are the only other shareholders in the Bank with stakes of 9.14 per cent. and 6.58 per cent., respectively.

The total voting rights of Kaupthing, through Kaupskil, and of Taconic Capital Advisors LP and related parties (**Taconic**), through TCA New Sidecar S.á.r.l., is restricted to 33 per cent. of total voting rights in the Bank according to the notification of the FME dated 22 September 2017 on the basis that Kaupthing and Taconic are considered to be related parties by the FME holding more than 5 per cent. of the shares in the Bank.

Various restrictions have been placed on Kaupthing by the FME. Kaupthing is required to notify the FME in advance of a proposed transfer of ownership of shares in the Bank or Kaupskil. Upon receipt of any such notification, the FME will carry out a new eligibility assessment of the prospective owners if the change of ownership affects the Board of the Bank. The FME officially set out the details of its approval and conditions in a press release dated 18 January 2010 (http://www.fme.is/utgefid-efni/frettir-og-tilkynningar/frettir/nr/602).

In addition, a profit-sharing agreement is in place whereby the proceeds from any future sale of the Bank will be divided between Kaupthing and the Icelandic government in proportions which will vary depending on the proceeds of any such sale, and will form part of Kaupthing's stability contribution.

STRATEGY

The Bank strives to position itself as a universal relationship bank in Iceland, providing a diverse and well-balanced range of financial products and services which reflect broadly the composition of the Icelandic economy. This allows the Bank to provide tailored and personalised solutions to its customers, particularly those who require comprehensive and diverse financial products and services.

The Board of Directors has adopted a strategic plan for the Bank, the key points of which are summarised below. Some of the information contained in this section, including with respect to the strategic plan, contains forward-looking statements that involve risks and uncertainties. See "*Presentation of Financial and Other Information - Forward-Looking Statements*".

Build long-term business relationships

The Bank intends to increase its focus on developing long-term business relationships through regular dialogue with customers so as to fully understand their needs and responsive and pro-active development of its products and services, which the Bank believes is fundamental to its business. The Bank aims to innovate and develop products and services which respond to the changing needs of its customers and to put the interests of its customers first in all transactions. For instance, the Bank is increasingly investing in its IT division to expand its digital products and services offering to improve its customers' experience and satisfaction when using the Bank's digital products and services. In order to move credit authority closer to its customers, the Bank has also automated a number of credit decisions through its digital projects and decentralised certain smaller credit decisions in respect of SMEs, by providing further training to employees in branches and giving them sufficient credit authority to make credit decisions locally and in less time. This decentralisation has not affected the current structure of the Bank's credit committees, which will continue to assess larger credit cases.

Increase operational efficiency

The Bank has recently implemented and expects to implement additional operational efficiency initiatives, which are expected to have bottom-line impact, in line with its medium-term target to reduce its cost-to-income ratio to approximately 50 per cent. (56.1 per cent. for the year ended 31 December 2017). The lean banking initiative aims to implement effective processes to help meet customers' needs by eliminating waste, instability and inflexibility in the Bank's infrastructure with the overall goal of improving customers' experiences. In addition, the Bank plans to increasingly pursue its digitalisation initiatives in several areas, particularly onboarding for private banking and capital markets and also focusing on the corporate lending process. These initiatives are expected to enhance customer satisfaction and experience, ultimately increasing the value of the Bank's brand, and to have bottom-line effect by reducing salary expenses and increasing customer demand and sales by streamlining product and loan delivery. The Bank has also announced cost cutting measures and plans to implement operational improvements and streamline its operations through outsourcing of non-core functions to reduce overhead and administrative costs. In March 2018, the Bank announced plans to merge certain branches and focus on optimising the branch network by reducing square metres occupied and to have digital branches, resulting in closing three branches.

Strengthen the core business

The Bank expects its core banking business (particularly with respect to net interest income, net fee and commission income and net insurance income) to benefit in the coming years from underlying market growth fuelled by anticipated growth in the Icelandic economy. For instance, the growth of private consumption in Iceland is expected to increase opportunities for mortgage lending. The Bank also expects to harness this growth to help bolster its leading position across businesses and increase its share in lending to small-to-medium-sized enterprise customers of the Bank and/or its subsidiaries, defined as corporates with loans up to ISK 2.0 billion (**SMEs**) as well as in leasing and insurance businesses. The Bank further anticipates that it will be able to capitalise on its broad revenue base to maintain the levels of fee and commission income with potential for growth, contributing to a positive outlook for the Bank's core business development. The Bank also expects its cost of risk to decrease in the future through a focus on collateralisation and closer relationships with its customers, allowing the Bank to encourage improved lending practices and early intervention should customers face financial difficulties.

Pursue value creation opportunities

The Bank plans to improve its competitiveness by pursuing several anticipated value creation opportunities in the upcoming years and taking a proactive approach to its business. One such opportunity is for increased cooperation across the Bank's divisions, in particular between the Retail Banking division and Vördur, for example through the use of the Bank's branch network to sell Vördur's products as a registered insurance intermediary. The Bank also intends to pursue additional opportunities in the financial technology space and seeks to increase income diversification within the Corporate Banking division. With increased clarity regarding future regulatory capital requirements with the introduction of CRD IV, there is a potential for the Bank to optimise its capital structure through distributions of surplus capital to shareholders and to reduce its risk-weighted assets as a percentage of total assets.

These initiatives are expected to tie into the Bank's overall strategies by enabling the Bank to remain balanced and diverse and to meet the changing needs of its customers.

BUSINESS

The Bank comprises the following operating segments:

Retail Banking provides a comprehensive range of products and services, including mortgage loans, savings and checking accounts, vehicle and equipment financing, factoring, payment cards, pension services, insurance and funds, to both individuals and SMEs. The Retail Banking division has a strong emphasis on digital banking solutions, including internet banking, the Arion Bank App and automated teller machines (**ATMs**). As of 31 December 2017, the Retail Banking division operated out of 24 branches across Iceland and its 367 full-time equivalent employees (**FTEs**) served over 100,000 customers during the year. In March 2018, the Bank announced plans to merge certain branches and focus on optimising its branch network by reducing square metres occupied and to have digital branches, resulting in closing three branches.

Corporate Banking provides customised lending solutions, including term loans, revolving credit facilities and guarantees, to large corporate customers across all industry sectors with an emphasis on top 100 companies in Iceland. The Corporate Banking division derives the majority of its income from the provision of loans to corporate customers. As of 31 December 2017, the Corporate Banking division served 191 large corporate customers with 15 FTEs working out of headquarters with day to day customer service support from dedicated corporate service representatives in 13 branches.

Investment Banking provides a full range of investment banking products and services, including equity and fixed income brokerage, initial public offerings and M&A advisory and bond and equity trading services, to a broad range of customers, including corporate customers, professional investors, asset management companies and pension funds. As of 31 December 2017, the Investment Banking division had 30 FTEs organised across the three subdivisions: Capital Markets, Corporate Finance and Research.

Asset Management (which includes Stefnir, an independently operating financial company wholly owned by the Bank) provides a full range of asset management products and services to institutional investors, such as pension funds and insurance companies, and high net worth individuals. As of 31 December 2017, the Asset Management division had more than 100,000 customers and 34 FTEs organised across the four subdivisions, Private Banking, Institutional Asset Management, Investment Services and Pension Funds Administration, and Stefnir had approximately 10,600 investors in over 40 funds served by 18 FTEs.

Treasury, which is a part of the Finance division, is responsible for liquidity, currency and interest rate management for the Bank. Treasury is also responsible for the internal pricing of interest rates and currency and for liaising with other financial institutions.

Other divisions and subsidiaries include the Bank's market making business in currencies and domestic securities. The subsidiaries are Valitor, Vördur, Eignarhaldsfélagid Landey ehf. (**Landey**) and other smaller entities.

Valitor is the Bank's international payments platform and comprises both card acquiring services and card issuing services. Valitor provides e-commerce and card-present card acquiring services to merchants and corporate customers and provides card issuing services and payment processing solutions to domestic and international partners.

Vördur is a universal insurance company providing policies for motor vehicles, home protection, property and life and health products.

Landey is the Bank's wholly owned property development company which manages assets, such as unfinished housing developments and building lots, and maintains and increases the value of these assets.

The tables below set forth operating income and earnings before tax for each reportable segment and the total assets for each reportable segment for the periods and as of the dates indicated.

	As of and for the year ended 31 December 2017							
	Retail banking(1)	**Corporate banking**	**Investment banking**	**Asset management**(2)	**Treasury**(3)	**Other divisions and subsidiaries**(4)	**Headquarters and elimination**(5)	**Total**
				(*ISK in millions*)				
Operating income	21,151	8,543	1,467	4,677	6,216	12,251	(927)	53,378
Earnings (loss) before tax	11,504	3,297	(57)	2,338	4,377	2,392	(3,420)	20,431
Total assets	527,652	274,917	16,165	75,564	483,794	89,936	(320,274)	1,147,754

(1) Includes Arion Bank Mortgages Institutional Investor Fund (the **ABMIIF**).
(2) Includes Stefnir.
(3) The "Treasury" reportable segment includes internal interest income and internal expense (which are eliminated upon consolidation) as well as interest income on the Group's cash, cash equivalents and other liquid assets held as a liquidity buffer.
(4) Includes Valitor, Landey and Vördur (including what was formerly Okkar Life Insurance).
(5) "Headquarters and elimination" includes the netting out of intragroup accounts, dividends paid in respect of the Bank's holdings in listed equity and valuation changes. "Headquarters" include overhead and the following support divisions: Risk Management, Finance (excluding Treasury), Legal, IT and Operations.

	As of and for the year ended 31 December 2016							
	Retail banking(1)	**Corporate banking**	**Investment banking**	**Asset management**(2)	**Treasury**(3)	**Other divisions and subsidiaries**(4)	**Headquarters and elimination**(5)	**Total**
				(*ISK in millions*)				
Operating income	19,702	7,874	3,746	4,345	6,160	12,310	409	54,546
Earnings before tax	11,996	4,307	3,643	1,832	4,069	5,164	(2,641)	28,370
Total assets	506,483	251,821	16,836	87,307	427,037	72,128	(325,588)	1,036,024

(1) Includes ABMIIF.
(2) Includes Stefnir.
(3) The "Treasury" reportable segment includes internal interest income and internal expense (which are eliminated upon consolidation) as well as interest income on the Group's cash, cash equivalents and other liquid assets held as a liquidity buffer.
(4) Includes Valitor, Okkar Life Insurance, Landey and Vördur. Additionally, it includes the Bank's share of operating income, earnings before tax and assets from BG12 slhf., EAB 1 ehf. and Kolufell, in which the Bank sold a majority of its shareholding in July 2016.
(5) "Headquarters and elimination" includes the netting out of intragroup accounts, dividends paid in respect of the Bank's holdings in listed equity and valuation changes. "Headquarters" include overhead and the following support divisions: Risk Management, Finance (excluding Treasury), Legal, IT and Operations.

RETAIL BANKING DIVISION

Overview

The Retail Banking division is a leading and innovative retail bank in Iceland that provides a comprehensive range of financial products and services to individuals and SMEs and seeks to build long-lasting and profitable relationships with its customers. In the period from 2009 to 2012, the Retail Banking division's key focus was to work with its customers to restructure their debts. However, during 2012, market conditions improved and, accordingly, demand for traditional financial products and services increased, which enabled the Retail Banking division to switch its focus to providing such products and services. In addition, the Retail Banking division continuously strives to differentiate its product and service offerings, for example by offering factoring, or asset-based lending, to SMEs in connection with trade finance and launching a new unit in 2012, which specialises in financing vehicles and various other types of equipment for personal and commercial use. The focus in recent months has been on digital services and improving the internet bank and the Arion Bank mobile app.

The table below sets forth certain operational data for the Retail Banking division as of and for the year ended 31 December 2017.

Market share of individual customers	27.9%[(1)]
Total number of customers (individuals and SMEs)	130,291[(2)]
Individual customers	114,167
SMEs	16,124
Total number of branches	24
Number of FTEs	367
Total loans outstanding	ISK 500,442 million
Households	ISK 361,651 million
SMEs	ISK 138,791 million
Deposits from customers and credit institutions	ISK 341,797 million

(1) Based on the monthly customer survey of individuals conducted by Capacent on a three-month average as of 31 December 2017.

(2) Includes active customers of the Bank. Based on the Finalta, McKinsey and the Bank's definition of active customers. Active customers are defined as customers of the Retail Banking division who either (i) have a product in force (such as a loan, mortgage or insurance policy) or (ii) have made a customer-initiated financial transaction in the preceding six months on an account-based product (such as a current account, credit card or debit card). For these purposes, financial transactions exclude any automated payments such as direct debits (there is no distinction between the different channels through which the transaction was conducted); or (iii) have a balance of more than EUR 250 or equivalent in a current account or term deposit account.

Operations and Distribution Capabilities

The Retail Banking division generates operating income through the provision of financial products and services to retail customers, on which the Bank earns interest income and fee and commission income. Operating income for the Retail Banking division was ISK 21,151 million and ISK 19,702 million for the years ended 31 December 2017 and 2016, respectively. As of 31 December 2017 and 2016, the Retail Banking division's customer loan portfolio amounted to ISK 500,442 million and ISK 460,420 million, respectively, and the total amount of deposits with the Retail Banking division amounted to ISK 341,797 million and ISK 299,912 million, respectively.

The Retail Banking division serves its customers through its branch network and other points of contact, such as ATMs, a call centre, internet banking and the Arion Bank app, focusing on customer relationships to address different areas with different needs.

Branches

Following its establishment in late 2008, the Bank has sought to streamline its retail banking operations by closing or merging a number of its branches as well as reducing the total size of its branch network, with six branches closed in the Reykjavík area and approximately 2,771 m^2 reduced since 2013 (equivalent to approximately 9 per cent. of the size of its current operations). In recent years, the focus has been on making the branch network even more efficient and convenient for customers. There was no reduction of branch m^2 in 2017; however, the Bank sold more than 1,000 m^2 of its storage space during the year. In implementing the further branch changes that were recently announced, it is estimated that square metres will decrease by about 3,023 m^2. The overall branch experience has been redefined, moving from traditional branches to more flexible units by adding new service formats. In the last four years, the Bank has opened a flagship branch in the Borgartún financial area, an airport branch in Keflavík airport and a digital branch in Kringlan shopping mall. New, flexible micro branch units have been designed and will open in new locations in 2018. In addition, the Bank has opened self-service areas which are open 24/7, remote bank services with extended opening hours and has operated a mobile ATM van.

This strategy has resulted in a flexible and optimised branch network with stronger individual branches, which the Retail Banking division believes are better suited to meet the needs of its customers. To maximise operational efficiency, the branch network is divided into five regions, each of which has its own business manager. The branches in the Reykjavík area have been merged into a single region instead of the previous two. This change makes it easier to coordinate services and to combine employees' expertise in order to meet customers' demands. This change also reduces the overall costs of operating the branch network and boosts efficiency. Smaller branches capitalise on the strength of larger branches within each cluster. This organisation of the branch network transfers more executive authority and responsibility to the branches, which are closer to the needs and concerns of the customers, thereby bringing the decision-making power closer to the customers and enhancing customer satisfaction and experience. In March 2018, the Bank announced its intent to merge certain branches and put more focus on optimising its branch network by reducing square metres and to have smaller, flexible branches resulting in the closing of three branches.

Owing to the Bank being an indirect successor of the Agricultural Bank, which was an old agricultural bank of Iceland, the Bank's branches are strategically situated in key tourism areas as well as in agricultural areas. As of 31 December 2017, the Bank had 24 branches throughout Iceland, of which eight branches were located in the greater Reykjavík area and 16 branches were located in rural areas in light of their agricultural heritage background. The Bank intends to close three branches in 2018, as announced in March 2018. In addition, nine of the Bank's branches were located in major tourist towns or by the main road in Iceland and the Bank was the only bank in the area in 11 locations. The Bank has also launched the only branch at the Keflavík international airport.

The Retail Banking division has trained and certified financial consultants within its larger branches in order to improve the level of service to its customers. The financial consultants are knowledgeable in a wide range of fields, including banking services, pensions and insurance and other financial instruments.

Internet Banking, Arion Bank App and ATMs

The Retail Banking division has continuously endeavoured to be a market leader in digital solutions to banking, increasing channel diversification to improve efficiency. Accordingly, the Retail Banking division has taken advantage of the major changes in customer behaviour in recent years, as customers have transitioned away from branches to internet and mobile banking as the preferred channel, by successfully implementing the Arion Bank app in August 2012. Internet banking enables customers to access the majority of the most utilised services available at a traditional branch, while the increasingly popular Arion Bank app allows customers to keep track of their finances with a single click. In addition, the new generation of ATMs enables customers to save time by allowing them to deposit and withdraw cash as well as pay their bills without assistance from a cashier.

The Retail Banking division plans to steadily reduce the volume of low value transactions handled at branches by putting greater emphasis on customers' experience, through the Arion Bank app and other digital solutions. By focusing on digitalisation of various processes, the Bank has reduced the internal lead time for customer onboarding by approximately 88 per cent. and launched new digital initiatives with respect to the mortgage loan application process, credit cards, leasing SME onboarding, mortgage refinancing and other services. The public response to these digital initiatives has been very positive, with the majority of credit assessments and mortgage applications being performed digitally and payment plans for credit cards, overdrafts and other functions are set up almost entirely by using the Arion Bank app.

Customers

As of 31 December 2017, the Retail Banking division had an estimated 130,291 active customers (defined as customers of the Retail Banking division who either (i) have a product in force (such as a loan, mortgage or insurance policy) or (ii) have made a customer-initiated financial transaction (excluding any automated payments such as direct debits) in the preceding six months on an account-based product (such as a current account, credit card or debit card); or (iii) have a balance of more than EUR 250 or equivalent in a current account or term deposit account), of which 87.6 per cent. were individuals and 12.4 per cent. were SMEs. The Retail Banking division enjoys a loyal and relatively stable customer base in Iceland, with its customers accounting for 27.9 per cent. of individual customers in Iceland and 27.4 per cent. of SMEs in Iceland for the year ended 31 December 2017 (*source: active customers definition based on Finalta, McKinsey; Capacent Gallup*). The Bank measures customer satisfaction on the basis of net promoter scores for its most important customer services.

Products and Services

The Retail Banking division offers a comprehensive range of financial products and services, including mortgage loans, savings and checking accounts, vehicle and equipment financing, payment cards, pension services, insurance and funds. The Retail Banking division also offers factoring, or trade financing, which is used by SMEs, both importers and exporters. In particular, the Bank uses factoring in connection with trade finance, where inventory financing is linked with the financing of receivables which suits the needs of exporters, such as seafood companies. The Bank also offers SME loans in cooperation with the European Investment Fund.

The Retail Banking division's goal is to provide personalised services to distinct customer segments and SME market sectors to meet its customers' needs. In addition, the Retail Banking division seeks to establish multi-product relationships with its customers by offering various financial products and services offered by the Bank's divisions through diversified delivery channels.

To increase product penetration and increase the number of products per customer, the Retail Banking division has also developed more proactive methods with respect to its product and services offering, including exploring new opportunities with Vördur's current customers (e.g. offering the Retail Banking division's mortgage loans), as well as the use of the branch network to sell Vördur's insurance products as a registered insurance intermediary.

Mortgage Loans

The Retail Banking division provides a full range of products and services relating to mortgage loans and has historically introduced innovative products and services designed for the evolving needs of its customers. This has enabled the Retail Banking division to maintain or increase its market share in an increasingly competitive market. The Bank was the first to introduce fixed five-year interest rates on non-CPI-linked mortgage loans in 2011. The Retail Banking division further strengthened its first mover advantage and competitive position in the market by offering mixed CPI-linked and non-CPI-linked mortgage loans, allowing customers to select the type of mortgage loan that best suits their risk appetite and ability to repay. Recent product developments include a mortgage product designed to temporarily lower the borrower's debt repayments during parental leave and a mortgage product for first-time home buyers with an up to 85 per cent. loan-to-value ratio. When mortgage loans are issued, the Retail Banking division strives to improve its product and services offering by implementing digitalisation initiatives.

Loans to SMEs

The Retail Banking division has significantly grown its portfolio of loans to SMEs in recent years, which has traditionally been relatively small, as compared to its competitors. In November 2017, the Retail Banking division established a new unit for SMEs to further enhance the Bank's market position in that sector. The new unit is responsible for loans, sales and quality management to SMEs. Loans to SMEs increased from ISK 127,275 million as of 31 December 2016 to ISK 138,685 million as of 31 December 2017, mainly driven by the increase in the volume of loans to SMEs in the real estate and construction industry sector, wholesale and retail trade industry sector and the seafood industry sector.

Customer Deposits

The Retail Banking division seeks to leverage its base of mortgage loans customers to achieve further growth in its market share of customer deposits, which is currently smaller than the market share of other large banks. The Retail Banking division's share of individual deposits increased from 27.0 per cent. as of 31 December 2016 to 27.2 per cent. as of 31 December 2017 (*source: Icelandic Central Bank*).

As customers in Iceland are accustomed to keeping deposits with their main bank and because CPI-linked deposits of individual customers are generally thought to be less likely to move from bank to bank due to regulations which limit the time periods during which such deposits can be withdrawn, there is a relatively stable market for deposits from individual customers, with deposits from SME customers being more price sensitive. However, the Retail Banking division believes that there is an opportunity to attract deposits from customers who have their mortgage loans with the Retail Banking division but deposits with another bank. The cooperation of the Retail Banking division with the Asset Management division has enabled many cross-selling opportunities, including combining the product and services offering of the Retail Banking division with insurance and pension products. Higher levels of SME activity in Iceland also provide cross-selling opportunities for the Retail Banking division. In addition, the Bank believes that its new digital customer onboarding platform together with the comprehensive digital offering will become a catalyst for attracting new customers to the Retail Banking division. In addition, a new role was created in November 2017 for a product manager for deposits, who is authorised to manage prices and interest rates on deposits as well as promote deposits within the branch network and via digital channels.

Credit Cards

The Bank offers its customers a selection of payment cards from both Visa and MasterCard. It offers standard, gold and platinum, as well as the Bank's flagship card, the World Elite MasterCard. Two types of prepaid cards are also available: the gift card for Icelandic customers and the currency card for travellers visiting Iceland.

Regulation (EU) 2015/751 on interchange fees for card-based payment transactions (the **EU Interchange Fee Regulation**) has not been implemented in Iceland yet, but according to information from the Ministry of Finance it is expected to be implemented in the course of 2019. The EU Interchange Fee Regulation will not generally affect debit card income as the cap is already set at 0.2 per cent. in Iceland. However, it will affect the Bank's revenue from domestic credit card turnover. The domestic interchange rate fee cap is now set at 0.6 per cent. but is expected to be lowered to 0.3 per cent. upon implementation of the EU Interchange Fee Regulation, resulting in revenue loss. The Bank budgeted for this expected revenue loss and has taken certain steps to mitigate the effect, mostly by reducing cost associated with the cards, simplifying the card product portfolio, reducing the number of third-party processors and increasing card related revenues other than interchange fees.

CORPORATE BANKING DIVISION

Overview

The Corporate Banking division is a full service Icelandic corporate bank, providing a range of financial products and services to larger corporate customers across all industry sectors through dedicated industry sector teams. The primary focus of the Corporate Banking division is to maintain long-term relationships with its existing customers and to deliver integrated solutions as well as personalised services to achieve revenue diversification. The Bank believes that its long-term relationships with leading corporate customers enable the Corporate Banking division to maintain its strong competitive position. In addition, the Corporate Banking division's relationship-based model benefits from and provides synergies across the other divisions of the Bank, in particular the Investment Banking division and the Private Banking subdivision of the Asset Management division.

The Corporate Banking division's proactive approach has significantly improved its market position in recent years. Since 2013, there has been material margin pressure in high quality credits due to increased competition from pension funds (typically investors in real estate asset-backed securities, rather than as direct corporate lenders), as yields on government bonds decreased and the credit quality of companies gradually improved due to deleveraging and the improving economy. In addition, following the financial crisis, local banks had imposed accelerated repayment schedules on corporate borrowers, resulting in shortening maturity profiles in the Bank's corporate loan portfolio. The Corporate Banking division managed to stabilise its margins and to extend maturity profiles in 2015 and onwards after realigning operations in 2013 and returning to a proactive approach in 2014. This proactive approach included reducing recovery efforts and increasing focus on the competitive landscape to identify new business opportunities, improving the mix of margins and maturity profiles and originating new loans to existing and new customers.

In the aftermath of the financial crisis in 2008 and the sharp depreciation of Icelandic Krona, many customers of the Corporate Banking division were overleveraged. The loans of almost all of the customers in this position have either been restructured or refinanced, and the loan portfolio of the Corporate Banking division is currently well-diversified and balanced.

Furthermore, the Corporate Banking division has placed an increased emphasis on customer retention and relationship development by organising into industry sector teams and focusing further on the relationship management role in the Corporate Banking division.

The table below sets forth certain operational data for the Corporate Banking division as of 31 December 2017.

Market share in Icelandic corporate lending (including corporate bond issuance)	21%(1)
Number of large customers serviced from the branch at Bank headquarters	191(2)
Total number of branches supporting distribution	13(3)
Number of FTEs	15(4)
Total loans and bonds outstanding to corporate banking customers	ISK 270,897 million(5)
Deposits	ISK 21,169 million

(1) Management belief based on internal analysis of competitors' public disclosures, based on book value of loans to corporates at period end. SMEs are covered by the Retail Banking division but are included in the market share of Corporate Banking.
(2) Counted by customer groups (as opposed to customer identification number).
(3) Represents branches with a dedicated corporate services presence.
(4) Represents the number of FTEs in the Corporate Banking division working out of the Bank's headquarters.
(5) Consists of loans to customers and bond instruments issued by customers but held by the Corporate Banking division.

Operations and Commercial Capabilities

The Corporate Banking division generates operating income through the provision of credit products and services to corporate customers, on which the Corporate Banking division earns interest income and fee and commission income. Operating income for the Corporate Banking division was ISK 8,543 million and ISK 7,874 million for the years ended 31 December 2017 and 2016, respectively. As of 31 December 2017 and 2016, the Corporate Banking division's loan portfolio amounted to ISK 270,897 million and ISK 248,222 million, respectively.

The Corporate Banking division is organised into three customer facing units and a small operations unit. A special recovery unit, which was responsible for the Bank's debt recovery, existed until the end of 2013 within the Corporate Banking division. The recovery unit was primarily involved in restructuring companies that experienced payment difficulties. During the restructuring process, the Bank acquired assets previously owned by the restructured companies. These assets were transferred into separate holding companies under the control of the Bank, and most have already been divested. The restructuring process is now overseen by the Legal division of the Bank.

The Corporate Banking division comprises teams of experienced account managers working out of the Bank's headquarters, who specialise in specific industry sectors to ensure strong expertise and with a focus on key performance indicators. The account managers are each responsible for specific customers, ensuring personal services and a clear overview of each customer's financial and service requirements. Each account manager also relies on the assistance of staff in a range of the Bank’s support function divisions, including the Credit Office, trade finance and guarantees, legal and documentation.

The Corporate Banking division relies on a relationship based model with a sales approach driven by key performance indicators. There are twelve designated business relationship managers in three expert sector teams in key industry sectors (i.e. trade and services, seafood and real estate and energy). Eight designated credit managers, reporting to the Chief Credit Officer, support credit quality through the structuring and analysis team which allows the account managers to focus on sales and loan portfolio growth as well as cross-selling and building relationships. The direct relationships of the key account managers with existing customers ensure tailored lending solution offerings. Sales targets are driven by a compensation plan and the division’s management focus on monthly targets based on key performance indicators, which are aligned with the Bank’s strategic goals.

Customers

The Corporate Banking division provides products and services to large corporate customers. The Corporate Banking division’s loan portfolio principally comprises large corporate customers and is well-diversified across all the main Icelandic industry sectors, with emphasis on the top 100 companies in Iceland. In addition, the Corporate Banking division acquires new customers through senior account managers of individual sector teams, industry relations and events as well as through active involvement of senior and/or executive management of the Bank.

Products and Services

Although a significant proportion of the Corporate Banking division’s business is the provision of credit, the Bank offers a wide range of financial products and services to meet the needs of each customer. Examples of such products and services include cash management solutions, a range of deposit products, automatic billing and collection services, online payment slips, internet banking and business-to-business solutions.

Loans to Corporate Customers

Loans to corporate customers are the core product that drives the operating income of the Corporate Banking division, with net interest income from loans to corporate customers amounting to ISK 6,002 million and ISK 6,436 million for the years ended 31 December 2017 and 2016, respectively, amounting to 70.3 per cent. and 82.5 per cent., respectively, of the total operating income of the Corporate Banking division, with the remainder derived from financial services as fee and commission income and other operating income, as described below.

Financial Services

In addition to generating income from loans to corporate customers, the Corporate Banking division also generates fee and commission income from provision of financial services, including guarantees, transaction/arrangement services and electronic services, which complement loans to corporate customers and have grown in recent years. The net fee and commission income from financial services amounted to ISK 1,171 million and ISK 1,082 million for the years ended 31 December 2017 and 2016, respectively.

Term Loans

The Corporate Banking division has a diversified loan portfolio, with term loans being the highest volume product in all customer sectors and the key driver of both operating income and net interest margin. The Corporate Banking division had ISK 235,354 million and ISK 210,264 million of term loans outstanding as of 31 December 2017 and 2016, respectively.

Revolving Credit Facilities

Revolving credit facilities are a lower volume and lower margin product of the Corporate Banking division, with ISK 30,493 million and ISK 31,019 million of revolving credit facilities outstanding as of 31 December 2017 and 2016, respectively. The revolving credit facilities are characterised by seasonality and high price sensitivity, with the seafood industry sector being the key source of demand, and the most significant seasonal drawdown period typically beginning in September/October, peaking in February and ending April/May. The Corporate Banking division provides current accounts, overdrafts and trade finance services in connection with the credit revolving facilities.

INVESTMENT BANKING DIVISION

Overview

The Investment Banking division provides a full range of investment banking products and services, including equity and fixed income brokerage, initial public offerings, capital markets and M&A advisory to a broad range of customers, including corporate customers, professional investors, asset management companies and pension funds. In addition, the Investment Banking Division holds a strong position in foreign exchange brokerage and bond issuances. The Investment Banking division was chosen by Global Finance magazine as the best Investment Bank in Iceland in 2017. As of 31 December 2017, the Investment Banking division had 30 FTEs organised across the three subdivisions: Capital Markets, Corporate Finance and Research.

The Investment Banking division is recognised as a leader in equity brokerage and initial public offerings, having managed all four initial public offerings listed on the Main Market of NASDAQ Iceland in 2015 and 2016, as well as eight out of 13 initial public offerings in Iceland since 2011. Furthermore, the Investment Banking division managed the only listing on NASDAQ Iceland First North in 2017.

The Investment Banking division benefits from the Bank's developed infrastructure and has implemented the Bank's lean banking principles in its operations, allowing it to focus on acquiring and developing customer relationships and deal flow. The Investment Banking division enjoys a large and solid customer base featuring strong and trusted relationships with Icelandic and international investors, which is the key component of the Investment Banking division's placement power and transaction capabilities. Leveraging the Bank's relative size, strong balance sheet and infrastructure enables the Investment Banking division to support its customers, for example by providing underwriting capabilities through the Corporate Finance subdivision and offering forward contracts in capital markets. The Investment Banking division further benefits from the significant cooperation among the various divisions of the Bank by leveraging customer relationships and the bank's broad product range.

The table below sets forth certain operational data for the Investment Banking division as of and for the year ended 31 December 2017, unless noted otherwise.

Net fee and commission income	ISK 1,298 million
Number of initial public offerings in 2015/2016/2017	3/1/0[(1)]
Number of initial public offerings since 2011	8[(2)]
Market share in equities brokerage on NASDAQ Iceland	24.3%
Market share in fixed income brokerage on NASDAQ Iceland	16.5%
Number of FTEs	30

(1) Out of three initial public offerings in Iceland in 2015, one in 2016.
(2) Out of 13 initial public offerings on the Main Market of NASDAQ Iceland since 2011.

Operations and Distribution Capabilities

The Investment Banking division generates operating income through specialist services, such as M&A and capital markets advisory as well as equity and debt brokerage and research. The operating income of the Investment Banking division was ISK 1,467 million (of which ISK 1,298 million was fee and commission income) and ISK 3,746 million for the years ended 31 December 2017 and 2016, respectively.

Customers

The Corporate Finance and Capital Markets subdivisions provide products and services predominantly to corporate customers, institutional investors, insurance companies and investment companies as well as high net worth individuals and families. The Research subdivision supports and provides services to customers of other fee-generating divisions of the Bank, such as Corporate Banking and Asset Management. The Research subdivision also conducts introductory customer meetings for other divisions of the Bank.

Customer relationship management of the Investment Banking division plays an important role in monitoring business relationships and opportunities as well as tracking customer communications and product initiatives. For example, existing and potential customers are contacted on a regular basis depending on potential deal flow and business relationship potential. The list of customers is based on previous business relationships of the Investment Banking division. In addition, the key companies of Iceland's 300 largest companies and various prominent institutional and private investors are contacted. The frequency of contacts varies based on the nature of previous business transactions, pending potential activity and the prospect of tapping into emerging opportunities.

Products and Services

The Bank leverages its universal banking service offerings, infrastructure and balance sheet to enable projects that generate diversified income from a broad customer base, including product offerings and services in relation to initial public offerings and equity issues, foreign exchange, M&A, restructurings and refinancings, bonds brokerage and issuance, equity brokerage, derivatives and money markets.

Corporate Finance

The Corporate Finance subdivision provides advisory services in relation to M&A and capital markets transactions. In particular, the M&A advisory services of the Corporate Finance subdivision include advice on acquisitions, takeovers, divestitures, mergers, corporate restructurings, spin-offs and leveraged buyouts. The capital markets advisory services of the Corporate Finance subdivision include advice on initial public offerings and stock exchange listings, follow-on offerings, private placements, block trades, share buybacks, delistings and bond issues.

Capital Markets

The Capital Markets subdivision provides securities brokerage and foreign exchange sales. The Capital Markets subdivision is a market leader in equity brokerage and enjoys a strong position in foreign exchange brokerage and bond issuances. In addition, the Capital Markets subdivision has been a leading player in restoring the equity markets in Iceland. The Capital Markets subdivision also benefits from strong relationships with all major investors in the domestic capital markets. The Capital Markets subdivision focuses on providing its growing customer base with a comprehensive range of capital markets services and access to expert knowledge. The focus in the medium term is expected to shift towards development of products and services as investors seek more opportunities to invest and distribute risk.

Research

The Research subdivision publishes macro research on the Icelandic economy and its developments and equity research on individual companies and industry sectors. The Research subdivision also publishes regular forecasts and updates on key economic issues and covers companies listed on NASDAQ Iceland. In addition, the Research subdivision holds regular conferences and presentations, at which new research and reports produced by the Research subdivision are presented. These include economic forecasts, analyses of the real estate market and analyses of the finances of various municipalities as well as various other industry sectors.

The Research subdivision provides support to the Capital Markets, Asset Management and Corporate Finance teams by providing their customers with research reports, presentations, opinions, memoranda or data analysis on listed companies and companies planning to go public in the near future. It also provides analysis on specific economic issues and assists with sales meetings with customers. The Research subdivision is independent in its research and analysis. It had 6 analysts as of 31 December 2017.

ASSET MANAGEMENT

Overview

The asset management operations of the Bank had ISK 984,653 million of assets under management as of 31 December 2017. The asset management operations of the Bank are composed of two distinct legal entities, the Asset Management division and the Bank's independent subsidiary Stefnir, a fund management company. The asset management operations offer a full range of investment products and services to customers with varying investment objectives, with a core focus on pension funds, institutional investors, high net worth individuals and digital distribution for retail customers, and are dedicated to establishing long-term relationships with its customers. The strong team and track record as well as good reputation make the asset management operations well-positioned to participate in the local transactions. In addition, the Bank believes that the asset management operations could benefit from leveraging the Bank's broader infrastructure to meet increasing risk management, transparency and regulatory requirements.

The table below sets forth the assets under management of the Asset Management division and Stefnir as of the dates indicated.

	As of 31 December				
	2017	**2016**	**2015**	**2014**	**2013**
			(ISK in millions)		
Asset Management division	637,688	646,471	596,809	519,531	481,828
Stefnir	346,965	408,288	399,839	404,069	413,628
Total	**984,653**	**1,054,759**	**996,648**	**923,599**	**895,457**

As of 31 December 2017, the asset management operations of the Bank had 52 FTEs, with 34 FTEs at the Asset Management division and 18 FTEs at Stefnir.

Asset Management Division

The Asset Management division has offered asset management to institutional clients, with a full range of financial products and services to pension funds starting in 1994. The Asset Management division also offers private banking services to high net worth individuals, family offices and legal entities. It has a strong relationship with the other divisions of the Bank. In addition to being the main distributor of Stefnir funds, the Asset Management division has partnerships with three major global asset and fund managers.

The Asset Management division comprises the Private Banking subdivision, the Institutional Asset Management subdivision, the Investment Services subdivision and the Pension Funds Administration subdivision. The Asset Management division had ISK 637,688 million in assets under management as of 31 December 2017, with 80 per cent. growth in assets under management from 2011 to 2017. As of 31 December 2017, the Asset Management division had more than 100,000 customers, the majority of which were retail customers in pension and mutual funds. Of assets under management as of 31 December 2017, 86.1 per cent. were assets of institutional investors and the remaining 13.9 per cent. were assets of high net worth individuals and other customers, such as pension fund members, mutual fund members and private banking customers.

Stefnir

Founded in 1996, Stefnir is Iceland's largest fund management company in terms of assets under management (*source: FME*), with ISK 346,965 million in assets under management as of 31 December 2017 in more than 40 funds, which were sourced from the Asset Management division as well as from external investors. Its return on equity was 59 per cent. for the year ended 31 December 2017. Stefnir provides fund management services to the Asset Management division and external investors and offers a wide range of products, including products offered by ABMIIF, fixed income, equity, private equity and balanced funds.

As of 31 December 2017, Stefnir had approximately 10,600 customers with investments in mutual funds. Of Stefnir's assets under management as of 31 December 2017, 72.3 per cent. were assets of institutional investors and the remaining 27.7 per cent. were assets of retail and other investors. Stefnir has a very high market penetration with its key customers, providing services to all of the largest domestic pension funds and all major domestic universal insurance companies. Stefnir is an independent subsidiary of the Bank, which is regulated by the FME, and places special emphasis on its independence and corporate governance. Stefnir has obtained financial and market share growth as a result of long-term strategic planning by its board of directors, which was initially implemented in 2009. Stefnir emphasises a healthy revenue mix, with product development and diversification of assets under management resulting in new income sources and higher income yielding products.

Arion Bank Mortgages Institutional Investor Fund (the **ABMIIF**), initially called the Kaupthing Mortgages Institutional Investor Fund, was established by Kaupthing in 2006 as an institutional investment fund. In 2011, the fund changed its name to the Bank Mortgages Institutional Investor Fund and, in 2012, Kaupthing transferred all of its shares in ABMIIF to the Bank with the consent of the covered bondholders. The day-to-day operations of ABMIIF are managed by Stefnir pursuant to ABMIIF's articles of association. The business of ABMIIF is to acquire loans and their related collateral pursuant to the terms of mortgage sale agreements to guarantee the Bank's covered bonds. ABMIIF has not traded since its establishment date, except for those matters incidental to the covered bonds, and will not do so while the covered bonds or any term advance remains outstanding.

Operations and Distribution Capabilities

Each of the Asset Management division and Stefnir generates operating income through interest income and management fees, which are calculated as a percentage of assets under management and vary based on product type and other factors. In addition, Stefnir generates operating income through performance fees, which are based on the performance of its products above a certain benchmark and are reviewed bi-annually in connection with financial reporting. The performance fees are not recognised on the Bank's consolidated statement of comprehensive income until either realised or are considered highly likely to be realised. Operating income for the Asset Management division and Stefnir was ISK 4,677 million and ISK 4,345 million for the years ended 31 December 2017 and 2016, respectively. The assets under management of the Asset Management division and Stefnir decreased from ISK 1,054,759 million as of 31 December 2016 to ISK 984,653 million as of 31 December 2017, with assets under management of the Asset Management division decreasing from ISK 646,471 million as of 31 December 2016 to ISK 637,688 million as of 31 December 2017. Assets under management of Stefnir were ISK 408,288 million as of 31 December 2016, decreasing to ISK 346,965 million as of 31 December 2017. The decrease in assets under management from 2016 to 2017 is primarily due to a decrease in the ABMIIF fund managed by Stefnir, as well as decreases in payments from alternative investments in connection with the closure of major investment projects and the loss of one institutional client for which the Asset Management division managed funds, due to the trend by certain pension funds in Iceland to bring asset management functions back in-house.

Customers

The customers of the asset management operations include institutional investors, corporations, high net worth individuals and retail investors. The Private Banking subdivision caters to individual customers with over ISK 15 million in assets under management. The Institutional Asset Management subdivision services pension funds, trade unions, insurance companies, government institutions and other institutional investors. The Pension Funds Administration subdivision offers full services to pension funds. The Investment Services subdivision distributes Stefnir funds, selling to individuals, companies, institutions and institutional investors, as well as offering funds of international fund managers.

Stefnir caters to both retail and professional customers, with the aim of managing its customers' assets in the best interests of such customers. Stefnir's dedication to long-term relationships with, and its focus on providing tailored solutions to, its customers make Stefnir a preferred partner of institutional customers.

Products and Services

The asset management operations offer a comprehensive range of investment products and services. In addition to mutual funds, alternative investment vehicles and pension plan schemes, the asset management operations offer customised asset allocation strategies and managed accounts designed to meet the diverse needs of investors. The asset management operations also offer funds from other leading global fund management companies.

Institutional Asset Management Subdivision

The Institutional Asset Management subdivision has developed a clear investment process and service philosophy based on the principles of equality and transparency for institutional investors, which they view as a key to maintaining long-term relationships and trust. Initially, investment opportunities are identified and analysed, with worthwhile investment opportunities being subsequently proposed to an investment committee. The investment committee evaluates the proposed opportunities in accordance with the investment policy statements and, if the evaluation is satisfactory, the trade is undertaken. The portfolios are subsequently supervised on a daily basis with periodic risk management assessments. Investments decisions for individual portfolios of institutional investors are made on a daily basis, investment policy statement are reviewed annually and long-term investment goals are reviewed every one to five years.

Pension Funds Administration Subdivision

The Pension Funds Administration subdivision has developed a unique product and services offering for pension funds, with extensive services in branches and service centres, own website and targeted marketing and sales. The Pension Funds Administration subdivision offers pension funds full service operations, including marketing, sales and services in branches and service centres and extensive resources to meet regulatory requirements. The ability to provide special services to pension funds has meant that, with the growth of the Icelandic pension system, the asset management operations have experienced comparable growth in their assets under management since 2009.

In addition, the success of individual funds that are managed by the Institutional Asset Management subdivision has also contributed to the growth of assets under management.

Private Banking Subdivision

The Private Banking subdivision seeks to provide highly personal financial services designed for the needs of individual customers with a special focus on high net worth individuals in Iceland with an account balance in excess of ISK 100 million. The Private Banking subdivision has specialised balanced portfolios and engages in both discretional and non-discretional asset management. The Private Banking subdivision relies on a team-based approach to investments and services, working closely with other divisions of the Bank, and has good access to local dealflow due to the size of the Asset Management division.

Each customer of the Private Banking subdivision has his own account manager, who provides personal service and financial advice suited to such customer's needs. The account managers of the Private Banking subdivision are highly experienced with an average of 21 years of experience in the financial markets.

The main emphasis of the Private Banking subdivision is to continue providing excellent services to its customers and achieving prudent investment results in accordance with risk levels.

Investment Services Subdivision

The Investment Services subdivision provides services to institutional and corporate customers. Retail services are provided mainly through digital channels and a call centre. The Investment services subdivision also distributes Stefnir funds as well as offering funds from international fund managers, together with overseeing sales of pension products. The emphasis of the Investment Services subdivision has been on increasing usage of digital channels. Transfer of retail sales and services to digital channels is expected to continue with opportunities to increase corporate customers' use of digital channels. The volume of customers' online sales into mutual funds has increased significantly from 2013 to 2017. Monthly subscriptions in funds have also increased over the same period of time. The pension products and services are primarily sold by the Retail Banking division and a subsidiary of Vördur, but going forward emphasis will be on increasing sales and services through digital channels.

Stefnir

Stefnir manages several funds which fall into the category of Undertakings for Collective Investment in Transferable Securities (**UCITS**), non-UCITS or institutional investor funds with total assets under management of ISK 347 billion as of 31 December 2017.

Stefnir also manages several private equity and real estate funds. Co-investors in the private equity funds comprise pension funds, insurance companies and other institutional investors, as well as high net worth individuals (based on their business expertise and active role in the proposed investment).

Other Divisions and Subsidiaries

Subsidiaries

The Bank is the parent company of a number of wholly owned and majority owned subsidiaries, the most significant of which are described below.

Valitor

Possible Valitor Disposal

The Bank is currently assessing a range of strategic alternatives with respect to its ownership of Valitor. In this regard, the Board of Directors examined the feasibility of a spin-off of Valitor to existing shareholders by means of a dividend in kind. The Board of Directors is of the opinion that, although a disposal of Valitor could be in the strategic interests of the Bank, the form of any such disposal requires further evaluation and may take the form of a sale of all or a portion of Valitor to a third party. The Board of Directors has resolved to examine the structural options with a view to disposing of Valitor in the medium term. However, no firm decision has been taken at this point in time with respect to a disposal of all or part of Valitor or with respect to the form or timing of any such transaction.

The Board of Directors has considered whether Valitor constituted a core operation of the Bank, in light of the fact that the Bank has focused in recent years on the development of its operations to serve the Icelandic market, while Valitor has expanded further internationally and intends to continue to do so, which will require considerable management and capital investment to undertake. Although the Board of Directors believes that Valitor's growth strategy would have long-term benefits for the Bank, the strategy could take a number of years to realise and may be different from the Bank's strategy of focusing on the Icelandic market.

Overview

Valitor, a wholly owned subsidiary of the Bank, is the largest card payments company in Iceland in terms of revenue (*source: Valitor, Borgun and Kortathjonustan annual reports*), providing both card acquiring and card issuing services in Iceland. Established in 1983, Valitor has a full and well-diversified product range, providing e-commerce and card-present acquiring services to merchants through direct and partner channels and card issuing services and payment processing solutions to domestic and international partners. Valitor has developed proprietary payment software solutions from an early stage, enabling it to employ a differentiation strategy in both card acquiring and card issuing services and to compete successfully in Iceland and internationally.

Valitor has strong processing volumes, processing approximately 292 million transactions in the year ended 31 December 2017. Valitor processed card acquiring services transactions in the amount of ISK 1,687 billion for the year ended 31 December 2017. Valitor has approximately 26,900 merchants and corporate customers for its card acquiring services and approximately 264,900 payment facilitator sub-merchants. In addition, Valitor has eight card issuing partners and 15 acquiring partners. Valitor has been a principal member of the MasterCard card scheme since 2009 and is currently in discussion with UnionPay and American Express for potential partnership. Since the end of 2015, Valitor has been an associate member of Visa Europe Ltd. (**Visa Europe**) via Visa Iceland, which is a principal member of the Visa card scheme. Visa Iceland has been a group member of Visa Europe since 1983. Valitor has held PCI-DSS level 1 security certification since 2011.

In March 2017, Valitor Payment Services Limited was granted an Electronic Money Institution authorisation by the Financial Conduct Authority in the United Kingdom. The regulatory authorisation is intended to help ensure Valitor's ability to support operations and customers within the United Kingdom regardless of Brexit negotiation outcomes.

In May 2017, Valitor announced the acquisition of IPS – International Payment Services Limited, a UK-based secure payment solutions provider. The acquisition will see the consolidation of IPS's technology into Valitor's own e-commerce solution through its subsidiary AltaPay.

In July 2017, Valitor announced the acquisition of Chip and PIN Solutions Ltd, a card-based payment provider located in the United Kingdom. The acquisition is intended to broaden Valitor's own direct merchant services solutions and enhance customer-centric service for merchants in the United Kingdom, in order to offer customers a complete payment solution to streamline all online, mobile and in-store payments.

Valitor's direct and partner channel strategies and innovative approach serve as a foundation for transaction volume growth. Accordingly, for the years ended 31 December 2017 and 2016, Valitor's international acquiring volume amounted to ISK 1,501 billion and ISK 818 billion, respectively. Revenue from international operations accounted for 68 per cent. and 58 per cent. of Valitor's total operating revenue in the years ended 31 December 2017 and 2016, respectively.

Valitor had 341 FTEs as of 31 December 2017. Valitor is included in the "Other Divisions and Subsidiaries" reporting segment of the Group.

Card Acquiring Services

Valitor has been specialising in international card acquiring services since 2003, being one of the first companies in Iceland to passport its regulatory authorisation to provide its services across borders in Europe, and offers e-commerce and card-present acquiring services to merchants both directly and through its network of selected partners. Valitor works with merchants, independent sales organisations, payment facilitators and payment service providers, offering both e-commerce and card-present acquiring services. In Iceland, Valitor provides its card acquiring services to merchants directly with its end-to-end e-commerce and card-present solutions. Internationally, Valitor provides its card acquiring services in many European countries through its network of selected partners as well as providing card acquiring services to merchants directly in selected markets, which currently include the United Kingdom, Ireland and the Nordic countries. Valitor's revenue from the card acquiring services, representing approximately 82 per cent. of Valitor's 2017 revenue, is based on a percentage of the processed volume, terminal rentals and other payment related services.

Card Issuing Services

Valitor has more than 30 years of experience in card issuing services and offers both card issuing and processing services. Through principal membership with MasterCard and Visa, Valitor provides card issuing services, both as limited network exempt and issuance of electronic money, to prepaid programmes under programme manager agreements with its business partners. Valitor operates an advanced card issuing platform, which is integrated with Visa and MasterCard systems, and gives it an ability to launch new customised programmes and work alongside partners to develop new products. In addition to providing card issuing services via banking partners, Valitor's card issuing platform is designed to accommodate the specific needs of the prepaid market. Valitor partners with both international issuing programme managers, such as WEX Europe and Caxton FX, as well as with Icelandic banks. Valitor's revenue from the card issuing services is based on processed volume, loads and the number of issued cards, with Valitor's card issuing services representing approximately 18 per cent. of Valitor's 2017 revenue.

Vördur

On 30 September 2016, the Bank acquired a 100 per cent. shareholding in Vördur, which is classified as a subsidiary of the Bank from the day of acquisition. Vördur had 85 FTEs as of 31 December 2017.

Vördur provides policies for motor vehicles, home protection, property and life and health products. Vördur is the fourth largest universal insurance company in Iceland based on insurance premiums and, after the merger of its life insurance subsidiary, Vördur líftryggingar hf, with Okkar Life Insurance, Vördur líftryggingar hf became the largest life insurance company in Iceland *(source: FME)*.

Prior to the acquisition of Vördur, the Bank operated its insurance business under the name Okkar Life Insurance, which was a wholly owned subsidiary of the Bank, founded in 1966 and acquired by Kaupthing in 2005. For the years ended 31 December 2016 and 2015, the operating income of Okkar Life Insurance was ISK 850 million and ISK 1,012 million, respectively.

Each of Valitor, Vördur and Stefnir are independent entities regulated by, and reporting directly to, the FME. Each of the subsidiaries has its own independent risk management function, with the Bank exercising ownership through strategy and board memberships.

Other Divisions

The Bank has five support divisions:

Finance

The Finance division includes funding and treasury, which together form the Treasury reportable segment, market-making, as well as accounting, analysis and facilities and property management. The accounting unit is responsible for the Bank's financial reporting, both internally and to external stakeholders, including the FME and the Icelandic Central Bank. The analysis unit is responsible for short- and long-term budgeting and for benchmarking the Bank with comparable financial institutions, both local and international. The funding unit is responsible for the Bank's long-term funding, in both the domestic and international markets and relationships with credit rating agencies. The treasury unit is responsible for the Bank's liquidity, currency and interest rate management, the internal pricing of interest rates and currency and liaison with other financial institutions. Market-making is responsible for market making in domestic securities. Facilities and

Property Management is responsible for managing and investing in the Bank's premises and is also responsible for managing and selling foreclosure assets. The Finance division had 99 FTEs as of 31 December 2017.

Risk Management

For information on the activities of the Risk Management division, see "*Risk Management*". The Risk Management division had 27 FTEs as of 31 December 2017.

Legal

The Legal division handles collection, appropriated assets and legal representation on behalf of the Bank as well as a range of other legal services for the Bank's other divisions. The Legal division had 43 FTEs as of 31 December 2017.

Information Technology

The IT division is responsible for developing, operating and advising on the Bank's information systems and solutions, including internet banking, websites, its internally developed and third party software and its hardware, such as data centres, telephone systems, ATMs and personal computers. The IT division had 86 FTEs as of 31 December 2017. For additional information on the IT division, see "- *Information Technology*".

CEO Office

The CEO office includes human resources, marketing, credit office, communications and the investor relations officer. The CEO office had 61 FTEs as of 31 December 2017.

Human resources offers advice and support when recruiting employees, helps develop leadership skills and nurtures employees' abilities. The team includes the Bank's specialists in lean management.

The marketing department is responsible for brand management, coordinating marketing initiatives, marketing and tactical plans for products and services and market research, such as statistical analysis, focus groups, interviews and surveys. The marketing department is also responsible for developing the Bank's internet banking solutions, websites, online communications and electronic distribution channels.

The Credit Office oversees the Bank's lending process and loan portfolio and is responsible for the operation of the lending committees and updating the credit rules. The Credit Office also conducts credit analysis of the Bank's largest borrowers along with other work related to loan documentation and monitoring of loan book quality.

The communications department handles press releases, internal communications across various divisions of the Bank as well as communication with Icelandic stakeholders and media.

The investor relations officer (along with the CEO and CFO) is authorised as a spokesperson to communicate with capital markets participants. Other responsibilities of the investor relations officer are to provide relevant information about the operation of the Bank to the market, including communications required by applicable regulations (e.g. notifications to NASDAQ Iceland, NASDAQ Stockholm and the Luxembourg Stock Exchange's regulated market) and other publications to the market.

Asset Holding Companies

Eignarhaldsfélagid Landey *ehf.* (***Landey***)

Landey, a wholly owned subsidiary of the Bank, is a property development company, which manages properties that currently do not generate any revenue but which may do so in the future. Such assets include unfinished housing developments, building lots and the rights attached to them. Landey's objective is to maintain and increase the value of its properties through professional development, design and construction in collaboration with the planning authorities until a satisfactory price can be obtained for such properties. Landey had 2 FTEs as of 31 December 2017.

Eignabjarg

Eignabjarg was a wholly owned subsidiary of the Bank which was liquidated in 2015. Eignabjarg had been responsible for managing and selling shareholdings in companies, which the Bank has acquired through debt restructurings or other enforcement procedures. Its function was to maximise the value of the shareholdings held, to develop a strategy for each asset and to implement good business practices and good corporate governance in the transferred companies.

In 2018, the Bank established a new entity, also called Eignabjarg ehf., in order to hold the assets of United Silicon which the Bank acquired as a result of foreclosing on its collateral.

Asset Portfolio Disposals

The disposals made by the Bank in respect of its asset portfolio have also included the disposals set forth below.

Refresco

The Bank holds an indirect stake in Refresco Group B.V. (**Refresco**) through partial ownership in two holding companies, Stodir hf. (**Stodir**) and EAB 1 ehf. (**EAB 1**). In March 2015, following an initial public offering, Refresco was listed on the Euronext Amsterdam exchange at a price of €14.5 per share. At that time, the Bank's indirect stake in Refresco through Stodir and EAB 1 was 4.61 per cent. Since then, EAB 1 and Stodir have divested part of their shareholding in Refresco. The Bank currently holds a 1.52 per cent. indirect stake in Refresco. Since its listing, Refresco shares had traded at prices from €12.98 to €16.44 per share, until 12 April 2017, when Refresco rejected an unsolicited non-binding proposal from PAI Partners SAS to acquire all issued shares in the company. Later in the year, on 25 October 2017, Refresco and a consortium of PAI and bcIMC agreed on a recommended cash public offer of €20 per share. All necessary approvals were granted during the first three months of 2018 and Refresco shares were therefore sold before the end of the first quarter of 2018. However, the final payment between shareholders of Stodir and EAB 1 was not completed until the second quarter of 2018.

Kolufell Disposal

In July 2016, the Bank sold a majority of its shareholding in the subsidiary Kolufell ehf. (**Kolufell**). Kolufell's main asset was investment property. The sale, and the resulting valuation change on the Group's remaining interest in Kolufell, had a positive impact on the Group's other operating income, resulting in the recognition of a gain in the amount of ISK 493 million for the year ended 31 December 2016. The Bank owned approximately 19.9 per cent. of Kolufell as of 31 December 2017 which is classified within financial instruments on the Group's consolidated statement of financial position.

Visa Europe Disposal

In June 2016, Valitor completed the sale of its shareholding in Visa Europe to Visa Inc., which had a positive impact on the Group's net financial income, resulting in the recognition of a gain in the amount of ISK 5,291 million for the year ended 31 December 2016.

Bakkavor Disposal

The Group, through the subsidiary BG12 slhf., revalued its 46.0 per cent. shareholding in Bakkavor Group Limited (**Bakkavor**), resulting in a change from a valuation according to the equity method (less impairment) to the sales value (less cost of sale) in anticipation of the disposal thereof. This revaluation had a positive impact on share of profit of associates in the Group's statement of comprehensive income, resulting in revised impairment in the amount of ISK 20,845 million for the year ended 31 December 2015 and profit from sale of ISK 733 million for the year ended 31 December 2016 when the disposal was completed, each of which in turn had a corresponding positive impact on the Group's operating income for both periods.

In January 2016, the Bank's subsidiary BG12 slhf. sold its entire shareholding in the subsidiary Bakkavor Group Ltd. The profit from the sale was ISK 498 million and was recognised in the statement of comprehensive income in 2016.

Síminn Disposal

In October 2015, Síminn hf. (**Síminn**), the largest telecommunications company in Iceland, was listed on the Main Market of NASDAQ Iceland. Following Síminn's initial public offering, the Bank sold approximately 22 per cent. of its shareholding in Síminn, which had a positive impact on the Group's net financial income, resulting in the recognition of a gain in the amount of ISK 4,185 million for the year ended 31 December 2015. The Bank owned approximately 1.0 per cent. of Síminn as of 31 December 2017, as a part of the trading book (which represents positions held with trading intent and associated hedging positions).

Reitir Disposal

In April 2015, Reitir fasteignafelag hf. (**Reitir**), the largest provider of commercial property for rent in Iceland, was listed on the Main Market of NASDAQ Iceland. Following Reitir's initial public offering, the Bank sold approximately 17 per cent. of its shareholding in Reitir, which had a positive impact on the Group's other income, resulting in a mark-to-market gain and a gain on disposal of a total amount of ISK 3,664 million for the year ended 31 December 2014 and a recognition of a gain in the amount of ISK 4,224 million for the year ended 31 December 2015. The Bank owned approximately 0.1 per cent. of Reitir as of 31 December 2017, as a part of the trading book.

Compliance

According to Icelandic law, a financial institution is required to establish and maintain a permanent and effective compliance function, which operates independently and has the following responsibilities:

- to monitor and, on a regular basis, assess the adequacy and effectiveness of measures and procedures put in place to detect and minimise any risk of failure by the financial institution to comply with its obligations under the Securities Transactions Act as well as the associated risks;
- to monitor and assess the actions taken to address any deficiencies in the financial institution's compliance with its obligations under the Securities Transactions Act; and
- to advise and assist the relevant persons responsible for carrying out investment services and activities to comply with the financial institutions' obligations under applicable Icelandic law.

Furthermore, according to guidelines on internal governance issued by the FME, a financial institution is required to establish a compliance function to manage its compliance risk.

The Bank's compliance officer coordinates the Bank's compliance activities. The Bank's compliance division had 9 FTEs as of 31 December 2017.

The compliance officer works independently and reports directly to the CEO in accordance with the FME requirements. The compliance officer has monthly meetings with the CEO, during which the compliance officer presents a report on activities during the past month and refers certain matters to the CEO. The compliance officer also meets the chief risk officer and the internal auditor on a monthly basis. In addition, the compliance officer reports to the Board Audit Committee on a quarterly basis and to the Board of Directors on an annual basis.

The compliance officer is also responsible for coordinating and monitoring the Bank's compliance with applicable anti-money laundering and terrorist financing laws, regulations and guidelines, including monitoring of compliance with international sanctions, and investigating and reporting suspicious activities to appropriate authorities.

Competition

As Iceland's economy continues to recover and demand for new lending and other banking products and services increases, the Bank expects to face increased competition from the other large Icelandic banks, pension funds and smaller specialised institutions as well as foreign banks seeking to establish operations in Iceland. See "*Risk Factors - Factors that may affect the Bank's ability to fulfil its obligations under Notes issued under the Programme - The Bank is exposed to competition and expects competition will increase*". The Bank expects to compete on the basis of a number of factors, including transaction execution, its products and services, its ability to innovate, reputation and price. The main competitors of the Bank's divisions and subsidiaries in the provision of its various products and services are set forth below.

Retail Banking Division

The Retail Banking division holds a 27.9 per cent. market share of individual customers in the retail banking market as of 31 December 2017 (*source: Capacent monthly survey of individuals, based on the question, "What is your main retail bank?"*).

The main competitors of the Retail Banking division in the deposits market are Landsbankinn and Íslandsbanki, both of which are government owned. Savings banks have largely disappeared since the financial crisis in 2008, although some smaller savings banks continue to operate in certain regions.

The Retail Banking division's strongest competition is in the mortgage loans market, in which the Retail Banking division's main competitors are Landsbankinn and Íslandsbanki. Pension funds have also become increasingly active in the mortgage loans market and, in 2017, gained market share through aggressive lending rates enabled, in part, by different regulatory requirements applicable to them (in particular, they are not subject to the Bank Levy). While the pension funds remain active in the mortgage loans market, the Bank expects their new lending to decrease as the ratio of mortgage loans in their portfolios has reached very high levels compared to historical averages, the Housing Financing Fund, an independent government institution that grants mortgage loans to individuals, municipalities, companies and organisations to finance housing purchases and construction, remains the largest player in the mortgage loans market for existing mortgage loans, although it has curtailed its origination of new mortgage loans, and its market share is expected to decrease as mortgage loans are refinanced or mortgaged properties are sold.

In addition, there is currently no meaningful foreign bank interest in the Icelandic retail banking market.

Corporate Banking Division

The Corporate Banking division's main competitors in the corporate banking market are Landsbankinn and Íslandsbanki, with a number of other participants active in the corporate banking market, such as pension funds (indirectly through investment in real estate asset-backed securities), public funds (e.g. the Housing Financing Fund), foreign lenders and smaller financial institutions (e.g. Kvika banki hf.). Pension funds, which compete with a cost structure very different from the cost structure of the banks, have also driven competition and increased margin pressure since 2013 as, although they are not direct corporate lenders, they provide funding through investment in real estate asset-backed securities. In addition, foreign banks increasingly consider entering the Icelandic corporate banking market.

Investment Banking Division

The Investment Banking division's main competitors in the investment banking market are Landsbankinn, Íslandsbanki and Kvika, although a few smaller boutiques also participate in the market. The investment banking market is characterised by intense competition on price and on transaction terms, which results in considerable pressure on margins, especially during times when fewer transactions are being concluded. The Bank's market share, measured by value of transactions in 2017, is 24.3 per cent. in equity brokerage and 16.5 per cent. in fixed income brokerage (*source: NASDAQ Iceland*).

Asset Management

The asset management industry sector is highly competitive and has only moderate barriers to entry. Competition in the asset management industry sector is largely based on investment performance, the level of fees, the quality and diversity of products and services, name recognition and reputation, the effectiveness of distribution channels and the ability to develop new investment strategies and products to meet the changing needs of investors. The main competitors of the fund management company Stefnir are Íslandssjódir (Íslandsbanki) and Landsbréf (Landsbankinn) in addition to smaller fund management companies such as GAMMA, Júpiter (Kvika), ALDA (Kvika) and ÍV.

The Asset Management division competes with wealth management firms such as VÍB (Íslandsbanki), Landsbankinn, Kvika and ÍV.

Valitor

The market for card and electronic payments is highly competitive and has many players, including dedicated payment processing companies, financial institutions and non-traditional payment processors, such as PayPal. Valitor's main competitor in the Icelandic card and electronic payments market is Borgun, a card issuing and acquiring subsidiary of Íslandsbanki, and also Kortathjonustan or Korti. As Valitor expands outside of Iceland, it also faces increasing competition from global card issuing and acquiring companies, such as Worldpay and Barclaycard (a division of Barclays Bank) which have an established presence in many markets where Valitor seeks to expand, including the United Kingdom, where Elevon, First Data, Wirecard, FIS and Raphaels Bank are also competitors. Valitor is the largest card payments company in Iceland in terms of revenue (*source: Valitor, Borgun and Kortathjonustan annual reports*).

Information Technology

The Bank's IT division is responsible for developing, operating and advising on its IT and communication systems and solutions, including digital banking, internally developed and third party software, and hardware such as data centres, telephones, ATMs and personal computers. The reliability of the IT and communications systems is a key factor in the Bank's activities as a financial enterprise.

The IT division had 86 FTEs as of 31 December 2017. The IT division consists of Software Development, IT Operations and the Project Office. Support functions focus on information security, quality management, and technical services management.

The Bank's IT infrastructure comprises two data centres in two different locations in Iceland, one owned by the Bank and the other outsourced by the Bank. Approximately 83 per cent. of the servers are virtual with a physical backup placed in a third location. The IT system serves all branches in the Retail Banking division's network.

The IT division maintains relationships with a wide range of blue chip suppliers, including Microsoft, SAP, Swift, Calypso, Reuters and Bloomberg. In addition, the IT division has substantial in-house expertise which allows for the development and integration of software internally.

Digital Banking

A key aspect of the Bank's business is customer satisfaction. The Bank is a leading digital bank in Iceland and believes that further digitalisation is essential to serving its customers in the future. Therefore, the Bank has initiated a strategic digital effort to expand digital access to the Bank's products and services, automate and simplify processes, make informed decisions based on accessible and reliable data, and offer clever and creative digital solutions.

The IT division is focusing on digital initiatives in order to continue to put customers' needs at the heart of the business. With multiple ring-fenced, cross-functional teams working on digital projects, the Bank is now at the forefront of technology and innovation.

The Bank's new digital onboarding process completely reimagines the customer's banking experience and signifies the first milestone in the Bank becoming a leader in digital banking. the Bank launched its digital mortgage service early 2017, which has resulted in increased demand, and decreased manual input and repetitive work. Digital credit card services now include new credit cards, credit card bill split, and credit card limit adjustments. Other digital credit products include vehicle financing, consumer loans and overdraft limit adjustments. The latest addition to the Bank's digital service offerings is personal finance management services to help customers manage their finances every month and onboarding for businesses. The objective of the digitalisation initiatives is to increase customer satisfaction, create new sales channels, and reduce costs.

Another initiative is the eID login, which makes digital banking more accessible for customers. The eID login is a national authentication and signature, allowing authentication by internet or mobile phone. In addition, the Bank benefits from an enclosed market, which allows for quick adaptation of new digital initiatives. The Bank's digital initiatives have resulted in a steady increase in the number of customers using digital channels. As of 31 December 2017, 76,368 customers of the Bank were active users of internet banking and 53,717 customers of the Bank were active users of the Arion Bank app (in each case defined as customers active for 90 days and counted on 30 June of each year), as compared to 77,178 of active users of internet banking and 41,044 active users of the Arion Bank app as of 31 December 2016. The number of customers using the Arion Bank app increased by approximately 12,700 customers during the twelve months ended 31 December 2017, and 70 per cent. of customers using internet banking were also using the Arion Bank app.

Regulatory Compliance

The regulatory landscape is expanding significantly in financial services and a number of regulations impacting the financial market are pending in Iceland such as GDPR, the Fourth Money Laundering Directive, MiFID II and the Payment Services Directive 2. The IT division has launched a number of initiatives in order to close regulatory compliance gaps in the Bank's information systems in an efficient manner, and will launch other regulatory initiatives in the near future.

Security

Control of information security is an essential tool to achieve the IT division's objectives. The Bank's Information Security Policy forms the basis of the measures used by the Bank to ensure the security of information, data systems and communication systems. Through the implementation of this policy, the Bank aims to prevent the inappropriate use of information, to safeguard the secure and uninterrupted transfer of electronic data and communications, and to integrate a risk management process into the work processes and daily tasks of all employees.

Legal and regulatory requirements relating to IT, particularly the secrecy of information relating to the Bank's customers, must be observed at all times when IT systems are used. The Bank operates two data centres in an active mode to ensure continuous system uptime and to minimise downtime in disaster scenarios.

Legal Proceedings

Litigation and other legal proceedings are a common occurrence in the banking industry due to the nature of the business. Due to the current public sentiment in Iceland, the likelihood of litigation against the Bank has increased. The Bank has formal controls and policies for managing legal claims. Once professional advice has been obtained and the amount of any possible loss has been reasonably estimated, the Bank takes appropriate steps to mitigate any adverse effects which a given claim may have on its financial standing.

Except as described below, there are no governmental, legal or arbitration proceedings (including such proceedings which are pending or threatened of which the Bank is aware) during the 12 months preceding the date of this Prospectus, which may have, or have had, a significant effect on the Bank's and/or the Group's financial position or profitability.

Claim for Alleged Violations of the Competition Act

With a writ issued in June 2013, Kortathjonustan claimed damages in the amount of up to ISK 1.2 billion plus interest in aggregate from the Bank, Íslandsbanki, Landsbankinn, Borgun hf. and Valitor as a result of losses that Kortathjonustan contends the five parties caused by violations of the Competition Act. The case was dismissed on procedural grounds rather than the merits by the District Court of Reykjavík in March 2017 and confirmed by the Supreme Court on 2 June 2017, citing in particular that the plaintiff had not met the requirements related to standing. In September 2017, Kortathjonustan brought proceedings against the Bank and the other defendants on the same grounds, this time claiming damages in the amount of ISK 922 million plus interest. The case was again dismissed on procedural grounds by the District Court of Reykjavík by a ruling in March 2018, which was confirmed by the Court of Appeal in May 2018. Kortathjonustan has appealed the Court of Appeal's ruling to the Supreme Court. If the defendants were ordered to pay damages, they would be jointly responsible for the payment of damages. The Bank has not recorded any provision in respect of this matter.

Claims for Damages due to Forced Bankruptcies

In June 2014, the former chairman of the board of directors of BM Valla hf., together with Lindarflot ehf., filed two cases against the Bank claiming damages in the amount of more than ISK 4 billion plus interest. The plaintiffs claim that the Bank caused them, as shareholders of BM Valla hf. and Fasteignafelagid Artun ehf., which had been customers of the Bank, damages by not allowing the companies to be financially restructured and thereby forcing the companies into bankruptcy, resulting in the sale of assets of the companies at values which the plaintiffs contend are lower than they would have been had the Bank permitted the companies to be financially restructured. In April 2018, the District Court of Reykjavík dismissed the case. The plaintiffs have appealed the judgement to the Court of Appeal. The Bank believes that it will be acquitted of the plaintiffs' claims in both cases and has therefore not recorded any provision in respect of this matter.

Valitor Damages Assessment

In its judgment in case No. 612/2012 from 24 April 2013, the Supreme Court of Iceland ruled that Valitor had not been authorised to rescind an agreement it had entered into with Datacell. In January 2015, Datacell and Sunshine Press Productions brought legal action against Valitor for compensatory damages amounting to approximately ISK 8.1 billion, plus accrued interest, relating to Valitor's termination of Datacell's vendor agreement. Court-appointed evaluators were subsequently asked to assess the damage in question at the request of the plaintiffs. The court-appointed evaluators announced their conclusions in March 2016. Valitor disagreed with the assessment stated in the report and filed a motion to appoint three court evaluators to re-evaluate the plaintiffs' alleged losses. The District Court of Reykjanes granted this motion. The reassessment has been completed, but it was not filed with the District Court. Valitor requested a new assessment, which would have examined particular aspects which had not yet been assessed, but the District Court has rejected the request. Valitor has appealed the decision to the Court of Appeal. Recently Datacell and Sunshine Press Production claimed a freezing of Valitor's assets on the basis of the aforementioned claim of compensatory damages but the district magistrate declined the claim. Datacell and Sunshine Press Productions have submitted that decision to the District Court, which has not yet ruled on this claim.

The Group has not recorded any provision in this case.

When the Bank acquired a 39.22 per cent. holding in Valitor between 2014 and 2015, the Bank signed agreements with the sellers (Landsbankinn and two Icelandic savings banks) regarding potential losses of Valitor in relation to these compensatory damages. Therefore, the Group believes that it will have the basis for a claim against the sellers for their share in the potential loss should Valitor be required by the District Court to pay damages in this case.

Dispute on Legacy Mortgage Loans Collateral

The Bank is involved in several court proceedings where the Bank's claim as mortgagee to 100 per cent. of the value of a property pledged as collateral in a mortgage loan is under dispute, in circumstances where allegedly only one of the two owners has signed a document granting the property as collateral. In 2017 the Supreme Court, in respect of cases which did not involve the Bank, ruled in several cases regarding this issue. In the majority of those cases the Supreme Court found in favour of the mortgagor, holding that the bank in question was entitled to enforce with respect to only 50 per cent. of the value of the property. The district court has ruled in several court cases involving the Bank regarding the aforementioned dispute. In the majority of those cases the district court invalidated 50 per cent. of the collateral, and the Bank is awaiting further rulings to assess the borderline cases. In judicial decisions to date, invalidation of 50 per cent. of the collateral for a given pledge has not affected the remaining 50 per cent. of the collateral or the borrowers' obligation to repay the debt in full. Therefore, the Bank has not recorded any provision in respect of the matter.

Disputes relating to United Silicon

United Silicon was granted a moratorium on payments on 14 August 2017 and filed for bankruptcy on 22 January 2018. The Bank had collateral in United Silicon's assets and the estate conveyed the assets to the Bank. The bankruptcy trustee has approved the Bank's collateral claims, but two unsecured creditors have contested that approval and the dispute has been referred to the District Court. The Bank has examined these challenges and believes they are without merit. However, the Bank and the estate have agreed that if the Bank's collateral claims are judged invalid by the District Court, the Bank will refund the estate the amount of the invalidated bond.

Penalty Interest During Extension of Payments

In March 2018, the Supreme Court of Iceland issued a judgment in case no. 159/2017, which concluded that the Bank was not permitted to calculate penalty interest on customers' debts during the period in which the customer was granted an extension of payments under the law on debt mitigation. The Bank is examining how many customers have paid penalty interest on their debts to the Bank during such extension period. A more detailed examination of these cases will reveal whether any customers may be able to claim repayment from the Bank or be entitled to have their debts reduced, particularly in cases where the debt has been paid in full. An evaluation is currently being made of what the impact will be on the Bank.

Possible Criminal Complaint and Related Correspondence

In 2017 and 2018, the Bank received a series of correspondence from a former customer of the Bank's predecessor Kaupthing. The correspondence alleged that the Bank had not conducted sufficient internal due diligence to ensure that its management and directors are fit and proper to carry on the operations of a financial institution, on the basis that certain individuals who are employed by the Bank were employed by its predecessor Kaupthing or the other Icelandic banks at the time of the financial crisis in 2008.

In May 2018, the Bank received further correspondence from this individual, which stated that he had filed a criminal complaint with the prosecutor in Iceland concerning Kaupthing's alleged wrongful appropriation of assets during the "winding up" process of Kaupthing. The individual alleges that the complaint involves both the Bank and certain of its employees. To date, there has been no indication from authorities in Iceland that any criminal proceedings will be brought against Kaupthing, the Bank or any of its employees in connection with this allegation.

Included in the correspondence described above was information which the individual claimed supports his allegations against the Bank and those employees named in the correspondence. The Bank has considered the allegations in this correspondence, along with the related materials, and has conducted its own review of these allegations and related materials, including with support of external counsel, and it remains of the view that the allegations are without merit and that those employees named in the correspondence are indeed fit and proper.

Resolved Legal Matters

FME Sanctions

In January 2016, the FME published an announcement in relation to the Bank's sale of the shares in Síminn in October 2015, in which the FME concluded that the Bank had not taken reputational risk properly into account when selling the shares in Síminn to certain customers of the Bank. As a consequence, the FME concluded that, as a result of the sale, the Bank was in breach of the sound business practices requirements of the Financial Undertakings Act. The Bank was not subject to any administrative fines in respect of these findings on the basis that the Bank had suffered reputational loss as a consequence of the transaction.

In November 2015, the FME concluded that the Bank had breached the insider trading provisions of the Securities Transactions Act when the Bank sold its interest in Hagar hf. The FME found that the Bank had been in possession of insider information at the time of the transaction and that the Bank had not proved that its counterparties had been in possession of the same information, as the Bank had claimed. As a consequence, the Bank received an administrative fine in the amount of ISK 30.0 million, which it paid in 2015.

In September 2015, following an inspection of certain loans made by the Bank, the FME published an announcement in which the FME concluded that the Bank had not followed its internal rules, specifically in respect of the decision of a credit committee, or provisions of the loan agreements when it annulled and deregistered certain collateral, in breach of the sound business practices requirements of the Financial Undertakings Act. The Bank was not subject to any administrative fines in respect of these findings.

European Surveillance Authority State Aid Investigation

In May 2015, the European Free Trade Association (**EFTA**) Surveillance Authority (**ESA**) began an investigation into potentially unlawful state aid granted to Íslandsbanki and the Bank through allegedly preferential terms provided by the Icelandic Central Bank to Íslandsbanki and the Bank on two separate loan conversion agreements for the rescheduling of short-term collateral and securities loans from the Icelandic Central Bank to long-term loans.

ESA investigated whether these loan conversion agreements, which were concluded between the Icelandic Central Bank and Íslandsbanki and the Icelandic Central Bank and the Bank in September 2009 and November 2009, respectively, could be regarded as unlawful state aid within the meaning of the EEA rules.

In November 2016, ESA concluded that the terms agreed by the Icelandic Central Bank were in line with commercial conditions at the time the agreements were entered into and the Icelandic Central Bank acted in line with the conduct of a private creditor and, consequently, the loan agreements did not constitute state aid within the meaning of the EEA rules.

ICA Investigation into Mortgage Loans Arrangements

The Bank, Íslandsbanki and Landsbankinn had been under investigation by the ICA in relation to alleged abuse of their collective dominant position relating to mortgage loan arrangements, on the basis of separate complaints from BYR hf. and MP Banki hf. made in 2010. The Bank has concluded a settlement with the ICA which has the objective of stimulating competition in retail banking services for individuals and small businesses. The Bank has undertaken actions that have the objective of reducing switching costs in financial services, promoting active competition among banks toward individuals and small businesses and negating circumstances that could enforce tacit co-ordination in the market for retail banking services. With the settlement the ICA has closed its investigation with respect to the Bank.

RELATED PARTY TRANSACTIONS

The Bank has a related party relationship with Kaupskil, the board of directors of Kaupskil, Kaupthing, the Group's associates, the Board of Directors of the Bank, the key management personnel of the Bank and close family members of the directors and key management personnel. In addition, Taconic Capital Advisors UK LLP, through TCA New Sidecar III s.à r.l., and Sculptor Investments s.à r.l., an affiliated entity of Och-Ziff Capital Management Group, by virtue of their shareholdings in the Bank (which shareholdings are managed by Kaupskil), are defined as related parties. In addition, Trinity Investments Designated Activity Company (an investment entity managed by Attestor Capital LLP), and Goldman Sachs International, through ELQ Investors II Limited, each manage their own respective shareholdings in the Bank and are defined as related parties.

Transactions with all related parties have been conducted on an arm's length basis and are in the normal course of business. There have been no guarantees provided or received for related party receivables or payables during the financial years ended 2017 or 2016.

See note 39 to the 2017 Consolidated Financial Statements for further information in relation to the Bank's related party transactions.

RECENT DEVELOPMENTS

On 31 May 2018, the Bank completed an initial public offering of its shares. Upon completion of this initial public offering and the subsequent listing of the Bank's shares in Iceland and Sweden in June 2018, the Bank has expanded its shareholder base. As a result, Kaupthing, through its subsidiary Kaupskil remains the largest shareholder in the Bank (with a 32.67 per cent stake) together with Taconic Capital Advisors (with a 10.00 per cent. stake), Attestor Capital (with a 9.14 per cent. stake) and Och-Ziff Capital Management (with a 6.58 per cent. stake). The National Treasury of Iceland no longer holds a stake in the Bank.

KEY FINANCIAL INDICATORS

The following table includes certain of the Bank's key financial indicators for the three month period ended 31 March 2018 and for the years ended 31 December 2017 and 2016. This information should not be considered in isolation from, or as a substitute for, financial information presented in the Interim Financial Statements or the 2017 Consolidated Financial Statements (each of which is incorporated by reference into this Base Prospectus) and should be read in conjunction with the Interim Financial Statements and the 2017 Consolidated Financial Statements, as applicable.

	As of and for the three month period ended	**As of and for the twelve month period ended**	
	31 March 2018	**31 December 2017**	**31 December 2016**
	%	%	%
Profitability			
Return on equity[1]………………………....	3.6	6.6	10.5
Return on assets[2]…………………………	0.7	1.3	2.1
Return on risk-weighted assets[3]…………	1.0	1.9	2.9
Net interest margin			
Net interest margin on interest-earning assets[4]…………	2.6	2.9	3.1
Net interest margin on total assets[5]………	2.4	2.7	2.9
Efficiency			
Cost-to-income ratio[6]……………………	70.8	56.1	56.0
Cost-to-total assets ratio[7]……………….	3.0	2.7	3.0

1 Return on equity is net earnings for the period as a percentage of average total equity (calculated as the average of the opening, quarter-end and closing balances for the applicable period). Return on equity is used as an alternative measure of performance of the Bank based on returns generated relative to equity and is a measure of the profits generated by the Bank from the equity of its shareholders. The higher this figure, the greater the profits of shareholders relative to their equity for the relevant period.

2 Return on assets is net earnings for the period as a percentage of average total assets (calculated as the average of the opening, quarter-end and closing balances for the applicable period). Return on assets is used as an alternative measure of performance of the Bank based on returns generated relative to total assets and is a measure of the profits generated by the Bank from its assets. The higher this figure, the greater the profits from the Bank's assets for the relevant period.

3 Return on risk-weighted assets is net earnings for the period as a percentage of average risk-weighted assets (calculated as the average of the opening, quarter-end and closing balances for the applicable period). For the calculation of risk-weighted assets see Note 43 of the 2017 Consolidated Financial Statements and Note 44 of the 2016 Consolidated Financial Statements. Return on risk-weighted assets is used as an alternative measure of performance of the Bank based on returns generated relative to risk-weighted assets and is a measure of the profits generated by the Bank from its risk-weighted assets (which is a prudential measure by which the assets of the Bank are adjusted to give different weight to certain risk based considerations as a means to assess those assets relative to such risks). The higher this figure, the greater the profits from the Bank's risk-weighted assets for the relevant period, which can then be compared to return on assets above to assess the risk based return of the Bank relative to the total asset return.

4 Net interest margin on interest-earning assets is interest income on interest-earning assets less interest expense (i.e. net interest income) as a percentage of average interest-earning assets (calculated as the average of the opening, quarter-end and closing balances for the applicable period). Net interest income was ISK 29,835 and ISK 29,900 million for the twelve month periods ended 31 December 2017 and 2016, respectively. "Interest-earning assets" means the sum of cash and balances with Central Bank, loans to credit institutions, loans to customers and interest-earning financial instruments (which is made up of bonds and debt instruments (ISK 51,7 55 million as at 31 December 2017 and ISK 69,565 million as at 31 December 2016), derivatives (ISK 7,624 million as at 31 December 2017 and ISK 5,159 million as at 31 December 2016) and listed bonds and debt instruments (ISK 7,318 million as at each of 31 December 2017 and 31 December 2016). See Note 22 of the 2017 Consolidated Financial Statements and Note 22 of the 2016 Consolidated Financial Statements). Net interest margin on interest-earning assets is used as an alternative measure of performance of the Bank based on the Bank's net interest margin relative to its interest-earning assets and is a measure of the difference in the interest income generated by the Bank's interest-earning assets and its interest expense by reference to the average interest-earning assets for the relevant period. The higher this figure, the greater the returns from the Bank's interest-earning assets for that period.

5 Net interest margin on total assets is net interest income as a percentage of average total assets (calculated as the average of the opening, quarter-end and closing balances for the applicable period). Net interest margin on total assets is used as an alternative measure of performance of the Bank based on the Bank's net interest margin relative to its total assets and is a measure of the difference in the interest income generated by the Bank's total assets and its interest expense by reference to the average total assets for the relevant period. The higher this figure, the greater the returns from the Bank's total assets for that period.

6 With respect to cost-to-income ratio, "cost" means salaries and related expense and other operating expense. "Income" means operating income. Cost-to-income ratio is used as an alternative measure of performance of the Bank based on the costs of the Bank relative to income generated and is a measure of the Bank's costs as compared with its income. The lower this figure, the lower the Bank's costs relative to its income.

7 With respect to cost-to-total assets ratio, "cost" means salaries and related expense and other operating expense. "Total assets" means total assets of the Bank as set out in the financial statements of the Bank (calculated as the average of the opening, quarter-end and closing balances for the applicable period). Cost-to-total assets ratio is used as an alternative measure of performance of the Bank based on the costs of the Bank relative to its total assets and is a measure of the Bank's costs as compared with its total assets. The lower this figure, the lower the Bank's costs relative to its total assets.

LOAN PORTFOLIO

The table below sets out details of the Bank's loans to customers as at 31 December 2017 and 31 December 2016 classified by type of loan.

	As at 31 December 2017					
	Individuals		Corporates		Total	
	Gross carrying amount	Book value	Gross Carrying amount	Book Value	Gross Carrying amount	Book value
Overdrafts............................	14,469	13,438	18,778	17,504	33,247	30,942
Credit cards..........................	11,133	10,931	1,123	1,109	12,256	12,040
Mortgage loans.....................	311,507	310,318	19,632	19,417	331,139	329,735
Other loans	33,629	30,600	368,312	361,784	401,941	392,384
Loans and receivables to customers............................	**370,738**	**365,287**	**407,845**	**399,814**	**778,583**	**765,101**

	As at 31 December 2016					
	Individuals		Corporates		Total	
	Gross carrying amount	Book value	Gross Carrying amount	Book Value	Gross Carrying amount	Book value
Overdrafts...............................	14,805	13,381	19,314	17,630	34,119	31,011
Credit cards.............................	11,363	11,099	1,180	1,151	12,543	12,250
Mortgage loans........................	285,784	282,996	16,298	15,975	302,082	298,971
Other loans	34,777	29,940	351,739	340,250	386,516	370,190
Loans and receivables to customers...............................	**346,729**	**337,416**	**388,531**	**375,006**	**735,260**	**712,422**

The table below sets out details of the book value of the Bank's loans and receivables to customers as at 31 December 2017 and 31 December 2016 classified by customer sector.

	31 December 2017	31 December 2016
Individuals..	47.7%	47.4%
Real estate activities and construction..................	16.7%	16.1%
Seafood...	10.3%	10.7%
Information and communication technology.........	3.0%	4.1%
Wholesale and retail trade	7.5%	7.4%

Financial and insurance activities	4.5%	4.9%
Industry, energy and manufacturing	3.8%	4.0%
Transportation	2.2%	0.9%
Services	2.4%	2.4%
Public sector	1.0%	1.2%
Agriculture and forestry	0.9%	0.9%
Total	**100%**	**100%**

As of 31 December 2017, the aggregate amount of the Bank's 10 largest loans to customers equalled 12.1 per cent. of the total gross amount of the Bank's customer loan portfolio as of such date.

In addition to its customer loans and receivables, the Bank has a portfolio of loans and receivables to credit institutions. The table below sets out details of the Bank's loans and receivables to credit institutions as at 31 December 2017 and 31 December 2016 classified by type of loan.

	31 December 2017	**31 December 2016**
	(*ISK million*)	
Bank accounts	51,303	45,631
Money market loans	32,309	32,267
Other loans	2,997	2,218
Loans to credit institutions	**86,609**	**80,116**

The table below shows the credit quality of the Bank's financial assets, including its net loans and receivables, as at 31 December 2017 and 31 December 2016.

	As at 31 December 2017			
	Neither past due nor impaired	**Past due but not impaired**[(1)]	**Individually impaired**[(2)]	**Total**
		(*ISK million*)		
Cash and balances with Central Bank	139,819	-	-	**139,819**
Loans to credit institutions	86,609	-	-	**86,609**
Loans to customers				
Loans to corporates	385,197	13,655	962	**399,814**
Loans to individuals	344,829	18,929	1,529	**365,287**
Financial instruments	78,784	-	-	**78,784**
Other assets with credit risk	8,948	-	-	**8,948**
Credit quality by class of financial assets	**1,044,186**	**32,584**	**2,491**	**1,079,261**

(1) "Past due but not impaired" includes loans to customers which the Bank has reviewed but for which it has determined that it was not necessary to record a provision.

(2) Represents book value of individually impaired loans to customers after provision for impairment was recorded.

	As at 31 December 2016			
	Neither past due nor impaired	**Past due but not impaired**[(1)]	**Individually impaired**[(2)]	**Total**
		(*ISK million*)		
Cash and balances with Central Bank	87,634	-	-	87,634
Loans to credit institutions	80,116	-	-	80,116
Loans to customers				
Loans to corporates	358,709	14,251	2,046	375,006
Loans to individuals	312,259	21,854	3,303	337,416
Financial instruments	82,042	-	-	82,042
Other assets with credit risk	8,617	-	-	8,617
Credit quality by class of financial assets	**929,377**	**36,105**	**5,349**	**970,831**

(1) "Past due but not impaired" includes loans to customers which the Bank has reviewed but for which it has determined that it was not necessary to record a provision.

(2) Represents book value of individually impaired loans to customers after provision for impairment was recorded.

The table below shows the ageing of the Bank's past due but not impaired loans and receivables by class as at 31 December 2017 and 31 December 2016.

31 December 2017	**Up to 3 days**	**4 to 30 days**	**31 to 60 days**	**61 to 90 days**	**More than 90 days**	**Total**
				(*ISK million*)		
Loans to corporates..........	4,361	4,221	1,774	1,339	1,960	**13,655**
Loans to individuals.........	3,065	8,149	4,387	350	2,978	**18,929**
Past due but not impaired loans................	**7,426**	**12,370**	**6,161**	**1,689**	**4,938**	**32,584**

31 December 2016	**Up to 3 days**	**4 to 30 days**	**31 to 60 days**	**61 to 90 days**	**More than 90 days**	**Total**
				(*ISK million*)		
Loans to corporates..........	5,388	4,282	1,589	1,211	1,781	**14,251**
Loans to individuals.........	3,196	8,708	4,989	391	4,570	**21,854**
Past due but not impaired loans................	**8,584**	**12,990**	**6,578**	**1,602**	**6,351**	**36,105**

The table below sets out details of the Bank's impaired loans and receivables to customers as at 31 December 2017 and 31 December 2017 classified by customer sector.

Impaired loans to customers	2017		2016	
	Impairment amount	Gross carrying amount	Impairment amount	Gross carrying amount
Individuals	4,010	5,539	7,069	10,372
Real estate activities and construction	467	762	770	1,056
Fishing industry	658	861	966	1,648
Information and communication technology	111	112	179	182
Wholesale and retail trade	490	702	540	868
Financial and insurance activities	297	314	261	298
Industry, energy and manufacturing	473	581	786	878
Transportation	1	1	4,301	4,307
Services	3,570	3,617	3,145	3,624
Public sector	45	45	89	113
Agriculture and forestry	165	244	175	284
	10,287	**12,778**	**18,281**	**23,630**

As at 31 December 2017, 8.8 per cent. of the book value of problem loans (defined as loans more than 90 days past due but not impaired and other problem (i.e. individually impaired) loans) was attributable to five customers and 15.5 per cent. to 10 customers. An additional 21.4 per cent. of problem loans as at 31 December 2017 was attributable to a further 26 customers.

FUNDING AND LIQUIDITY

Funding

The Bank is partially funded with domestic deposits. Its total deposit base at 31 March 2018 was ISK 453,059 million, or 48.8 per cent. of its total liabilities. In addition to deposits, the Bank's other funding comprises Notes issued under this Programme and its covered bonds, bills issued and other loans and equity.

At the beginning of 2017 the Bank tapped its outstanding EUR 300 million (ISK 36 billion) 1.625 per cent. Notes due 2021 originally issued in late 2016 for a further EUR 200 million (ISK 24 billion). In June 2017, the Bank issued EUR 300 million (ISK 35 billion) 0.75 per cent. Notes due 2020 and in March 2018, the Bank issued EUR 300 million (ISK 35 billion) 1.00 per cent. Notes due 2023. The proceeds of these issues were partly used to repay the Resettable Notes held by Kaupthing and to tender outstanding notes due in March 2018 for EUR 100 million from EUR 300 million to EUR 200 million, thereby reducing refinancing risk for 2018. During 2017, the Bank also issued (i) private placements in NOK and SEK for an equivalent of ISK 19.6 billion, (ii) a total of ISK 29.9 billion of covered bonds and (iii) commercial paper amounting to ISK 20 billion.

As at 31 March 2018, the aggregate amount of the Bank's 10 largest deposits equalled 17 per cent. of the aggregate amount of the Bank's total deposits at that date.

The Bank is focused on maintaining a large and stable deposit base originated from its clients. Deposits are expected to continue to form the core of the Bank's funding in the future. However, there are external factors that might affect the Bank's deposit base in the short to medium term, such as the increased availability of other investment opportunities for investors who currently hold deposits with the Bank. The Bank intends to continue diversifying its funding profile by issuing bonds in the domestic and international bond market when conditions permit.

Liquidity

On 1 December 2013 new liquidity rules issued by the Icelandic Central Bank took effect, overriding the rules on liquidity and cash ratios that have previously been reported by the Group. The new rules are based on the liquidity standards introduced in the Basel III Accord which began to be implemented in 2015 on a global level. The standard defines the LCR, which is the balance between highly liquid assets and the expected net cash outflow of the Group in the next 30 days under stressed conditions.

The criteria for liquid assets used to meet unexpected outflow is stricter under these new liquidity measures. The assets must be non-pledged, liquid and easily priced on the market, repo-able at the Icelandic Central Bank and not issued by the Group or its related entities.

The Icelandic Central Bank has set a guideline for the minimum LCR. The requirement for foreign currency is 100 per cent. effective from 1 January 2017.

The LCR as at 31 December 2017 and 31 December 2016 is shown below:

Liquidity coverage ratio	2017	2016
FX	323%	263%
Total	221%	171%(1)

(1) The Bank's liquidity facility from the Icelandic government expired at the end of 2016, which reduced the Bank's liquidity buffer by ISK 30 billion and, consequently, decreased the LCR.

As per the LCR methodology, the Bank's deposit base is split into different categories depending on customer type. A second categorisation is used where term deposits refer to deposits with a residual maturity greater than 30 days. Deposits that can be withdrawn within 30 days are marked stable if the customer has a business relationship with the Bank and the amount is covered by the Deposit Insurance Scheme. Other deposit funds are considered less stable. A weight is attributed to each category, representing the expected outflow under stressed conditions.

The table below shows the breakdown of the Group's deposit base according to the LCR categorisation, with the associated expected stressed outflow weights as at year ended 31 December 2017 and 31 December 2016. The table contains deposits at the Bank and at banking subsidiaries. Thus, amounts due to Central Bank and amounts due to credit institutions at non-banking subsidiaries are excluded.

	As at 31 December 2017					
	Deposits maturing within 30 days					
	Less stable	**Weight (%)***	**Stable**	**Weight (%)***	**Term deposits****	**Total deposits**
	(*ISK million, except percentages*)					
Retail	163,542	11%	52,401	5%	68,741	284,684
Corporations	51,968	40%	811	20%	5,757	58,536
Sovereigns, central-banks and PSE	14,583	40%	—	—	1,383	15,966
Pension funds	53,116	100%	—	—	15,391	68,507
Domestic financial entities	23,175	100%	—	—	15,949	39,124
Foreign financial entities	2,714	100%	—	—	—	2,714
Total	**309,098**		**53,212**		**107,221**	**469,531**

*"Weight" represents the proportion of deposits the Group considers to be expected to become unavailable to the Group under stressed conditions.
**"Deposits" in this context refer to deposits with maturities greater than 30 days

	As at 31 December 2016					
	Deposits maturing within 30 days					
	Less stable	**Weight (%)***	**Stable**	**Weight (%)***	**Term deposits****	**Total deposits**
	(*ISK million, except percentages*)					
Retail	137,055	10%	44,331	5%	63,106	244,492
Corporations	55,094	40%	921	20%	5,850	61,865
Sovereigns, central-banks and PSE	11,653	40%	—	—	1,379	13,032
Pension funds	31,157	100%	—	—	15,959	47,116
Domestic financial entities	24,310	100%	—	—	16,730	41,040
Foreign financial entities	2,150	100%	—	—	—	2,150

Other foreign parties	4,466	100%	3,276	25%	2,288	10,030
Total	**265,885**		**48,528**		**105,312**	**419,725**

*“Weight” represents the proportion of deposits the Group considers to be expected to become unavailable to the Group under stressed conditions.
**“Deposits” in this context refer to deposits with maturities greater than 30 days

RISK MANAGEMENT

Overview

The Bank seeks to manage its risks through a process of ongoing risk identification, measurement and monitoring, using limits and other controls. This process of risk management and the ability to evaluate, manage and price the risks encountered is critical to the Bank's continuing profitability and its ability to ensure that the Bank's exposure to risk remains within acceptable levels.

The Board of Directors is ultimately responsible for the Bank's risk management framework and ensuring that satisfactory risk policies and governance for controlling the Bank's risk exposure are in place. The Board of Directors defines the overall risk appetite of the Bank which is translated into exposure limits and targets that are monitored by the Risk Management division, which reports its findings regularly to the CEO and the Board of Directors. Risk is measured, monitored and reported according to internal policies, principles and processes that are reviewed and approved by the Board of Directors at least annually. The Board of Directors is also responsible for the internal capital adequacy assessment process (the **ICAAP**) and internal liquidity adequacy assessment process (**ILAAP**). The Board of Directors has determined that management of risks encountered within subsidiaries should principally be carried out within each subsidiary.

The CEO is responsible for enforcement of the risk management policies established by the Board of Directors, sustaining an effective risk management framework, processes and controls as well as maintaining a high level of risk awareness among the Bank's employees.

The table below sets forth the Bank's risk appetite metrics measured as of 31 December 2017. In each case, the Bank is operating within prescribed legal limits and within its prescribed risk appetite.

	As of 31 December 2017	Legal Limit
Credit risk		
Largest customer exposure—Group level(1)	9.2%	≤25.0%
Sum of exposure to the three largest industry sectors (real estate and construction, seafood and wholesale and retail trades)(2)	66.1%	N/A
Exposure to the largest industry sector (real estate and construction)(2)	32.1%	N/A
Expected loss(3)	0.39%	N/A
Market risk		
Total equity exposure(4)	13.0%	N/A
Unlisted equity exposure(5)	7.9%	N/A
Indirect equity exposure(6)	0.65%	N/A
Funding and liquidity risk		
Total LCR(7)	221%	≥100.0%(6)
Loan-to-deposit ratio(8)	166%	N/A
Encumbered asset ratio(9)	18.8%	N/A
Capital management		
Capital adequacy ratio(10)	24.0%	≥19.8%
Leverage ratio(11)	15.4%	≥3.0%
Assets and liability management		
Currency imbalance—Group level(12)	0.1%	≤15.0%
Interest rate risk(13)	2.7%	N/A

(1) Largest customer exposure—Group level is defined as net exposure to a single customer or group of connected customers as a percentage of the Group's total own funds, comprising Tier 1 and Tier 2 capital.

(2) Exposure to the largest industry sector or the three largest industry sectors is defined as the book value of loans to the largest industry sector or the three largest industry sectors, as the case may be, as a percentage of the corporate loan portfolio.

(3) Expected loss is defined as the one-year expected loss for the customer loan portfolio as a percentage of the total customer loan portfolio and is calculated using the following formula: expected loss = probability of default x loss given default x exposure at default, where exposure at default is an estimate of the gross exposure under a loan upon default by a customer.

(4) Total equity exposure is defined as the total equity position of the Bank, excluding investments in core assets, as a percentage of the Group's total own funds, comprising Tier 1 and Tier 2 capital.

(5) Unlisted equity exposure is defined as the unlisted equity position of the Bank, excluding investments in core assets, as a percentage of the Group's total own funds, comprising Tier 1 and Tier 2 capital.
(6) Indirect equity exposure is defined as the maximum capital loss to the Bank due to derivatives and margin lending in the event of an equity market stress event, based on assumptions which the Bank has adopted for such purposes.
(7) LCR is defined and calculated in accordance with the CRD IV framework.
(8) Loan-to-deposit ratio is defined as the ratio of total loans to customers to total customer deposits on a Group level.
(9) Encumbered asset ratio is defined as assets pledged as security for borrowings as a percentage of total assets on a Group level.
(10) Capital adequacy ratio is defined and calculated in accordance with the CRD IV framework as the Group's total own funds, comprising Tier 1 and Tier 2 capital, as a percentage of total risk-weighted assets.
(11) Leverage ratio is defined and calculated in accordance with the CRD IV framework.
(12) Currency imbalance is defined as the Group's net position by which foreign currency assets exceed foreign currency liabilities as a percentage of the Group's total own funds, comprising Tier 1 and Tier 2 capital.
(13) Interest rate risk is defined as the amount at risk, which is calculated as a change in fair value due to yield curve movements that corresponds to the 99th percentile of the loss distribution.

The Bank operates the following committees to manage risk:

- *Board Risk Committee*, which is responsible for supervising the Bank's risk management framework, risk appetite and ICAAP/ILAAP. The Board Risk Committee regularly reviews reports on the Bank's risk exposures. The Board Risk Committee meets as often as required but at least five times annually. As of the date of this Prospectus, the Board Risk Committee consists of Måns Höglund (chairman), John P. Madden III and Steinunn Kristín Thórdardóttir.

- *Asset and Liability Committee* (the **ALCO**), which is responsible for managing any asset and liability mismatches, liquidity risk, market risk, interest rate risk and capital management. The ALCO meets as often as required but at least eight times annually. As of the date of this Prospectus, the ALCO consists of Höskuldur H. Ólafsson (CEO), Stefán Pétursson (Chief Financial Officer) and Sigurbjörg Ólafsdóttir, with Gísli S. Óttarsson (Chief Risk Officer) as a non-voting observer, none of whom is a member of the Board of Directors.

- *Underwriting and Investment Committee* (the **UIC**), which decides on underwriting and principal investments. The UIC meets as often as required but at least quarterly. As of the date of this Prospectus, the UIC consists of Höskuldur H. Ólafsson (CEO), Stefán Pétursson (Chief Financial Officer) and Elísabet Árnadóttir (Head of Business Relations, Retail Banking) with Gísli S. Óttarsson (Chief Risk Officer) as a non-voting observer, none of whom is a member of the Board of Directors.

- *Data Committee* (the **DC**), which is responsible for ensuring that data is managed properly. The DC meets ten times annually. As of the date of this Prospectus, the DC consists of Gísli S. Óttarsson (Chief Risk Officer), Stefán Pétursson (Chief Financial Officer), Halldór Hardarson (Head of Marketing) and Hrannar Már Hallkelsson (Head of Software Development).

- *Security Committee* (the **SC**), which is responsible for security matters, both information security and physical security. The SC meets as often as required but at least quarterly. As of the date of this Prospectus, the SC consists of Höskuldur H. Ólafsson (CEO), Ida Brá Benediktsdóttir (Managing Director of Retail Banking), and Rakel Óttarsdóttir (Managing Director of IT). The Bank maintains a role of security officer, who reports to the SC.

The Bank has four levels of credit committees:

- the Board Credit Committee (the **BCC**), which decides on all major credit risk exposures (new exposures greater than 5 per cent. of the Bank's own funds and other major credit decisions that may materially increase the Bank's credit risk);

- the Arion Credit Committee (the **ACC**), which operates within limits specified as a fraction of the Bank's capital (new exposures less than 5 per cent. of the Bank's own funds and other credit decisions if the exposure to a group of financially related parties is less than 10 per cent. of the Bank's own funds);

- the Corporate Credit Committee (the **CCC**), which operates within tighter credit approval limits (new exposures less than or equal to ISK 750 million, refinancing up to ISK 1,000 million and other credit decisions if the total exposure to a group of financially related parties is less than 5 per cent. of the Bank's own funds); and
- the Retail Branch Credit Committee (the **RBC**), which also operates within tighter credit approval limits (new exposures less than or equal to ISK 100 million and other credit decisions if the total exposure to a group of financially related parties is less than ISK 500 million).

The BCC meets as often as required and each of the other three credit committees has scheduled meetings at least twice a week.

In addition, the Bank operates five Collateral Valuation Committees, which set guidelines on collateral assessment and valuation, and two Debt Cancellation Committees, which deal with applications to reach composition with debtors.

The Bank's internal audit division conducts independent reviews of the Bank's operations, risk management framework, processes, policies and measurements. Internal audits examine both the adequacy and completeness of the Bank's control environment and processes as well as the Bank's compliance with its procedures, internal rules and external regulations. Results of internal audits are discussed with the Bank's management and reported to the Board Risk Committee.

The Risk Management division is headed by the Chief Risk Officer. It is independent and centralised and reports directly to the CEO. The division is divided into three subdivisions: (i) Credit Control, which monitors weak and impaired credit exposures on a customer-by-customer basis and the loan portfolio credit risk; (ii) Balance Sheet Risk, which oversees all risks related to asset and liability mismatches, including capital, and is responsible for the Bank's ICAAP/ILAAP; and (iii) Operational Risk, which is a part of the Bank's second line of defence and monitors risks associated with the daily operations of the Bank. The Bank's Data Officer is part of the Risk Management division.

The Bank is exposed to four major areas of risk: credit risk, market risk, liquidity risk and operational risk. In addition, the Bank manages its capital position with the focus on optimising the capital structure in the medium term and maintaining the Group's capitalisation comfortably above the regulatory minimum, including capital buffer and the supervisory review and evaluation process (**SREP**) requirements.

Credit Risk

Credit risk is managed and controlled by setting limits on the amount of risk the Bank is willing to accept for individual counterparties and groups of connected customers and by monitoring exposures in relation to such limits. The main sources of credit risk are from the customer loan portfolio, commitments and guarantees, counterparty credit risk and equity risk in the banking book, which arises primarily from investment in positions that are not made for short-term trading purposes and assets repossessed as a result of credit recovery, i.e. restructuring or collection.

The Bank's credit policy forms the basis for its credit strategy as integrated in the business plan, risk appetite towards credit exposure, credit rules and its credit procedures and controls. It contains high level criteria for the granting of credit and also outlines roles and responsibilities for further implementation and compliance. The emphasis of the credit policy is on keeping a high quality credit portfolio by maintaining a strict credit process and seeking business with financially strong parties with strong collateral and good repayment capacity. The risk level of each credit is considered in the pricing decision.

The Bank's main asset is its customer loan portfolio. Therefore, managing and analysing the customer loan portfolio is of utmost importance. Credit risk management entails diversification of risk, well-informed lending decisions, good oversight of the portfolio performance and a clear identification of any sign of weaknesses to conduct a timely recovery.

To ensure well-informed lending decisions, the Credit Office assesses credit risk before a credit decision is made and participates in credit committee meetings at the ACC and CCC levels. Various controls ensure that a loan is only disbursed following a thorough review of all documents and the registration of all relevant information regarding the loan and collaterals into the Bank's IT systems.

During the repayment phase, Risk Management monitors the credit portfolio. The Credit Control department aggregates the portfolio monthly, based on consistent criteria, to analyse the outstanding risk, the collateral level, as well as the portfolio quality. Credit Control analyses loans that have been classified at risk and maintains an independent and centralised overview of distressed credits. Credit Control, based on its analysis, suggests provisions and reviews write-offs. Monthly credit risk reports are sent to the ACC, the Board Risk Committee (the **BRIC**) and the Board of Directors.

The Bank seeks to limit its total credit risk through diversification of the loan portfolio across industry sectors and by limiting large exposures to groups of connected customers. For additional information on the Bank's maximum exposure to credit risk by type of financial instrument and industry sector classification of customer, see the note titled "*Credit risk*" in the Annual Financial Statements. As of 31 December 2017 and 2016, the Bank's total on- and off-balance sheet credit risk exposure equalled ISK 1,266,324 million and ISK 1,124,007 million, respectively. The major industry sector exposures for loans to customers as of 31 December 2017 were (i) individuals (47.7 per cent. of loans to customers), (ii) real estate activities and construction (16.7 per cent. of loans to customers) and (iii) fishing industry (10.3 per cent. of loans to customers).

Underwriting and Credit Approval Process

As discussed above, the Bank has a tiered structure of credit approval committees.

The BCC, which acts on behalf of the Board of Directors, is the Bank's top credit, investment and underwriting authority. The ACC, which has granting limits below those of the BCC's, has the right to delegate authority within its own credit limits and sets credit approvals rules and guidelines for the divisions of the Bank.

For each credit application, the Bank gathers information and evaluates certain elements that serve as a basis for the decision, for example the borrower's profile and financial analysis, evaluation of any proposed collateral, the borrower's credit rating and related parties' total exposure. The first stage is interaction between the borrower and an account manager in the relevant division, followed by the preparation of a credit application, which must contain the following minimum information about the borrower:

- credit rating (internal rating system);
- financial accounts;
- collateral;
- the borrower's request and the account manager's proposal;
- the borrower's ability to pay;
- general information about the borrower; and
- the rationale for the proposal.

When the loan application is submitted for approval to the relevant credit committee, it is first analysed by the Credit Office. The Credit Office prepares an opinion for all credit applications that are submitted to the BCC, the ACC and the CCC. The Credit Office also monitors the activities of the RBC. It ensures that credit decisions are within a committee's credit approval authority. The Chief Risk Officer or his designated representative has the right to attend all credit committee meetings and is authorised to escalate controversial credit decisions from one committee to a committee with a higher authority.

The Credit Office is also responsible for the approval of the corporate credit rating performed by account managers by challenging the qualitative input and verifying the quality of quantitative information used to produce the ratings.

The relevant credit committee then either approves or declines the loan application, and the decision is recorded in the minutes of the meeting, which are signed and registered. If the loan application has been approved, the account manager and the borrower then negotiate the terms and conditions of the loan, and the loan is documented by the Legal division in accordance with the approval of the relevant credit committee. When the back office receives the signed documents, it disburses the loan.

Collateral

The Bank generally requires collateral, but a central element in its assessment of a proposed borrower's creditworthiness is the borrower's ability to service debt. The main types of collateral obtained by the Bank include:

- retail loans to individuals are collateralised by mortgages on residential properties;
- corporate loans are collateralised by real estate, fishing vessels and other fixed and current assets, including inventory and trade receivables, cash and securities; and
- derivative exposures are collateralised by cash, treasury notes and bills, asset backed bonds, listed equity and funds that consist of eligible securities.

The Bank collects and stores collateral information, including information on collateral maintenance and valuation. In addition to collateral, other important credit risk mitigating techniques are pledges, guarantees and master netting agreements.

To ensure consistent collateral value assessment, the Bank has five collateral valuation committees. The committees set guidelines on collateral valuation techniques, collateral value and valuation parameters. The committees are divided by area of expertise as follows:

- agriculture;
- fishing vessels and fishing quotas;
- real estate;
- securities; and
- inventory and trade receivables.

The collateral value is monitored and additional collateral requested in accordance with the underlying agreement. The collateral value is reviewed in line with the adequacy of the allowance for impairment losses.

Portfolio Credit Quality

The Bank emphasises monitoring and reporting the quality of its loan portfolio. The credit portfolio quality is regularly aggregated and assessed in terms of industry concentration, single name concentration, product type and credit rating.

The Bank uses an internal rating system to rate its customers, companies and individuals. The rating model for larger companies bases its rating both on qualitative factors, such as industry sector stability and outlook, and quantitative factors, such as their equity and liquidity ratios. The rating models for SMEs and individuals are purely quantitative models.

During the repayment phase, Risk Management monitors the credit portfolio. The Credit Control department aggregates the portfolio monthly, based on consistent criteria, to analyse the outstanding risk, the collateral level, as well as the portfolio quality. Credit Control analyses loans that have been classified at risk and maintains an independent and centralised overview of distressed credits. Credit Control, based on its analysis, suggests provisions and reviews write-offs. Monthly credit risk reports are sent to the ACC, the BRIC and the Board of Directors.

Impairment and Provisions

The Credit Control department is in charge of the Bank's provisioning process. Provisions for impairment are made both on a portfolio level and by individual assessment. All exposures to borrowers with loans that are considered impaired are moved to risk class 5 (DD rating), with the exception that impairment on prime mortgages to individuals do not trigger movement to risk class 5 for other exposures to the borrower, and vice versa.

On 1 January 2018, the Bank implemented IFRS 9 Financial instruments, and as part of the implementation, the process for provisioning for loss allowance has been split in to three stages. Stage 1 calculates one-year expected credit losses. Stage 2 calculates expected lifetime credit losses. Stage 3 calculates expected lifetime credit losses for impaired financial assets. Calculation of the loss allowance is performed for all loans, facilities and loan commitments carried at amortised cost or at fair value through other comprehensive income (for these purposes, referred to as "loans"). For further information on the calculation methodology, see note 42 in the Interim Financial Statements.

Financial assets and financial liabilities – Classification and Measurement

Loss allowance for Performing Loans

Stage 1 loss allowance is calculated for all performing loans. Stage 1 assets are subject to one-year expected credit losses. The calculation is based on estimates of the borrower's one year probability of default, loss given default and exposure at default. Assets classified as Stage 2 have encountered significant increase in credit risk as defined by the Bank and carry expected lifetime credit losses. The calculation is based on estimation of the borrower's lifetime probability of default, loss given default and exposure at default. Probability of default, loss given default and exposure at default models for loans are based on the Bank's internal models.

Individual Assessment

Loans classified as Stage 3 are impaired when objective evidence demonstrates that a loss event has occurred and that the loss event has an impact on the future cash flows of the asset or the asset is 90 days or more past due. The level of detail for credit monitoring depends on the size of the exposure, where factors such as delinquency by the borrower, forbearance measurements, and the internal credit rating are considered. For larger borrowers, interviews with account managers are also conducted. Loans are not classified as Stage 3 even if the value of collateral prudently covers the outstanding amount.

Portfolio Assessment

The provisioning process for prime mortgages and other exposures to individuals, where the amount of the exposure is within a predetermined and acceptable range, is made on a portfolio basis. The impairment is based on a 90 days delinquency status and a collateral allocation method where the collateral is usually the tax value of the pledged real estate property. For additional information on the Bank's measurement of impairment, see the note titled "Financial assets and financial liabilities" in the Annual Financial Statements.

Counterparty Credit Risk

The Bank offers financial derivative instruments to professional investors. The table below sets forth the derivative trading products that are currently offered by the Bank to its customers classified according to the primary risk factor and type of derivative instrument.

Primary risk factor	Swaps	Forwards	Options
Interest rate	X		
Foreign exchange	X	X	X
Securities (equities and bonds).........		X	X
Commodities		X	X

Valuation changes are made in response to changes in interest rates, exchange rates, security prices and commodity prices.

The Bank sets limits on a customer's total exposure to control the Bank's risk associated with derivatives trading. These limits are generally specific for each customer and may refer specifically to different categories of contract. Generally, collateral is required to cover potential losses on a contract. Should the net-negative position of the contract fall below a certain level, a call is made for additional collateral. If additional collateral is not supplied within a tightly specified deadline, the contract is closed. The margin call process is monitored by the Risk Management division.

Large Exposures

In accordance with applicable Icelandic regulations, a large exposure is defined as an exposure to a group of financially related borrowers, which exceeds 10.0 per cent. of the Group's eligible capital. The legal maximum for individual large exposures is 25.0 per cent. of the Group's eligible capital, net of eligible collateral. As of 31 March 2018, the Bank had one large exposure to a foreign credit institution. The exposure was 12.9 per cent. of the Group's eligible capital before taking account of eligible credit risk mitigation, or 6.6 per cent. after credit risk mitigation effects.

The table below sets forth all gross exposures exceeding 10.0 per cent. of the Group's eligible capital as of 31 December 2017 and 2016, together with the net amount of each of those exposures after taking into account eligible collateral.

	As of 31 December			
	2017		2016	
	Gross	Net	Gross	Net
Borrower 1	<10%	<10%	<10%	<10%
Sum of large exposure gross and net >10%	**0%**	**0%**	**0%**	**0%**

Market Risk

Market risk is the current or prospective risk that changes in financial market prices and rates will cause fluctuations in the value and cash flows of financial instruments. The risk arises from imbalances in the Group's balance sheet as well as in market making activities and position taking in bonds, equities, currencies, derivatives and other commitments which are marked to market.

The Group monitors market risk and separates its exposures for its trading book (which represents positions held with trading intent and associated hedging positions) and banking book. Market risk in the trading book arises from market-making activities and non-strategic derivatives positions arising from the Bank's customers' investments and risk management needs. Market risk in the banking book arises from various mismatches in assets and liabilities, principally in relation to currencies, maturities and interest rates. Market risk in the trading and banking books is managed separately by the Treasury division and Market Making.

The Bank's overall market risk allowance is set by the Board of Directors in the Bank's risk appetite, and the CEO, or through the appropriate framework set up by the CEO, determines the limit framework for each trading desk and sets individual limits. The ALCO is responsible for managing the Bank's overall market risk. The Risk Management division is responsible for measuring and monitoring market risk exposure and reporting the exposure, usage and limit breaches.

The Group's strategy towards market risk is to seek to limit the risk exposure that arises in its banking book as a result of imbalances in the Group's balance sheet, but accept limited risk in its trading book, in accordance with its strategic goals for net profit.

The Balance Sheet Risk subdivision is responsible for monitoring compliance with the limits that have been set in each of the trading and banking books. In respect of the trading book, it reviews exposures for potential shortfalls and analyses scenarios with traders. Any issues of concern are escalated to the relevant managing directors and the Chief Risk Officer, and performance, exposures and relevant risks are summarised and reported daily to relevant employees and managing directors and on a regular basis to the Board of Directors. In respect of the banking book, market risk exposure is monitored and reported on a monthly basis and measured against the risk limits set in terms of the Bank's risk appetite.

The elements of the Group's market risk are presented below.

Interest Rate Risk

Interest rate risk arises from the possibility that changes in market rates adversely affect net interest earnings and fair value of interest-bearing instruments on the Bank's balance sheet. The Bank's operations are subject to interest rate risk due to mismatches in the fixing of interest rates between assets and liabilities, resulting in a repricing risk for the Bank. The Bank also faces interest basis risk between interest-bearing assets and interest-bearing liabilities due to different types of floating-rate indices in different currencies.

The Bank's interest rate risk for foreign currencies is limited as foreign denominated assets predominantly have short interest fixing periods (i.e. the period during which interest is payable at a fixed rate), and the Bank hedges its foreign denominated fixed rate borrowings. For domestic rates, longer interest fixing periods are more common, and this especially applies to indexed mortgages issued between 2004 and 2006. The profile of the interest fixing periods of indexed mortgages is however largely matched by that of the Bank's structured covered bond issues, which serves as a hedge against repricing risk. The Bank has been able to manage relatively small interest gaps for interest fixing periods.

In the past few years domestic rates, nominal and real, have fallen. Due to favourable refinancing spreads, prepayments and/or refinancing of loans have been considerable. Prepayment risk is mitigated by prepayment fees and the Bank's own prepayment options on its borrowings. The Bank's prepayment of structured covered bonds is a reaction to mortgage prepayments and mortgage refinancing. Additional prepayments of the one remaining outstanding series of structured covered bonds are possible, but the issuance is not partly callable and would need to be prepaid in full. As of 31 December 2017, the series had a book value of ISK 78,267 million.

For additional information on the Bank's interest rate risk, see the note titled "Market risk" in the Annual Financial Statements.

Indexation Risk

A significant part of the Bank's balance sheet is linked to the Icelandic CPI. Index-linked loans and borrowings are typically annuities, where the principal and monthly payments change in the same proportion as the CPI. The Bank is exposed to indexation risk as indexed assets exceed indexed liabilities. As of 31 December 2017, the total amount of the Bank's CPI-linked assets was ISK 363,791 million and the total amount of its CPI-linked liabilities was ISK 230,851 million. See the note titled "*Market risk*" in the Annual Financial Statements.

Currency Risk

Currency risk is the risk of loss due to adverse movements in foreign exchange rates. The Bank is exposed to currency risk through a currency mismatch between its assets and liabilities. Deposits denominated in Icelandic Krona are the primary source of funding for the Bank, whereas a substantial part of the Bank's assets consists of loans to customers denominated in foreign currency. Net exposures per currency are monitored centrally in the Bank.

The table below sets forth the currencies to which the Bank had significant exposure for the year ended 31 December 2017. The analysis calculates the effect of a 10.0 per cent. movement of each indicated currency rate against Icelandic Krona on the Bank's income statement as a result of the change in fair value of currency sensitive non-trading monetary assets and liabilities. A negative amount reflects a potential net reduction in income statement or equity, while a positive amount reflects a potential net increase in income statement or equity. The table below assumes that all other variables remain constant.

	Year ended 31 December 2017	
	-10.0%	**+10.0%**
	(ISK in millions)	
EUR	239	(239)
USD	(75)	75
GBP	(277)	277
DKK	232	(232)
NOK	(36)	36
Other	(101)	101

(1) A +10.0 per cent. in the table denotes a depreciation of Icelandic Krona.

Equity Price Risk

Equity price risk is the risk that the fair value of equities held as financial instruments and investments in associates on the Group's consolidated balance sheet decreases as the result of changes in the level of equity indices and individual stocks. In addition to equity price risk in the trading book, the non-trading equity price risk exposure is primarily due to restructuring of the Bank's assets, i.e. restructuring of troubled companies which the Bank has taken over after the financial crisis in 2008. The associated risk has, however, been significantly reduced in recent years through successful divestment of such assets. For information on assets taken over by the Bank and held for sale and equity exposures, see the notes titled "Financial assets and financial liabilities" and "Other assets" in the Annual Financial Statements.

Derivatives

Derivatives are a part of the Bank's customer product offering. The types of derivatives currently offered are forward contracts, swaps and options. Eligible underlying market factors are interest rates, foreign exchange rates, equities and commodities. Exposure limits, hedging requirements and collateral requirements are determined in accordance with the Bank's risk appetite and monitored by Risk Management on a daily basis. The Bank also uses derivatives to reduce market risk on its balance sheet.

Prepayment Risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay, or request repayment of, loans earlier or later than expected, such as with respect to fixed rate mortgage loans when interest rates decline. Prepayment risk is mitigated by prepayment fees and the Bank's own prepayment options on its borrowings.

Liquidity and Funding Risk

Liquidity risk is defined as the risk that the Group, although solvent, either does not have sufficient financial resources available to meet its liabilities when they become due or can secure them only at excessive cost. Liquidity risk arises from the inability to manage unplanned decreases in available funding or changes in funding sources. The ALCO is responsible for managing liquidity risk within the risk appetite set by the Board of Directors, the Treasury division manages the liquidity positions on a day-to-day basis and the Balance Sheet Risk subdivision monitors the liquidity risk, with processes and reports regarding the liquidity status reviewed regularly by the executive management. The Treasury division provides the other divisions of the Bank with funds for their activities against a charge of internal interest.

The Bank's primary source of funding is deposits from individuals, businesses and financial institutions. The Bank's liquidity risk stems from the fact that the average maturity of its loans exceeds the average maturity of its deposits. As of 31 December 2009, over 90 per cent. of the Bank's deposits were on demand, as compared to 59.7 per cent. as of 31 December 2012, 52.2 per cent. as of 31 December 2013, 58.0 per cent. as of 31 December 2014, 57.3 per cent. as of 31 December 2015, 70.0 per cent. as of 31 December 2016 and 71.8 per cent. as of 31 December 2017. As of 31 December 2017, 71.8 per cent. of the Group's deposits were on demand, 18.7 per cent. had a maturity of up to three months, 6.5 per cent. had a maturity of between three and 12 months, 2.8 per cent. had a maturity of between one and five years and 0.5 per cent. had a maturity of more than five years.

As of 31 December 2017, a majority (73.9 per cent.) of the Group's deposits were deposits in the Retail Banking division, of which 92.2 per cent. were denominated in Icelandic Krona, 13.5 per cent. were CPI-linked and 7.8 per cent. were denominated in foreign currency. Deposits in the Corporate Banking division, which as of 31 December 2017 accounted for 4.1 per cent. of the Group's deposits, were spread across a broad range of industry sectors, as set forth in the table below.

	% of deposits in the Corporate Banking division
Industry sector	**As of 31 December 2017**
Real estate	18.2%
Wholesale and retail trades	11.7%
Financial services	14.3%
Seafood	15.2%
Industry, energy and manufacturing	7.3%
Technology	3.9%
Other	29.5%
Total deposits in the Corporate Banking division	**100%**

See also "*Funding and Liquidity – Liquidity*" for a breakdown of the Group's deposit base according to the LCR categorisation and a description of that categorisation.

The Bank calculates the net stable funding ratio (**NSFR**), which measures the amount of available stable funding (**ASF**) at the Group against the required stable funding (**RSF**), as per the definition of the Icelandic Central Bank's Rules No. 1032/2014. Under NSFR, funding with maturity greater than one year is considered stable. Different weights are applied to funding with shorter maturities depending on the type of funding. In general, RSF is determined by applying different weights to the Group's on- and off-balance sheet items on the asset side depending on the level of maturity and liquidity. On the other hand, ASF is calculated by applying different weights to the Group's on- and off-balance sheet items on the liability side depending on the level of maturity and/or expected stickiness. The ratio for foreign currency is required to exceed 100 per cent. The purpose of the requirements with respect to the foreign exchange ratio is to prevent domestic financial institutions from accumulating short-term need for market funding in foreign currency, as the Icelandic Central Bank is not a lender of last resort in foreign currency.

The table below sets forth the Group's total NSFR as of the dates indicated based on sub-consolidated figures for the Bank and ABMIIF.

	As of 31 December	
	2017	**2016**
ISK	115%	113%
Foreign exchange(1)	181%	191%
Total NSFR	**125%**	**124%**

(1) The foreign exchange ratio is the calculation of NSFR for the Bank's consolidated statement of financial position restricted to foreign currency. When calculating the foreign exchange ratio, a negative foreign exchange imbalance is subtracted from the numerator and a positive foreign exchange imbalance is subtracted from the denominator.

The foreign exchange imbalance discrepancy between the Group's official foreign exchange imbalance and the imbalance reported in the NSFR is due to the fact that the Bank's subsidiaries have a substantial positive foreign exchange imbalance but are settled in Icelandic Krona. See "*Risk Factors - Factors that may affect the Bank's ability to fulfil its obligations under Notes issued under the Programme - The Bank is exposed to significant liquidity risk*".

The Group carries out an ongoing process for the ILAAP, with the aim of ensuring that the Group has in place sufficient risk management processes and systems to identify, manage and measure the Group's liquidity. As part of the ILAAP, main liquidity and funding risks are identified and stressed scenarios considered to provide senior management and regulators with a better understanding of the Group's liquidity and funding positions. The FME supervises the Group and reviews the Group's ILAAP.

Operational Risk

Operational risk is the risk of direct or indirect loss or damage to the Bank's reputation resulting from inadequate or failed internal processes or systems, from human error or external events that affect the Bank's image and operational earnings. The Bank assesses its primary sources of operational risk as IT risk, legal risk and reputational risk.

Operational risk is inherent in every activity undertaken within the Bank, in outsourced activities and in all interactions with external parties. The Bank aims to reduce the frequency and impact of operational risk events in a cost effective manner and seeks to do so with a selection of internal controls and quality management, along with sufficiently qualified staff.

Each division within the Bank is primarily responsible for taking and managing its own operational risk. Operational risk function is responsible for developing and maintaining tools for identifying, measuring, monitoring and reporting the Bank's operational risk. The Bank uses the Basel II standardised approach to the calculation of capital requirements for operational risk.

The Operational Risk subdivision serves as a partner to senior management and supports and challenges the senior management to align the business control environment with the Bank's strategy by measuring and mitigating risk exposure, with the view of contributing to optimal returns for the stakeholders.

The Bank's losses due to operational risk are registered in the Bank's loss database. Loss events are analysed to understand the cause of the event and any control failure, and changes to controls are made where applicable to reduce the risk of the event recurring. Losses are categorised according to the Basel II event categories for operational risk.

Capital Management

The Bank's capital ratios are calculated in accordance with the Financial Undertakings Act and Regulation No. 233/2017 on prudential requirements. Iceland has adopted the European Union Capital Requirements Directive and Regulation (CRD IV/CRR), but has temporarily excluded Article 501 on capital requirements relief for small and medium enterprises. The Bank uses the standardised approach to calculate capital requirements for credit risk, credit valuation adjustment, market risk and operational risk.

As at 31 December 2017, the Bank's consolidated exposures as stipulated in CRR is the Bank's accounting consolidation without Vördur. As the full accounting consolidation has been applied in prior statements, figures for earlier dates are restated to reflect the defined consolidated exposures. The capital position and solvency requirements of Vördur should be viewed independently from capital adequacy for the Bank's consolidated exposures. An adjustment is made to the Bank's Pillar 2 requirements as the latest SREP result is based on the accounting consolidation which includes an add-on due to the solvency requirements of Vördur.

The Bank carries out an ongoing process, the ICAAP, with the aim of ensuring that the Bank has in place sufficient risk management processes and systems to identify, manage and measure the Bank's total risk exposure. The ICAAP is aimed at identifying and measuring the Bank's risk across all risk types and ensuring that the Group has sufficient capital in accordance with its risk profile. The FME supervises the Bank, reviews the Bank's ICAAP and sets capital requirements for the Bank's consolidated exposures as a whole following the SREP. Stress tests constitute an important part of the ICAAP, because they demonstrate how the Bank's capital could be affected by sharp macroeconomic changes, downturns in the Bank's core businesses or other major events.

Capital requirements according to Pillar 1 are based on the sum of risk-weighted assets for credit risk, credit valuation adjustment, market risk and operational risk, computed using formulas from CRD IV and the CRR. See "*Risk Factors - Factors that may affect the Bank's ability to fulfil its obligations under Notes issued under the Programme - Application of CRD IV could adversely affect the Bank's results*". The Bank uses the standardised approach to calculate the capital requirements for credit risk, credit valuation adjustment, market risk and operational risk.

Banking operations are categorised as either trading book or banking book, and the calculation of risk-weighted assets is conducted differently for the assets in each book. Banking book exposures, including on-balance and off-balance sheet items, derivatives and repurchase agreements, give rise to credit risk and risk-weighted assets are measured by means of a hierarchy of risk weightings classified according to the nature of each asset and counterparty, taking into account eligible collateral or guarantees. Trading book risk-weighted assets are determined by taking into account market related risks, such as foreign exchange, interest rate risk and equity position risks. Operational risk also gives rise to risk-weighted assets, measured on the basis of the Bank's average operating income over three years.

To measure the Pillar 2 capital requirement, the Bank uses internal economic capital models. Capital add-ons under Pillar 2 are based on risks that are underestimated or not covered in Pillar 1, including credit risk, market position risk, concentration risk, interest rate risk in the banking book, indexation risk, reputational risk, legal and compliance risk, business risk and political risk. Capital is allocated to the Group's business units based on the capital requirements that arise due to their exposures and operations. The performance of the business units is then evaluated based on the return on allocated capital. The Bank is seeking to implement return on allocated capital as a management tool, such that, should capital scarcity arise, return on allocated capital will guide in aligning the business with available capital and the reallocation of capital.

The table below sets forth the implementation of the capital buffer requirements in accordance with the Financial Undertakings Act, as prescribed by the Financial Stability Council and approved by the FME.

Capital buffer requirement as a percentage of risk-weighted assets	**As of 1 June 2016**	**As of 1 January 2017**	**As of 1 March 2017**	**As of 1 November 2017**
Capital conservation buffer	1.75%	2.50%	2.50%	2.50%
Capital buffer for systemically important institutions	2.00%	2.00%	2.00%	2.00%
Systemic risk buffer(1)	3.00%	3.00%	3.00%	3.00%
Countercyclical risk buffer(1)	—	—	1.00%	1.25%
Combined capital buffer requirement	**6.75%**	**7.50%**	**8.50%**	**8.75%(2)**

(1) The institution specific systemic risk buffer and the countercyclical risk buffer are determined using the weighted average of respective buffer levels in countries where the Bank has exposure, and weighting is determined by the percentage of risk-weighted assets relating to credit risk. With the FME's possible recognition of systemic risk buffers and countercyclical buffers in other countries, those requirements will apply to the corresponding foreign exposures, resulting in a higher combined buffer requirement. The maximum countercyclical risk buffer which can be applied in Iceland is 2.5 per cent.; however, the FME is authorised to apply a higher countercyclical risk buffer on the basis of a recommendation from the Financial Stability Council. In April 2018, the Financial Stability Council proposed a 0.50 per cent. increase to the countercyclical capital buffer to take effect from 1 May 2019, as confirmed by the FME.

(2) Because the institution specific systemic risk buffer and the countercyclical risk buffer are determined as described above, the Bank had the effective combined capital buffer requirement of 8.40 per cent. based on the Bank's risk profile as of 31 December 2017.

The Bank's Pillar 2R capital add-on, which is the result of ICAAP/SREP, may be comprised of 56.25 per cent. CET1 capital, 18.75 per cent. AT1 capital and 25.00 per cent. Tier 2 capital. With the current capital structure of the Bank, the Pillar 2R requirement is solely met with CET1 capital.

The table below sets forth the total regulatory capital requirement, as applied to the Bank on the basis of its consolidated exposures, as a percentage of risk-weighted assets as of 31 December 2017.

Total regulatory capital requirement as a percentage of risk-weighted assets	
Pillar 1 capital requirement	8.0%
Pillar 2R capital requirement(1)	3.4%
Combined buffer requirement(2)	8.4%
Total regulatory capital requirement	**19.8%**
Available capital	24.0%

(1) SREP result based on the Group's financial position as of 31 December 2017. The Pillar 2 requirement is 3.7 per cent. of risk-weighted assets based on accounting consolidation. Based on the Group's consolidation situation under CRR, which excludes Vördur, the requirement is 3.4 per cent.

(2) With the possible recognition by the FME of systemic risk buffers and countercyclical buffers applied in other countries, those requirements will apply to the corresponding foreign exposures, resulting in a higher combined buffer requirement.

The table below sets forth the CET1 regulatory capital requirement, as applied to the Bank, as a percentage of risk-weighted assets as of 31 December 2017.

CET1 regulatory capital requirement as a percentage of risk-weighted assets	
Pillar 1 CET1 requirement	4.5%
Pillar 2R CET1 requirement(1)	1.9%
Combined buffer requirement	8.4%
Total CET1 regulatory capital requirement	**14.8%**
Available CET1 capital	23.6%

(1) SREP result based on the Group's financial position as of 31 December 2017. The Pillar 2 requirement is 3.7 per cent. of risk-weighted assets based on accounting consolidation. Based on the Group's consolidation situation under CRR, which excludes Vördur, the requirement is 3.4 per cent.

Stress Testing

Overview

The Bank's stress testing framework is aligned with the relevant FME guidelines, which in turn are based on the Guidelines on Stress Testing of the European Banking Authority. Stress testing at the Bank focuses on sensitivity and scenario analyses. The sensitivity analysis measures the potential impact of a specific single risk factor or simple multi-risk factors affecting capital or liquidity. In turn, scenario analysis measures the Bank's resilience to a given scenario, which comprises a set of risk factors that are aligned in an internally consistent way, presuppose the simultaneous occurrence of forward-looking events covering a range of risks and business areas and aims at revealing the nature of linked risks across the Bank and across time, system-wide interactions and feedback effects. The stress tests serve as an important management tool for the Bank and are incorporated into the review of the Bank's risk appetite and the Bank's limits framework, and raise risk awareness and improve general understanding of the Bank's operations. The Board of Directors and Board Risk Committee consider the results for strategic, capital and contingency planning.

The Bank's business plan is stress tested annually with at least two adverse economic scenarios. One of the two stressed scenarios carried out on the business plan is provided by the Central Bank in collaboration with the FME. The Bank's Economic Research department contributes an economic base case projection as well as stressed projections that are used in the Bank's internal stress test on capital planning and in preparation of the Bank's five year business plan. The design of the bank-wide internal stress test is challenged and reviewed by the Executive Committee and the Board Risk Committee. The impact is estimated on the Bank's earnings and own funds as well as for the Bank's capital and liquidity ratios and other risk appetite metrics. In addition to the internal bank-wide stress test and the Central Bank stress test, the Bank performs both focused ad hoc stress tests and regular planned stress tests. The focused stress tests are used to estimate losses for example due to changes in regulations.

The table below sets forth the stress tests which the Bank regularly performs.

Stress Test	Frequency	Description
Icelandic Central Bank and FME stress tests	Annually	Stressed scenarios provided by the Icelandic Central Bank in collaboration with the FME
Internal stress tests on the Bank's business plan	Annually	Risks and stressed scenarios designed on the basis of input from each division, stressed macro-economic projections provided by the Research subdivision
ICAAP/ILAAP	Annually	Interest rate risk, value-at-risk on trading book, credit risk stress tests
Focused stress tests	Daily/Monthly	Liquidity and market risk, risk appetite for indirect equity positions

CAPITAL ADEQUACY

The Bank's capital policy is to maintain a strong capital base to support business development and to meet regulatory capital requirements, even in times of stress.

Capital requirements according to Pillar 1 are based on the sum of risk-weighted assets (**RWA**) for credit risk, market risk and operational risk, computed using formulas from the EU's Capital Requirements Directives (the **CRD**), which have now been replaced by CRD IV.

- The CRD offers different approaches for calculating RWA for these risk types.
- The Bank uses the following approaches for its capital requirement calculations:
- The standardised approach is used to calculate the capital requirements for credit risk;
- The standardised method is used to calculate the capital requirements for market risk; and
- The basic indicator approach is used for operational risk.

The Ministry of Industries and Innovation has formed a committee to implement CRD IV and the CRR in Iceland. The transposition of the CRD IV into Icelandic law is set to take place in three separate amendments. The first amendment was introduced on 9 July 2015 by Act No. 57/2015, which amended the Act on Financial Undertakings No. 161/2002. This amendment includes the CRD IV's provisions on capital buffers and adopts for the Minister of Industries and Innovation a regulation implementing the provisions of the CRR and related technical standards. The second amendment was introduced on 21 September 2016 by Act No. 96/2016, which includes the CRD IV's provisions on capital requirements, supervisory review and evaluation process (SREP) and leverage ratios. On 6 March 2017 the Ministry Finance and Economic Affairs adopted Regulation No. 233/2017 on prudential requirements for financial undertakings, which implements the CRR No. 575/2013/EU.

The timeframe for further implementation in Iceland has not yet been published (see "*Risk Factors –Factors that may affect the Bank's ability to fulfil its obligations under Notes issued under the Programme – Application of CRD IV could adversely affect the Bank's results*"). On 22 January 2016, the Financial Stability Council of Iceland published its recommendation to the FME to introduce a 2 per cent. capital buffer for systemically important financial institutions (including the Bank), a systemic risk buffer (of 3 per cent. in the case of the Bank) and a 1 per cent. countercyclical capital buffer. On 1 March 2016, the FME decided to uphold these recommendations. As regards the systemic risk buffer, a phase-in period is foreseen in the case of less significant credit institutions but it has applied, along with the capital buffer for systemically important financial institutions, to systemically important credit institutions (including the Bank) since 1 April 2016. The countercyclical capital buffer applied as of 1 March 2017.

Banking operations are categorised as either trading book or banking book and the calculation of RWA is conducted differently for the assets in different books. Banking book exposures, including on-balance and off-balance sheet items, derivatives and repurchase agreements, give rise to credit risk and RWA are measured by means of a hierarchy of risk weightings classified according to the nature of each asset and counterparty, taking into account eligible collateral or guarantees. Trading book RWA are determined by taking into account market related risks such as foreign exchange, interest rate and equity position risks. Operational risk also gives rise to risk-weighted assets, measured on the basis of the Bank's average operating income over three years.

The Bank carries out an ongoing process, the ICAAP, with the aim of ensuring that the Bank has in place sufficient risk management processes and systems to identify, manage and measure the Bank's total risk exposure. The ICAAP is aimed at identifying and measuring the Bank's risk across all risk types and ensuring that the Bank has sufficient capital in accordance to its risk profile. The FME supervises the Bank, reviews the Bank's ICAAP and sets capital requirements for the Bank's consolidated exposures as a whole.

To measure the Pillar 2 capital requirement the Bank uses an internal economic capital model. Pillar 2 is based on Pillar 1 calculations, using internal models for credit risk calculations, and takes into consideration risks that are not covered under Pillar 1, including credit risk, market position risk, concentration risk, interest rate risk in the banking book, indexation risk, reputational risk, legal and compliance risk, business risk and political risk.

Although the Bank uses credit rating models for credit risk monitoring, these models are not used for capital adequacy calculations. The Bank intends to recalibrate those models for use in its ICAAP. The Bank has implemented methods and tools for operational risk management based on the minimum requirements for the standardised approach. The Bank expects to continue refining these tools and methods as part of its internal management of operational risk and is using them within its ICAAP.

Stress tests are an important part of the ICAAP and show how the Bank's capital could be affected by sharp macro-economic changes, downturns in the Bank's core business or other major events.

The Group is subject to capital requirements which are specified by the FME following a SREP. The Group’s own funds exceeded the FME’s requirements under the SREP in each of the years ended 31 December 2017 and 2016. Based on the FME’s final SREP result delivered in October 2017, the Group’s total regulatory capital requirement has been 19.8 per cent. with effect from 1 November 2017, including fully implemented capital buffer requirements, and based on the Bank’s consolidated exposures.

As of 31 March 2018, the Group’s capital base amounted to ISK 183,711 million (exceeding the FME’s requirements under the SREP), as compared to ISK 183,958 million as of 31 December 2017. The Group’s capital adequacy ratio, calculated in accordance with Icelandic requirements, was 23.6 per cent. as of 31 March 2018 (exceeding the minimum legal requirement of 8.0 per cent.), as compared to 24.0 per cent. as of 31 December 2017.

The table shows the Group's RWA calculations as at 31 March 2018, 31 December 2017 and as at 31 December 2016.

	As of 31 March	**As of 31 December**	
Own Funds[1]	**2018**	**2017**	**2016**
	(ISK million, except percentages)		
Total equity	204,245	225,734	211,384
Deductions related to the consolidated exposures	(7,870)	(8,635)	(8,126)
Non-controlling interest not eligible for inclusion in CET1 capital	(128)	(128)	(172)
Common equity Tier 1 capital before regulatory adjustments	196,247	216,971	203,086
Intangible assets	(10,834)	(11,125)	(8,201)
Tax assets	(425)	(357)	(198)
Cash flow hedges	(314)	265	(22)
Foreseeable dividend[2]	(975)	(25,000)	-
Additional value adjustments	(116)	(119)	(127)
Equity holdings in financial	-	-	-

sector entities[3]			
Common equity Tier 1 capital	**183,583**	**180,635**	**194,538**
Non-controlling interest not eligible for inclusion in CET1 capital	128	128	172
Tier 1 capital	**183,711**	**180,763**	**194,710**
Subordinated liabilities	-		-
Regulatory adjustments to Tier 2 capital[4]	-	-	-
Equity holdings in financial sector entities[3]	**-**	**-**	**-**
General credit risk adjustments[5]	**-**	**3,195**	**4,557**
Tier 2 capital	**-**	**3,195**	**4,557**
Total own funds	**183,711**	**183,958**	**199,267**

(1) As of 31 December 2017 and 31 March 2018, the Group's capital adequacy is calculated on the basis of its prudential consolidation which excludes insurance subsidiaries. The figures as of 31 December 2016 have been adjusted accordingly.

(2) As of 31 March 2018, the foreseeable dividend was 50 per cent. of the accumulated net earnings in 2018, which reflects the Bank's dividend policy. As of 31 December 2017, the foreseeable dividend was the amount of the equity reduction executed in the first quarter of 2018 through the purchase by the Bank of its own shares and the First Monetisation Dividend.

(3) The Financial Undertakings Act No. 161/2002 states that the Bank's CET1 holdings of instruments in financial sector entities are to be deducted from CET1, while the CRR specifies a 10.0 per cent. threshold for such deductions. Such deductions were previously split between Tier 1 and Tier 2 capital, but currently apply to the corresponding type of capital instrument.

(4) Straight-line amortisation for maturities within five years.

(5) Under IAS 39, the Bank's general credit risk adjustments are considered part of Tier 2 capital as stipulated in the CRR. As per the EBA's opinion, all provisions under IFRS 9 are considered specific credit risk adjustments (**SCRA**), rather than general adjustments. The FME has adopted the EBA's opinion on this matter, and as a result, since adopting IFRS 9 on 1 January 2018, the Group's own funds no longer include general credit risk adjustments, and these are now treated as SCRA, effectively reducing the Group's risk-weighted assets.

INVESTMENTS

The Bank has a small portfolio of debt and equity investments. These instruments are classified either as trading assets (being assets which are held by the Bank with a view to generating profit from short-term changes in price) or as assets held at fair value through profit and loss. The Bank's shares and equity instruments include those shareholdings that the Bank has acquired in recent years through debt restructurings and other enforcement procedures. Since 2012, the Bank has made steady progress in the sale of companies acquired as a result of these collateral enforcement procedures (see "*Description of the Bank - Other Divisions and Subsidiaries - Asset Holding Companies*").

The tables below shows the classification of the Bank's investment portfolio as at 31 December 2017 and 2016.

	As at 31 December 2017			
	Trading	**Designated at fair value**	**Available for sale**	**Total**
	(*ISK million*)			
Listed bonds and debt instruments	2,452	46,638	—	49,090
Unlisted bonds and debt instruments	23	2,642	—	2,665
Total bonds and debt instruments	**2,475**	**49,280**	**—**	**51,755**
Listed shares and equity instruments	1,677	5,380	—	7,057
Unlisted shares and equity instruments	1,303	10,397	—	11,700
Bond funds with variable income	1,782	15,651	—	17,433
Total shares and equity instruments	**4,762**	**31,428**	**—**	**36,190**

	As at 31 December 2016			
	Trading	**Designated at fair value**	**Available for sale**	**Total**
	(*ISK million*)			
Listed bonds and debt instruments	5,284	61,055	—	66,339
Unlisted bonds and debt instruments	102	3,124	—	3,226
Total bonds and debt instruments	**5,386**	**64,179**	**—**	**69,565**
Listed shares and equity instruments	2,949	9,125	—	12,074

Unlisted shares and equity instruments	1,348	10,579	—	11,927
Bond funds with variable income	1,027	2,007	—	3,034
Total shares and equity instruments	**5,324**	**21,711**	**—**	**27,035**

MANAGEMENT AND EMPLOYEES

MANAGEMENT

Shareholders’ meetings

The Bank's shareholders in general meetings are the supreme authority in the affairs of the Bank, within the limits established by the articles of association and statutory law. The Bank's annual general meeting is required to be held before the end of April each year.

Board of Directors

The Board is the supreme authority between shareholders’ meetings, as further stipulated by law, regulations, and the articles of association.

The Board appoints the CEO. The Board also manages the Bank’s affairs and ensures that its organisation and activities are at all times maintained in good order. The Board and the CEO undertake the administration of the Bank.

The Board is responsible for ensuring that the Bank’s book-keeping and the handling of its funds is sufficiently supervised. The Board represents the Bank and may grant directors, the CEO or others authority to sign for the Bank.

The Board bears the principal responsibility for the Bank’s daily operations and is required to regularly discuss the manner in which it discharges its duties, its substantive areas of focus and the main goals of its work.

The Board also bears the principal responsibility for the development and long-term success of the Bank. To that effect, individual directors must exercise their duties with due diligence and care, and with good faith in the best interests of the Bank and its shareholders. The Board confirms and bears the principal responsibility for the Bank’s strategy.

The Board and the CEO are required to inform the FME without delay of any issues they become aware of that could affect the ongoing operation of the Bank.

The Board, which must be of a size and composition that makes it possible for the Board to discharge its duties efficiently and with integrity, currently comprises six members (one member of the Board having resigned since the Annual General Meeting held on 15 March 2018, to be replaced by an Alternate Director until the shareholders decide otherwise). All the members are nominated by Kaupskil except one who was nominated by Attestor Capital LLP.

The Bank's Board comprises the following members:

Eva Cederbalk, Chairman

Born in 1952, Eva was first elected to the Board of Directors at a meeting of shareholders held on 23 June 2017 and elected as Chairman on 26 June 2017. Eva is Swedish and currently resides in Sweden. She is an independent member of the Board of Directors and is not a shareholder of the Bank. Eva is the chairman of the Board Credit Committee.

Eva currently serves on the board of directors of National Bank of Greece Group, Ikano Group S.A. and Svolder AB. She previously worked within Swedish financial services and until 2011 served as CEO of SBAB Bank AB (publ) and prior to that was CEO of the insurance company DIAL AB and held executive positions within SEB AB (publ). Eva also previously served as chairman of the board of directors of Klarna AB and on the boards of directors of Gimi AB, Ticworks AB and Íslandsbanki.

Brynjólfur Bjarnason, Vice Chairman

Born in 1946, Brynjólfur was first elected as a Director at a shareholders' meeting on 20 November 2014. He is not a shareholder of the Bank and is an independent Director. Brynjólfur is a member of the Board Credit Committee and the chairman of the Board Audit Committee.

Brynjólfur graduated with an MBA from the University of Minnesota in 1973 and a cand. oecon. degree in business studies from the University of Iceland in 1971.

Brynjólfur was managing director of the Enterprise Investment Fund from 2012 to 2014. Between 2007 and 2010 he was the chief executive officer of Skipti. Brynjólfur was chief executive officer of Síminn from 2002 to 2007 and chief executive officer of Grandi hf. from 1984 to 2002. Between 1976 and 1983 he was managing director of the publisher AB bókaútgáfa. He was also head of the economics department of VSÍ from 1973 to 1976. Brynjólfur has broad experience as a director and has served on numerous boards, several of which as chairman. Brynjólfur has served on the board of Genís since 2011 and the board of the Reykjavík Dramatic Society Playwright Fund since 2009.

Herdís Dröfn Fjeldsted, Director

Born in 1971, Herdís was first elected to the Board of Directors at the Annual General meeting held on 15 March 2018. She is an independent member of the Board of Directors and is not a shareholder of the Bank. Herdís is a member of the Board Audit Committee and the Board Remuneration Committee.

Herdís was until recently the CEO of The Icelandic Enterprise Investment Fund (Framtakssjódur Íslands – FSÍ), a role in which she served for over four years. Previously she was Investment Manager at FSÍ from the year 2010. Herdís is a board member at The Icelandic-Canadian Chamber of Commerce. Before joining FSÍ, Herdís worked as a Senior Investment Analyst at Thule Investments from 2004 to 2010. Through the years she has served many companies as a member of a board of director and in various sectors, including as Chairman of Icelandic Group and VÍS hf., Vice-Chairman of Promens hf. and Director at Invent Farma, Icelandair Group and Copeinca ASA. Herdís graduated with a BSc in Business Administration with emphasis on International Marketing from the Technical University of Iceland in 2004 and a Master's degree in Corporate Finance from Reykjavík University in 2011. She is a Certified Securities Broker.

John P. Madden III, Director

Born in 1973, John is a dual US and British citizen and he lives in the United Kingdom. He was first elected to the Board of Directors at a shareholders' meeting on 15 September 2016. He is not a shareholder of the Bank. John is a member of the Board Remuneration Committee and the Board Risk Committee. He gained a BA in political economy from Williams College in Massachusetts in 1996. John is a senior managing director at Kaupthing, which is the majority shareholder of the Bank through its subsidiary Kaupskil. He has also worked with BC Partners, Arle and ICG since 2014.

Between 1998 and 2013, John worked at Arcapita, first in the United States, then in the United Kingdom. Prior to 1998, he was at Lehman Brothers, New York. John serves on the board of directors at Fairhold Securitisation Limited, Karen Millen Holdco 1 Limited, Huurre Group OY and Noreco ASA.

Måns Höglund, Director

Born in 1951, Måns is Swedish and lives in Portugal. He was first elected to the Board of Directors at a shareholders' meeting on 24 March 2011. He is not a shareholder of the Bank and is an independent Director. Måns is Chairman of the Board Risk Committee and is a member of the Board Credit Committee.

Måns graduated from Stockholm School of Economics in 1975 where he became a lecturer and researcher after completing his studies. He served in various posts at Hambros Bank in London between 1977 and 1984 and was regional director for Denmark and Iceland for two years. In 1984 he started working for Götabanken in London and was transferred to the Bank's Stockholm operation in 1989 where he was head of the international finance division until 1991. From 1991 to 1999 he worked for Swedbank, where his roles included director and head of the bank's large corporate business. In 1999 to 2002 he worked for both Unibank (as head of Sweden operation) and Nordea (as Head of Private Banking, Sweden).

From 2002 to 2011 Måns worked for Swedish Export Credit Corporation (**SEK**) as executive director and head of corporate and structured finance. He was also a member of SEK's Executive Committee.

Steinunn Kristín Thórdardóttir, Director

Born in 1972, Steinunn was first elected to the Board of Directors at a shareholders' meeting on 30 November 2017. She is not a shareholder of the Bank and is an independent Director. Steinunn is a member of the Board Credit Committee and the Board Risk Committee.

Steinunn was partner and CEO of Beringer Finance Norway in 2015-2016 and interim CEO of Beringer Finance in Iceland and global head of food and seafood until 2017. In 2010 she founded Akton AS, a management consulting company in Norway where she worked as a managing director until 2015. Steinunn worked at Íslandsbanki (later Glitnir) in Iceland from 2001 until 2005 when she became the managing director and head of the bank's UK operations and remained there until 2008. Before that Steinunn worked at Enron Corporation from 1999 to 2001. Steinunn was a board member of Silver Green AS and Silver Green TC AS in Norway from 2011 to 2013, Versobank AS in Estonia from 2012 to 2013, board member of the Icelandic State Financial Investment (ISFI) from March 2011 to October 2011 and alternate board member at Kredittbanken, later Glitnir Norway, from 2005 to 2008. Steinunn is a member of Exedra, a discussion forum for women in leadership in various sectors, as well as a board member of Cloud Insurance AS, an insurance tech company that provides solutions to traditional insurance companies, Acton Capital AS and Akton AS and a board member of the British-Icelandic Chamber of Commerce and vice chairman of the Norwegian-Icelandic Chamber of Commerce. Steinunn has a master's degree in international management from Thunderbird, Arizona and a BA in international business and politics from University of South Carolina.

Conflicts of Interest

John P. Madden III is an employee of Kaupthing. The Bank and Kaupthing, as owner of Kaupskil, may have different interests with respect to the financial reorganisations of customers who have obligations with both parties. According to the Rules of Procedure for the Board, a director is not permitted to attend Board meetings or participate in the discussion or the decision-making process if any conflicts of interest arise concerning that particular director.

There are no other conflicts of interest between the duties of the members of the Board listed above to the Bank and their private interests or other duties. The address of each member of the Board is Borgartún 19, 105 Reykjavík.

Alternate Directors

In the event that a Director resigns or is unable to attend a meeting of the Board, an alternate director attends such meeting. The Board's alternate directors are as follows:

Ólafur Örn Svansson, lawyer;

Sigurbjörg Ásta Jónsdóttir, lawyer; and

Thórarinn Thorgeirsson, managing director at Kaupthing's legal department.

Conflicts of Interest

Thórarinn Thorgeirsson is an employee of Kaupthing. The Bank and Kaupthing, as owner of Kaupskil, may have different interests with respect to the financial reorganisations of customers who have obligations with both parties. Accordingly, the Bank has implemented a procedure whereby Thórarinn Thorgeirsson is not permitted to act as an alternate director where such a conflict arises.

There are no other conflicts of interest between the duties of the Board's alternate directors listed above to the Bank and their private interests or other duties. The address of each of the Board's alternate directors is Borgartún 19, 105 Reykjavík.

Board's sub-committee members (other than Directors)

Heimir Thorsteinsson. Heimir is member of the Board Audit Committee.

Senior Management

The Bank's senior management team comprises the following members:

Höskuldur H. Ólafsson, CEO

Höskuldur graduated with a degree in business administration from the University of Iceland in 1987. He joined the Bank as CEO in June 2010 from Valitor – VISA Iceland, where he was CEO from 2006. Prior to that he worked at the Icelandic transportation company, Eimskip, for almost 20 years and held a range of management positions, including that of deputy CEO. He has also served on the boards of directors of numerous companies and organisations in Iceland and abroad. Höskuldur is the chairman of the Icelandic Financial Services Association (**SFF**) and is also a board member of the Icelandic Chamber of Commerce.

Gísli S. Óttarsson, Chief Risk Officer and Managing Director

Gísli received a Ph.D. in mechanical engineering from the University of Michigan in 1994. Gísli worked as a software designer and adviser for various engineering software companies in the United States before he joined Kaupthing's risk management division as head of research and development in January 2006. In April 2009, Gísli became the chief risk officer of the Bank.

Ida Brá Benediktsdóttir, Managing Director of Retail Banking

Ida Brá was born in 1976 and was appointed managing director of Retail Banking in June 2017. Ida has worked for the Bank and its predecessor since 1999 when she joined the research department. She has held various positions within the Bank including the head of department within the treasury. In 2013 Ida became the head of Private Banking and in 2016 was appointed as the managing director of the Investment Banking division. Before taking over Private Banking, Ida was Head of Corporate Communications. Ida has served on the board of numerous companies, including Ólafsfjördur savings bank, AFL, Landfestar and HB Grandi hf.

Ida graduated with a degree in business administration from the University of Iceland in 1999 and has a Master's in finance from the Rotterdam School of Management. She is also a certified stockbroker.

Jónína S. Lárusdóttir, Managing Director of Legal Division

Jónína graduated from the faculty of law at the University of Iceland in 1996 and qualified as a district court attorney the following year. In 2000, Jónína completed a master's degree from the London School of Economics and Political Science, including European competition law. In 1996, Jónína started working for the A&P law firm, but moved to the Ministry of Commerce in 2000 where she was a specialist in the financial markets department. She was appointed director of the general office of the Ministry of Industry and Commerce in 2004. In 2007, she became permanent secretary of the Ministry of Commerce, now the Ministry of Economic Affairs, where she worked until late 2010 when she took over the post of managing director of the Bank's Legal Division. Jónína has served on and chaired numerous committees and has worked as a lecturer in several institutions, including the faculty of law of the University of Iceland. She was chairman of the Depositors' and Investors' Guarantee Fund in 2003 and 2004.

Lýdur Thór Thorgeirsson, Managing Director of Investment Banking

Born in 1976, Lýdur was appointed managing director of the Investment Banking division in October 2017 and currently serves as acting managing director of the Corporate Banking Division. From 2010 to 2017 he worked for GAMMA Capital Management hf., first as a fund manager of institutional investor funds and from 2013 as managing director of Alternative Investments. Lýdur worked for Kaupthing from 2009 to 2010, where he was manager of international corporate loans. Prior to that he was at the Bank and its predecessor in the Corporate Finance division from 2007. Between 2000 and 2005 Lýdur worked for Íslandsbanki in both in its Leveraged Finance and Risk Management departments. Lýdur has served on the boards of directors of numerous companies. Lýdur graduated with a Bachelor of Science degree in electronic and computer engineering from the University of Iceland and received a Master of Business Administration degree from the MIT Sloan School of Management. Lýdur is a certified securities broker in Iceland.

Margrét Sveinsdóttir, Managing Director of Asset Management

Margrét graduated with an MBA from Babson College in Massachusetts in 1990. She has a degree in business administration from the University of Iceland and is a certified stockbroker. Margrét has been managing director of Asset Management at the Bank since February 2009. She has more than 20 years' experience in the financial sector, having worked in credit analysis, customer relationship management and asset management. She started her career in the corporate banking division of the Industrial Bank of Iceland in 1985. Margrét then moved on to Íslandsbanki Securities Ltd, later the asset management division of Glitnir, where she was head of securities brokerage and advisory. In 2007, she became head of financial institutions client relations at Glitnir. Margrét has served on a number of boards of directors, including: The Depositors' and Investors' Guarantee Fund on behalf of SFF, Vördur Life Insurance and several funds in Luxembourg. She has also contributed to several books and magazines on asset management services, investments and financial planning.

Rakel Óttarsdóttir, Managing Director of Corporate Development & Marketing

Rakel joined the IT division of Kaupthing Bank in 2005 where she was an account manager. In 2010 she became head of project management in the Corporate Development & Marketing division of the Bank. In December 2011 she was appointed managing director of Corporate Development & Marketing. Before joining the Bank, Rakel was head of development at TM Software. Rakel is a computer science graduate from the University of Iceland and has an MBA from Duke University in the United States.

Stefán Pétursson, Chief Financial Officer and Managing Director

Stefán graduated with an MBA from Babson College in Massachusetts in 1991 and a degree from the faculty of business of the University of Iceland in 1986. Stefán was appointed CFO at the Bank in August 2010. In 1986 to 1989, Stefán worked as head of administration at the Icelandic Fisheries Laboratories Institute. After completing his studies in the United States, Stefán joined Landsvirkjun. He began as head of funding but later took over as treasurer and finally CFO, a position he held from 2002. Stefán was on leave from Landsvirkjun in 2008 while serving as the CEO of the investment company HydroKraft Invest hf. Stefán has held a number of directorship positions and other positions of responsibility in recent years. He is currently a member of the board of Landey hf.

Hákon Már Pétursson, Compliance Officer

Hákon studied law at the University of Iceland and University of Copenhagen, and is also a certified stockbroker. From 2006 to 2009 he worked as a specialist in the Securities Market division at the FME. During this time he was, among other things, the FME's representative in the Takeover Directive expert group and the Markets in Financial Instruments Directive (**MiFID**) expert group at the Committee of European Securities Regulators. He was also a guest lecturer at the University of Iceland and University of Reykjavík. From 2009 to 2011 he worked for KVASIR Legal on various matters relating to banking and financial restructuring. Hákon joined the Bank's Compliance Division in 2011.

Lilja Steinthórsdóttir, Chief Audit Executive

Lilja gained an MBA degree from the University of Edinburgh in 1998. She qualified as a chartered accountant in 1984 and graduated with a degree in business administration in 1980. Before she joined the Bank in late 2006 as chief audit executive, she was the chief auditor at the Icelandic Central Bank for eight years. She established an accounting firm in Akureyri in 1986 and headed it for 13 years when it was sold to Deloitte. She is a member of the Institute of State Authorised Public Accountants and has served on the audit committee on behalf of the organisation. She also served on the audit committee of Icelandic Banks' Data Centre from 1998 to 2010, first on behalf of the Icelandic Central Bank and then the Bank.

Helgi G. Björnsson, Customers' Ombudsman

In 1993, Helgi was appointed deputy branch manager at Búnadarbanki (a predecessor of the Bank) in Akureyri and became branch manager at Höfdi, Reykjavík, in 1999. He was then branch manager in Grafarvogur, Reykjavík, until spring 2010 when he joined the Customers' Ombudsman department as a specialist. Helgi was appointed Customers' Ombudsman of the Bank in April 2012. Between 1989 and 1993 Helgi worked for the Director of Tax Investigations and also advised on accounting for companies in north eastern Iceland. From 1987 to 1989 Helgi worked at Bifröst University in Iceland, teaching accounting, production management and human resource management. Helgi graduated with a diploma in industrial technology from the Technical College of Iceland (now Reykjavík University) in 1987.

Sture Stölen, Head of Investor Relations

Born in 1967, Sture was appointed as the Head of Investor Relations in February 2017. Sture served as the head of investor relations at SAS AB in Sweden from 2001 to 2013. From 1993 to 2001, Sture held various positions in treasury and finance in SAS AB. Since 2013, Sture has been senior adviser and partner at Wildeco Ekonomisk Information AB in Sweden, a position he currently holds. Sture was a board member of Forex Bank AB in Sweden from 2013-2014. He has served as head of investor relations in TF Bank AB (publ) since January 2016. Sture holds a Master of Science in Finance from the Norwegian School of Business in Oslo, Norway from 1993.

There are no conflicts of interest between the duties of the members of senior management listed above to the Bank and their private interests or other duties. The address of each member of senior management is Borgartún 19, 105 Reykjavík.

Corporate Governance

The Bank's Corporate Governance framework is based on law, the Bank's articles of association and the Guidelines on Corporate Governance issued by the Icelandic Chamber of Commerce, Nasdaq Iceland hf. and the Confederation of Icelandic Employers in accordance with the Bank's Corporate Governance Statement. The Bank is directed and controlled by this framework. By establishing rules on corporate governance, the Bank sets forth criteria of conduct in key areas, which complement statutory rules. The Bank believes that a strong governance culture enhances trust, reduces risk and increases economic benefit for the Bank and its shareholders in the long term. The Bank continually seeks to update its corporate governance framework in response to new events, changes in statutory law and developments in domestic and international standards.

Management

The CEO is appointed by the Board. He is in charge of the day-to-day operations of the Bank and represents it in all matters concerning normal operations. The CEO is assisted by an executive management committee, in which all nine managing directors hold a seat.

Customers' Ombudsman

The Customers' Ombudsman is appointed by, and responsible to, the CEO, in accordance with a government recommendation made at the end of 2008.

The role of the Ombudsman is to ensure that the business of customers is handled fairly and objectively when dealing with recovery cases, prevent discrimination between customers and to ensure that the process for handling cases is transparent and documented. In the case of companies, the Ombudsman must also ensure that competition perspectives are taken into account, viable companies are entered into the restructuring process and rules on financial restructuring are adhered to.

In order to achieve these objectives, the Ombudsman takes part in the formation of procedures and solutions for customers as appropriate. In addition, the Ombudsman reviews specific cases upon request from customers, the Bank's employees or at his own initiative. Such a review can take place both while cases are being processed and after they are closed. The Ombudsman has access to information and data on specific issues. The Ombudsman submits information about the outcome of cases to clients, employees and the Board as appropriate.

Internal Audit

The Internal Auditor is appointed by the Board and reports directly to the Board. The Board sets the Internal Auditor a charter which lays out the responsibilities associated with the position and the scope of work. Internal Audit is required to provide independent and objective assurance and consulting services designed to add value and improve the Bank's operations. The scope of the audit is the Bank, its subsidiaries and pension funds serviced by the Bank.

The internal audit is governed by the audit charter, an FME directive on the internal audit function in financial institutions and international standards on internal auditing. All internal audit work is completed by issuing an audit report with deadlines for the implementation of audit findings. Implementations are followed up by Internal Audit every quarter.

With respect to 2016 and 2017, the Internal Auditor’s overall conclusion on the effectiveness of the Bank’s internal controls and the Bank’s risk and control culture was that they were unsatisfactory (Is. *ófullnægjandi*) and should be improved, particularly relating to controls and risk awareness in the Corporate Banking division (as evidenced by the matters relating to United Silicon) and anti-money laundering processes at the Bank generally. To address these conclusions, the Bank has been making improvements and is on target for implementing the recommended anti-money laundering controls and the Credit Office has been established in part to strengthen the lending process and control of the loan portfolio. See also *“The Bank is exposed to credit risk and its customer loan portfolio contains certain problem and impaired loans”, “The Bank is exposed to operational risks”* and *“The Bank must comply with anti-money laundering and anti-bribery regulations, and the violation of such regulations may have severe consequences”* in *“Risk Factors”*.

Employees

During 2017, the average number of FTEs in the Group was 1,250 (compared to 1,201 in 2016). As of 31 December 2017, the number of FTEs at the Group was 1,284.

The table below sets forth the information on the number of FTEs by division as of the dates indicated.

	As of 31 December	
	2017	2016
Retail Banking	367	358
Corporate Banking	15	28
Investment Banking	30	30
Asset Management	52	54
Asset Management division	34	33
Stefnir	18	21
Finance[1]	99	51
Risk management[2]	27	30
Legal	43	42
Operations[3]	82	143
IT	86	105
CEO office[4]	61	48
Other divisions and subsidiaries[5]	422	349
Total	**1,284**	**1,238**

(1) Includes Treasury.
(2) As of 30 June 2017, part of the employees of Corporate Banking and Risk management were transferred to Credit Management within the CEO Office.
(3) As of 30 June 2017, the employees and functions of the former Operations division had been transferred to Finance and IT.
(4) Includes marketing, HR and Credit Management.
(5) Includes Valitor (335 FTEs as of 31 December 2017 and 257 FTEs as of 31 December 2016).

TAXATION

Iceland

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

Furthermore, investors should note that the appointment by an investor in Notes, or any person through which an investor holds Notes, of a custodian, collection agent or similar person in relation to such Notes in any jurisdiction may have tax implications. Prospective investors are advised to consult their tax advisers as to the consequences, under the tax law of the countries of their respective citizenship, residence or domicile, of a purchase of Notes, including but not limited to, the consequences of receipt of payments under the Notes and their disposal or redemption.

The summary below is of a general nature based upon the law and practice of Iceland as in effect on the date of this Base Prospectus. It should not be construed as providing specific advice as to Icelandic taxation and is subject to any change in law or practice in Iceland that may take effect after such date. It relates only to the position of persons who are the absolute beneficial owners of the Notes.

Non-Icelandic Tax Residents

As a general rule, Article 3 (8) of the Income Tax Act No. 90/2003 (the **ITA**) provides that any interest received from Iceland (outbound payments), such as the interest payable under the Notes, by any person or entity residing outside of Iceland is taxable income in Iceland. According to Article 70 (8) of the ITA, the current tax rate on taxable income under Article 3 (8) is (a) 12 per cent. for individuals (only applicable to interest income exceeding the annual amount of ISK 150,000.00); and (b) 12 per cent. for legal entities.

From the general rule of Article 3 (8) of the ITA, there are certain exemptions listed in the provision, e.g. if an applicable double taxation treaty states otherwise. Also, according to Article 3 (8), cf. Article 3 (3) of Regulation no. 630/2013, the Bank is not required by Icelandic law to deduct or withhold tax from interest payments on notes or bonds that are issued by a financial institution, in its own name, registered with a securities depository in 1) a member state of the OECD, 2) a member state of the EEA, 3) a member state of The European Free Trade Association (**EFTA**), or 4) the Faroe Islands, and which do not constitute business covered by Articles 13. b – 13. n of Act No. 87/1992 on Foreign Exchange, as amended (which contain some restrictions on cross-border capital movements since Iceland is under foreign exchange restrictions subject to Icelandic law). In 2015, the ITA was amended by Amendment Act No. 107/2015 to provide for an exemption from the general rule for payments of interest on notes or bonds issued in connection with a composition agreement or by financial institutions which are subject to winding-up proceedings or a composition process. The Bank has obtained confirmation from the Directorate of Internal Revenue in Iceland (the **RSK**) that the Programme is within the scope of the exemption contained in paragraph 3 of Article 3 (8) of the ITA, although an exemption will need to be applied for in respect of each Tranche of Notes. Accordingly, the Bank will, based on this confirmation, register any Notes issued under the Programme with the RSK and request that the RSK provide a certificate confirming that the relevant Notes are exempt from such taxation.

In the absence of an applicable exemption, the Bank will be making the relevant withholding at source in accordance with the provisions of Regulation no. 630/2013, on the taxation and withholding of interest to non-Icelandic tax residents subject to limited tax liability (as based on Article 3 (8) of the ITA and Article 41 of the Act No. 45/1987 on Withholding of Public Levies at Source). Condition 7 provides for payment by the Bank of the necessary additional amounts in such circumstances to cover any resulting amounts deducted or withheld.

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

Capital gains on the sale of the Notes are classified as interest under Icelandic tax law. Accordingly, based on the wording of Article 3 (8) of the ITA, cf. Article 3 (3) of Regulation no. 630/2013, capital gains on the sale of the Notes should not be subject to Income tax in Iceland, provided a tax exemption is in place in accordance with the above.

No Icelandic issue tax or stamp duty will be payable in connection with the issue of any Notes.

Icelandic Tax Residents

Beneficial owners of the Notes that are resident in Iceland for tax purposes are subject to income tax in Iceland on their interest income in accordance with Icelandic tax law. The applicable tax rate depends on their tax status.

Capital gains on the sale of the Notes are subject to the same tax as interest income of Icelandic residents.

Subject to certain exemptions (which apply, inter alia, to most banks and pension funds), the Bank is required to withhold a 22 per cent. tax on the interest paid to the holders of Notes who are Icelandic residents, cf. Act No. 94/1996 on Withholding of Tax on Financial Income. Such withholding is considered a preliminary tax payment but does not necessarily constitute the final tax liability of the holder. However, the Bank should generally not be held responsible for withholding tax on income related to bonds that have been registered as exempted with the Director of Revenue, unless the Bank has knowledge that the bonds have been acquired by an Icelandic tax resident, cf. *inter alia* explanatory notes accompanying Act No. 39/2013, amending the ITA. This exemption of the withholding obligation does not affect the tax obligations of the relevant bondholder.

FATCA DISCLOSURE

Foreign Account Tax Compliance Act

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

FATCA or an IGA with respect to payments on the Notes, no person will be required to pay additional amounts as a result of the withholding.

The proposed financial transactions tax (FTT)

On 14 February 2013, the European Commission published a proposal (the **Commission's Proposal**) for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (each, other than Estonia, a **participating Member State**). However, Estonia has since ceased to participate.

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

Under the Commission's Proposal, the FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in the Notes where at least one party is a financial institution and at least one party is established in a participating Member State. A financial institution might be, or be deemed to be, "established" in a participating Member State in a broad range of circumstances, including: (a) by transacting with a person established in a participating Member State or (b) where the financial instrument that is subject to the dealings is issued in a participating Member State.

However, the FTT proposal remains subject to negotiation between participating Member States. It may therefore be altered prior to any implementation, the timing of which remains unclear. Additional European Union member states might decide to participate.

Prospective holders of the Notes are advised to seek their own professional advice in relation to the FTT and its potential impact on the Notes.

Luxembourg Taxation

The following information is of a general nature only and is based on the laws presently in force in Luxembourg, though it is not intended to be, nor should it be construed to be, legal or tax advice. The information contained within this section is limited to Luxembourg withholding tax issues and prospective investors in the Notes should therefore consult their own professional advisers as to the effects of state, local or foreign laws, including Luxembourg tax law, to which they may be subject.

Please be aware that the residence concept used under the respective headings below applies for Luxembourg income tax assessment purposes only. Any reference in the present section to a withholding tax or a tax of a similar nature, or to any other concepts, refers to Luxembourg tax law and/or concepts only.

Withholding Tax

(i) Non-resident holders of Notes

Under Luxembourg general tax laws currently in force, there is no withholding tax on payments of principal, premium or interest made to non-resident holders of Notes, nor on accrued but unpaid interest in respect of the Notes, nor is any Luxembourg withholding tax payable upon redemption or repurchase of the Notes held by non-resident holders of Notes.

(ii) Resident holders of Notes

Under Luxembourg general tax laws currently in force and subject to the law of 23 December 2005 as amended (the **Relibi Law**) mentioned below, there is no withholding tax on payments of principal, premium or interest made to Luxembourg resident holders of Notes, nor on accrued but unpaid interest in respect of Notes, nor is any Luxembourg withholding tax payable upon redemption or repurchase of Notes held by Luxembourg resident holders of Notes.

Under the Relibi Law payments of interest or similar income made or ascribed by a paying agent established in Luxembourg to an individual beneficial owner who is a resident of Luxembourg will be subject to a withholding tax of 20 per cent. Such withholding tax will be in full discharge of income tax if the beneficial owner is an individual acting in the course of the management of his/her private wealth. Responsibility for the withholding of the tax will be assumed by the Luxembourg paying agent. Accordingly, payments of interest under the Notes coming within the scope of the Relibi Law will be subject to a withholding tax at a rate of 20 per cent.

SUBSCRIPTION AND SALE

The Dealers have, in an Amended and Restated Programme Agreement (as amended and/or supplemented and/or restated from time to time, the **Programme Agreement**) dated 10 July 2018, agreed with the Bank a basis upon which they or any of them may from time to time agree to purchase Notes. Any such agreement will extend to those matters stated under "*Form of the Notes*" and "*Terms and Conditions of the Notes*". In the Programme Agreement, the Bank has agreed to reimburse the Dealers for certain of their expenses in connection with the establishment and any future update of the Programme and the issue of Notes under the Programme and to indemnify the Dealers against certain liabilities incurred by them in connection therewith. The Programme Agreement provides that the obligations of the Dealers to subscribe for Notes are subject to certain conditions precedent, including (among others), the receipt of legal opinions from legal counsel.

United States

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

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

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that it will not offer, sell or deliver Notes (a) as part of their distribution at any time or (b) otherwise until 40 days after the completion of the distribution, as determined and certified by the relevant Dealer or, in the case of an issue of Notes on a syndicated basis, the relevant lead manager, of all Notes of the Tranche of which such Notes are a part, within the United States or to, or for the account or benefit of, U.S. persons except in accordance with Regulation S of the Securities Act. Each Dealer has further agreed, and each further Dealer appointed under the Programme will be required to agree, that it will send to each dealer to which it sells any Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

Until 40 days after the commencement of the offering of any Series of Notes, an offer or sale of such Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with an available exemption from registration under the Securities Act.

Prohibition of sales to EEA Retail Investors

Unless the Final Terms in respect of any Notes specifies “Prohibition of Sales to EEA Retail Investors” as “Not Applicable”, each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that it has not offered, sold or otherwise made available and will not offer, sell or otherwise make available any Notes which are the subject of the offering contemplated by the Offering Circular as completed by the Final Terms in relation thereto to any retail investor in the EEA. For the purposes of this provision:

(i) the expression **retail investor** means a person who is one (or more) of the following:

(a) a retail client as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, **MiFID II**); or

(b) a customer within the meaning of Directive 2002/92/EC (as amended, the Insurance Mediation Directive), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or

(c) not a qualified investor as defined in the Prospectus Directive; and

(ii) the expression an **offer** includes the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe the Notes.

If the Final Terms in respect of any Notes specifies "Prohibition of Sales to EEA Retail Investors" as "Not Applicable", in relation to each Member State of the EEA which has implemented the Prospectus Directive (each, a **Relevant Member State**), each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the **Relevant Implementation Date**) it has not made and will not make an offer of Notes which are the subject of the offering contemplated by this Base Prospectus as completed by the final terms in relation thereto to the public in that Relevant Member State, except that it may, with effect from and including the Relevant Implementation Date, make an offer of such Notes to the public in that Relevant Member State:

(a) at any time to any legal entity which is a qualified investor as defined in the Prospectus Directive;

(b) at any time to fewer than 150 natural or legal persons (other than qualified investors as defined in the Prospectus Directive) subject to obtaining the prior consent of the relevant Dealer or Dealers nominated by the Bank for any such offer; or

(c) at any time in any other circumstances falling within Article 3(2) of the Prospectus Directive,

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

For the purposes of this provision:

- the expression an **offer of Notes to the public** in relation to any Notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe the Notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State; and

- the expression **Prospectus Directive** means Directive 2003/71/EC (as amended), and includes any relevant implementing measure in the Relevant Member State.

United Kingdom

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that:

(a) in relation to any Notes which have a maturity of less than one year, (i) it is a person whose ordinary activities involve it in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of its business and (ii) it has not offered or sold and will not offer or sell any Notes other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or as agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses where the issue of the Notes would otherwise constitute a contravention of Section 19 of the FSMA by the Bank;

(b) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Bank; and

(c) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Notes in, from or otherwise involving the United Kingdom.

Iceland

The investment described in this Base Prospectus has not been and will not be registered for public distribution in Iceland with the Financial Supervisory Authority pursuant to the Icelandic Act on Securities Transactions No. 108/2007 (as amended) (the **Icelandic Securities Act**).

Each Dealer has acknowledged and agreed, and each further Dealer appointed under the Programme will be required to acknowledge and agree, that this Base Prospectus may be distributed only to, and may be directed only at, persons who are (i) qualified investors under the private placement exemption of Article 50 (1) Item 1 a) as defined in Article 43 Item 9 of the Icelandic Securities Act or (ii) other persons to whom this Base Prospectus may be communicated lawfully in accordance with the Icelandic Securities Act (all such persons together being referred to as the Relevant Persons). This Base Prospectus must not be acted on or relied on by persons who are not Relevant Persons. Any investment or investment activity to which this Base Prospectus relates is available only to Relevant Persons and will be engaged in only with Relevant Persons. Any person who is not a Relevant Person should not act or rely on this Base Prospectus or any of its contents. This Base Prospectus must not be distributed, published, reproduced or disclosed (in whole or in part) by recipients to any other persons.

Belgium

Other than in respect of Notes for which "Prohibition of Sales to Belgian Consumers" is specified as "Not Applicable" in the applicable Final Terms, each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that an offering of Notes may not be advertised to any individual in Belgium qualifying as a consumer within the meaning of Article I.1 of the Belgian Code of Economic Law, as amended from time to time (a **Belgian Consumer**) and that it has not offered, sold or resold, transferred or delivered, and will not offer, sell, resell, transfer or deliver, the Notes, and that it has not distributed, and will not distribute, any prospectus, memorandum, information circular, brochure or any similar documents in relation to the Notes, directly or indirectly, to any Belgian Consumer.

Japan

The Notes have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (Act No.25 of 1948, as amended; the **FIEA**) and each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that it will not offer or sell any Notes, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (as defined under Item 5, Paragraph 1, Article 6 of the Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949, as amended)), or to others for re-offering or resale, directly or indirectly, in Japan or to, or for the benefit of, a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FIEA and any other applicable laws, regulations and ministerial guidelines of Japan.

Hong Kong

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that:

(a) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any of the Notes (except for Notes which are a "structured product" as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong) (the **SFO**) other than (i) to persons whose ordinary business is to buy or sell shares or debentures (whether as principal or agent); or (ii) to "professional investors" as defined in the SFO and any rules made under the SFO; or (iii) in other circumstances which do not result in the document being a "prospectus" as defined in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) of Hong Kong (the **C(WUMP)O**) or which do not constitute an offer to the public within the meaning of the C(WUMP)O; and

(b) it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the Notes, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to the Notes which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" as defined in the SFO and any rules made under the SFO.

General

Each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree that it will (to the best of its knowledge and belief) comply with all applicable securities laws and regulations in force in any jurisdiction in which it purchases, offers, sells or delivers Notes or possesses or distributes this Base Prospectus and will obtain any consent, approval or permission required by it for the purchase, offer, sale or delivery by it of Notes under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such purchases, offers, sales or deliveries and neither the Bank nor any of the other Dealers shall have any responsibility therefor.

None of the Bank and the Dealers represents that Notes may at any time lawfully be sold in compliance with any applicable registration or other requirements in any jurisdiction, or pursuant to any exemption available thereunder, or assumes any responsibility for facilitating any such sale.

GENERAL INFORMATION

Authorisation

The update of the Programme and the issue of Notes have been duly authorised by a resolution of the Bank's Board dated 18 June 2018.

Listing of Notes

Application has been made to the CSSF to approve this document as a base prospectus. Application has also been made to the Luxembourg Stock Exchange for Notes issued under the Programme to be admitted to trading on the Luxembourg Stock Exchange's regulated market and to be listed on the Official List of the Luxembourg Stock Exchange. The Luxembourg Stock Exchange's regulated market is a regulated market for the purposes of MiFID II.

Documents Available

For the period of 12 months following the date of this Base Prospectus, copies of the following documents will, when published, be available for inspection from the registered office of the Bank and from the specified office of the Paying Agent for the time being in London:

(a) the articles of association (with an English translation thereof) of the Bank;

(b) the Annual Financial Statements (with an English translation thereof) in each case together with the audit reports prepared in connection therewith. The Bank currently prepares audited consolidated accounts on an annual basis. The Bank does not currently prepare non-consolidated accounts;

(c) the most recently published audited annual financial statements of the Bank and the most recently published unaudited interim financial statements (if any) of the Bank (with an English translation thereof), in each case together with any audit or review reports prepared in connection therewith. The Bank currently prepares unaudited consolidated interim accounts on a quarterly basis;

(d) the Agency Agreement, the Deed of Covenant and the forms of the Global Notes, the Notes in definitive form, the Coupons and the Talons;

(e) a copy of this Base Prospectus;

(f) the Terms and Conditions of the Notes contained in the previous Base Prospectus dated 23 April 2014, pages 47 to 70 (inclusive) prepared by the Bank in connection with the Programme;

(g) the Terms and Conditions of the Notes contained in the previous Base Prospectus dated 5 June 2015, pages 49 to 72 (inclusive) prepared by the Bank in connection with the Programme;

(h) the Terms and Conditions of the Notes contained in the previous Base Prospectus dated 7 June 2016, pages 48 to 71 (inclusive) prepared by the Bank in connection with the Programme;

(i) the Terms and Conditions of the Notes contained in the previous Base Prospectus dated 19 June 2017 pages 60 to 90 (inclusive) prepared by the Bank in connection with the Programme; and

(j) any future offering circulars, prospectuses, information memoranda, supplements and Final Terms to this Base Prospectus and any other documents incorporated herein or therein by reference.

Clearing Systems

The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg (which are the entities in charge of keeping the records). The appropriate Common Code and ISIN for each Tranche of Notes allocated by Euroclear and Clearstream, Luxembourg will be specified in the applicable Final Terms. If the Notes are to clear through an additional or alternative clearing system the appropriate information will be specified in the applicable Final Terms.

The address of Euroclear is Euroclear Bank SA/NV, 1 Boulevard du Roi Albert II, B-1210 Brussels. The address of Clearstream, Luxembourg is Clearstream Banking S.A., 42 Avenue JF Kennedy, L-1855 Luxembourg.

Conditions for determining price

The price and amount of Notes to be issued under the Programme will be determined by the Bank and each relevant Dealer at the time of issue in accordance with prevailing market conditions.

Yield

In relation to any Tranche of Fixed Rate Notes or any Tranche of Fixed Reset Rate Notes, as applicable, an indication of the yield in respect of such Notes will be specified in the applicable Final Terms. The yield is calculated at the Issue Date of the Notes on the basis of the relevant Issue Price. The yield indicated will be calculated as the yield to maturity as at the Issue Date of the Notes and will not be an indication of future yield.

Significant or Material Change

There has been no significant change in the financial position of the Group since 31 March 2018 and there has been no material adverse change in the prospects of the Bank since 31 December 2017.

Litigation

Except as disclosed in "*Description of the Bank—Legal Proceedings*" on page 138 of this Base Prospectus, neither the Bank nor any other member of the Group is or has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Bank is aware) in the 12 months preceding the date of this document which may have or have in such period had a significant effect on the financial position or profitability of the Bank or the Group.

Auditors

On 19 March 2015 Deloitte, members of The Institute of State Authorised Public Accountants in Iceland, were appointed auditors of the Bank. Deloitte has audited the Annual Financial Statements, without qualification, in accordance with International Standards on Auditing.

Deloitte does not have a material interest in the Bank.

Dealers transacting with the Bank

In the ordinary course of their business activities, the Dealers and their affiliates make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers. Such investments and securities activities may involve securities and/or instruments of the Bank or the Banks' affiliates. Certain of the Dealers or their affiliates that have a lending relationship with the Bank routinely hedge their credit exposure to the Bank consistent with their customary risk management policies. Typically, such Dealers and their affiliates would hedge such exposure by entering into transactions which consist of either the purchase of credit default swaps or the creation of short positions in securities, including potentially the Notes issued under the Programme. Any such short positions could adversely affect future trading prices of Notes issued under the Programme. The Dealers and their affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or financial instruments and may hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

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