

BASE PROSPECTUS



ARION BANK HF.

(incorporated with limited liability in Iceland)

€2,000,000,000

Euro Medium Term Note Programme

Under this €2,000,000,000 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 €2,000,000,000 (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 the Markets in Financial Instruments Directive (Directive 2004/39/EC).

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**). The Programme has been rated BBB- by Standard & Poor's. Standard & Poor's is established in the European Union and is registered under the 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 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 and will not necessarily be the same as the rating assigned to the Programme by Standard & Poor's. 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.

Arranger

Deutsche Bank

Dealers

Barclays

Deutsche Bank

J.P. Morgan

Nomura

Citigroup

Goldman Sachs International

Morgan Stanley

Pareto Securities

UBS Investment Bank

The date of this Base Prospectus is 7 June 2016.

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, including by Directive 2010/73/EU), and includes any relevant implementing measure in a relevant Member State of the European Economic Area (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 and Iceland), Japan and Hong Kong, see "*Subscription and Sale*".

This Base Prospectus has been prepared on a basis that would permit an offer of Notes with a denomination of less than €100,000 (or its equivalent in any other currency) only in circumstances where there is an exemption from the obligation under the Prospectus Directive to publish a prospectus. As a result, any offer of Notes in any Member State of the EEA which has implemented the Prospectus Directive (each, a **Relevant Member State**) must be made pursuant to an exemption under the Prospectus Directive from the requirement to publish a prospectus for offers of Notes. Accordingly any person making or intending to make an offer of Notes in that Relevant Member State may only do so in circumstances in which no obligation arises for 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, in each case, in relation to such offer. Neither the Bank nor any Dealer have authorised, nor do they authorise, the making of any offer of Notes in circumstances in which an obligation arises for the Bank or any Dealer to publish or supplement a prospectus for such offer.

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 INFORMATION

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 section of this Base Prospectus.

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

- **2015 Consolidated Financial Statements** means the audited consolidated annual financial statements of the Bank for the financial year ended 31 December 2015;
- **2014 Consolidated Financial Statements** means the audited consolidated annual financial statements of the Bank for the financial year ended 31 December 2014;
- 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** or **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 and percentages included in the Base Prospectus have been subject to rounding adjustments; accordingly, figures shown in the same category presented in different tables may vary slightly and figures shown as totals in certain tables may not be an arithmetic aggregate of the figures which precede them.

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, there is no assurance that the Stabilisation Manager(s) (or persons acting on behalf of a Stabilisation Manager) will undertake stabilisation action. 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 be ended 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.

CONTENTS

Clause	Page
Overview of the Programme	7
Risk Factors	10
Documents Incorporated by Reference	33
Form of the Notes	35
Applicable Final Terms	38
Terms and Conditions of the Notes	48
Use of Proceeds	72
Financial Markets in Iceland	73
Description of the Bank	75
Management and Employees	108
Taxation	116
Subscription and Sale	120
General Information	123

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.
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 " <i>Risk Factors</i> ".
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 " <i>Subscription and Sale</i> ") 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 €2,000,000,000 (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 " <i>Form of the Notes</i> ".
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.
Floating Rate Notes:	Floating Rate Notes will bear interest at a rate determined: <ul style="list-style-type: none">(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 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 other 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.

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 6. In the event that any such deduction is made, the Bank will, save in certain limited circumstances provided in Condition 6, 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 8.1(c).
- Status of the Notes: The Notes will constitute direct, unconditional, unsubordinated and unsecured obligations of the Bank and will 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.
- Rating: The Programme has been rated BBB- by Standard & Poor's. 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 and will not necessarily be the same as the ratings assigned to the Programme. 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.
- Selling Restrictions: There are restrictions on the offer, sale and transfer of the Notes in the United States, the EEA (including the United Kingdom and Iceland), 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 Iceland's economy which was in recession throughout 2009 and 2010 and, although GDP growth returned in 2012, 2013, 2014 and 2015, Iceland's economy remains vulnerable to a range of internal risks and external shocks

Iceland's economy entered into a severe recession in the fourth quarter of 2008, with gross domestic product (**GDP**) falling by 6.6 per cent. in 2009 and by 4.1 per cent. in 2010, in each case relative to the year before. The recession followed a period of high growth of Iceland's economy that began in 2003 and was characterised by enhanced access to credit at lower interest rates, which resulted in rising real estate prices and a sharp expansion of private consumption. GDP grew at an annual rate of over 7 per cent. in each of 2004 and 2005. The economic growth became increasingly imbalanced, however, as the mounting debt of households, rising real estate prices and expansion of private consumption in turn fuelled inflationary pressures and a widening deficit.

Early in October 2008, Iceland's economy experienced a serious banking crisis when nearly nine-tenths of Iceland's banking system collapsed. The three large commercial banks, Glitnir Bank hf. (**Glitnir**), Landsbanki Íslands hf. (later renamed LBI hf.) (**Landsbanki**) and Kaupthing Bank hf. (**Kaupthing**), were taken into special resolution regimes on the basis of emergency legislation passed by Parliament. This collapse accelerated the prevailing recessionary forces, as did the international contraction in world trade and economic activity in the last months of 2008 and the first half of 2009.

To restore confidence and stabilise the economy, a joint economic programme was developed in November 2008 (the **Joint Economic Programme**) by the Icelandic government, the Icelandic Central Bank (the **Central Bank**) and the International Monetary Fund (the **IMF**) under a two year Stand-By Arrangement that was subsequently extended until 31 August 2011. The Stand-By Arrangement included a loan of approximately U.S.\$2.1 billion and was accompanied by bilateral loan commitments from European neighbours and other loan commitments and standing facilities aggregating approximately U.S.\$3 billion. The Joint Economic Programme was successfully concluded in August 2011.

Although Iceland's economy has shown some signs of recovery since 2011, with GDP growth of 1.2 per cent. in 2012, 4.4 per cent. in 2013, 1.9 per cent. in 2014 and 4.0 per cent. in 2015, in each case relative to the year before, it is too early to predict whether or not there will be a sustained and stable recovery because of the difficulties in resolving the problems arising out of the financial crisis and sustaining the economic recovery process.

Iceland's economy is also vulnerable to a range of risks affecting the banking system (see "*Iceland's banking sector is in the process of being restructured and remains subject to considerable risks. Should any of these risks materialise the Bank could be materially and adversely affected, either directly or by association should the risks primarily materialise in relation to other Icelandic banks*") as well as risks relating to a range of domestic and external factors discussed below.

The domestic factors that could undermine or reverse Iceland's recent economic recovery include:

- *Removal of capital controls:* As a result of the financial crisis in 2008, the Central Bank introduced capital controls in November 2008 which are in the process of being gradually relaxed in accordance with the capital controls liberalisation strategy established in March 2011.

In June 2015 the Icelandic government announced a plan towards removal of the capital controls. The plan was threefold: firstly, the estates of Glitnir, Landsbanki, Kaupthing and other smaller bankrupt banks agreed to certain stability conditions, which have since been fulfilled by making contributions to the 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 (the **District Court**)); secondly, offshore holders of ISK-denominated deposits or government bonds will be offered a currency auction held by the Central Bank; and thirdly, controls will gradually be lifted on the domestic market when conditions allow.

As of the date of this Base Prospectus, the first part of the plan has been completed with each of the estates of Glitnir, Landsbanki and Kaupthing reaching formal composition agreements approving a composition proposal through which they would exit winding-up proceedings with their creditors. In order to allow each of Glitnir, Landsbanki and Kaupthing to implement their respective composition agreements, the Central Bank has granted them certain exemptions from Icelandic foreign capital controls on the basis that Glitnir, Landsbanki and Kaupthing, among other things, have made a "stability contribution" to the Central Bank.

The implementation of the second part of the plan commenced on 20 May 2016, when the Icelandic Minister of Finance and Economic Affairs submitted before the Icelandic Parliament Bill no. 1314, on the Treatment of Króna-denominated Assets Subject to Special Restrictions (the **Bill**). The Bill was enacted on 23 May 2016 as Act No. 37/2016 on the Treatment of Króna-denominated Assets Subject to Special Restrictions (the **Króna Asset Act**). The Króna Asset Act seeks to address treatment of specified króna-denominated assets, defined as **Offshore Króna Assets** in art. 2(1) of the Act. Offshore Króna Assets, which are currently subject to capital controls and total over ISK300 billion, include various assets and funds denominated in Icelandic krónas, owned or held by non-resident parties (as defined in the Act on Foreign Exchange no 87/1992, as amended (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 Króna Asset Act, therefore, is for the Central Bank to hold a foreign currency auction in which all owners of Offshore Króna Assets will be given the option of exchanging these assets for euros, at a particular exchange rate. Any Offshore Króna Assets not exchanged in this foreign currency auction will be subject to restrictions, as further set out in the Offshore Króna Act.

Whilst the Icelandic government and the Central Bank have announced further easing of the capital controls in 2016 and the plan for lifting them is in progress, such capital controls may nevertheless continue to be in place for some time as there is no set date for their complete removal. As of the date of this Base Prospectus, only limited exemptions from the capital controls have been granted by the Central Bank as part of this plan, allowing certain types of pension funds to engage in foreign currency investments.

- *Lack of foreign direct investment:* Even if gradual liberalisation of the capital control regime is successful, there can be no assurance that additional foreign direct investment in Iceland will

materialise when capital controls are removed. Should there be insufficient foreign direct investment in Iceland following removal of the capital controls, Iceland's fiscal and balance of payments deficits could worsen.

- *Other factors:* Other factors also pose significant risks to Iceland's economic and fiscal position. For example, as a result of slower than expected economic growth, lower than projected tax revenue, high labour costs and other factors, Iceland missed its budget targets in 2010, 2011 and 2012. However, in 2013 and 2014 Iceland was within its budget targets. Whilst inflation currently remains within the Central Bank's target rate, due to concerns of an output gap over the next two years the Central Bank's inflation outlook for this period is that the rate of inflation could rise. As a result of these other factors, including the high level of corporate and household debt, the ongoing restructuring of the financial sector including the winding-up of the failed banks, and levels of consumption or foreign direct investment, Iceland's economy risks a return to recession, either on its own or in tandem with the economies of its largest trading partner, the European Union.

Iceland's economy 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 and the European sovereign debt crisis could have a material adverse effect on the recovery of Iceland's economy. Although the financial sector in Iceland is still subject to 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 exports (being tourism, fish products and aluminium).

Should Iceland's economy be adversely affected by domestic factors or external shocks, whether as a result of any of the above factors or for other reasons, this could adversely affect the ability of the Bank's customers to repay their loans (many of which have already been restructured) which in turn could have a material adverse effect on the Bank's business, financial conditions, results of operations, cash flows and prospects, and its ability to make payments in respect of the Notes.

Iceland's banking sector is in the process of being restructured and remains subject to considerable risks. Should any of these risks materialise the Bank could be materially and adversely affected, either directly or by association should the risks primarily materialise in relation to other Icelandic banks

Following the collapse of Glitnir, Landsbanki and Kaupthing (the **Old Banks**), the Icelandic Financial Supervisory Authority (the **FME**) transferred certain of their assets and liabilities (including the domestic deposits) into three new banks, Íslandsbanki hf. (**Íslandsbanki**), Landsbankinn hf. (**Landsbankinn**) and the Bank, respectively (the **New Banks**), that were established in October 2008. The Icelandic banking sector is dominated by the New Banks but also includes other commercial banks and savings banks. The New Banks have so far engaged in only limited new lending, primarily domestic lending in krona. The vast majority of the New Banks' funding comes from deposits by customers, however since 2015 the New Banks have had access to international lending and certain of the New Banks, including the Bank, have raised funding in the international markets (see "*Description of the Bank – Funding and Liquidity*" below for further information in respect of the Bank). Since October 2008, the Icelandic government has maintained a policy that deposits in banks domiciled in Iceland are guaranteed by the Icelandic government but this guarantee has never been enacted into law by the Icelandic Parliament and may be withdrawn by the Icelandic government at any time, which may adversely affect the availability of deposits and therefore have a negative impact on the business and assets of Icelandic banks. Moreover, as current capital controls are lifted, funding of Icelandic banks could be adversely affected by the withdrawal of deposits by customers who are currently unable to do so due to such capital controls. The Icelandic government has stated its intention to manage the exchange controls with a view to mitigating the risk of capital flight from such customers. However, there is no guarantee that the Central Bank will be able to halt capital flight as controls are lifted. In addition, the ability of the Central Bank to manage the controls may be affected by the need for foreign investment to spur economic growth. If the capital control regime is terminated too quickly, or in a manner which fails to

protect the Icelandic financial sector from the negative impact of its removal, Icelandic banks would suffer a material adverse effect.

Further, the growth of foreign currency transactions by Icelandic banks is expected to be limited by continued capital controls. Whilst in June 2015 the Icelandic government announced a plan towards the gradual removal of capital controls and further easing of capital controls is expected in 2016 (see “ - *The Bank's business is materially affected by Iceland's economy which was in recession throughout 2009 and 2010 and, although GDP growth returned in 2012, 2013, 2014 and 2015, Iceland's economy remains vulnerable to a range of internal risks and external shocks*”), capital controls may nevertheless continue to be in place for some time as there is currently no set date for their complete removal and only limited exemptions have been granted so far.

Uncertainty about the quality of the loan assets held by the New Banks and the continued high levels of non-performing loans on their balance sheets is a major risk to the business, financial condition, performance and prospects of Icelandic banks. However, levels of non-performing loans on the balance sheets of the New Banks have declined from 52 per cent. as at 30 June 2010 to 2.1 per cent. as at 31 March 2016. Iceland's New Banks are capitalised with pre-crisis domestic loans extended by the failed banks, many of which are being restructured and many of which may be unrecoverable. During the period from 2003 through 2007, the Old Banks maintained liberal lending policies, and Icelandic households and businesses took on a large amount of debt, of which a large proportion was denominated in, or indexed to the value of, a foreign currency. Prior to October 2008, the Old Banks lent extensively in foreign currency. As a result, a large portion of the assets of the New Banks consist of foreign currency loans to businesses and individuals in Iceland that were made before the financial crisis. As a result of the pre-crisis lending practices of the Old Banks, these borrowers were highly indebted before the crisis, and the subsequent collapse of the krona raised their foreign loan balances sharply. In many cases, these borrowers lack sources of foreign currency income or assets to service their borrowings. The depreciation of the krona and the resulting changes in operating conditions have caused these borrowers financial and operating difficulties. Many borrowers have negotiated deferred payments or have had their loans frozen temporarily, many others are in need of balance sheet restructuring and defaults have escalated. In the current economic climate, it is exceptionally difficult to determine both borrowers' actual capacity to pay and the value of loan collateral. Uncertainty about the quality of the loan book also reflects legal risk regarding loans linked to foreign currencies, especially with respect to commercial loans indexed to a foreign currency, and various adverse judgments by the Supreme Court of Iceland in relation to such loans have resulted in significant impairments being taken by Icelandic banks. As a result, loan recovery is unusually uncertain, in terms of both the amount recoverable and whether loans will be repaid on time.

Levels of non-performing 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 foreign exchange indexed loans. Worldwide financial and economic developments, and particularly financial and economic developments in the United Kingdom and the other European countries that constitute Iceland's main trading partner countries, will also have an effect. If the assets of one or more of the New Banks turn out to be inadequate to sustain the relevant bank's capital adequacy ratios, capital contributions from the Icelandic government will likely be necessary to restore their financial condition. Any such rescue could be costly for the Icelandic government and would represent a major setback for the growth and international acceptance of the new Icelandic banking system.

Iceland's savings banks, which represent a smaller share of the banking system than the commercial banks, have also experienced distress. The total assets of the savings bank system amounted to ISK 22 billion as of 31 December 2015 compared to ISK 627 billion as of 31 December 2007. The biggest factor in this decline was the collapse of Reykjavik Savings Bank (**SPRON**), the largest of the savings banks, which was taken over by the FME in March 2009. **SPRON**'s deposits were subsequently transferred to the Bank, and a bond was issued to the Bank to back up those deposits, secured by the estate of **SPRON** and by an indemnity by

the Icelandic government. Overall, the savings banks have made substantial write-offs due to falling securities prices and anticipated loan losses.

Iceland's new banking system is small and the New Banks have limited opportunities for growth in the near term. Given the existing leverage of Icelandic households and businesses and continuing lack of economic growth, the New Banks are not expected to grow significantly through domestic lending in the near term. It is also unlikely that the New Banks will grow through international operations in the near future. The New Banks have begun to re-establish credit lines with foreign institutions which is beginning to give them access to foreign currency transactions, but on a limited scale. They are unlikely to be able to engage in such transactions to any meaningful degree until capital controls are completely removed, which may not happen for a considerable time as, whilst in June 2015 the Icelandic government announced a plan towards the gradual removal of capital controls and further easing of capital controls is expected in 2016, there is currently no set date for the complete removal of capital controls. If Iceland's banking system does not increase in size and in the strength of its assets and business, or if some or all of the New Banks should collapse, Iceland's economy could be vulnerable to renewed disruptions, cessation or reversal of growth and a deepening recession. The New Banks could also be adversely affected if other developments in the Icelandic economy or in world affairs result in further slowing of growth in Iceland's economy or trigger a deepening recession.

In addition, the guarantee by the Icelandic government of deposits in domestic commercial and savings banks that has been in place since October 2008 has never been enacted into Law by the Icelandic Parliament, and the basis of this guarantee is an announcement from the Prime Minister's Office of 6 October 2008 stating that deposits in domestic commercial and savings banks and their branches in Iceland will be fully covered. This announcement has since been repeated by subsequent Governments and the European Free Trade Association Surveillance Authority has not objected to the guarantee under the EEA State Aid rules to date. It is assumed that the blanket guarantee will be gradually lifted when the banking market, both domestic and foreign, has stabilised. However, a sudden lifting of the guarantee, with or without regulatory intervention, could have an impact on deposit holders and the outflow of deposits held by the Bank.

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 on 20 November 2015, 23 November 2015, and 24 November 2015, respectively. The Glitnir composition agreement was approved by the District Court on 7 December 2015 and became final and binding on 14 December 2015; the Landsbanki composition agreement was approved by the District Court on 18 December 2015 and became final and binding on 25 December 2015; and the Kaupthing 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 each of Glitnir, Landsbanki and Kaupthing to implement their respective composition agreements, the Central Bank has granted them certain exemptions from Icelandic foreign capital controls on the basis that Glitnir, Landsbanki and Kaupthing, have, among other things, made a "stability contribution" to the 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 transfer of its shares in Íslandsbanki), and lower 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 ehf. (**Kaupskil**). However, 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.

The occurrence of any of the factors described above could seriously undermine Iceland's economy and confidence in the banking system in Iceland and could have a material adverse effect on the Bank's business,

financial conditions, results of operations, cash flows and prospects, and its ability to make payments in respect of the Notes.

Existing currency restrictions – Icelandic rules on foreign exchange

On 28 November 2008, the Icelandic Parliament passed Act No. 134/2008 (the **Amending Act**) on Amendments to the Foreign Exchange Act granting the Central Bank powers to intervene in the currency-market with the view of stabilising the foreign exchange rate of the Icelandic krona. For this purpose, the Central Bank issued new Rules on Foreign Exchange no. 1082 of 28 November 2008 (the **Foreign Exchange Rules**). The Foreign Exchange Rules were codified with the adoption of Act No. 127/2011 in 2011 amending the Foreign Exchange Act. The Foreign Exchange Act has since been amended several times. The general regime on currency restrictions is set out in Article 13 of the Foreign Exchange Act.

The Foreign Exchange Rules as codified with certain minor amendments effectively prohibit the outflow of foreign currency from Iceland except in the case of a payment for goods or services. Therefore, all financial transactions leading to currency outflow are prohibited unless explicitly permitted. More specifically these rules include provisions prohibiting certain transactions, including lending and borrowing between resident and non-resident parties, as well as currency-derivatives of any kind and the acquisition by domestic parties of financial instruments denominated in foreign currency. Furthermore, these rules make it compulsory for Icelanders and Icelandic companies to “repatriate” all of their foreign currency.

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

In addition to the general exemptions, the Foreign Exchange Act provides for specific exemptions from the restrictions under this legislation, subject to the Central Bank’s approval. An application of any such exemptions must be made to the Central Bank and this process can take around 8 weeks.

However, in the case of the winding-up, bankruptcy or insolvency of the Bank the exemptions from the Foreign Exchange Act may not apply and, therefore, restrictions will be effected in respect of payments of foreign currency due under the Notes, whether by reason of the Foreign Exchange Act, the Act on Bankruptcy no. 21/1991 or applicable provisions under the Act on Financial Undertakings, which may effectively prohibit the outflow of foreign currency from Iceland.

Subject to the preceding paragraph, the payment by the Bank of interest on the relevant Interest Payment Date and of principal on the relevant Maturity Date will, therefore, be exempt from the restrictions of the Foreign Exchange Act under the general exemption. However, it is not clear whether the general exemption covers prepayments and, therefore, whether it covers the payment of an Early Redemption Amount or an Optional Redemption Amount under the Notes.

Accordingly, the Bank has separately obtained specific exemptions from the Foreign Exchange Act set out in the Central Bank’s letters dated 10 April 2014 and 20 November 2015 which confirms that, subject to the preceding paragraph of this risk factor, the payment of an Early Redemption Amount or an Optional Redemption Amount under the Notes will be exempt from the Foreign Exchange Act. The amendments made in March 2012 by Act No. 17/2012 imposed further restrictions on the outflow of foreign currency. This involved two amendments to the capital controls regime, among others, in response to a perceived increase in circumvention of the capital controls. Before these amendments, an investor could change its interests in the principal amortisation and indexation payments under a Consumer Price Index (**CPI**) indexed annuity bond into foreign currency and transfer such payments out of the economy. This legislation removed the previous exemption provided for such payments and these are now subject to the general capital controls

regime, meaning that only interest payments remain within the exemption. Furthermore, the wide exemptions for payments by the winding-up committees of the failed Icelandic banks to creditors were removed and are now subject to the Central Bank's approval.

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

In May 2014 additional amendments were made to the Foreign Exchange Act 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 are classified as dividends under Article 13 j. (1). Article 16 a. of the Foreign Exchange Act was also amended so that it now provides that fines can be imposed on institutions pursuant to the Foreign Exchange Act or applicable rules thereunder regardless of whether the relevant violation can be linked to the actions of the institution's representative or its employees.

Amendments were made to the Foreign Exchange Act in June 2015 and July 2015. The amendments were made primarily in connection with the conclusion of the winding-up proceedings of the estates of Glitnir, Landsbanki, Kaupthing and other smaller bankrupt 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. After the amendments, the estates are prohibited from (i) purchasing foreign currency other than from domestic banks, (ii) intra group lending and borrowing and (iii) 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 Central Bank's new investment regime. Restrictions were 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 (which was itself further amended in November 2015) which grants the estates exemption from some of the restrictions of the Foreign Exchange Act.

On 25 March 2011, the Central Bank announced a new strategy for the gradual removal of remaining capital controls in phases, each of which is subject to conditions. The three conditions for lifting of controls include: macroeconomic stability, an adequate level of foreign reserves and a sound financial system. In June 2015 the Icelandic government announced a plan towards the gradual removal of capital controls (see “- *The Bank's business is materially affected by Iceland's economy which was in recession throughout 2009 and 2010 and, although GDP growth returned in 2012, 2013, 2014 and 2015, Iceland's economy remains vulnerable to a range of internal risks and external shocks*”). The Icelandic government and the Central Bank have announced that further easing of capital controls is expected in 2016 and will be aimed at individuals and the investments of legal entities.

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

In light of this, prospective investors must consider the risk of further changes to the above capital controls and the impact this may have on an investment in the Notes.

The Bank has a number of significant exposures and its loan portfolio contains a high level of impaired loans and would be materially adversely affected should a customer to which it has a large exposure default or if the level of impairment in its loan portfolio were to increase

The Bank was established as the successor to Kaupthing following its takeover by the FME at the end of 2008. Following the establishment of the Bank, a portfolio of assets and liabilities was transferred to the Bank. These assets and liabilities resulted in significant foreign exchange, interest rate and liquidity mismatches. In addition, the serious recession in Iceland in 2009 and 2010 resulted in a significant increase in non-performing loans and poor asset quality.

The valuation of assets that were transferred to the Bank from Kaupthing attempted to account for all realised and foreseen losses and this has significantly reduced the credit risk that would otherwise have been present in the Bank's loan portfolio. However, the Bank is still exposed to credit risk in its loan portfolio as a result of these transfers relating to the accuracy of the transfer valuation performance of the loans and the extent to which the Bank is successful in restructuring non-performing loans. The Bank also has credit concentrations transferred in a few significant customers and certain business sectors.

In accordance with applicable Icelandic regulations, a large exposure is defined as an exposure to a group of financially related borrowers which exceeds 10 per cent. of a bank's capital base. The legal maximum for individual large exposures is 25 per cent. of a bank's capital base, net of eligible collateral. As at 31 December 2015, the Bank had one large exposure (as defined by Icelandic regulation). Should any of the customers to which the Bank has a large exposure default, this would have a material adverse effect on the Bank's business, financial conditions, results of operations, cash flows and prospects, and its ability to make payments in respect of the Notes.

As at 31 December 2015, 2.5 per cent. of the Bank's customer loans (the **customer loan portfolio**) were classified as problem loans. As at 31 December 2015, the Bank's provisions on its customer loan portfolio amounted to 4.3 per cent. of the total gross amount of the portfolio and 4.7 per cent. of the aggregate amount of customer loans outstanding had been wholly or partially impaired. At 31 December 2015, the value of collateral that the Bank holds relating to loans individually determined to be impaired amounted to ISK 8.1 billion, or 24.2 per cent., of the aggregate carrying amount of such loans.

As at 31 December 2015, the aggregate amount of the Bank's 10 largest customer loans equalled 11.7 per cent. of its total gross customer loans at that date. The Bank's loan portfolio is also highly concentrated in Icelandic borrowers.

The Bank has developed a number of solutions to assist customers that are experiencing payment difficulties. The recovery strategy is based on identifying clusters of similar customers, such as small to medium sized enterprises (**SMEs**) and individuals, and implementing standardised solutions for those customers. In the

case of larger companies, the solutions are tailored to the circumstances of each company. Although significant progress has been made in restructuring the debts of the Bank's largest corporate customers, considerable work remains in relation to the restructuring of the debts of SMEs and individuals, especially in the case of customers with foreign currency loans that have been the subject of court cases. The goal of the corporate restructuring process is to create companies with a healthy capital structure, no covenant breaches, satisfactory operating results and motivated management teams and owners, although no assurance can be given as to the extent to which this can be achieved or that the Bank will not be forced to put a significant number of corporate customers into liquidation, thereby experiencing material losses.

Should a customer to which the Bank has a large exposure default or if the outcome of the restructuring process is that a greater number of loans prove to be non-recoverable in whole or in part than originally anticipated, the Bank's business, financial conditions, results of operations, cash flows and prospects, and its ability to make payments in respect of the Notes, would be materially adversely affected.

The Bank has a high proportion of inflation-linked mortgage loans and there is a risk that legislation might be imposed which varies the terms of these loans in a manner that is adverse to the Bank

A high proportion of the Bank's mortgage loans are inflation-linked. Under these loans, the monthly repayment increases if and to the extent that inflation in Iceland increases. Following the financial crisis in 2008, inflation in Iceland increased significantly. This resulted in higher payments falling due under inflation-linked loans at the same time as borrowers faced lower wages and less purchasing power. There was significant debate in Iceland focused on these loans in the period preceding the parliamentary elections in April 2013. The Icelandic government announced at the end of November 2013 an action plan aimed at reducing the country's housing debt. On the basis of the action plan, the Icelandic Parliament passed two new laws. Firstly, the Parliament passed Act No. 35/2014 on the adjustment of Mortgage Loans. The objective of this Act is to write down the principal of indexed residential mortgages. Secondly, the Parliament passed Act No. 40/2014, which amended the Pension Act No. 129/1997 and authorised households with residential mortgages, in the period between 1 July 2014 and 30 June 2017, to use payments which would otherwise go to a private pension fund to reduce the principal amount of their mortgages. This option is open to all residential mortgage holders regardless of the form of their mortgage. This action plan will be financed by an increase in the Bank Levy (as defined below - see "*Changes in tax laws or in their interpretation could harm the Bank's business*") that will increase the Bank's financial burden and decrease its profitability. There is a risk that additional legislation may be adopted or other government action taken to reduce the payment burden under inflation-linked mortgages. Should this occur, it would have a materially negative impact on the Bank's loan portfolio, financial condition and results of operations.

The Bank is exposed to significant liquidity risk. In particular, the Bank's funding is dominated by deposits and a significant amount of these are on demand. The Bank is also limited in its ability to seek alternative sources of funding

The Bank's primary source of funding is deposits from individuals, corporations and financial institutions. The Bank's liquidity risk stems from the fact that the maturity of its loans exceeds the maturity of its deposits, the majority of which are on demand deposits.

The Bank's total deposit base was ISK 469.4 billion at 31 December 2015. The Bank's other funding at 31 December 2015 was in the form of long-term senior debt and subordinated debt (ISK 256.1 billion and ISK 10.4 billion, respectively, at 31 December 2015) and equity (ISK 192.8 billion at 31 December 2015). As at 31 December 2015, around 57 per cent. of the Bank's deposits were on demand, 20.3 per cent. had a maturity of up to three months, 19.2 per cent. had a maturity of between three and 12 months, 2.9 per cent. had a maturity of between one and five years and 0.4 per cent. had a maturity of more than five years.

On 1 December 2013, new liquidity rules issued by the Central Bank took effect, overriding rules on liquidity and cash ratios that had previously been reported by the Group. The new rules are based on liquidity standards introduced in the Basel III Accord, which began to be implemented in 2015 on a global

level. These standards specify the Liquidity Coverage Ratio (**LCR**), which is the balance between highly liquid assets and the expected net cash outflow of the Group in the following 30 day period under stressed conditions.

As per the LCR methodology, the Group'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 Group and the amount is covered by the Depositors' and Investors' Guarantee Fund, which is a fund set up in Iceland pursuant to the provisions of Act No. 98/1999 and which guarantees a minimum level of protection to depositors in commercial banks and savings banks, and to customers of companies engaging in securities trading pursuant to law. Other deposit funds are considered less stable. A weight is attributed to each category, representing the expected outflow under stressed conditions.

According to the LCR classification, 56.8 per cent. of the Bank's deposits as at 31 December 2015 are categorised as "less stable" while deposits classified as "stable" or "term deposits" represent 10 and 33.2 per cent, respectively of all deposits. Deposits from financial entities being wound up represent 13.3 per cent. of total deposits and deposits from pension funds and domestic financial entities represent 16 and 9.1 per cent, respectively, of total deposits.

The Bank's strategy is to seek to increase the maturity profile of its liabilities and to strengthen the Bank's liquidity reserve. The Bank has made significant progress in converting its on demand deposits to term deposits. At 31 December 2009, over 90 per cent. of the Bank's deposits were on demand compared to 57 per cent. at 31 December 2015. However, no assurance can be given that the Bank will continue to be successful in so converting its base deposits or will otherwise be able to increase the maturity profile of its funding.

The Bank's non-deposit funding principally comprises medium term note and covered bond issues (including covered bonds previously issued by Kaupthing and assured by the Bank in January 2012), other loans (including subordinated loans from the Icelandic state, a loan from the Central Bank, senior unsecured bond offerings denominated in euro, Norwegian krone (**NOK**) and U.S. dollars) and equity funding.

For so long as the Bank is unable to match more closely the maturity profiles of its assets and liabilities, the Bank will continue to be exposed to a material risk that it may be unable to repay its funding or will only be able to do so at excessive cost. The Bank is also exposed to the risk that it experiences a material loss of its least stable deposits in the future. In either of these cases, the Bank's business, financial conditions, results of operations, cash flows and prospects and its ability to make payments in respect of the Notes would be materially adversely affected.

The Bank is exposed to significant foreign exchange risk through a currency mismatch between its assets and liabilities and through legal uncertainties relating to certain foreign currency loans

The Bank is primarily exposed to currency risk through a currency mismatch between its assets and liabilities, given that it has a greater proportion of foreign currency denominated assets on its balance sheet than foreign currency denominated liabilities.

The Bank's strategy for reducing its currency imbalance is first to seek to convert into ISK foreign currency denominated loans to customers who have ISK income and second to hedge its other currency imbalances, principally through agreements with the Central Bank and other counterparties. Notwithstanding the foregoing, for so long as the Bank is unable to match more closely the currencies of its assets and liabilities, the Bank will continue to be exposed to a material risk that it may experience significant losses as a result of changes in currency exchange rates.

Currently, the legitimacy of certain types of loans remains unclear. In a series of judgments since 2010, the Supreme Court of Iceland has held that certain types of foreign currency-linked loans and lease agreements

with SMEs were in fact loans in Icelandic krona and indexed to a foreign currency exchange rate. As a result, these loans were held to be in breach of applicable Icelandic legislation relating to interest and price indexation. Following these judgments, the Bank recalculated approximately 2,000 retail and corporate foreign currency indexed ISK loans as ISK denominated loans. This recalculation of foreign currency-linked loans was finalised in 2013.

The recalculation of foreign currency-linked loans adversely affected the Bank's results of operations and financial position in 2011, 2012 and 2013. There remains uncertainty regarding these loans in three respects:

- estimation uncertainty in relation to the types of loan covered by the Supreme Court of Iceland judgments and with respect to the assumptions used in the method of recalculation of recalculated loans;
- there are differing views as to the rate of interest that should be paid with respect to recalculated loans from the date of their recalculation; and
- there may be future cases or new legislation in respect of other categories of loan not currently considered to be vulnerable by the Bank.

Reflecting this uncertainty, there is no assurance that the Bank will not make further material impairment provisions in respect of its customer loans during 2016 and future years. Any such provisions could materially adversely affect the Bank's results of operations and financial condition, and therefore impact its ability to make payments in respect of the Notes.

The Bank is exposed to a range of other typical market risks, including interest rate risk, equity price risk and inflation risk

The Bank's exposure to market risk arises from imbalances in 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 in the Bank's balance sheet but to accept limited market risk in its trading book. The market risk in the trading book arises from proprietary trading activities whereas market risk in the banking book arises from mismatches in assets and liabilities principally in relation to currencies, maturities and interest rates. The Bank principally trades Icelandic treasury notes and housing fund bonds and, to a limited extent, listed equity securities. 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 on 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.

In relation to its balance sheet, the Bank's operations are subject to interest rate risk associated with mismatches between its interest bearing assets and its interest bearing liabilities. The principal mismatch is the large maturity gap resulting from the fact that the Bank has significant on demand liabilities. The Bank also faces interest rate risk between its interest bearing assets and interest bearing liabilities due to different floating rate calculations in different currencies. The Bank's own account equity price risk principally arises as a result of the fact that, through the loan restructuring process, it has acquired significant shareholdings in troubled companies. The Bank is exposed to inflation risk when there is a mismatch between its inflation-linked assets and liabilities. As at 31 December 2015, the total amount of the Bank's inflation-linked assets was ISK 311.6 billion and the total amount of its inflation-linked liabilities was ISK 216.6 billion. The Bank also has significant maturity mismatches in its inflation-linked assets and liabilities. Whilst the Bank has implemented a range of risk management procedures designed to control these risks, 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.

Any losses experienced by the Bank as a result of its market risk exposures could materially adversely affect the Bank's business, financial conditions, results of operations, cash flows and prospects and its ability to make payments in respect of the Notes.

While the Bank seeks to manage its operational risks, these risks remain an inherent part of its business

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 is dependent on processing numerous complex transactions. The recording and processing of these transactions are potentially exposed to the risk of human and technological errors 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 there can be no assurance that risk assessments made in advance will adequately estimate the costs of these errors.

The Bank has implemented controls designed to mitigate operational risks but these controls cannot eliminate such risks and failures in internal control could subject the Bank to regulatory scrutiny. These events could potentially result in financial loss as well as harm to the Bank's reputation.

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, or that they will be misunderstood, not implemented correctly or misapplied by the Bank's personnel. 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. The Bank's more qualitative approach to managing risks takes into account a broader set of risks, but is less precise than quantified modelling and could prove insufficient. Unanticipated or incorrectly quantified risk exposures could have a material adverse effect on the Bank's business, financial condition and results of operations, and its ability to make payments in respect of the Notes.

The Bank is exposed to competition, principally from other large Icelandic banks, and expects that this competition will increase as Iceland's economy recovers

The Bank currently faces competition from the two other large commercial banks in Iceland, Landsbankinn and Íslandsbanki. The Bank also faces competition domestically from the Housing Financing Fund, a provider of financing for residential housing in Iceland (see "*Financial Markets in Iceland – Other relevant institutions*"). As Iceland's economy recovers and demand for new lending and other banking products increases, the Bank expects to face increased competition from both the other large Icelandic banks and smaller specialised institutions as well as, potentially, foreign banks seeking to establish operations in Iceland.

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. If the Bank is unable to compete

effectively in the future in any market in which it has a significant presence, this could adversely affect its business, results of operations and prospects.

The Bank is exposed to the risk of failure of its information technology (IT) systems and breaches of its security systems

The Bank relies on the proper functioning and continuity of its IT systems. Any significant interruption, degradation, failure or lack of capacity of its IT systems or any other systems in its clearing operations or elsewhere could cause it to fail to complete transactions on a timely basis or at all. A sustained failure of the Bank's IT systems centrally or across its branches would have a significant impact on its operations and the confidence of its customers in the reliability and safety of its banking systems.

The secure transmission of confidential information is a critical element of the Bank's operations. The Bank cannot guarantee that its existing security measures will prevent security breaches, including break-ins, viruses and disruptions. Persons that circumvent the security measures could use the Bank's or its clients' confidential information wrongfully, which could expose it to a risk of loss, adverse regulatory consequences or litigation.

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

The Bank's operations entail considerable regulatory and legal risk, including litigation and liability risk. The Bank and certain of its subsidiaries are subject to government regulation and supervision as financial companies in Iceland, and regulations may be extensive and may change rapidly, as they have done since the global financial crisis. In addition, certain of the Bank's and its subsidiaries' operations are contingent upon licences issued by financial authorities.

Violations of rules and regulations, whether intentional or unintentional, may lead to the withdrawal of some of these licences or to liability claims. Any breach of these or other regulations 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, which could adversely affect the way the Bank operates its business and its market reputation.

The Bank is also exposed to legal risks in its role as a financial intermediary and consultant to third party businesses. 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 trading transactions will claim that the Bank failed to properly inform them of the associated risks or that they were not authorised or permitted to enter into these transactions with the Bank and that their obligations are therefore not enforceable. The Bank is also exposed to customer claims, including significant claims in relation to loans advanced by its predecessor, Kaupthing. See "*The Bank is involved as defendant in ongoing litigation which, if determined adversely to the Bank, could result in significant losses. In addition, the Bank is a plaintiff in a case which, if not successful, could have a material adverse effect on the Bank's results of operations*".

The Bank may also be subject to claims arising from disputes with employees for, among other things, alleged illegal dismissal, discrimination or harassment. These risks may often be difficult to assess or quantify and their existence and magnitude often remain unknown for substantial periods of time. Liability resulting from any of the foregoing or other claims could have a material adverse effect on the Bank's business, financial condition and results of operations, and its ability to make payments in respect of the Notes.

The Bank is involved as defendant in ongoing litigation which, if determined adversely to the Bank, could result in significant losses. In addition, the Bank is a plaintiff in a case which, if not successful, could have a material adverse effect on the Bank's results of operations

The Bank is involved as defendant in a number of cases, including:

- cases concerning the legality of foreign currency-linked loans owed to the Bank; and
- competition claims by the Icelandic Competition Authority (**ICA**), see "*The Bank is subject to investigations by the ICA in relation to alleged abuse of a dominant position and any determination that the Bank has violated the law could result in fines or business restrictions*".

Should any of the cases described above be determined adversely to the Bank, this could have a material adverse effect on its results of operations and financial condition, and therefore impact its ability to make payments in respect of the Notes. See "*Description of the Bank – Litigation*".

The Bank is subject to investigations by the ICA in relation to alleged abuse of a dominant position and any determination that the Bank has violated the law could result in fines or business restrictions

The ICA has opened the following formal investigations concerning the Bank:

- an investigation into the alleged abuse of an alleged collective dominant position by the three largest retail banks in Iceland, including the Bank. The investigation was initiated by separate complaints from BYR hf., MP banki hf. and an insurance company in 2010. The complaints from BYR hf. and MP banki hf. concern the terms of the banks' mortgage arrangements, which, according to the complaint, deter individuals from moving their business to other banks and thereby restrict competition; and
- with a writ issued in June 2013, Kortapjónustan hf. (**Kortapjónustan**) claimed damages of ISK 1.2 billion plus interest from the Bank, Íslandsbanki, Landsbanki, Borgun hf. and Valitor Holding hf., as a result of losses Kortapjónustan contends the five parties caused the company due to violations of the Competition Act. The Bank has put forward its arguments in the case and has requested that Kortapjónustan's claims be rejected. The case has been put on hold as Kortapjónustan's court-appointed evaluator prepares its report on Kortapjónustan's alleged loss.

The Bank has made objections to all of the complaints. The extent of the investigations and outcome of the cases is still uncertain as well as any effect on the Bank, although if the Bank is found to have violated the law it could be subject to fines or future restrictions on its business activities, either of which could materially adversely affect its results of operations, financial condition and reputation.

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

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. The unavailability of tax rulings could diminish the range of structured transactions the Bank can enter into with its clients.

In December 2010, the Icelandic Parliament passed a new law (Act No. 155/2010) under which certain types of financial institution, including the Bank, are required to pay an annual levy (the **Bank Levy**) calculated at 0.041 per cent. of the carrying amount of their liabilities as determined for tax purposes, with effect from the year ending 31 December 2010. In December 2011, a transitional provision was introduced under which financial institutions, including the Bank, must pay an additional 0.0875 per cent. of their tax base as assessed for the years 2012 and 2013. In late 2013, the Bank Levy was further increased in order to finance a government plan on household debt relief in relation to inflation-linked mortgage loans (see "*The Bank has a high proportion of inflation-linked mortgage loans and there is a risk that legislation might be imposed*").

which varies the terms of these loans in a manner that is adverse to the Bank”). The Bank Levy for the year 2013 was 0.376 per cent. on the total debt of the Bank excluding tax liabilities in excess of ISK 50 billion at end of the year. Non-financial subsidiaries are exempt from the Bank Levy. For the year 2012 the Bank Levy was 0.1285 per cent. on the total debt of the Bank excluding tax liabilities. There can be no assurance that the Bank Levy may not be increased further in the future, including in the event the 2013 increase in the Bank Levy is insufficient to meet the costs of the above government plan on household debt relief or such relief does not result in a sufficient reduction in the payment burden for the borrowers concerned and any such increase could have a material adverse effect on the financial condition of the Bank.

In June 2009, the Icelandic Parliament adopted an amendment to the income tax law as a result of which payments of Icelandic sourced interest by an Icelandic debtor (such as the Bank) to a foreign creditor (including holders of Notes who are not Icelandic) is taxable in Iceland and can be subject to withholding tax at the rate of 10 per cent. This withholding is applicable unless the foreign creditor can demonstrate and obtain approval from the Icelandic Inland Revenue that an exemption applies, such as the existence of a relevant double taxation treaty (and in such a case the provisions of the double tax treaty will apply). Also exempt are bonds issued by certain financial institutions (including the Bank) and energy companies. Subject to certain other requirements, the exemption applies to bonds that are held through a clearing system (such as the Icelandic Securities Depository, Euroclear and Clearstream, Luxembourg) within a member state of the Organisation for Economic Co-operation and Development (the **OECD**), the EEA, a founding member state of European Free Trade Association or the Faroe Islands.

In December 2011, the Icelandic Parliament passed a new law (Act No. 165/2011) under which certain types of financial institution, including the Bank, were required to pay a special additional 5.45 per cent. tax levied on all remuneration paid to employees, with effect from 1 January 2012. This levy was subsequently raised to 6.7 per cent. but has since been lowered and as of 1 January 2014 the levy has been set at 5.5 per cent of such remuneration.

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

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

The introduction of new rules in Iceland reflecting CRD IV and the CRR could limit the Bank's ability to effectively manage its capital requirements. These and other changes to capital adequacy and liquidity requirements imposed on the Bank may require the Bank to raise additional tier 1, core tier 1 and tier 2 capital by way of further issuances of securities and could result in existing tier 1 and tier 2 securities ceasing to count towards the Bank's regulatory capital, either at the same level as at present or at all. 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 may have a material adverse effect on the Bank's financial condition and results of operations and may also have other effects on the Bank's financial performance and on the pricing of the Notes, both with or without the

intervention by regulators or the imposition of sanctions. Prospective investors in the Notes should consult their own advisers as to the consequences of the implementation of CRD IV and the CRR in Iceland.

Catastrophic events, terrorist attacks and other acts of war could have a negative impact on the Bank's business

Catastrophic events, terrorist attacks, other acts of war or hostility, and responses to those acts may create economic and political uncertainties, which could have a negative impact on economic conditions in Iceland and, more specifically, on the Bank's business, financial condition, results of operations, cash flows and prospects, in ways that cannot be predicted.

The Bank may be unable to recruit or retain experienced and qualified personnel and is dependent on key members of management

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 is significant, due to the relatively small number of available qualified individuals. The geographical location of employment in Iceland may also make employment by the Bank less attractive to a large portion of potential applicants.

The loss of the services of key members of the Bank's senior management or staff with institutional and client knowledge may significantly delay the Bank's achievement of its business objectives and could have a material adverse effect on its business and prospects.

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, there can be no assurance that the coverage that the Bank maintains is adequate to cover the losses for which it believes it is insured.

The Bank's accounting policies and methods are critical to how it reports its financial condition and results of operations. They require management to make estimates about matters that are uncertain

Accounting policies and methods are fundamental to how the Bank records and reports its financial condition and results of operations. Management must exercise judgment in selecting and applying many of these accounting policies and methods so they comply with IFRS.

Management has identified certain accounting policies in the notes to its financial statements as being critical because they require management's judgement to ascertain the valuations of assets, liabilities, commitments and contingencies. See note 2 to the 2015 Consolidated Financial Statements.

A variety of factors could affect the ultimate value that is obtained either when earning income, recognising an expense, recovering an asset or reducing a liability. The Bank has established detailed policies and control procedures that are intended to ensure that these critical accounting estimates and judgements are well controlled and applied consistently. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. Because of the uncertainty surrounding the Bank's judgements and the estimates pertaining to these matters, the Bank cannot guarantee that it will not be required to make changes in accounting estimates or restate prior period financial statements in the future.

Abnormal pricing as a consequence of capital controls

The currency controls described in "*Existing currency restrictions – Icelandic rules on foreign exchange*" mean that domestic parties, primarily investors, are restricted from transferring their funds and investing outside of the Icelandic market unless such funds are considered re-investible funds pursuant to Articles 13e and 13f the Foreign Exchange Act. Consequently they are confined to and must focus their investments on Iceland, which entails various risks, including a risk for abnormal pricing and financial bubbles occurring within several sectors of the Icelandic market. This applies both to investments in shares of listed and un-listed companies, investment funds, various other financial instruments, and real-estate (primarily commercial) and may have a negative impact on the Bank's business.

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 Notes, issued by a financial institution such as the Bank which holds bank deposits are subordinated to Article 101 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 Noteholders after the claims of those depositors have been paid.

The Council of the European Union has published revised proposals for a bank recovery and resolution directive which is intended to enable a range of actions to be taken in relation to credit institutions and investment firms considered to be at risk of failing. The full scope of the directive and its impact on the Bank is currently unclear but the implementation of the directive or the taking of any action under it 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**). On 27 November 2013, the EFTA Working Group on Financial Services stated that "it would appear that [the proposal represented by the June 2012 draft of the BRRD] may be deemed EEA relevant and thus likely to be incorporated into the EEA Agreement once adopted by the EU side." A committee has been established, charged with the task of preparing new legislation implementing the BRRD in Iceland. However, as at the date of this Base Prospectus, the proposed new legislation has not been put before the legislator. The BRRD is designed to provide authorities with a credible set of tools to intervene sufficiently early and quickly in an unsound or failing institution so as to ensure the continuity of the institution's critical financial and economic functions, while minimising the impact of an institution's failure on the economy and financial system.

The BRRD provides that it will be applied by Member States from 1 January 2015, except for the general bail-in tool (see below) which has 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) an institution is failing or likely to fail, (b) there is no reasonable prospect that any alternative private sector measures would prevent the failure of such institution 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 firm or the whole or part of its business on commercial terms; (ii) bridge institution - which enables resolution authorities to transfer all or part of the business of the firm to a "bridge institution" (an entity created for this purpose that is wholly or partially in public control); (iii) asset separation - which enables resolution authorities to transfer impaired or problem assets to 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 institution and to convert certain unsecured debt claims (including Notes) to equity (the **general bail-in tool**), which equity 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.

An institution 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).

The powers currently set out in the BRRD will impact how credit institutions and investment firms are managed as well as, in certain circumstances, the rights of creditors. Once the BRRD is implemented in Iceland, holders of Notes may be subject to write-down or conversion into equity on any application of the general bail-in tool, which may result in such holders losing some or all of their investment. The exercise of any power under the BRRD 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.

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

Iceland is obligated to implement certain EU instruments with EEA relevance, including legislation relating to financial markets, as a member state of the EEA. Where implementation of such instruments into Icelandic law is inadequate, i.e. Iceland has failed to adapt national law to conform to EEA rules, citizens may be unable to rely on them and the Icelandic courts barred from applying them (unless Icelandic legislation may be interpreted to conform with the relevant EEA rules). As a result Noteholders may not, in all circumstances, enjoy the same legal protection they would expect as holders of securities issued by issuers in EU member states where EU instruments are directly applicable or have been adequately implemented into national legislation.

FACTORS 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 is likely to limit the market value of Notes. During any period when the Bank may elect to redeem 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.

The Bank may be expected to redeem Notes when its cost of borrowing is lower than the interest rate on the Notes. At those times, an investor generally would not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the 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 Bank has the right to convert the interest rate on any Notes 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 may bear interest at a rate that converts from a fixed rate to a floating rate, or from a floating rate to a fixed rate. Where the Bank has the right to effect such a conversion, this will affect the secondary market in, and the market value of, the Notes since the Bank may be expected to convert the rate when it is likely to result in a lower overall cost of borrowing for the Bank. If the Bank converts from a fixed rate to a floating rate in such circumstances, 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. If the Bank converts from a floating rate to a fixed rate in such circumstances, the fixed rate may be lower than then prevailing market rates.

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.

Risks related to Notes generally

Set out below is a description of material risks relating to the Notes generally:

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.

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 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 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 6 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 depository 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 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. 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.

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 involves the risk that if market interest rates subsequently increase above the rate paid on the Fixed Rate Notes, this will adversely affect the value of the Fixed Rate 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 EU and registered under the CRA Regulation (and such registration has not been withdrawn or suspended), subject to transitional provisions that apply in certain circumstances whilst the registration application is pending. Such general restriction will also apply in the case of credit ratings issued by non-EU credit rating agencies, unless the relevant credit ratings are endorsed by an EU-registered credit rating agency or the relevant non-EU rating agency is certified in accordance with the CRA Regulation (and such endorsement action or

certification, as the case may be, has not been withdrawn or suspended). The list of registered and certified rating agencies published by the European Securities and Markets Authority (**ESMA**) on its website in accordance with the CRA Regulation is not conclusive evidence of the status of the relevant rating agency included in such list, as there may be delays between certain supervisory measures being taken against a relevant rating agency and the publication of the updated ESMA list. Certain information with respect to the credit rating agencies and ratings 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 2015 Consolidated Financial Statements and the 2014 Consolidated Financial Statements, including the information set out at the following pages of the 2015 Consolidated Financial Statements and the 2014 Consolidated Financial Statements, respectively, in particular:

	2015 Consolidated Financial Statements	2014 Consolidated Financial Statements
Consolidated Statement of Financial Position	Page 9	Page 8
Significant Accounting Policies	Pages 69 to 78	Pages 66 to 76
Consolidated Statement of Cash Flows....	Pages 11 to 12	Page 11
Consolidated Statement of Comprehensive Income.....	Page 8	Page 8
Consolidated Statement of Changes in Equity.....	Page 10	Page 10
Notes.....	Pages 13 to 78	Page 13 to 76
Independent Auditors' Report	Page 7	Page 7

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 unaudited consolidated interim financial statements as at and for the three month period ended 31 March 2016, in particular:

Interim Consolidated Statement of Comprehensive Income.....	Page 5
Interim Consolidated Statement of Financial Position	Page 6
Interim Consolidated Statement of Changes in Equity	Page 7
Interim Consolidated Statement of Cash Flows.....	Page 8 to 9
Significant Accounting Policies.....	Page 54
Notes.....	Page 10 to 53

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.

The non-incorporated parts of the documents referred to herein 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 <http://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 depository (the **Common Depository**) 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 and subject, in the case of definitive Notes, to such notice period as is specified 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 either (a) not less than 60 days' written notice from Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Global Note) to the Fiscal Agent as described therein or (b) only upon the occurrence of an Exchange Event or (c) at any time at the request of the Bank. For these purposes, **Exchange Event** means that (i) an Event of Default (as defined in Condition 8) 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 12 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 8. 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 5 June 2015 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.

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

**Issue of [Aggregate Nominal Amount of Tranche] [Title of Notes]
under the €2,000,000,000
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 7 June 2016 [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 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 an *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 [original date] [and the supplement to it dated [date]] which are incorporated by reference in the Base Prospectus dated 7 June 2016. 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 7 June 2016 [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 17 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]
[[[] month
[LIBOR/EURIBOR/NIBOR/STIBOR/REIBOR/CIBOR
]] +/- [] per cent. Floating Rate]
[Zero coupon]
(see paragraph [12]/[13]/[14]below)
9. Redemption/Payment Basis: Subject to any purchase and cancellation or early redemption, the Notes will be redeemed on the Maturity Date at [] 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 [12/13] applies and for the period from (and including) *[date]*, up to (and including) the Maturity Date, paragraph [12/13] applies][Not Applicable]
11. Put/Call Options: [Issuer Call]
[Not Applicable]

[(see paragraph [15]/[16] below)]

PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE

12. 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)
13. 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:
- Reference Rate: [currency][] month [LIBOR/EURIBOR/NIBOR/STIBOR/REIBOR/CIBOR].
 - 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)
 - 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:
- Floating Rate Option: []
 - Designated Maturity: []
 - Reset Date: []
(In the case of a LIBOR or EURIBOR based option, the first day of the Interest Period)
- (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][Bond Basis] [30E/360][Eurobond Basis] 30E/360 (ISDA)]
14. 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

15. 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)
16. 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)

GENERAL PROVISIONS APPLICABLE TO THE NOTES

17. Form of Notes:

(a) Form:

[Temporary Global Note exchangeable for a Permanent Global Note which is exchangeable for Definitive Notes [on 60 days' notice given at any time/only upon an Exchange Event]]

[Temporary Global Note exchangeable for Definitive Notes on and after the Exchange Date]

[Permanent Global Note exchangeable for Definitive Notes [on 60 days' notice given at any time/only upon an Exchange Event/at any time at the request of the Bank]]

[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 2005.¹]

(N.B. The exchange upon notice/at any time options 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]." Furthermore, such Specified Denomination construction is not permitted in relation to any issue of Notes which is to be represented on issue by a Temporary Global Note exchangeable for Definitive Notes.)

(b) New Global Note:

[Yes][No]

18. 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 13(c) relates)

19. 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]

¹ Include for Notes that are to be offered in Belgium.

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:

Duly authorised

By:

Duly authorised

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/] 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 [[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 **CRA Regulation**).]

(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 only)

Indication of yield: []

5. OPERATIONAL INFORMATION

(i) ISIN: []

(ii) Common Code: []

(iii) 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)]

(iv) Delivery: Delivery [against/free of] payment

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

[(vi) Intended to be held in a manner which would allow Eurosystem eligibility: [Yes. 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 [Not Applicable/give names]

Managers:

- (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]

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 23 April 2014 as supplemented by a supplemental agency agreement dated 5 June 2015 and a second supplemental agency agreement dated 7 June 2016 (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, including by Directive 2010/73/EU), 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 5 June 2015 and made by the Bank. The original of the Deed of Covenant is held by the common depository 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 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.

Definitive Notes are issued with Coupons attached, unless they are Zero Coupon Notes in which case references to Coupons and Couponholders in the 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 S.A./N.V. (**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 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.

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 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 day which is both:

- (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 "Bond 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:

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

where:

"Y₁" is the year, expressed as a number, in which the first day of the Interest Period falls;

"Y₂" is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"M₁" is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

"M₂" is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"D₁" is the first calendar day, expressed as a number, of the Interest Period, unless such number is 31, in which case D₁ will be 30; and

"D₂" 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 D₁ is greater than 29, in which case D₂ 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:

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

where:

"Y₁" is the year, expressed as a number, in which the first day of the Interest Period falls;

"Y₂" is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"M₁" is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

"M₂" is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"D₁" is the first calendar day, expressed as a number, of the Interest Period, unless such number would be 31, in which case D₁ will be 30; and

"D₂" 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 D₂ 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:

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

where:

"Y₁" is the year, expressed as a number, in which the first day of the Interest Period falls;

"Y₂" is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"M₁" is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

"M₂" is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

"D₁" 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 D₁ will be 30; and

"D₂" 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 D₂ 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 12 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 12. 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.

3.3 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 12.

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 6 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 (without prejudice to the provisions of Condition 6) 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 6) in respect of such principal (whether or not such Coupon would otherwise have become void under Condition 7) 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 7) 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, the relevant place of presentation;
 - (ii) each Additional Financial Centre (other than TARGET2 System) specified in the applicable Final Terms; and

- (iii) 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
- (b) 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 6;
- (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 6.

5. REDEMPTION AND PURCHASE

5.1 Redemption at maturity

Unless previously redeemed or purchased and cancelled as specified below, each Note will be redeemed by the Bank at its Final Redemption Amount of at least 100 per cent. 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, 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 12, the Noteholders (which notice shall be irrevocable), if:

- (a) 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 6 as a result of any change in, or amendment to, the laws or regulations of a Tax Jurisdiction (as defined in Condition 6) or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the date on which agreement is reached to issue the first Tranche of the Notes; and
- (b) such obligation 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 on which the Bank would be obliged to pay such additional amounts 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 advisers of recognised standing to the effect that the Bank has or will become obliged to pay such additional amounts 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)

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 12 (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 12 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 and Condition 8:

- (a) 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

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 8 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 12.

6. 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).

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 12.

7. 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 6) 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.

8. EVENTS OF DEFAULT

8.1 Events of Default

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 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.

8.2 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.

9. 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.

10. 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 12.

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.

11. 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 7.

12. 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. 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) 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 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.

13. 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 12 as soon as practicable thereafter.

14. 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.

15. 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.

16. GOVERNING LAW AND SUBMISSION TO JURISDICTION

16.1 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.

16.2 Submission to jurisdiction

- (a) Subject to Condition 16.2(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 16.2, 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.

16.3 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.

16.4 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.

16.5 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.

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 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. Kaupthing, through its subsidiary Kaupskil, holds an 87 per cent. stake in the Bank and the Ministry of Finance and Economic Affairs holds the remaining 13 per cent. 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 (see "*Risk Factors – Iceland's banking sector is in the process of being restructured and remains subject to considerable risks. Should any of these risks materialise the Bank could be materially and adversely affected, either directly or by association should the risks primarily materialise in relation to other Icelandic banks*"). 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

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

¹ <http://sedlabanki.is/lisalib/getfile.aspx?itemid=848>

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 Central Bank and the Iceland Stock Exchange

At the beginning of 1999, the Bank Inspectorate of the Central Bank and the Insurance Supervisory Authority were merged into a new independent entity, the Financial Supervisory Authority (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.

The Central Bank (www.sedlabanki.is) is responsible for implementing monetary policy consistent with the goal of maintaining price stability. The activities of the Central Bank are primarily governed by Act No. 36/2001, on The Central Bank. The 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 Central Bank also oversees surveillance of the rules on foreign exchange. See “*Risk Factors - Existing currency restrictions – Icelandic rules on foreign exchange*” and “*Risk Factors - The Bank’s business is materially affected by Iceland’s economy which was in recession throughout 2009 and 2010 and, although GDP growth returned in 2012, 2013, 2014 and 2015, Iceland’s economy remains vulnerable to a range of internal risks and external shocks*”).

The Iceland Stock Exchange (NASDAQ OMX 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.

DESCRIPTION OF THE BANK

OVERVIEW

Arion Bank hf. is the entity to which certain assets and liabilities of Kaupthing were transferred following the assumption of control of Kaupthing by the Icelandic government towards the end of 2008. The Bank was established on 18 October 2008 and is incorporated in Reykjavik and domiciled in Iceland. It is a public limited company established 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.

The Bank faced a number of challenges following its establishment. In particular, the assets and liabilities acquired by the Bank resulted in significant foreign exchange, interest rate and liquidity mismatches. In addition, an asset shortfall of ISK 38.3 billion resulted in a priority claim on Kaupthing, see "*—Related Party Transactions*". Further, a serious recession in Iceland in 2009 and 2010 resulted in significant non-performing loans and poor asset quality.

To address these risks, the Bank has focused on restructuring its loan portfolio and expanding its sources of funding as well as reducing other mismatches and maintaining high levels of liquidity and capital. In addition, a strategic plan was adopted in October 2010 which seeks to position the Bank as a universal bank providing a range of quality services and focuses on improving the Bank's competitiveness.

Since 2011, the Bank has made significant progress in loan restructuring and has completed the majority of this work, although it expects that some personal and corporate borrowers will continue to require assistance for some time.

As a result of debt restructurings and other enforcement procedures, the Bank has in recent years acquired a significant amount of assets (largely in the form of shareholdings in companies). Since 2012, the Bank has made steady progress in the sale of companies acquired as a result of these collateral enforcement procedures and has now sold most of these companies (see "*- Asset Holding Companies*" and "*- Asset Portfolio Disposals*").

In the year ended 31 December 2015, the Bank's net interest income was ISK 26.9 billion (compared to ISK 24.2 billion in 2014), its operating income was ISK 86.6 billion (compared to ISK 54.0 billion in 2014) and its net earnings were ISK 49.7 billion (compared to ISK 28.6 billion in 2014). As at 31 December 2015, the Bank's total assets were ISK 1,011.1 billion.

In the three month period ended 31 March 2016, the Bank's net interest income was ISK 7.3 billion (compared to ISK 5.8 billion in the three month period ended 31 March 2015), its operating income was ISK 12.1 billion (compared to ISK 21.8 billion in the three month period ended 31 March 2015) and its net earnings were ISK 2.9 billion (compared to ISK 14.9 billion in the three month period ended 31 March 2015). As at 31 March 2016, the Bank's total assets were ISK 1,029 billion.

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

HISTORY

The Bank was established at the end of 2008 as the vehicle to receive the transfer of certain assets and liabilities of Kaupthing following the Icelandic government assuming control over Kaupthing towards the end of 2008. Kaupthing was the product of a merger in May 2003 of two of Iceland's then leading banks, Kaupthing Bank hf. and Bunadarbanki Islands hf. (**Bunadarbanki**). Bunadarbanki was established in 1929 by a law passed by the Icelandic parliament, the Althingi. At the beginning of 1998, Bunadarbanki became a

limited liability company and was privatised in stages up to the beginning of 2003. Kaupthing hf. was established in Reykjavik in 1982, coinciding with the launch of the free capital market in Iceland. Kaupthing hf. later became an investment bank before its merger with Bunadarbanki in 2003.

In July 2009, the Icelandic government and the resolution committee of Kaupthing (the **Kaupthing Resolution Committee**) reached agreement on the valuation of the assets transferred to the Bank through the issue of a compensation instrument by the Bank to Kaupthing. In addition, the agreement identified certain ring-fenced assets in respect of which Kaupthing's creditors were accorded a share in certain future increases of value through an escrow and contingent rights agreement (the **ECVRA**) and creditors (through the Kaupthing Resolution Committee) were also granted an option to purchase up to 87 per cent. of the Bank's equity, see "*—Related Party Transactions*".

In March 2009, following a ruling from the FME, the Bank acquired all the deposits and card transactions of over 20,000 customers from SPRON. The operations of the six SPRON branches and its online bank were discontinued following the acquisition. In April 2009, the Bank acquired Mýrasýsla Savings Bank (**SPM**) in Borgarnes and merged SPM with its branch in Borgarnes, increasing its customer base by a further 2,000 clients.

In December 2009, the Kaupthing Resolution Committee acting through Kaupskil, a wholly-owned subsidiary of Kaupthing, exercised its option to acquire shares in the Bank and, following a capital injection in January 2010, Kaupthing is currently the owner of 87 per cent. of the Bank with the Icelandic government owning the remaining 13 per cent.

In March 2010 a new board of directors (the **Board**) was appointed at the Bank's annual general meeting and, on 1 June 2010, the Board appointed a new chief executive officer (**CEO**).

On 30 June 2011, the Bank and Kaupthing executed a settlement agreement under which the compensation instrument and the ECVRA were both discharged.

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 Bonds**) under the covered bond programme established by Kaupthing on 30 March 2006 (the **Kaupthing Covered Bond Programme**). As a part of this acquisition, the Bank was substituted for, and has 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 Bonds. The Kaupthing Covered Bonds are inflation-linked with final maturities between 2033 and 2048, and have an aggregate face value of approximately ISK 92.5 billion.

The Bank paid an agreed cash consideration to the Kaupthing Resolution Committee in connection with its acquisition of the Fund. The mortgage portfolio which the Bank now holds following the acquisition of all of the units in the Fund was valued at ISK 110 billion when it was acquired.

KAUPTHING

In October 2008, Kaupthing was taken into a special resolution regime (see "*Risk Factors - The Bank's business is materially affected by Iceland's economy which was in recession throughout 2009 and 2010 and remains vulnerable to external shocks and a range of internal risks*"), and the Kaupthing Resolution Committee was appointed by the FME.

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 has 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 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 Central Bank (see "*Risk Factors - Iceland's banking sector is in the process of being restructured and remains subject to considerable risks. Should any of these risks materialise the Bank could be materially and adversely affected, either directly or by association should the risks primarily materialise in relation to other Icelandic banks*").

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 Central Bank on 22 January 2010 (such loan having been purchased by Kaupthing from the Central Bank) and to return certain foreign currency deposits held by the Bank for Kaupthing.

More information about Kaupthing, its current status and completion of the winding-up proceedings can be found on www.kaupthing.com.

SHAREHOLDER 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. The Kaupthing Winding-up Committee appoints one member of Kaupskil's board but the other two must be independent. Further, under a special representation agreement between Kaupskil and Kaupthing dated 20 April 2010, Kaupthing has agreed to respect the independence of the board of directors of Kaupskil and Kaupthing's duty to promote sound and solid financial operations of the Bank free of external intervention. The board of directors of Kaupskil is required to report to the FME on the implementation of this policy on a quarterly basis. In order to facilitate

supervision, Kaupskil is required to transfer the ownership of all financial and insurance subsidiaries to a single parent company if the FME considers such a transfer necessary.

Various restrictions have been placed on Kaupthing by the FME, including with regard to the sale of shares of the Bank before September 2012. 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 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>).

Following the completion of the Composition Agreement, Kaupthing holds 87 per cent. of the Bank's shares through Kaupskil (with the remaining 13 per cent. held by the Icelandic government). 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

Following the appointment of a new Board and CEO in mid-2010, a new strategic plan for the Bank was adopted in October 2010. The key elements of the strategy are:

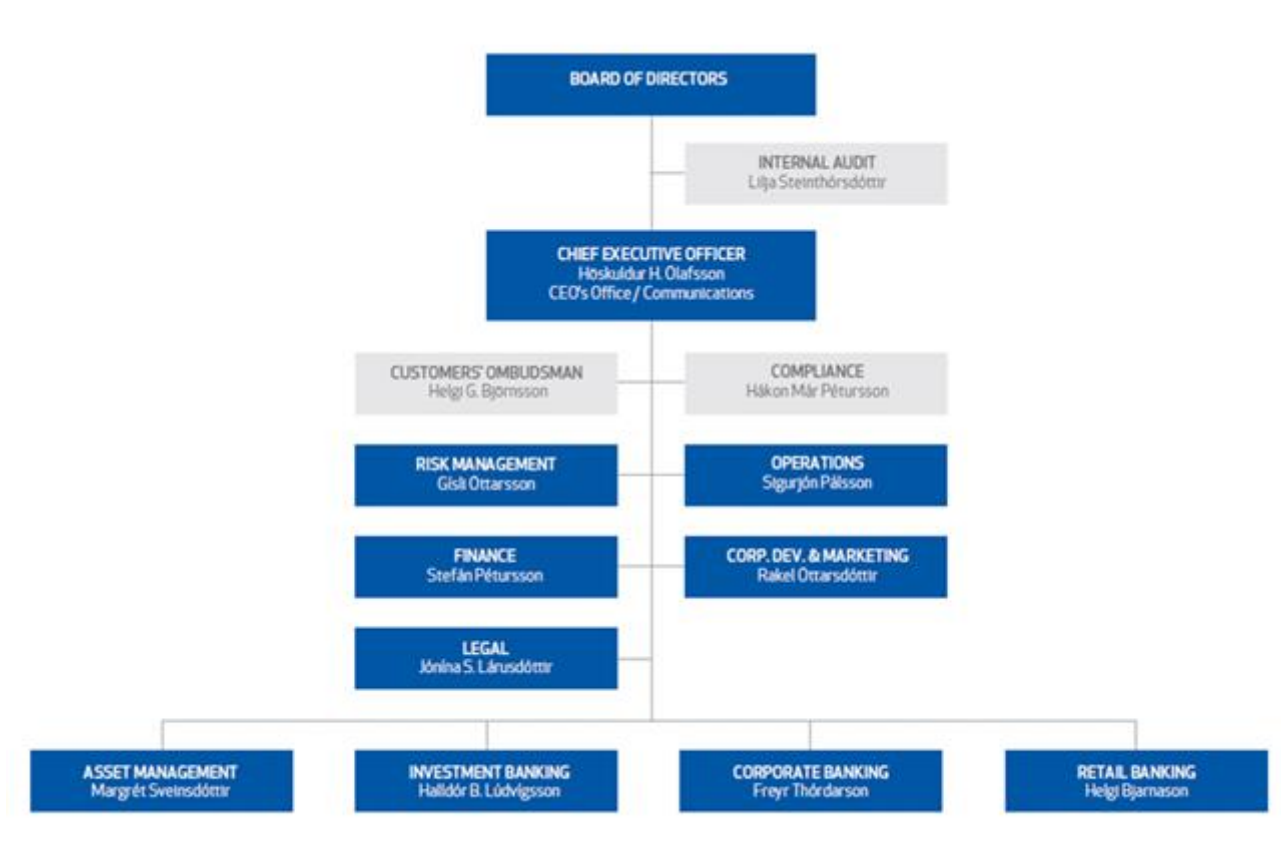
- positioning the Bank as a universal bank in Iceland, providing a wide range of services and focusing on tailored and personalised solutions for its customers, with special emphasis being placed on the Bank's ability to meet the financial needs of those customers, both retail and corporate, which require comprehensive and diverse financial services;
- improving the Bank's competitiveness by focusing on its product offering, quality of service, efficiency and profitability in its operations. In particular, the Bank reduced its branch network from 39 branches at the end of 2008 to 23 branches at the end of 2015 and has also sought to reduce back office costs and streamline its organisational structure; and
- in relation to business customers, emphasising the Bank's focus on developing long-term business relationships through continuous dialogue with customers so as to fully understand their needs and continuous product development which the Bank believes is fundamental to successful business relationships. The Bank aims to innovate and develop products and services which respond to the changing needs of its customers and to put its customers' interests first in all transactions.

The Bank's core values (or Cornerstones) were introduced in 2012 and are "We make a difference, we say what we mean, and we get things done". The Cornerstones guide the Bank in everything it says and does, particularly in its interaction with its main stakeholders, that is its customers, employees, society and shareholders.

From its creation at the end of 2008, the immediate and ongoing areas of focus for the Bank have been the restructuring of its loan portfolio, expansion of its sources of funding and the need to rebuild trust with its customers, Icelandic society as a whole and international financial institutions and investors. In addition, the Bank inherited certain significant risks in terms of loan and funding concentrations and currency mismatches, which it has sought to reduce whilst focusing on maintaining high levels of liquidity and capital.

BUSINESS

The chart below illustrates the Bank's principal operating and support functions as at 31 March 2016.



The Bank has six main reporting segments:

Corporate Banking provides comprehensive financial services and customised solutions to the Bank's larger corporate clients in Iceland. Corporate Banking provides a full range of conventional lending products, deposit accounts as well as value added electronic corporate solutions to meet the needs of each customer.

Retail Banking, the Bank, through its retail branch network, Arion Bank Mortgages Institutional Investor Fund and AFL-sparisjodur (**AFL**), provides a comprehensive range of services, including deposits and loans, savings, payment cards, pension savings, insurance, securities and funds. To maximise operational efficiency the branch network is divided into six clusters, with the smaller branches capitalising on the strength of larger units within each cluster. As at 31 March 2016, the Bank had 23 branches throughout Iceland and over 100,000 retail customers.

Asset Management division comprises the following divisions: Institutional Asset Management, Private Banking and Investment Services. Asset Management manages financial assets on behalf of its clients according to a pre-determined investment strategy. Asset Management also administers pension funds. It is the main distributor of funds managed by Stefnir hf. to individuals, companies and institutional investors and is also responsible for distribution of funds managed by international fund management companies. Stefnir hf., which manages a broad range of mutual funds, investment funds and institutional investor funds, is an independently operating financial company owned by the Bank.

Investment Banking is divided into Corporate Advisory, Capital Markets and Research. Corporate Advisory advises clients on securities offerings and the admission of securities for trading on regulated securities markets and also provides M&A advisory services. Capital Markets handles securities brokerage and foreign exchange trading for the Bank's customers. Research publishes regular analyses of listed

securities, the major business sectors, markets and the Icelandic economy and also produces economic forecasts. Investment Banking's clients are private individuals, companies and institutions.

Treasury is responsible for the Bank's liquidity management as well as 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 domestic securities and currencies. The subsidiaries are Eignarhaldsfélagið Landey ehf., Okkar líftryggingar hf., Valitor Holding hf. and other smaller entities.

The tables below show operating income and earnings before tax for each segment for each of the years ended 31 December 2015 and 31 December 2014 and the total assets of each reporting segment at, 31 December 2015 and 31 December 2014.

Year ended/as at 31 December 2015

	Corporate Banking	Retail Banking	Asset Manage- ment	Investment Banking	Treasury	Other Divisions and Sub- sidiaries	Head- Quarters and Elimination	Total
	<i>(ISK million)</i>							
Operating income	7,012	16,346	4,882	36,434	6,758	7,646	7,477	86,555
Earnings before tax.....	3,391	8,077	3,431	38,312	6,513	777	(8,047)	52,454
Total assets ...	236,621	448,547	5,884	62,904	179,375	50,166	27,546	1,011,043

Year ended/as at 31 December 2014

	Corporate Banking	Retail Banking	Asset Manage- ment	Investment Banking	Treasury	Other Divisions and Sub- sidiaries	Head- Quarters and Elimination	Total
	<i>(ISK million)</i>							
Operating income	9,481	15,277	4,144	7,640	4,454	12,086	908	53,990
Earnings before tax.....	12,303	8,193	2,735	6,421	4,481	6,815	(14,508)	29,083
Total assets ...	231,575	416,912	5,230	33,730	160,210	65,459	20,620	933,736

Corporate Banking Division

The Bank's Corporate Banking division provides a range of financial services and products to its corporate clients. The prime focus of the division is to maintain long-term relationships with its clients and to deliver tailored solutions and personalised services. The division had 26 full time equivalent employees (**FTEs**) at 31 December 2015.

The Corporate Banking division provides services to corporate clients, from medium-sized businesses to large corporations. Corporate Banking comprises a team of account managers specialising in industries,

such as services, manufacturing and real estate, and/or lending, such as project finance and structured finance. The account managers are each responsible for specific clients, thus ensuring personal services and a clear overview of each client's financial requirements. Each account manager also relies on the assistance of staff in a range of support functions, including trade finance and guarantees, legal and documentation, portfolio management and corporate services.

Although a significant proportion of the Corporate Banking division's business is the provision of credit, the Bank offers a wide range of products and financial solutions to meet the needs of each customer. Examples of these services include cash management solutions, a range of deposit products, automatic billing and collection services, online payment slips, internet banking and factoring.

The Corporate Banking loan portfolio principally comprises large corporate customers many of which had become over-leveraged following the 2008 financial crisis and the sharp depreciation of the Icelandic krona. The loans of a majority of the Corporate Banking customers in this position have either been restructured, refinanced or are still undergoing a restructuring process.

In 2011, the Bank started to offer factoring, or asset-based lending, 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 fishing companies.

At the beginning of 2012, the Bank entered into a partnership with European insurer, Euler Hermes, which enables its corporate clients to insure themselves against counterparty default. This type of credit insurance is increasingly important to companies engaged in the export and import business.

The Corporate Banking division is organised into six units; corporate lending, specialised lending, factoring, legal and documentation, portfolio management and corporate services. A seventh unit, recovery, existed until the end of 2013. The recovery unit was responsible for the Bank's debt recovery and was particularly involved in restructuring companies which were experiencing payment difficulties. During the restructuring process, the Bank acquired assets previously owned by the restructured companies. These assets have been transferred into separate holding companies under the control of the Bank. The restructuring process is now overseen by the Bank's legal department.

Retail Banking Division

The Retail Banking division provides a range of banking services to individual as well as SMEs. Retail Banking serves its customers through its branch network and other points of contact such as online banking, a call centre and automatic telling machines (ATMs). As at 31 December 2015, the Bank had 23 branches throughout Iceland and over 100,000 retail customers. The branches provide a comprehensive range of financial services, including advice on deposits and loans, payment cards, pension savings, insurance, securities and funds, with a focus on tailored solutions and personalised services to meet customer needs. Retail Banking had 355 FTEs at 31 December 2016.

Following its establishment in late 2008, the Bank has sought to streamline its retail banking operations by merging a number of its branches. This strategy has resulted in a reduction of the branch network and has created larger and stronger branches which the Bank believes are better able to meet the needs of its customers.

Retail Banking seeks to build long-lasting and profitable relationships with its customers. To maximise operational efficiency the branch network is divided into six clusters, and each cluster has its own business manager. Smaller branches capitalise on the strength of larger units within each cluster. As a result, more executive authority and responsibility is transferred to the branches and therefore closer to the customers. Three of the business managers work in the greater Reykjavík area and three in other large urban areas.

Retail Banking is in the process of establishing financial consultants within its branches with a view to improving the level of service to its customers. The financial consultants are expected to be knowledgeable in a wide range of fields including banking services, pensions and insurance and other financial instruments.

In the period up to 2012, the Bank's key focus was to work with its customers to restructure their debts. However, during 2012 the Bank noted clear signs that demand for traditional financial services was increasing and accordingly switched its focus to providing such services. In August 2012, the Bank launched a new application which enables its customers to keep track of their finances with a single click and without having to log in. Use of the application has steadily increased and, during 2014, 50 per cent. of online access to Arion Online Bank was through this application.

In October 2011, the Bank was the first bank in Iceland to offer non-inflation indexed mortgages with interest fixed for five years. The Bank also offers mixed mortgages which are partly indexed and partly non-inflation indexed, which allows customers to find the type of loan that best suits their risk appetite and ability to repay. The Bank's latest product is designed to temporarily lower the borrower's debt repayments during parental leave.

In the autumn of 2012, Retail Banking launched a new unit which specialises in financing vehicles and various other types of equipment for personal and commercial use. In late 2012, the savings bank, Sparisjodur Olafsfjardar, merged with the Bank. This increased the number of the Bank's branches by one and allows the Bank to improve the services it offers in northern Iceland and to consolidate its position in that region.

Asset Management Division

The Asset Management division is responsible for managing assets on behalf of the Bank's clients, including institutional investors, corporations, high net worth clients and retail investors. It offers a wide range of services and a broad product mix. In addition to mutual funds, alternative investment vehicles and pension plan schemes, the division offers customised asset allocation strategies and managed accounts designed to meet the diverse needs of investors. The division also offers funds from other leading global fund management companies.

Private Banking, a unit within the Asset Management division, seeks to provide first-class financial services tailored to the needs of individual clients with over ISK 10 million in assets under management. Each private banking client has his own account manager who provides personal service and financial advice suited to the client's needs.

Institutional Asset Management, another unit within the Asset Management division, services pension fund clients, trade unions, insurance companies, government institutions and other institutional investors. The services offered to these clients include portfolio management and advice on devising investment strategies.

The Bank's subsidiary, Stefnir Asset Management Company (**Stefnir**), is also part of the Asset management division. Stefnir is Iceland's largest fund management company with assets of around ISK 400 billion under active management as at 31 December 2015. Stefnir caters for both retail and professional clients with the aim of managing its clients' assets as best serves their interests. The company was founded in 1996 and its employees possess on average over 10 years' experience in the financial market. Stefnir has 16 specialists in four teams managing a diverse collection of mutual, investment and institutional investment funds. The company also manages assets of several limited partnerships that have been established around private equity investments in well-known Icelandic companies. Stefnir is wholly-owned by the Bank and had 23 FTEs at 31 December 2015.

By the end of 2015, the Bank had consolidated assets under management of ISK 997 billion. Asset Management had 34 FTEs at 31 December 2015.

During 2012, the Bank's subsidiary, Verdis, was merged into the Bank. Verdis provided custody and fund administration services which are now provided under the Bank's brand.

The Asset Management division aims to continue satisfying its clients' needs by offering first-class services and a broad product range with competitive returns on investments as well as safeguarding its clients' interests.

Investment Banking Division

The Investment Banking division is divided into three units, Corporate Finance, Capital Markets and Research. The Investment Banking division had 31 FTEs at 31 December 2015.

Corporate Finance

Corporate Finance provides advisory services to corporate clients and investors in relation to merger and acquisition (**M&A**) and capital markets transactions, together with advice on funding and capital controls. The Bank's principal investments are also managed within Corporate Finance.

The collapse of the Icelandic stock market in 2008 and the over-leveraging of a significant proportion of Icelandic companies had a significantly negative impact on M&A activities in Iceland. During 2009 and 2010, Corporate Finance was involved in a limited number of share listings and delistings as well as the sale of shares in companies which had been acquired by the Bank in settlement of debts owed. Corporate Finance has also provided valuation reports, managed bond offerings and advised clients on investment opportunities.

In 2011, Corporate Finance managed the listing of Hagar hf. (**Hagar**), which the Bank had acquired through a debt enforcement process, in Iceland's first public equity offering since 2008.

During 2012, Corporate Finance managed the sale of the Group's shares in Hagar, BM Vallá hf., Penninn a Islandi ehf., Boyfood Oy in Finland and Fram Foods AB in Sweden. Corporate Finance also advised the Bakkavor Group on its financial restructuring and arranged the listing of asset-backed bonds issued by institutional investor funds run by Stefmir on NASDAQ OMX Iceland.

In 2013, Corporate Finance managed the listing of each of VÍS hf., N1 ehf. and Skipti ehf., the sale of a stake in Sena ehf., the sale of Klakki ehf.'s stake in VÍS hf., the sale of Fram Foods Ísland hf. (which was owned by the Bank's subsidiary Eignabjarg ehf.) and the acquisition of both Skeljungur hf. and Magn P/F by SF IV slhf. (which is managed by the Bank's subsidiary Stefmir). Corporate Finance has also been involved in merger talks between the Bank's subsidiary Landfestar ehf. and Eik Fasteignafélag hf. (**Eik**). In addition, Corporate Finance arranged the listing on NASDAQ OMX Iceland of covered bonds issued by institutional investor funds managed by Stefmir.

In 2014, Corporate Finance arranged the refinancing of Reitir fasteignafélag hf. (**Reitir**), the largest commercial real estate company in Iceland and the sale and listing of HB Grandi hf., a fishing company, on NASDAQ OMX Iceland. In 2015 it arranged the listing of Reitir, Eik and Síminn hf. (**Síminn**), the largest telecommunication company in Iceland, on NASDAQ OMX Iceland.

Capital Markets Unit

The Capital Markets unit provides securities brokerage and FX sales for institutional investors and corporate clients. It is divided into FX and Fixed Income Sales and Equity Sales.

FX and Fixed Income Sales offers domestic and foreign brokerage of currency, fixed income and derivatives for institutional investors, corporate clients and smaller domestic financial institutions. Equity Sales is responsible for the brokerage of domestic and foreign equities for institutional investors and corporate

clients. Trading on the FX market is significantly restricted in Iceland by the capital controls established in 2008. In the fixed income market, the principal instruments traded are government bonds.

On the equities side, the Bank focuses on the United States and Nordic equity markets. The Bank also remains active in the domestic equity market although the market is currently limited. However, a number of companies have been listed on NASDAQ OMX Iceland since 2011.

In the fixed income market, while the Icelandic government bond market has reached saturation levels, additional investment options, such as asset-backed bonds and corporate bonds, have been introduced.

Trading on the foreign exchange market remains minimal, although the Central Bank held a number of currency auctions in 2014 as part of the process of lifting capital controls. The main aim of Capital Markets is to provide its growing client 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 product development as investors seek more opportunities to invest and distribute risk.

Research

Arion Research publishes macro research on the Icelandic economy and its developments, as well as research on individual companies and sectors. It publishes regular forecasts and updates on key economic issues. Arion Research holds regular conferences at which new research and reports produced by the unit are presented, such as economic forecasts, analysis of the real estate market, analysis of the finances of various municipalities as well as other different sectors. As more domestic initial public offerings take place, Arion Research is also focusing on providing clients of Investment Banking and Asset Management with research on listed companies and companies planning to go public in the near future. Arion Research is independent of the other divisions of the Bank.

Other Divisions and Subsidiaries

Other divisions

The Bank has five support divisions:

- ***Corporate Development & Marketing:*** This division assists the Bank in implementing organisational changes, entering new markets, introducing new products, acquiring or divesting assets or divisions and establishing strategic partnerships. The division also develops the Bank's marketing strategy and 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. Finally, the division is responsible for developing the Bank's internet banking solutions, websites, online communication and electronic distribution channels. This division had 29 FTEs at 31 December 2015.
- ***Finance:*** The Finance division includes funding and treasury (which together form the Treasury reporting segment) as well as accounting and analysis. The accounting unit is responsible for the Bank's financial reporting, both internally and to external stakeholders, including the FME and the Central Bank. The analysis unit is responsible for short-term 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 the treasury unit is responsible for the Bank's liquidity, currency and interest rate management, the internal pricing of interest rates and currency, liaison with other financial institutions, proprietary trading and market making in domestic securities and currencies. The Finance division had 50 FTEs at 31 December 2015.

- **Risk Management:** For a description of the activities of the Risk Management division, see "*Risk Management*". The Risk Management division had 27 FTEs at 31 December 2015.
- **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 42 FTEs at 31 December 2015.
- **Operations:** The Operations division comprises information technology (**IT**), human resources, back office and property management units. The Operations division had 260 FTEs at 31 December 2015.

Subsidiaries

The Bank is the parent company of a number of wholly-owned and majority-owned subsidiaries, of which the most significant are:

- *Okkar líftryggingar hf. (Okkar Life Insurance).* Okkar Life Insurance was founded in 1966 and acquired by Kaupthing in 2005. Okkar Life Insurance provides a range of insurance policies against illness, disability and death. Okkar Life Insurance has sales and distribution partnerships with the Bank and KB ráðgjöf, which also sells pension products on behalf of the Bank. Okkar is wholly-owned by the Bank and had 16 FTEs at 31 December 2015.
- *Valitor Holding hf. (Valitor).* Valitor is a leading payment services company in Iceland. It is a group member of Visa Europe and a licensee of MasterCard and provides card acquiring services to merchants and card issuing services to Icelandic and international banks, savings banks and cardholders. Valitor had 240 FTEs at 31 December 2015. After acquiring a 38 per cent. shareholding in Valitor from Landsbanki in December 2014, the Bank owns 98.8 per cent. shareholding in Valitor as at the date of this Base Prospectus.
- *AFL.* The Bank also increased its shareholding in the savings bank AFL to 100 per cent. in September 2015. On 15 October 2015, the Bank's merger with AFL was approved by the Icelandic Financial Supervisory Authority.

Vörður Tryggingar hf. (Vörður). In October 2015, the Bank concluded a conditional purchase agreement with BankNordik P/F (**BankNordik**) to acquire a 51 per cent. shareholding in the Icelandic insurer Vörður. The Bank and BankNordik also entered into another agreement at the same time in relation to the purchase of the remaining shareholding in Vörður, which will come into effect when restrictions on the sale of the remaining minority shareholding have been lifted and no later than in 2017. The purchase price agreed for 100 per cent. of the shares of Vörður was €37.3 million. These transactions are conditional on the approval of the relevant Icelandic authorities, and the parties expect to complete the sale of the initial 51 per cent. shareholding in Vörður over the coming months.

Asset Holding Companies

Eignarhaldsfélagið Landey ehf. (Landey)

Landey 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. The company'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.

Eignabjarg ehf. (Eignabjarg)

Eignabjarg was a wholly-owned subsidiary of the Bank and was liquidated as of 31 December 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.

During 2012 and 2013, Eignabjarg completed a significant number of disposals from its asset portfolio:

- Hagar was listed on the main market of NASDAQ OMX Iceland in December 2011. In February 2012, Eignabjarg sold a 13.3 per cent. share in Hagar in a private placement. By the end of 2012, Eignabjarg had sold its entire stake in Hagar.
- All share capital in Sigurplast ehf. was sold in April 2012 to the company Hilmar D. Ólafsson ehf.
- BM Vallá hf., which specialises in the production of cement, prefabricated housing units, walls and pumice, was sold to BMV Holding ehf. in October 2011. The sale was completed in June 2012, following approval from the ICA.
- The entire share capital of Penninn á Íslandi ehf., which owns and operates a range of stores in Iceland, was offered for sale at the beginning of 2012. In June 2012, the company was sold to a consortium of investors led by Ingimar Jónsson, Ólafur Stefán Sveinsson and Stefán D. Franklín.
- In March 2012, the Bank offered Fram Foods ehf. for sale. In April 2012, the Bank decided to sell each business unit separately as no satisfactory offer had been received. In July 2012, the subsidiary, Boyfood Oy in Finland, was sold to the Finnish company, Felix Abba Oy. In November 2012, the subsidiary, Fram Foods AB in Sweden, was sold to the Swedish company, Domstein Sverige AB.

Asset Portfolio Disposals

In addition to the disposals made by Eignabjarg (see “- *Asset Holding Companies*”), the disposals made by the Bank in respect of its asset portfolio have also included the following:

- In December 2013, Eik and the Bank signed an agreement relating to the acquisition by Eik of all of the share capital in Landfestar ehf. Eik financed the acquisition through the issuance of new share capital to the Bank, resulting in the Bank becoming the largest shareholder of Eik. The Bank sold part of its shareholdings in Eik during 2014 and in April 2015 the Bank sold its remaining shares in Eik when the company was listed on the main list of NASDAQ OMX Iceland. The Bank currently holds no stake in Eik.
- In May 2014, HB Grandi hf. was listed on the main list of NASDAQ OMX Iceland. Following the sale of 18.8 per cent. of the Bank’s shareholding in HB Grandi hf. in April 2014, the Bank owns approximately 6 per cent. of HB Grandi hf. as at 31 March 2016.
- In April 2015, Reitir was listed on the main market of NASDAQ OMX Iceland. Following Reitir’s listing, the Bank sold approximately 17 per cent. of its shareholding in the company and owns 8.7 per cent. of Reitir as at 31 March 2016.
- In October 2015, Síminn, the largest telecommunication company in Iceland, was listed on the main market of NASDAQ OMX Iceland. Following Síminn’s listing, the Bank sold a shareholding of approximately 22 per cent. of Síminn. Accordingly, as at 31 March 2016, the Bank’s shareholding in Síminn is approximately 5.1 per cent.

LOAN PORTFOLIO

The table below sets out details of the Bank's loans to customers as at 31 December 2015 and 31 December 2014 classified by type of loan.

	As at 31 December 2015		
	Individuals	Corporates	Total
	<i>(ISK million)</i>		
Overdrafts.....	16,840	24,248	41,088
Credit cards.....	10,842	1,054	11,896
Mortgage loans.....	271,895	12,889	284,784
Other loans.....	38,058	334,849	372,907
Provision on loans.....	(13,016)	(17,309)	(30,325)
Loans to customers.....	324,619	355,731	680,350

	As at 31 December 2014		
	Individuals	Corporates	Total
	<i>(ISK million)</i>		
Overdrafts.....	17,955	24,420	42,375
Credit cards.....	11,065	943	12,008
Mortgage loans.....	271,639	10,406	282,045
Other loans.....	33,763	303,998	337,761
Provision on loans.....	(13,111)	(13,570)	(26,681)
Loans to customers.....	321,311	326,197	647,508

The table below sets out details of the book value of the Bank's loans and receivables to customers as at 31 December 2015 and 31 December 2014 classified by customer sector.

	2015	2014
Individuals.....	47.7%	49.6%
Real estate activities and construction.....	15.1%	12.5%
Fishing industry.....	11.1%	11.8%
Information and communication technology.....	4.7%	3.6%
Wholesale and retail trade.....	7.6%	8.5%
Financial and insurance activities.....	4.9%	4.3%
Industry, energy and manufacturing.....	3.1%	3.9%
Transportation.....	0.9%	0.9%
Services.....	2.9%	2.8%
Public sector.....	1.2%	1.2%

	<u>2015</u>	<u>2014</u>
Agriculture and forestry	0.8%	0.9%
Total	100%	100.0%

As at 31 December 2015, the aggregate amount of the Bank's 10 largest customer loans and receivables equalled 11.7 per cent. of its total gross customer loans and receivables at that 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 2015 and 31 December 2014 classified by type of loan.

	<u>2015</u>	<u>2014</u>
	<i>(ISK million)</i>	
Bank accounts.....	74,587	79,587
Money market loans	7,976	23,007
Other loans	4,982	6,198
Loans to credit institutions	87,491	108,792

The table below shows the credit quality of the Bank's financial assets, including its net loans and receivables, as at 31 December 2015 and 31 December 2014.

<u>As at 31 December 2015</u>				
	<u>Neither past due nor impaired</u>	<u>Past due but not impaired</u>	<u>Individually impaired</u>	<u>Total</u>
	<i>(ISK million)</i>			
Cash and balances with Central Bank	48,102	-	-	48,102
Loans to credit institutions	87,491	-	-	87,491
Loans to customers				
Loans to corporates	337,153	17,302	1,276	355,731
Loans to individuals	291,277	26,532	6,810	324,619
Financial instruments	82,714	-	-	82,714
Other assets with credit risk	4,581	-	-	4,581
Total	851,318	43,834	8,086	903,238

<u>As at 31 December 2014</u>				
	<u>Neither past due nor impaired</u>	<u>Past due but not impaired</u>	<u>Individually impaired</u>	<u>Total</u>
	<i>(ISK million)</i>			

Cash and balances with Central Bank	21,063	-	-	21,063
Loans to credit institutions	108,792	-	-	108,792
Loans to customers				
Loans to corporates	308,588	15,114	2,495	326,197
Loans to individuals	277,859	32,847	10,605	321,311
Financial instruments	70,704	-	-	70,704
Other assets with credit risk	3,514	-	-	3,514
Total	790,520	47,961	13,100	851,581

The table below shows the ageing of the Bank's past due but not impaired loans and receivables by class as at 31 December 2015 and 31 December 2014.

<u>As at 31 December 2015</u>	<u>Up to 3 days</u>	<u>4 to 30 days</u>	<u>31 to 60 days</u>	<u>61 to 90 days</u>	<u>More than 90 days</u>	<u>Total</u>
	<i>(ISK million)</i>					
Loans to corporates.....	9,638	3,779	1,681	662	1,542	17,302
Loans to individuals.....	3,706	9,437	5,237	554	7,598	26,532
Past due but not impaired loans	13,344	13,216	6,918	1,216	9,140	43,834

<u>As at 31 December 2014</u>	<u>Up to 3 days</u>	<u>4 to 30 days</u>	<u>31 to 60 days</u>	<u>61 to 90 days</u>	<u>More than 90 days</u>	<u>Total</u>
	<i>(ISK million)</i>					
Loans to corporates.....	6,553	2,434	2,267	565	3,295	15,114
Loans to individuals.....	3,436	10,589	5,974	847	12,001	32,847
Past due but not impaired loans	9,989	13,023	8,241	1,412	15,296	47,961

The table below sets out details of the Bank's impaired loans and receivables to customers as at 31 December 2015 and 31 December 2014 classified by customer sector.

<u>Impaired loans to customers specified by sector</u>	
<u>2015</u>	<u>2014</u>

	<u>Impairment amount</u>	<u>Gross carrying amount</u>	<u>Impairment amount</u>	<u>Gross carrying amount</u>
Individuals	10,593	17,403	11,016	21,621
Real estate activities and construction	1,515	1,867	1,396	1,981
Fishing industry	257	373	1,115	2,366
Information and communication technology	308	332	251	251
Wholesale and retail trade	681	893	751	831
Financial and insurance activities	5,953	6,011	6,739	6,756
Industry, energy and manufacturing	828	1,025	296	474
Transportation	4,433	4,440	18	18
Services	504	682	375	641
Public sector	143	215	27	35
Agriculture and forestry	126	186	230	340
Total	25,341	33,427	22,214	35,314

As at 31 December 2015, 4 per cent. of the book value of all non-performing loans was attributable to five customers and 7 per cent. to 10 customers. An additional 10 per cent. of non-performing loans as at 31 December 2015 was attributable to a further 26 customers.

FUNDING AND LIQUIDITY

Funding

The Bank is predominantly funded with domestic deposits. Its total deposit base at 31 December 2015 was ISK 480.7 billion, or 59.4 per cent. of its total liabilities. The Bank's other funding at 31 December 2015 comprised bonds, other debt and equity.

The Bank's funding profile changed significantly in 2012. In January 2012, the Bank acquired a mortgage portfolio from Kaupthing and was substituted as issuer under six series of Kaupthing Covered Bonds. In February 2012, the Bank issued its first series of covered bonds. The bonds, which mature in 2034, are denominated in Icelandic krona and the total issue amounted to ISK 2.5 billion. The Bank issued a total of ISK 5 billion in covered bonds in 2012. In May 2012 the Bank became the first Icelandic bank to issue covered bonds that were not inflation-linked and further issuances of such covered bonds took place in January 2013.

In February 2013, the Bank completed a senior unsecured bond offering denominated in Norwegian krone. This is the first time the Bank has raised funding in the international markets and it is also the first international bond offering by an Icelandic financial institution since 2007. The bonds, with a value of NOK 500 million (ISK 11.2 billion), were placed with more than 60 investors in Norway, Sweden, Finland, the United Kingdom, continental Europe and Asia.

In March 2015, the Bank completed a senior unsecured bond offering denominated in Euros. The total amount raised was €300 million from approximately 100 international institutional investors. The bonds are 3-year fixed rate instruments with a 3.125 per cent. coupon and were sold at a rate corresponding to a 3.10 per cent. premium over interbank rates. This issuance represented the first issue by an Icelandic bank since

the financial crisis of bonds denominated in euros sold to a broad group of international institutional investors.

In June 2015, the Bank completed a senior unsecured offering denominated in Norwegian Krona, issuing NOK 500 million of Notes with a five year maturity.

On 11 January 2016, the Bank issued the Resettable Notes (see “ - *Kaupthing*” above).

As at 31 December 2015, the aggregate amount of the Bank's 10 largest deposits equalled 13.3 per cent. of the aggregate amount of the Bank's total deposits at that date. At the beginning of 2010, the Bank received a senior unsecured loan from the Central Bank amounting to ISK 61.3 billion and an ISK 29.5 billion subordinated loan from the Icelandic State that qualifies as Tier II capital. In June 2011, the Bank received a foreign currency subordinated loan from the Icelandic State in an amount equivalent to ISK 6.1 billion that qualifies as Tier II capital, see “—*Related Party Transactions*”.

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 lifting of capital controls and 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 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 Central Bank and not issued by the Group or its related entities.

The Central Bank has set a guideline for the minimum LCR which requires that, as at 1 January 2014, the LCR is 100 per cent. in foreign currency and 70 per cent. in total (ISK and foreign currency). The latter benchmark increases by 10 per cent. every year until a 100 per cent. requirement is implemented in 2017.

The LCR as at 31 December 2015 and 31 December 2014 is shown below:

Liquidity coverage ratio	2015	2014
FX.....	218%	254%
Total.....	134%	174%

As per the LCR methodology, the Group'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 Bank's deposit base according to the LCR categorisation, with the associated expected stressed outflow weights as at year ended 31 December 2015 and 31 December 2014. Some similar categories are grouped together.

As at 31 December 2015						
Deposits maturing within 30 days						
	Less stable	Weight (%)	Stable	Weight (%)	Term deposits*	Total deposits
<i>(ISK million)</i>						
Retail	86,095	10%	39,598	5%	53,599	179,292
SME	37,884	10%	3,928	5%	4,327	46,139
Operational relationship	-	25%	-	5%		
Corporations	36,300	40%	823	20%	4,945	42,068
Sovereigns, central-banks and PSE	11,900	40%	-	-	1,304	13,204
Financial entities being wound up	16,948	100%	-	-	47,062	64,010
Pension funds	41,609	100%	-	-	35,104	76,713
Domestic financial entities	32,727	100%	-	-	11,016	43,743
Foreign financial entities	5,193	100%	-	-		5,193
Other foreign parties	3,707	100%	3,260	25%	1,923	8,890
Total	272,363		47,609		159,280	479,252

*Term deposits in this context refer to deposits with maturities greater than 30 days

As at 31 December 2014						
Deposits maturing within 30 days						
	Less stable	Weight (%)	Stable	Weight (%)	Term deposits*	
<i>(ISK million)</i>						
Retail	78,659	10%	36,076	5%	53,803	
SME	36,060	10%	3,895	5%	6,011	
Operational relationship	-	25%	-	5%	1,190	
Corporations	36,961	40%	830	20%	5,873	
Sovereigns, central-banks and PSE	12,196	40%	-	-	2,870	
Financial entities being wound up	19,796	100%	-	-	67,105	
Pension funds	36,824	100%	-	-	19,765	
Domestic financial entities	22,634	100%	-	-	16,752	
Foreign financial entities	4,532	100%	-	-	522	

Other foreign parties	3,425	100%	3,026	25%	2,082
Total	251,087		43,827		175,973

RISK MANAGEMENT

Overview

The Bank seeks to manage its risks through a process of on-going risk identification, measurement and monitoring, using limits and other controls. This process of risk management and the ability to evaluate, manage and price the risk 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 is ultimately responsible for the Bank's risk management framework and ensuring that satisfactory risk management processes and policies for controlling the Bank's risk exposure are in place. The Board defines the overall risk appetite of the Bank which is translated into exposure limits and targets that are monitored by the Bank's Risk Management division, which reports its findings regularly to the Bank's CEO and the Board. Risk is measured, monitored and reported according to internal policies, principles and processes that are reviewed and approved by the Board at least annually. The Board is also responsible for the Bank's internal capital adequacy assessment process (**ICAAP**). The Board has determined that management of risks encountered within subsidiaries should principally be carried out within each subsidiary.

The CEO is responsible for sustaining an effective risk management framework, policies and control as well as maintaining a high level of risk awareness among the Bank's employees.

The Bank operates the following committees to manage risk:

- Board Audit and Risk Committee (the **BARC**). This committee is responsible for supervising the Bank's risk management framework, risk appetite and ICAAP. The BARC regularly reviews reports on the Bank's risk exposures.
- Asset and Liability Committee (the **ALCO**). This committee is chaired by the CEO and is responsible for managing any asset-liability mismatches, liquidity risk, market risk, interest rate risk and capital management.
- Underwriting and Investment Committee (the **UIC**). This committee decides on underwriting and principal investments.
- Credit Committees. The Bank operates four credit committees: The Board Credit Committee (**BCC**) which decides on all major credit risk exposures, the Arion Credit Committee (**ACC**) which operates within limits specified as a fraction of the Bank's capital, and the Corporate Credit Committee (**CCC**) and Retail Branch Committees (**RBC**) which operate within tighter credit granting limits.

In addition the Bank operates five Collateral Valuation Committees, which set guidelines on collateral assessment and valuation, and a Debt Cancellation Committee which deals 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. Internal audit results are discussed with the Bank's management and reported to the BARC.

The Bank's 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 four units: Credit Analysis, which supports and monitors the credit granting process; Credit Control, which monitors credit exposures on a customer-by-customer basis; Balance Sheet Risk, which oversees all risks related to asset and liability mismatch, including capital and is responsible for the Bank's ICAAP; and Operational Risk which monitors risks associated with the daily operation of the Bank.

The Bank is exposed to four major areas of risk: credit risk, market risk, liquidity risk and operational risk.

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 clients, and by monitoring exposures in relation to such limits.

The Bank's main asset is its loan portfolio. Therefore managing and analysing the loan portfolio is of utmost importance. Great emphasis is placed on the quality of the credit portfolio, by maintaining a strict credit process, critically inspecting loan applications, actively monitoring the credit portfolio and identifying and reacting to possible problem loans at an early stage as well as restructuring of impaired credits.

The Bank seeks to limit its total credit risk through diversification of the loan portfolio across sectors and by limiting large exposures to groups of connected clients. Note 41 to the 2015 Consolidated Financial Statements shows the Bank's maximum exposure to credit risk by type of instrument and industry classification of customer. As at 31 December 2015 and 31 December 2014, the Bank's total on and off balance sheet credit risk exposure totalled ISK 1,094,624 million and ISK 958,299 million respectively. The major industry exposures at 31 December 2015 were (i) individuals (32 per cent. of the total exposure), (ii) financial and insurance activities (18 per cent. of the total exposure), and (iii) real estate and construction (13 per cent. of the total exposure).

Credit Approval Process

As discussed above, the Bank has a tiered structure of credit approval committees.

The BCC, which acts on the behalf of the Board, is the Bank's top credit, investment and underwriting authority. The ACC, which sits below the BCC's granting limits, has the right to delegate authority within its own credit limits and sets credit granting rules and guidelines for the business units. The Risk Management department is represented at credit committee meetings in an advisory role with a view to ensuring that all credit decisions are taken in line with the Bank's credit policy. Risk Management has the power to escalate a controversial credit committee decision to a higher authority.

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, a financial analysis of the borrower, any proposed collateral, the borrower's credit rating and related parties and their total exposure.

Credit Analysis is Risk Management's primary interface with the Bank's credit committees. Credit Analysis prepares an opinion for all credit applications that go before the BCC, the ACC and the CCC. The Chief Risk Officer or his designated representative from Credit Analysis participates in all meetings of the CCC, the ACC and the BCC as a non-voting advisor. Credit Analysis also monitors the activities of the RBC. Credit Analysis ensures that credit decisions are within a committee's credit granting authority and is authorised to escalate controversial credit decisions from one committee to a committee with a higher authority.

Credit Analysis 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 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 are:

- Retail loans to individuals: Mortgages on residential properties;
- Corporate loans: Real estate, fishing vessels and other fixed and current assets, including inventory and trade receivables, cash and securities;
- Derivative exposures, cash, treasury notes and bills, asset backed bonds, listed equity and funds that consist of eligible securities.

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, valuation parameters and haircuts on the applied collateral value. 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 value of any collateral given is monitored by Risk Management and additional collateral may be requested in accordance with the underlying agreement. The value of any collateral given is taken into account when determining the adequacy of the allowance for impairment losses made in relation to each loan.

Credit Monitoring

The Bank has credit concentrations to a few significant customers and to certain business sectors, such as the real estate activities and construction sector, the fishing industry and wholesale and retail trade.

The Bank uses an internal rating system to rate its loans to companies and individuals. The rating model for larger companies bases its rating both on qualitative factors (such as sector stability and outlook) and quantitative factors (such as their equity and liquidity ratios). The rating model for SMEs and individuals are purely quantitative models.

To monitor the performance of its loan portfolio, the Bank relies on an Early Warning System (**EWS**), which is a forward-looking classification system for loans and borrowers. The monthly EWS classification is a prelude to the credit review by the Credit Control department. The need for impairment and/or financial restructuring is identified and evaluated during the review. The loan portfolio is grouped into four categories according to the borrower's financial strength and behaviour: Green, Yellow, Orange and Red.

In this system, borrowers in the Green category are financially the strongest, whereas a possible loss has been identified in the case of borrowers in the Red category. The EWS attempts to anticipate a deterioration in a customer's credit quality.

The classification is based on borrowers' contractual arrangements with the Bank, i.e. the timeliness of payments and compliance with other loan terms, financial ratio and the borrowers' credit ratings. The table below shows certain underlying criteria for the EWS.

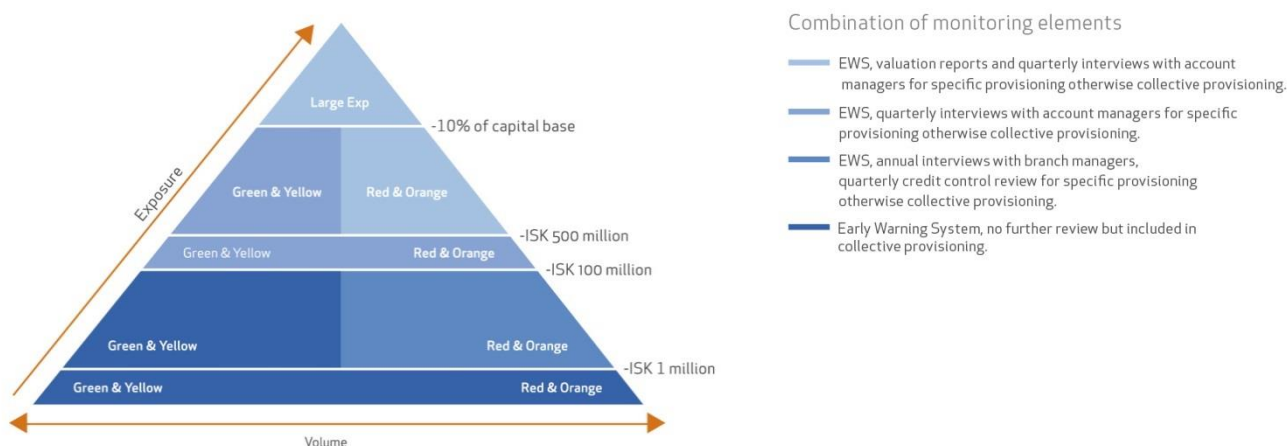
Category	Provision	Default	(Debt/EBITDA)/LTV	Equity ratio	Credit rating	Covenant breach
Green	No	<30	<4.0–5.0 / <75-80%	>15-25%	≥B-	None
Yellow	No	30-90	4.0–6.0 / <75-90%	10-25%	CCC+	Minor
Orange	No	>90	>5.0–6.0 / 90-100%	<10-20%	<CCC+	Serious
Red	Yes	>90	>5.0–6.0 / >100%	<10-20%	<CCC+	Serious

The classification is made on a customer basis; all conditions must be met for all loans of each borrower for that borrower to be classified as Green.

The classification is intentionally strict since its main purpose is to draw attention to plausible evidence of impairment e.g. payment difficulties of borrowers with resulting credit loss by the Bank. Risk Management, has the authority to reassess the classification if an account manager has solid arguments for the change.

Risk Management's Credit Control department monitors individual credits based on selected samples. The samples are determined by the size of the exposure and its risk. The risk measurements are based on the EWS. The level of detail in credit monitoring depends on credit size and loan volume. Credit monitoring consists of a quarterly review by Credit Control which usually involves communication with the borrower's account manager. A semi-annual valuation report is prepared for borrowers with a credit above 10 per cent. of the capital base and for borrowers in the orange and red category with credit above ISK 500 million.

The following chart describes how four different depth-levels of monitoring are applied to loans, depending on the size of the exposure and the EWS classification.



Based on this monitoring, a specific provision for impairment is determined based on the customer's aggregate exposure, the realisable value of collateral in accordance with the valuation committees' guidance. Special provisioning is based on the FME's rule No. 834/2003 on the Annual Accounts of Credit Institutions and reflects the estimated loss on loans.

Collective provisioning is applied to credits other than those that have been specifically impaired. Also exempt from collective provisions are loans that are more than 90 days in default but which have been

determined not to require specific impairment. Collective provisions are estimates of expected loss based on the borrower's probability of default, standardised loss given default values and exposure at default.

Loan Provisioning

The Group analyses whether loans are impaired at both a borrower-specific level and a collective level. Analysing whether loans are impaired at a borrower-specific level involves an assessment of a combination of factors, including the borrowers' exposure, the number of days in default and an internal classification where customers are classified according to financial position, defaults and credit rating. In determining specific provisions for impairment on individually assessed borrowers at this level, the following factors are considered:

- the Group's aggregate exposure to the borrower;
- the amount and timing of expected receipts and recoveries;
- the likely distribution available on liquidation or bankruptcy;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of collateral (or other credit mitigates) and likelihood of successful repossession; and
- the likely deduction of any costs involved in recovery of amounts outstanding.

The amount of the loss impaired is the difference between the assets' carrying value and the present value of estimated future cash flow.

Collective provisions are taken for all loans other than those that have been specifically impaired. Also exempt from collective provisions are loans that are more than 90 days in default, but have been determined not to require specific impairment.

In assessing collective impairment two deciding quantitative components are addressed in order to perform the calculation: (i) the probability of default and (ii) the loss given default. The Group uses internally developed models to calculate the probability of default, and these models are regularly benchmarked against actual outcomes to ensure their accuracy. When calculating loss given default, the Group also uses internally developed models.

Impairment losses are recognised in profit or loss and are reflected in an allowance account against loans. When an event occurs after an impairment loss has been recognised which causes the amount of impairment loss to decrease, the decrease in the impairment loss is reversed through profit or loss.

In some cases financial assets are acquired at a deep discount. The Group includes such incurred credit losses in the estimated cash flows when calculating the effective interest rate of the relevant financial assets. If the Group revises its estimate of payments or receipts, the Group adjusts the carrying amount of the financial assets to reflect the actual and revised estimated cash flows. The Group recalculates the carrying amount by calculating the present value of estimated future cash flows at the financial instrument's original effective interest rate. The adjustment is recognised as an increase in value of loans in profit or loss when the recalculation results in an increase in the carrying amount and an impairment when the recalculation results in a decrease in the carrying amount.

Loans are written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from the realisation of collateral have been received.

Counterparty Credit Risk

The Bank offers financial derivative instruments to professional investors. The table below shows derivative trading activities that are currently permitted. The derivative instruments are 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		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 to the total exposure and on the customer's negative value, net of collateral, to control the Bank's risk towards these instruments. These limits are generally client-specific and may refer specifically to different categories of derivative 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 extra collateral is not supplied within a tightly specified deadline, the contract is closed. The margin-call process is monitored by Risk Management.

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 per cent. of the Bank's capital base. The legal maximum for individual large exposures is 25 per cent. of the Bank's capital base, net of eligible collateral, and the sum of all large exposures cannot exceed 400 per cent. of the Bank's capital base. The Bank had no large exposures in excess of the legal limit of 25 per cent. at 31 December 2015. The sum of all large exposures at 31 December 2015 was 11 per cent. of the Bank's capital base before collateral mitigation or 11 per cent. net of eligible collateral, which is well below the 400 per cent. legal maximum.

The table below shows all gross exposures exceeding 10 per cent. of the Bank's capital base as at 31 December 2015 and 31 December 2014, together with the net amount of each of those exposures after taking account of collateral.

	As at 31 December			
	2015		2014	
	Gross	Net	Gross	Net
1	11%	11%	<10%	<10
2	<10%	<10%	14%	14%
3.....	<10%	<10%	11%	10%
Sum of large exposure gross and net >10%	11%	11%	25%	24%

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 Bank'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 keeps track of market risk and separates its exposures for its trading book and banking book. Market risk in the trading book arises from proprietary trading activities. 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 book and in the banking book is managed separately by the Treasury.

Market risk allowance is set by the Board and the CEO determines the limit framework for each trading desk and sets individual limits. ALCO is responsible for managing the Bank's overall market risk. Risk Management 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 as a result of imbalances in the Group's balance sheet but accept limited risk in its trading book.

Interest Rate Risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Bank's operations are subject to interest rate risk associated with mismatches between interest bearing assets and interest bearing liabilities. The mismatch is characterised by a large gap between the interest fixing period of assets and liabilities with a large amount of liabilities being demand deposits while the interest rates of assets are generally fixed for a long period resulting in a yield curve risk for the Bank. Note 42 to the Bank's 2015 Consolidated Financial Statements provides further information on the Bank's interest rate risk. 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, of which the largest is euro.

The Bank's strategy for managing its interest rate risk is to strive for an interest rate balance between assets and liabilities through targeted lending practices.

Indexation Risk

The Bank is exposed to indexation risk when there is a mismatch between its index-linked assets and liabilities. As at 31 December 2015, the total amount of the Bank's index-linked assets was ISK 311.6 billion and the total amount of its index-linked liabilities was ISK 216.6 billion. See note 42 to the 2015 Consolidated 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 assets and liabilities. ISK denominated deposits are the primary source of funding for the Bank whereas a substantial part of the Bank's assets consist of foreign currency denominated loans to customers. Net exposures per currency are monitored centrally in the Bank.

There have been a number of court cases in which the legality of different types of foreign currency loan has been considered by the Icelandic courts in recent years. See "*—Litigation*". Although these cases have clarified the law relating to these loans, there remains uncertainty regarding certain foreign currency linked

loans. Nevertheless, the Bank considers that its portfolio of foreign currency linked loans is fully provisioned for the most likely outcome.

The table below indicates the currencies to which the Bank had significant exposure at 31 December 2015. The analysis calculates the effect of a 10 per cent. movement of the currency rate against the ISK (with +10% in the table denoting a depreciation of the ISK) 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 in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase. An equivalent decrease in each of the below currencies against the ISK would have resulted in an equivalent but opposite impact.

The table assumes that all other variables remain constant.

	As at 31 December 2015	
	-10%	+10%
	<i>(ISK million)</i>	
EUR.....	(1,105)	1,105
USD.....	(209)	209
GBP.....	(2,425)	2,425
DKK.....	221	(221)
NOK.....	304	(304)
Other.....	3	(3)

Equity Price Risk

Equity price risk is the risk that the fair value of equities decreases as the result of changes in the level of equity indices and individual stocks. The non-trading equity price risk exposure is mainly due to restructuring of the Bank's assets i.e. restructuring of troubled companies which the Bank has taken over. For information on assets seized and held for sale and equity exposures, Notes 27 and 21 to the 2015 Consolidated Financial Statements provide information on assets seized by the Bank and held for sale.

Derivatives

Customers can enter into derivatives contracts with the Bank. The types of derivatives currently offered by the Bank are FX swaps and forwards, interest rate swaps, cross-currency swaps, as well as options and forwards on equities, treasury notes and bonds with a government guarantee. Limits on exposures and collateral are determined in accordance with the Bank's risk appetite. The Bank also uses derivatives to reduce market risk on its balance sheet. The Bank's exposure to derivative instruments is not considered to be a material risk.

Prepayment Risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall. The Bank was not materially exposed to prepayment risk at 31 December 2015.

Liquidity Risk

Liquidity risk is defined as the risk that the Group, though solvent, either does not have sufficient financial resources available to meet its liabilities when they fall due, or can secure them only at excessive cost. Liquidity risk arises from the inability to manage unplanned decreases or changes in funding sources.

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 maturity of its loans exceeds the maturity of its deposits, of which 66.2 per cent. are on demand or with a term of less than 30 days.

The Bank's strategy is to diversify the funding profile of the Bank by establishing access to domestic and international debt markets and to prudently manage the maturity profile of its liabilities. Additionally, the Bank's strategy is to always maintain sufficient liquidity by maintaining a high level of liquid assets and available funding to its near term liabilities and expected payment outflows. The Bank has made significant process in converting its on demand deposits to term deposits. As at 31 December 2009, over 90 per cent. of the Bank's deposits were on demand compared to 59.7 per cent. at 31 December 2012, 52.8 per cent. as at 31 December 2013, 58.1 per cent. as at 31 December 2014 and 57.3 per cent. as at 31 December 2015.

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.

Operational risk is inherent in every activity undertaken within the Bank, in outsourced activities and in all interaction with external parties. The Bank aims to reduce the frequency and impact of operational risk events in a cost effective manner.

Each business unit within the Bank is primarily responsible for taking and managing their 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 basic indicator approach to the calculation of capital requirements for operational risk. The Bank's capital base for operational risk is measured as 15 per cent. of the average over three years of the sum of net interest income and net non-interest income, as required by applicable legislation.

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 amendments 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. Losses are categorised according to the Basel II event categories. The category "Execution, Delivery and Process Management" accounted for 60 per cent. of total reported loss events. Measured by amount, the category "Clients, Products and Business Practice" accounted for 74 per cent. of the total losses.

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 timeframe for further implementation in Iceland has not yet been published (see "*Risk Factors – Changes to the Capital Requirements Directive 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 shall apply 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 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. Banking book off balance sheet items giving rise to credit, foreign exchange or interest rate risk are assigned risk weights appropriate to the category of the 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, and counterparty risk.

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 Group 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 concentration risk, residual risk, country risk, settlement risk, liquidity risk, interest rate risk in the banking book, 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 supervisory review and evaluation process (**SREP**). The Group's capital base exceeded the FME's SREP requirements in each of 2013, 2012 and 2011.

The Bank's capital base at 31 December 2015 amounted to ISK 195,729 million. The Group's capital adequacy ratio, calculated in accordance with Icelandic requirements, was 24.2 per cent., exceeding the minimum legal requirement of eight per cent.

The table shows the Group's RWA calculations as at 31 December 2015 and as at 31 December 2014.

	31 December	
	2015	2014
Capital Base	<i>(ISK million, except percentages)</i>	
Total equity	201,894	162,212
Non-controlling interest not eligible for inclusion in CET1 capital	(9,108)	(1,385)
Intangible assets	(9,285)	(9,596)
Tax assets	(205)	(655)
Other statutory deductions	(3,151)	(111)
Common equity Tier 1 capital	180,145	150,465
Non-controlling interest not eligible for inclusion in CET1 capital*	9,108	1,385
Total Tier 1 capital	189,253	151,850
Subordinated Liabilities	10,365	31,639
Regulatory adjustments to Tier 2 capital**	(771)	
Other statutory deductions	(3,118)	(101)
Tier 2 capital	6,476	31,538
Total capital base	195,729	183,388
*CET1 capital according to CRR definition while Tier 1, capital base and RWA are calculated according to The Act on Icelandic Undertakings No. 161/2002. Capital ratios according to CRR are generally lower than the ratios shown here		
**Straight-line amortisation for maturities within five years.		
<i>Risk weighted assets</i>		
Credit risk	681,034	591,994
Market risk FX	38,401	18,915
Market risk other	7,035	2,890
Operational risk	81,441	82,211
Total risk weighted assets	807,911	696,010
CET1 ratio using current RWA*	22.3%	21.6%
Tier 1 ratio	23.4%	21.8%
Capital adequacy ratio	24.2%	26.3%

* CET1 capital according to CRR definition while Tier 1, capital base and RWA are calculated according to The Act on Icelandic Undertakings No. 161/2002. Capital ratios according to CRR are generally lower than the ratios shown here.

COMPLIANCE

According to Icelandic law, financial institutions are required to establish a compliance function and must ensure that it is effective and independent of other aspects of the institution's operations. The compliance function is required to:

- monitor and regularly assess the adequacy and effectiveness of policies and procedures designed to detect any risk of failure by an institution and to put in place procedures to minimise that risk;
- monitor and assess the actions taken to address any deficiencies in the institution's compliance with its obligations; and
- provide the employees of the institution responsible for carrying out the execution of securities transactions with the necessary training, advice and assistance to enable them to discharge the institution's obligations under applicable Icelandic law.

The Bank's compliance officer coordinates the Bank's compliance activities. The Bank's compliance department had seven FTEs at 31 December 2015.

The compliance officer works independently and reports directly to the CEO in accordance with both FME and internal audit requirements. The compliance officer has monthly meetings with the CEO at 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.

The compliance officer is also responsible for the Bank's anti-money laundering (AML) and terrorist financing procedures. The compliance officer organises and is responsible for:

- know your customer (KYC) due diligence;
- constant monitoring of the Bank's clients; and
- coordinating the Bank's compliance with applicable AML and terrorist financing laws, regulations and guidelines.

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 “- *Asset Holding Companies*”).

The table below shows the classification of the Bank's investment portfolio as at 31 December 2015.

As at 31 December 2015			
Trading	Designated at fair value	Available to sale	Total

(ISK million)

Listed bonds and debt instruments	2,526	74,757		77,283
Unlisted bonds and debt instruments	99	1,412		1,511
Total bonds and debt instruments	2,625	76,169		78,794
Listed shares and equity instruments	2,138	13,869		16,007
Unlisted shares and equity instruments	1,668	10,665	5,852	18,185
Bond funds with variable income	1,090	222		1,312
Total shares and equity instruments	4,896	24,756	5,852	35,504

COMPETITION

The Bank currently faces competition from the two other large commercial banks in Iceland, Landsbankinn and Íslandsbanki, although this competition is currently limited as all three banks are focused on restructuring their loan portfolios and improving their asset and liability matching. The Bank also faces competition domestically from the Housing Financing Fund (see “*Financial Markets in Iceland – Other relevant institutions*”).

As Iceland's economy recovers and demand for new lending and other banking products increases, the Bank expects to face increased competition from both the other large Icelandic banks and smaller specialised institutions as well as, potentially, foreign banks seeking to establish operations in Iceland. 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 Bank also believes that it has a leading investment banking franchise in Iceland although there is currently little activity in this area in Iceland.

INFORMATION TECHNOLOGY

The Bank's IT division is responsible for developing, operating and advising on the Bank's information systems and solutions, including the Internet Bank, websites, its internally developed and third party software, its hardware such as data centres, telephone systems, ATMs and personal computers. The IT division had 111 FTEs at 31 December 2015. The Bank's focus in the IT area in the next few years will be on upgrading its systems and thereby improving its operational efficiency.

The Bank engages in a wide range of activities involving finance and financial services. The reliability of information and communications systems is a key factor in the Bank's activities as a financial enterprise.

Control of information security is an essential tool to achieve this objective. The Bank's Information Security Policy forms the basis of the measures used by the Bank to ensure the security of data, 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 security and the secrecy of information on customers are required to be observed at all times when IT is used. The Bank operates two data centres in an active mode to ensure continuous system uptime and to minimise downtime in disaster scenarios.

LITIGATION

Litigation is a common occurrence in the banking industry due to the nature of the business undertaken. Due to the current economic climate in Iceland, the chances of litigation against the Bank have 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 the claims may have on its financial standing.

Competition law investigation

The ICA has opened a formal investigation into the alleged abuse of an alleged collective dominant position by the three largest retail banks in Iceland, including the Bank. The investigation was initiated by separate complaints from BYR hf. and MP banki hf. made in 2010. The complaints from BYR hf. and MP banki hf. concern the terms of the Banks' mortgage arrangements, which, according to the complaint, deter individuals from moving their business to other banks and thereby restrict competition. The extent of the investigation and outcome is still uncertain. However, if the Bank were deemed to have violated the Competition Act, it could result in a fine or restrictions by the ICA.

With a writ issued in June 2013, Kortþjónustan claimed damages of ISK 1.2 billion plus interest from the Bank, Íslandsbanki, Landsbanki, Borgun hf. and Valitor, as a result of losses Kortþjónustan contends the five parties caused the company due to violations of the Competition Act. The Bank has put forward its arguments in the case and has requested the rejection of Kortþjónustan's claims. The case has been put on hold as Kortþjónustan's court-appointed evaluator prepares its report on Kortþjónustan's alleged loss.

Legal proceedings regarding damages

The former chairman of the board of directors of BM Vallá hf., together with Lindarflöt ehf., have 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 Vallá hf. and Fasteignafélagið Ártún ehf., damage by not allowing the companies to be financially restructured and thereby forcing the companies into bankruptcy. The Bank believes it likely that it will be acquitted of the plaintiffs' claims in both cases and has not therefore made any provision.

In its judgment on 24 April 2013 in case No. 612/2012, the Supreme Court determined that Valitor had not been authorised to rescind an agreement between the company and Datacell ehf. In January 2015 Datacell ehf. and Sunshine Press Productions ehf. brought legal action against Valitor for the payment of compensation relating to damage which the companies considered they had sustained on account of the rescinding by Valitor of the agreement. Court-appointed assessors were subsequently asked to assess the damage in question at the request of the plaintiffs. The assessors announced their conclusions, which have not been made public, in March 2016. Valitor is now considering what its next steps in the case are.

Legal proceedings regarding CPI loans

Recently, three cases were heard by the Icelandic courts for the purpose of verifying the legitimacy and the presentation of loans linked to the CPI. The Supreme Court upheld the arguments of the lenders in two of those cases (case no 160/2015 and case no. 243/2015). In the third case, the District Court acquitted a lender of a borrower's claim, on similar grounds to the two previous cases (case no E-338/2013). The Bank made no provision due to the court cases regarding the CPI.

Uncertainty regarding the book value of foreign currency lending

In recent years there has been considerable uncertainty over the legality of foreign currency loans to individuals and companies and the recalculation of those loans which are currency-linked loans in Icelandic krona. Firstly, there has been uncertainty over which loans are considered legal foreign currency loans and

which loans are considered currency-linked loans in Icelandic krona, and secondly, over how loans in the latter category should be recalculated. The Bank has been required to recalculate numerous loans which are considered currency-linked loans in Icelandic krona on the basis of the Interest and Indexation Act No. 38/2001 and after review of relevant judgments passed by the Supreme Court of Iceland.

The uncertainty surrounding the legality of foreign currency loans has continued in 2016 and the Group constantly monitors judgments involving itself and others to refine its provisions on foreign currency loans. There remains uncertainty regarding foreign currency linked loans in certain respects, including regarding the legality of particular loans. Nevertheless, the Group considers that its portfolio of foreign currency linked loans is fully provisioned for the most likely outcome.

EFTA Surveillance Authority Investigation

In May 2015 the 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 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 Central Bank to long-term loans.

ESA is investigating whether these loan conversion agreements which were concluded between the Central Bank and Íslandsbanki and the 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.

ESA will call for comments from Icelandic authorities and interested third parties before reaching a decision and the outcome of this investigation, as of the date of this Base Prospectus, remains unclear.

Legal matters concluded

In April 2013 the ICA imposed a ISK 500 million fine on Valitor for abusing its dominant position on the payment card market and violating conditions set out in an earlier decision of the ICA. In a judgment of the Supreme Court in April 2016, the Supreme Court upheld the ICA's decision from April 2013. Valitor paid the fine in 2013.

RELATED PARTY TRANSACTIONS

The Bank has a related party relationship with Kaupskil, Kaupthing, the Bank's associates, the Board of the Bank, the key management personnel of the Bank and close family members of the directors and key management personnel.

Icelandic State Financial Investments (**ISFI**, a separate state institution under the Ministry of Finance and Economic Affairs) holds a 13 per cent. stake in the Bank. ISFI and related entities are defined as related parties and balances and transactions with these entities are included in the table in Note 40 to the 2015 Consolidated Financial Statements under Shareholders with significant influence over the Group.

No unusual transactions took place with related parties during 2015 or 2014. Transactions with related parties have been conducted on an arm's length basis. There have been no guarantees provided or received for related party receivables or payables during 2015 or 2014.

See note 40 to the 2015 Consolidated Financial Statements for further information in relation to the Bank's related party transactions.

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 seven members. All the members are nominated by Kaupskil except one, Thóra Hallgrímsdóttir who was nominated by the ISFI.

The Bank's Board comprises the following members:

Monica Caneman, Chairman

Monica was born in 1954. She is Swedish and lives in Sweden. She was first elected as a Director at a shareholders' meeting on 18 March 2010. She is not a shareholder of the Bank and is an independent Director. Monica is also Chairman of the Board Credit Committee.

Monica graduated in economics from the Stockholm School of Economics in 1976. She worked at Skandinaviska Enskilda Banken (now SEB) from 1977 to 2001. Monica held various positions at SEB in marketing and commercial banking. She became a member of the Group Executive Committee and Group Management in 1995 and became deputy CEO in 1997. She became an alternate member of the Board at the same time. Monica left SEB in 2001. Since then she has built a career around board assignments.

She currently sits on the board of numerous companies and non-profit organisations and is the chairman of several of them.

Guðrún Johnsen, Vice-Chairman

Guðrún was born in 1973. She was first elected as a Director at a shareholders' meeting on 18 March 2010. She is not a shareholder of the Bank. Guðrún is Chairman of the Board Remuneration Committee and is a member of the Board Audit and Risk Committee.

Guðrún completed her BA in economics at the University of Iceland in 1999. In 2002 she graduated with an MA in applied economics at the University of Michigan, Ann Arbor in the United States and with an MA in statistics from the same university the following year. Guðrún worked as a securities broker at the Icelandic Investment Bank (FBA) between 1999 and 2001, and as a teaching and research assistant at the University of Michigan, Ann Arbor from 2002 to 2003. Between 2004 and 2006 she worked as a specialist in the Financial Systems and Monetary Department of the International Monetary Fund (IMF) in Washington, DC.

Guðrún has been an assistant professor at Reykjavík University School of Business since 2006. She has served on the board of a fund management company of MP Bank and is the current chairman of the research company THOR. In 2009 and 2010 Guðrún worked as a senior researcher for the Parliamentary Special Investigation Commission looking into the causes and events leading up to the fall of the Icelandic banking sector in 2008.

Guðrún is currently a lecturer in finance in the faculty of business administration at the University of Iceland. Guðrún also undertakes work for Kaupthing on a contractual basis. This is permissible by Icelandic law and guidelines.

Kirstín Th. Flygenring, Director

Kirstín was born in 1955. She was first elected to the Board as an Alternate at a shareholders' meeting on 22 March 2012. She was elected to the Board as a Director at the Bank's annual general meeting on 20 March 2014. She is not a shareholder of the Bank. Kirstín is a member of the Board Remuneration Committee.

Kirstín graduated with a cand. oecon. degree in business administration from the University of Iceland in 1980. In 1983 she completed an MA in economics from Northwestern University in Illinois. She completed practical media studies at the University of Iceland in 1993-1994.

Kirstín was marketing manager at the Icelandic Freezing Plants Corporation (now Icelandic Group hf.) from 1986 to 1989. Between 1995 and 1998 she was an economist and deputy managing director at the Fisheries Association of Iceland. From 1989 to 2000 she was editor of the economics glossary at the Icelandic Language Institute at the University of Iceland. From 2002 to 2007 she was an economist in the Department of Economics at the Central Bank. She was a part-time lecturer and adjunct at the University of Iceland between 2007 and 2012 and was a specialist at the Institute for Research in Finance and Economics at Reykjavík University from 2007 to 2009. From 2011 to 2013 she was a member of a three-person committee on the Icelandic parliament's investigative committee on the Housing Financing Fund.

Benedikt Olgeirsson, Director

Benedikt was born in 1961. He was first elected as a Director at a shareholders' meeting on 18 December 2013. He is not a shareholder of the Bank and is an independent Director.

Benedikt completed a degree in civil engineering from the University of Iceland in 1986. He then received an MSc in construction engineering and project management at the University of Washington in Seattle. He has also completed courses at Wharton Business School and Harvard Business School. Between 1988 and 1992 Benedikt worked as a project manager in civil engineering. He was a manager at Eimskip between

1993 and 2004, most recently as head of Eimskip's operations in Hamburg. He was managing director of Parlogis from 2004 to 2005, and managing director of Atorka between 2005 and 2009.

Benedikt has been Deputy CEO of Landspítali University Hospital since 2010.

Brynjólfur Bjarnason, Director

Brynjólfur was born in 1946. He 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 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..

Måns Höglund, Director

Måns was born in 1951. He is Swedish and lives in Portugal. He was first elected as a Director 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 Audit and 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.

Thóra Hallgrímsdóttir, Director

Thóra was born in 1974. She was first elected as an Alternate Director at the Bank's Annual General Meeting on 24 March 2011. She was elected as a Director at the Bank's Annual General Meeting on 21 March 2013. She is not a shareholder in the Bank and is an independent Director. Thóra is a member of the Board Audit and Risk Committee.

Thóra gained a degree in law from the University of Iceland in 2000. She qualified as a district court attorney in 2002. Thóra worked in the insurance business for ten years, from 2000 for Tryggingamidstöðin hf. and from 2005 for Sjóvá-Almennar tryggingar hf. as a legal advisor in claims. She was director of claims for Sjóvá-Almennar tryggingar hf. from 2006 to 2007 and in 2007-2011 was general counsel for Sjóvá-Almennar tryggingar hf. Thóra served on behalf of Sjóvá-Almennar tryggingar hf. on the board of International Motor Insurance in Iceland sf. and was an alternate member of the board of the Icelandic Financial Services Association.

Since 2011 Thóra has worked as a specialist for the School of Law in Reykjavík University, specialising in insurance law, contract law and tort law. Thóra is a member of the Board of VIRK, the Icelandic Rehabilitation Fund, nominated by SA-Confederation of Icelandic Employers, and is an alternate member of the Insurance Complaints Committee, nominated by the Icelandic Financial Services Association. She is also chairman of the insurance arbitration committee and the chairman of the seamen's and fishermen's arbitration committee, as appointed by the relevant minister. Thóra is also chief editor of the journal *Tímarit lögfræðinga* issued by the Association of Icelandic Lawyers.

Gudrún Johnsen undertakes work for Kaupthing on a contractual basis. This is permissible by Icelandic Law and guidelines. 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.

Board of Directors Alternates

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:

- Björg Arnardóttir (who is a non-independent member of the Board, as an employee of Kaupthing) B.Sc. Business Administration and Account Manager in Asset Management at Kaupthing;
- Sigurbjörg Ásta Jónsdóttir, lawyer
- Ólafur Örn Svansson Attorney at Law and owner at Forum lögmenn ehf.

Björg Arnardóttir 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 Björg Arnardóttir 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)

Lúðvík Karl Tómasson, CPA, Vice President Global Corporate Controller and Treasurer, Alvogen. Lúðvík is a member of the Board Audit and Risk 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 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.

Freyr Thórdarson, Managing Director of Corporate Banking

Freyr was born in 1973 and lives in Iceland. Freyr completed a Bachelor's degree in business administration at Reykjavík University in 2003 and earned an MBA degree from the Reykjavík University School of Business in 2010. Before that, he studied at Universität Salzburg in Austria and completed a Vor-diplom in Communication Science in 1999. Freyr has worked in banking and finance since 2001, both in Iceland and abroad, at Straumur Investment Bank, Gnúpur investment company, and Íslandsbanki/Glitrir. In 1999 to 2001, prior to his financial career, Freyr worked at a bottling company called IcelandSpring on plant development and management. Since 2009, Freyr has managed restructuring and asset recovery projects in Kaupthing hf.'s Scandinavian portfolio as a Senior Director. He currently sits on the board of Norvestia Oyj, which is listed on the NASDAQ OMX Helsinki, and also sits on the boards of two unlisted industrial companies in Scandinavia on behalf of Kaupthing. Freyr was previously a member of the Board from 22 March 2012 until 13 May. He was hired as the Managing Director of Corporate Banking on 13 May 2013.

Helgi Bjarnason, Managing Director of Retail Banking

Helgi graduated from the faculty of mathematics of the University of Iceland in 1992 and completed a degree in actuarial mathematics from the University of Copenhagen in 1997. From 1997 to 2006, Helgi worked as an actuary at Okkar Life Insurance. In 2006, Helgi started work at Sjóvá Almennar Insurance and served as managing director of the life insurance company in addition to being vice-president of the non-life company. In October 2010, Helgi joined the Bank as managing director of Operations. Helgi has served on various boards of directors, such as the Association of Icelandic Actuaries, the Confederation of Employers and the Icelandic Financial Services Association. He is currently on the board of Okkar Life Insurance. He was appointed managing director of Retail Banking in October 2011.

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.

Íða Brá Benediktsdóttir, Managing Director of Investment Banking

Íða Brá was born in 1976 and was appointed managing director of Investment Banking in February 2016. Íða 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. Since 2013 Íða has been head of Private Banking. Before taking over Private Banking, Íða was Head of Corporate Communications. Íða has served on the board of numerous companies, including Ólafsfjörður savings bank, AFL, Landfestar and HB Grandi hf.

Íða 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.

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, Okkar 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.

Sigurjón Pálsson, Managing Director of Operations

Sigurjón joined the Investment Banking division of Kaupthing in 2005 and later became a departmental head in Corporate Recovery at the Bank. Sigurjón was appointed managing director of Operations in October 2011. Sigurjón previously held a management position at the contracting firm Ístak hf., where he was in charge of IT and other key projects. Sigurjón is educated as an engineer and has a master's degree from KTH in Stockholm and MIT.

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 Steinhórsdóttir, 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 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 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 Höfði, 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.

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 OMX 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 the Board in accordance with a government recommendation made at the end of 2008.

The role of the Ombudsman is to ensure fairness and objectivity 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. Internal Audit had 7 employees at 31 December 2015.

Employees

During 2015, the average number of FTEs at the Group was 1,139 (compared to 1,128 during 2014). At 31 December 2015, the number of FTEs at the Group was 1,147.

The Bank had 885 average number of full time equivalent employees during 2015 and 876 full time equivalent employees at year end.

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) 10 per cent. for individuals (only applicable to interest income exceeding the annual amount of ISK 125,000.00); and (b) 10 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 6 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 20 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 Notes, including whether withholding would ever be required pursuant to FATCA or an IGA with respect to payments on instruments such as 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 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 Notes.

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 (the **participating Member States**). However, Estonia has since stated that it will not 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 EU 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 or to a residual entity (within the meaning of the laws of 21 June 2005 ratifying the treaties entered into by Luxembourg and certain dependent and associated territories of EU Member States (the **Territories**), as amended) established in an EU Member State (other than Luxembourg) or one of the Territories and securing such payments for the benefit of such individual beneficial owner will be subject to a withholding tax of 10 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 10 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 7 June 2016, 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.

United States

The Notes have not been and will not be registered under the Securities Act 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 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. 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.

Public Offer Selling Restriction under the Prospectus Directive

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, including by Directive 2010/73/EU), 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.

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) 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 Securities and Futures Ordinance and any rules made under that Ordinance; 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 or which do not constitute an offer to the public within the meaning of that Ordinance; 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 Securities and Futures Ordinance and any rules made under that Ordinance.

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 11 May 2016.

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 the Markets in Financial Instruments Directive (Directive 2004/39/EC).

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 2015 Consolidated Financial Statements and the 2014 Consolidated 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; and
- (h) 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, 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, 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 2016 and there has been no material adverse change in the prospects of the Bank since 31 December 2015.

Litigation

Except as disclosed in "*Description of the Bank—Litigation*", 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

The 2014 Consolidated Financial Statements were audited, without qualification and in accordance with International Standards on Auditing by Ernst & Young ehf., members of The Institute of State Authorised Public Accountants in Iceland whose address is Borgartúni 30, Reykjavík105, Iceland.

On 19 March 2015 Deloitte ehf., members of The Institute of State Authorised Public Accountants in Iceland, were appointed auditors of the Bank. Deloitte ehf. have audited the 2015 Consolidated Financial Statements, without qualification, in accordance with International Standards on Auditing. The comparative figures in the 2015 Consolidated Financial Statements have been audited by Ernst & Young ehf.

Neither Ernst & Young ehf. nor Deloitte ehf. have a material interest in the Bank.

Dealers transacting with the Bank

Certain of the 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.

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