

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

€1,500,000,000

Covered Bond Programme

Under this €1,500,000,000 Covered Bond Programme (the **Programme**), Arion Bank hf. (the **Issuer** or the **Bank**) may from time to time issue bonds (the **Covered Bonds**) denominated in any currency agreed between the Issuer and the relevant Dealer (as defined below). Covered Bonds may be issued in bearer form (**Bearer Covered Bonds**), registered form (**Registered Covered Bonds**) or in uncertificated and dematerialised book entry form registered in the Icelandic Securities Depository Ltd. (**ISD Covered Bonds** and the **ISD** respectively). The maximum aggregate nominal amount of all Covered Bonds from time to time outstanding under the Programme will not exceed €1,500,000,000 (or its equivalent in other currencies calculated as described in the Programme Agreement described herein), subject to increase as described herein.

The Covered Bonds 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 Issuer (each a **Dealer** or **Manager** and together the **Dealers** or **Managers**), which appointment may be for a specific issue or on an ongoing basis. References in this offering circular (the **Offering Circular**) to the relevant Dealer shall, in the case of an issue of Covered Bonds being (or intended to be) subscribed by more than one Dealer, be to all Dealers agreeing to subscribe for such Covered Bonds.

The Covered Bonds may be held in a manner which is intended to allow for Eurosystem eligibility. This simply means that the Covered Bonds may upon issue be deposited with Clearstream Banking, *société anonyme* (**Clearstream, Luxembourg**) or Euroclear Bank S.A./N.V. (**Euroclear**) as one of the international central securities depositories as common safekeeper and does not necessarily mean that the Covered Bonds will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria.

See Risk Factors for a discussion of material factors to be considered in connection with an investment in the Covered Bonds.

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 as to the economic and financial soundness of the transactions contemplated by this Offering Circular or the quality or solvency of the Issuer in accordance with Article 7(7) of the Prospectus Act 2005. Application has also been made to the Luxembourg Stock Exchange for Covered Bonds 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 Offering Circular to Covered Bonds being listed (and all related references) shall mean that such Covered Bonds have been admitted to trading on the Luxembourg Stock Exchange's regulated market and have been admitted to the official list (the **Official List**) of the Luxembourg Stock Exchange. The Luxembourg Stock Exchange's regulated market is a regulated market for the purposes 2014/65/EU Directive (as amended, **MiFID II**).

Notice of the aggregate nominal amount of Covered Bonds, interest (if any) payable in respect of Covered Bonds, the issue price of Covered Bonds and certain other information which are applicable to each Tranche (as defined under "*Terms and Conditions of the Covered Bonds*") of Covered Bonds 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 Covered Bonds to be listed on the Luxembourg Stock Exchange will also be published on the website of the Luxembourg Stock Exchange (www.bourse.lu).

The Programme provides that Covered Bonds 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 Issuer and the relevant Dealer. The Issuer may also issue unlisted Covered Bonds and/or Covered Bonds not admitted to trading on any market.

The Covered Bonds 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 "*Form of the Covered Bonds*" for a description of the manner in which Covered Bonds will be issued. Registered Covered Bonds are subject to certain restrictions on transfer, see "*Subscription and Sale and Selling Restrictions*".

Amounts payable on Covered Bonds may be calculated by reference to one of LIBOR or EURIBOR as specified in the relevant Final Terms. As at the date of this Offering Circular, the administrators of LIBOR, EURIBOR and USD LIBOR are not included in ESMA's register of administrators under Article 36 of the Regulation (EU) No. 2016/1011 (the **Benchmarks Regulation**).

As far as the Issuer is aware, the transitional provisions in Article 51 of the Benchmarks Regulation apply, such that the administrators of LIBOR and EURIBOR are not currently required to obtain authorisation/registration (or, if located outside the European Union, recognition, endorsement or equivalence).

The Issuer may agree with any Dealer that Covered Bonds may be issued in a form not contemplated by the Terms and Conditions of the Covered Bonds herein, in which event a supplement to the Offering Circular, if appropriate, will be made available which will describe the effect of the agreement reached in relation to such Covered Bonds.

Covered Bonds issued under the Programme may be rated or unrated. Where a Series of Covered Bonds is rated, such rating will be disclosed in the Final Terms and be provided by Moody's Investors Service Limited (**Moody's**), Fitch Ratings Ltd. (**Fitch**) or S&P Global Ratings, a division of S&P Global Inc. (**S&P**). Each rating agency is established in the European Union and is registered under the Regulation (EC) No. 1060/2009 (as amended) (the **CRA Regulation**). As such each of Moody's, Fitch and S&P is included in the list of credit rating agencies published by the European Securities and Markets Authority (**ESMA**) on its website (at <http://www.esma.europa.eu/page/List-registered-and-certified-CRAs>) in accordance with the CRA Regulation. A security rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency.

Interest amounts payable on Floating Rate Covered Bonds may be calculated, inter alia, by reference to one of LIBOR or EURIBOR, as specified in the relevant Final Terms. As at the date of this Base Prospectus, (i) the administrator of LIBOR (ICE Benchmark Administration Limited) is included in ESMA's register of administrators under Article 36 of Regulation (EU) No. 2016/1011 (the **Benchmarks Regulation**) and (ii) the administrators of EURIBOR are not included in ESMA's register of administrators under the Benchmarks Regulation. As far as the Bank is aware, the transitional provisions in Article 51 of the Benchmarks Regulation apply, such that the administrator of EURIBOR (European Money Markets Institute) is not currently required to obtain authorisation/registration.

Arranger

Barclays

Dealers

Barclays

Deutsche Bank

UBS Investment Bank

Arion Bank hf.

The date of this Offering Circular is 8 January 2019.

This Offering Circular comprises a base prospectus (with any relevant Final Terms, the **Prospectus**), for the purposes of Article 5.4 of Directive 2003/71/EC as amended (which includes the amendments made by Directive 2010/73/EU (the **Prospectus Directive**)).

The Issuer (the **Responsible Person**) accepts responsibility for the information contained in this Offering Circular and the Final Terms for each Series of Covered Bonds issued under the Programme. To the best of the knowledge of the Issuer (having taken all reasonable care to ensure that such is the case) the information contained in this Offering Circular is in accordance with the facts and does not omit anything likely to affect the import of such information.

Subject as provided in the applicable Final Terms, the only persons authorised to use this Offering Circular in connection with an offer of Covered Bonds are the persons named in the applicable Final Terms as the relevant Dealer or the Managers, as the case may be.

Copies of the Final Terms will be available from the registered office of the Issuer and the specified office set out below of each of the Paying Agents (as defined below) and copies of the Final Terms relating to Covered Bonds which are admitted to trading on the regulated market of the Luxembourg Stock Exchange will be filed with the CSSF and also be published on the website of the Luxembourg Stock Exchange, www.bourse.lu.

Certain information under the heading "*Book-entry Clearance Systems*" has been extracted from information provided by the clearing systems referred to therein. The Issuer confirms that such information has been accurately reproduced and that, so far as it is aware, and is able to ascertain from information published by the relevant clearing systems, no facts have been omitted which would render the reproduced information inaccurate or misleading.

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

The Dealers (other than the Issuer) 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 (other than the Issuer) as to the accuracy or completeness of the information contained or incorporated by reference in this Offering Circular or any other information provided by the Issuer in connection with the Programme. No Dealer (other than the Issuer) accepts any liability in relation to the information contained or incorporated by reference in this Offering Circular or any other information provided by the Issuer in connection with the Programme.

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

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

Investors should review, *inter alia*, the documents deemed incorporated herein by reference when deciding whether or not to purchase any Covered Bonds.

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

This Offering Circular may only be used for the purposes for which it has been published.

This Offering Circular does not constitute an offer to sell or the solicitation of an offer to buy any Covered Bonds in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Offering Circular and the offer or sale of Covered Bonds may be restricted by law in certain jurisdictions. The Issuer and the Dealers do not represent that this Offering Circular may be lawfully distributed, or that any Covered Bonds may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular no action has been taken by the Issuer or the Dealers which is intended to permit a public offering of any Covered Bonds or distribution of this document in any jurisdiction where action for that purpose is required. Accordingly, no Covered Bonds may be offered or sold, directly or indirectly, and neither this Offering Circular 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 Offering Circular or any Covered Bonds may come must inform themselves about, and observe, any such restrictions on the distribution of this Offering Circular and the offering and sale of Covered Bonds. In particular, there are restrictions on the distribution of this Offering Circular and the offer or sale of Covered Bonds in the United States, the European Economic Area (**EEA**) (including the United Kingdom, the Republic of Italy and Iceland), Japan and Hong Kong, see "*Subscription and Sale and Selling Restrictions*".

In making an investment decision, investors must rely on their own examination of the Issuer and the terms of the Covered Bonds being offered, including the merits and risks involved. The Covered Bonds have not been approved or disapproved by the United States Securities and Exchange Commission or any other securities commission or other regulatory authority in the United States, nor have the foregoing authorities approved this Offering Circular or confirmed the accuracy or determined the adequacy of the information contained in this Offering Circular. Any representation to the contrary is unlawful.

None of the Dealers or the Issuer makes any representation to any investor in the Covered Bonds regarding the legality of its investment under any applicable laws. Any investor in the Covered Bonds should be able to bear the economic risk of an investment in the Covered Bonds for an indefinite period of time.

MIFID II PRODUCT GOVERNANCE/TARGET MARKET

The Final Terms in respect of any Covered Bonds will include a legend entitled "MiFID II product governance" which will outline the target market assessment in respect of the Covered Bonds and which channels for distribution of the Covered Bonds are appropriate. Any person subsequently offering, selling or recommending the Covered Bonds (a distributor) should take into consideration the target market assessment; however, a distributor subject to Directive 2014/65/EU (as amended, **MiFID II**) MiFID II is responsible for undertaking its own target market assessment in respect of the Covered Bonds (by either adopting or refining the target market assessment) and determining appropriate distribution channels.

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

IMPORTANT– EEA RETAIL INVESTORS

PROHIBITION OF SALES TO EEA RETAIL INVESTORS – The Covered Bonds are not intended to be offered, sold or otherwise made available to and, with effect from such date, should not be offered, sold or otherwise made available to any retail investor in the European Economic Area (**EEA**). For these purposes, a retail investor means a person who is one (or more) of: (i) a retail client as defined in point (11) of Article 4(1) of MiFID II; (ii) a customer within the meaning of Directive 2002/92/EC (as amended, the **Insurance Mediation Directive**), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or (iii) not a qualified investor as defined in Directive 2003/71/EC (as amended, the Prospectus Directive). Consequently no key information document required by Regulation (EU) No 1286/2014 (as amended, the **PRIIPs Regulation**) for offering or selling the Covered Bonds or otherwise making them available to retail investors in the EEA has been prepared and therefore offering or selling the Covered Bonds or otherwise making them available to any retail investor in the EEA may be unlawful under the PRIIPs Regulation.

PRESENTATION OF FINANCIAL AND OTHER INFORMATION

Presentation of Financial Information

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

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

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

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

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

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

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

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

The selected condensed consolidated interim financial information as of and for the nine months ended 30 September 2018 has, unless otherwise stated, been derived from the Bank’s unaudited condensed

consolidated interim financial statements for the nine months ended 30 September 2018 incorporated by reference in this Base Prospectus (the **Interim Financial Statements**).

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

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

The audited consolidated financial statements as of and for the years ended 31 December 2017 and 2016 do not reflect the changes from the application of IFRS 9 and IFRS 15. Those audited consolidated financial statements applied IAS 39 and IAS 18, Revenue, which were the accounting standards in effect at the time for each period. Therefore, due to the adoption of the new accounting standards, the consolidated financial statements as of and for the years ended 31 December 2017 and 2016 and the comparative figures as of and for the three month period ended 30 September 2017, are not directly comparable with the Interim Financial Statements.

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

Operating Segment Reporting

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

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

KPIs and Non-IFRS Information

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

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

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

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

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

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

General

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

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

- 2017 Consolidated Financial Statements means the audited consolidated annual financial statements of the Bank for the financial year ended 31 December 2017;
- **2016 Consolidated Financial Statements** means the audited consolidated annual financial statements of the Bank for the financial year ended 31 December 2016;
- References in this Base Prospectus to the **Group** are to the Bank and its consolidated subsidiaries, taken as a whole;
- **U.S. dollars, U.S.\$** and "\$ refer to **United States dollars**;
- **ISK, krona 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 in this Base Prospectus, including financial information, have been subject to rounding adjustments. Accordingly, in certain instances (a) the sum or percentage change of such numbers may not conform exactly to the total figure given and (b) the sum of the numbers in a column or row in certain tables may not conform exactly to the total figure given for that column or row.

Forward Looking Statements

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

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

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

- deterioration of the economic conditions or the banking system in Iceland, as a result of political and economic factors, either domestic or international;
- exposure to Iceland's key industry sectors, in particular tourism, seafood, aluminium, energy and real estate;
- an adverse shift in public sentiment and potential political or legislative action;
- exposure to liquidity, maturity, foreign exchange, and market funding risks, and various other typical financial institution market risks relating to interest rates, equity pricing and inflation;
- failure or breach of the Bank's information technology systems;
- unauthorised disclosure of confidential information and any resulting liability, litigation, and reputational damage;
- exposure to tax liabilities or competitive disadvantages in respect of VAT on the Bank's services;
- existing customer loan portfolio exposure to problem and impaired loans;

- costs and competitive disadvantages resulting from the Bank Levy and other taxes;
- domestic economic constraints on near-term growth;
- failure to implement the Bank's strategy or failure to achieve the anticipated benefits of this strategy;
- exposure to existing and increasing competition in Iceland;
- regulatory and legal risks inherent in the Bank's businesses;
- ongoing legal proceedings and investigations by government authorities;
- inadequate implementation by Iceland of the EEA rules;
- potential inability to successfully maintain salary levels, and overrunning salaries and related expense may give rise to reputational risk while heavy cost-cutting measures may have adverse effects on operations;
- restrictions under the Capital Controls on the Bank's operations and abnormal pricing and financial bubbles that may result from the Capital Controls;
- potential inability to recruit or retain experienced personnel or key members of the Executive Committee;
- credit rating downgrade or a change in outlook;
- various operational risks, including risk of systems failures, human error, regulatory breaches, and employee misconduct;
- damage to the reputation of the Bank, its subsidiaries or its shareholders;
- exposure to unidentified, unanticipated or incorrectly quantified risks as a result of risk management methods;
- reliance on third party service providers;
- violation of anti-money laundering or anti-bribery regulations;
- application of CRD IV;
- restriction, suspension or termination of relationships with key card scheme operators;
- failure of the Asset Management division to sustain or increase its level of assets under management and/or exposure of the division to pressure on fee margins;
- incurrence of unforeseen liabilities from prior and future acquisitions and disposals; and
- inadequate implementation by Iceland of the EEA rules.

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

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

STABILISATION

In connection with the issue of any Tranche of Covered Bonds, 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 Covered Bonds or effect transactions with a view to supporting the market price of the Covered Bonds of the Series (as defined below) of which such Tranche forms part at a level higher than that which might otherwise prevail. However, stabilisation may not necessarily occur. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the relevant Tranche of Covered Bonds is made and, if begun, may cease at any time, but it must end no later than the earlier of 30 days after the issue date of the relevant Tranche of Covered Bonds and 60 days after the date of the allotment of the relevant Tranche of Covered Bonds. Any stabilisation action or over-allotment shall be conducted in accordance with all applicable laws and rules.

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RISK FACTORS

The following factors may affect the ability of the Bank to fulfil its obligations under Covered Bonds issued under the Programme. Most of these factors are contingencies which may or may not occur and the Bank is not in a position to express a view on the likelihood of any such contingency occurring.

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

The Issuer believes that the factors described below represent the principal risks inherent in investing in the Covered Bonds issued under the Programme, but the inability of the Bank to pay interest, principal or other amounts on or in connection with any Covered Bonds may occur for other reasons which may not be considered significant risks by the Bank based on information currently available to it or which it may not currently be able to anticipate. Prospective investors should also read the detailed information set out elsewhere in this Offering Circular and reach their own views prior to making any investment decision.

Factors that may affect the Issuer's ability to fulfil its obligations under Covered Bonds issued under the Programme

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

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

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

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

- *Fluctuations in the value of Icelandic Krona:* In 2017, Icelandic Krona appreciated significantly by 8.0 per cent. against the U.S. dollar and 4.7 per cent. against the euro (*source: Bloomberg*). The continued appreciation in the value of Icelandic Krona could lead to decreased demand for Icelandic exports or services, including tourism (i.e. as a source of foreign income), and could make Iceland less competitive relative to other economies and currencies. Alternatively, a devaluation of Icelandic Krona and an increase in the cost of imports could diminish consumer confidence and lead to contraction in certain sectors, such as real estate.
- *Inflation:* While inflation currently remains within the target rate of 2.5% per annum set by the Central Bank of Iceland (*Seðlabanki Íslands*) (the **Icelandic Central Bank**), its current inflation outlook is that the rate of inflation could rise in excess of the target rate in 2018 and again in 2020, while falling below target in 2019 due to proposed changes in VAT (*source: Icelandic Central Bank*). In the view of the International Monetary Fund (the **IMF**), inflation was being contained by falling import prices and appreciation of Icelandic Krona. Wage growth is expected to erode competitiveness over time, and an increase in salary costs as a result of inflation could have a direct impact on the Bank's profitability. In addition, the current account surplus is expected to shrink steadily as a

percentage of GDP. In the view of the IMF, these processes, if not sufficiently restrained by macroeconomic policies, could overheat the economy (*source: IMF*).

- *Easing of capital controls:* In response to the financial crisis in 2008, the Parliament of Iceland (*Alþingi*) introduced capital controls in November 2008 with the intent of stabilising the foreign exchange rate of Icelandic Krona (the **Capital Controls**). As of the date of this Base Prospectus, the Capital Controls have largely been lifted by the Icelandic Central Bank. See “*Capital Controls – Foreign Exchange Act*”. However, the remainder of the Capital Controls, although limited, may continue to be in place for some time and there is currently no set date for their complete lifting, and there can be no assurance that the elements of the Capital Controls which have already been lifted will not be re-imposed. See “- *The Capital Controls restrict to some extent the manner in which the Bank conducts its business and may result in abnormal pricing and financial bubbles in Iceland*”.
- *Lack of foreign direct investment:* No assurance can be given that sufficient levels of foreign direct investment in Iceland will materialise following the easing or complete lifting of the Capital Controls, which may result in fiscal and balance of payments deficits and a worsening of Iceland’s economic and fiscal positions.
- *Other factors:* Other domestic factors also pose significant risks to Iceland’s economic and fiscal position, including the high level of corporate and household debt, political factors (particularly in light of public sentiment regarding the financial sector), the remainder of the capital controls enacted in Iceland in November 2008 (the **Capital Controls**), any restructuring of the financial sector and winding down of Kaupthing, Glitnir and Landsbanki, as well as levels of consumption.

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

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

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

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

Key risks in these industry sectors include:

- *Tourism:* In 2011, the Icelandic government approved a new public strategy for tourism in Iceland in recognition of tourism's potential as a means to diversify and stimulate national, regional and local economic growth, as well as to create jobs, attract foreign direct investment and earn foreign currency income. As a result, the tourism industry sector has emerged in recent years as an important contributor to Iceland's GDP, with the number of tourists increasing but growth is expected to moderate in the medium term (source: *Statistics Iceland, Isavia, Arion Bank Research*), 30 per cent. in 2015, 40 per cent. in 2016, and 24 per cent. in 2017, in each case as compared to the previous year (source: *Statistics Iceland, Isavia, Arion Bank research*). In view of its contribution to the Icelandic economy, any decline of the Icelandic tourism industry sector, whether as a result of a global economic downturn, financial difficulties of key companies in the tourism industry, natural disasters, a significant appreciation of Icelandic Krona or otherwise, could have an adverse impact on the Icelandic economy.
- *Seafood:* Although Iceland's exports of other products have increased in relative terms, seafood remains a principal export for Iceland. The principal focus of the Icelandic seafood industry sector is the fishing, farming and processing of different seafood species. The seafood industry in Iceland therefore depends on the availability of plentiful stocks of various seafood species and the international demand for seafood, and any decline in stocks, a decrease in quotas for a particular seafood species, a decrease in international demand or a significant appreciation of Icelandic Krona could have a material adverse effect on the seafood industry sector.
- *Aluminium:* Iceland's aluminium industry sector has developed as a result of the availability of extensive, relatively inexpensive renewable energy sources to support energy-intensive aluminium smelting operations. Consequently, aluminium (smelted from imported raw materials) has become a principal component of Iceland's exports. Should the price of aluminium decline, to the point where it is no longer economical for aluminium producers to ship raw materials for smelting in Iceland, or if aluminium producers are able to find equivalent or cheaper sources of energy for their smelting operations, Iceland's aluminium exports could decline.
- *Energy:* According to the National Energy Authority of Iceland (*Orkustofnun*), nearly all stationary energy in Iceland is derived from renewable sources, such as hydro, wind and geothermal sources, and Iceland has become a key exporter of know-how regarding renewable energy sources. If Iceland is not able to keep up with the pace of worldwide developments in energy technology, for example, due to a shortage of skilled technicians or a lack of educational programmes specialising in energy, or if foreign investment in Icelandic energy projects and initiatives is not sufficient for its projected growth, Iceland's advantage in the energy industry sector could be impaired.
- *Real estate:* As tourism and the Icelandic population continue to increase, and assuming continued low levels of unemployment in Iceland, there will be a corresponding need for additional real estate development. For example, the Research subdivision of the Bank estimates that 8,000 to 9,000 housing units will be needed in the next three years, (an increase of approximately 6-7 per cent. from current levels). However, any deterioration of the underlying factors which are driving this increased demand for real estate, such as a decline in tourism or an unexpected macroeconomic event increasing unemployment, could have a material adverse effect on the real estate industry sector in Iceland.

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

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

Due to the financial crisis in 2008 and the subsequent deep recession in Iceland, public sentiment towards the banking sector has at times been negative. Any such negative sentiment could ultimately be reflected in political and legislative decisions which could have material adverse effects on the Bank. One possibility which has been discussed in Iceland is the potential for a law requiring the separation of commercial banking activities from investment banking activities, which could require the Bank to divest or otherwise restructure some of its most significant operations. Since 2017, the Minister of Finance has established various committees to examine the structure of the banking system in Iceland. In February 2018, the Minister of Finance announced a committee for the preparation of a white paper focusing on a full strategic review of the Icelandic financial system. The white paper has now been completed and submitted to the Minister of Finance and Economic Affairs. The white paper was made available on 13 December 2018 and is currently in the Icelandic government's consultation portal, where comments are invited until 15 January 2019. The white paper will form part of parliamentary discussion, once the Icelandic Parliament is in its 2019 spring session.

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

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

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

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

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

The Bank is exposed to significant liquidity risk

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

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

The Bank has recently extended the maturity profile of its liabilities, strengthened its liquidity reserve and converted a large portion of its demand deposits to term deposits (with 70.0 per cent. of the Bank's deposits being on demand as of 31 December 2016, as compared to over 90 per cent. as of 31 December 2009). See "*Risk Management - Liquidity Risk*". However, no assurance can be given that the Bank will continue to be successful in converting its demand deposits to term deposits or will otherwise be able to increase the maturity profile of its funding.

The Bank's non-deposit funding primarily consists of Covered Bonds issued under the Programme that are denominated, among others in, euro, Norwegian krone (**NOK** or **Norwegian Krone**) and U.S. dollars, as well as bonds issued under the Bank's covered bond facilities (including covered bonds previously issued by Kaupthing and assured by the Bank since January 2012), bond issuances under its multicurrency EUR 2,000,000,000 medium term euro note programme (the **EMTN Programme**), other loans and equity funding.

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

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

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

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

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

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

The current environment of particularly low interest rates has resulted in interest-earning assets (in particular residential mortgage loans) generating lower yields upon origination or refinancing and other loans and securities held also generating lower levels of interest income when compared to historical levels.

In addition, the Icelandic government has recently introduced legislation to abolish the stamp fee on collateral and has imposed restrictions on repayment fees which banks can charge, which has increased the ability of customers to refinance their debts. The Bank has seen a consequential increase in refinancings as interest rates have decreased, and there can be no assurance that the Bank can obtain funding at similarly low interest rates in order to maintain net interest income.

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

In addition, the Bank is exposed to inflation risk when there is a mismatch between its assets and liabilities linked to the Consumer Price Index (the **CPI**). As of 31 December 2017, the total amount of the Bank's CPI-linked assets was ISK 63,791 million and the total amount of its CPI-linked liabilities was ISK 230,851 million. In the event of periods of very low inflation or of deflation, CPI-linked assets would generate diminished levels of net interest income, which could have a material adverse effect on the Bank's net interest margin. Such assets would also decrease in value during periods of very low inflation or of deflation. The Bank also has significant maturity mismatches in its CPI-linked assets and liabilities, which arise from the fact that a significant proportion of the Bank's CPI-linked mortgages is not match-funded. The Bank is faced with interest rate risk and liquidity risk when CPI-linked mortgages are funded with liabilities which

have a shorter interest-fixing period and maturity. Although the Bank has implemented a range of risk management procedures designed to mitigate these risks, no assurance can be given that these controls will be effective in all circumstances, in which case the Bank could experience material losses. Any losses experienced by the Bank as a result of its market risk exposures could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Covered Bonds.

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

The availability, integrity, reliability and operational performance of the Bank's information technology (IT) systems, including Valitor Holding hf.'s (**Valitor**) global payments platform, are critical to the Bank's operations. The Bank's business relies on the efficient and uninterrupted operation of numerous systems, including computer hardware and software systems, data centres, third party telecommunications networks and the systems of third parties. Although the Bank's IT systems and Valitor's global payments platform have demonstrated a high level of reliability and performance to date, no assurance can be given that the Bank will be able to continue to maintain past levels of performance. In particular, the Bank currently uses a system provided by Reiknistofa Bankanna (**RB**), which is a centralised cash settlement system in Iceland, as its core system for deposits and payments, with all payment instructions settled through the RB system. RB intends to replace its current deposit and payment system with the Sopra Banking system, which is expected to become effective in late 2017. This would in turn require the Bank to replace its core deposit and payment systems, and the Bank is currently exploring its options with respect to future partners for its core deposit and payment systems. The implementation of a new cash settlement system or any other IT operations, outsourced or otherwise, could be subject to unexpected implementation costs and delays, and no assurance can be given that such implementations will be delivered on time or within budget.

The Bank's ability to provide products and services to its customers on a timely basis or at all would be impaired by damage, interruption, failure or lack of capacity of its IT systems, core deposit and payment systems, global payments platform, any other systems in its clearing operations or the systems of third parties on which it relies due to malicious increases in usage or attacks by hackers (including as a result of denial of service or similar attacks which exceed network or gateway capacity), hardware or software defects, human error, unauthorised access, natural hazards, disasters or similarly disruptive events as well as due to planned upgrades and improvements which may be subject to developmental delay or fail to be effective. Although the Bank maintains customary insurance policies for its operations, such insurance policies may not be adequate to compensate the Bank for all losses that may occur as a result of any such damage, interruption, failure or lack of capacity. 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 and Valitor's global payments platform.

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

The secure transmission of confidential information is a critical element of the Bank's operations, with the Bank processing personal customer data (including, in certain instances, customer names, addresses, credit and debit card numbers and bank account details), merchant data (including merchant names, addresses, sales data and bank account details), transaction data (including payment instructions, money transfers, securities trading and various other electronic communications and transfers within Iceland and cross-border) and other confidential information as part of its business. Therefore, the Bank is responsible for safeguarding such confidential information and must comply with strict data protection and privacy laws when dealing with such data in the jurisdictions in which it operates, including through the Bank's subsidiaries Valitor Holding hf. (**Valitor**), Stefmir hf. (**Stefmir**) and Vörður tryggingar hf. (**Vörður**). The Bank seeks to ensure that procedures are in place for compliance with the relevant data protection and privacy laws by its employees and any third party service providers. The Bank has also taken steps to implement and maintain appropriate security measures to protect confidential information.

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

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

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

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

In addition to the basic corporate income tax rate of 20 per cent. in Iceland, the Bank is subject to certain other taxes which are specific to financial institutions in Iceland and increase its effective tax rate and its effective cost of funding, which in turn can inhibit its ability to compete effectively with domestic and foreign lenders who are not subject to such additional taxes.

In particular, in December 2010, the Parliament of Iceland passed Act No. 155/2010 on Special Tax on Financial Institutions, pursuant to which certain types of financial institutions, including the Bank, are required to pay an annual levy (the **Bank Levy**), which, since the year ended 31 December 2013, has been calculated at 0.376 per cent. on the total debt of the Bank in excess of ISK 50.0 billion as of the end of the applicable period. Non-financial subsidiaries are exempt from the Bank Levy. Whereas the Bank Levy was originally introduced as a temporary measure, there is currently no fixed date for its removal and no assurance can be given as to whether the Bank Levy will be reduced, eliminated or increased further in the future. In addition, in December 2011, the Parliament of Iceland enacted Act No. 165/2011 on Financial Activities Tax, pursuant to which certain types of financial institutions, including the Bank, are currently required to pay a special additional 5.5 per cent. tax levied on all remuneration paid to employees (the **Financial Activity Tax**). Under Income Tax Act No. 90/2003, as amended (the **Income Tax Act**), the Bank is subject to an additional tax of 6.0% as a financial institution in respect of taxable profit exceeding ISK 1.0 billion irrespective of joint taxation or carry-forward losses (the **Special Financial Activity Tax**). The Bank

Levy, the Financial Activity Tax and the Special Financial Activity Tax place an increased cost burden on the Bank and subject it to a competitive disadvantage relative to other lenders not subject to such taxes, including international banks, domestic pension funds and the Housing Financing Fund. The Bank (on a standalone basis) was the highest corporate tax payer in Iceland in respect of operations in 2016, with total tax amounting to ISK 10.5 billion (source: *Icelandic Directorate of Internal Revenue*).

In addition, the Bank's results of operations could be harmed by changes in tax laws and tax treaties or the interpretation thereof, changes in corporate tax rates and the refusal of tax authorities to issue or extend advanced tax rulings, any of which could result in the Bank being subject to a higher effective tax rate. The unavailability of tax rulings could also diminish the range of structured transactions the Bank can enter into with its customers.

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

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

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

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

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

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

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

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

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

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

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

In particular:

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

the book value of those loans amounted to ISK 2,491 million or 19.5 per cent. of the aggregate carrying amount of such loans to customers;

- the Bank has significant lending exposure to the real estate and construction and fishing industry sectors, with exposure amounting to 16.7 per cent. and 10.3 per cent., respectively, of the total net carrying value of the Bank's customer loan portfolio as of 31 December 2017;
- as of 31 December 2017, the aggregate amount of the Bank's 10 largest loans to customers equalled 12.1 per cent. of the total gross amount of the Bank's customer loan portfolio as of such date;
- the Bank's customer loan portfolio is also highly concentrated among Icelandic borrowers; and
- on 1 January 2018, the Bank implemented IFRS 9. IFRS 9 replaced the "incurred credit loss" model used under IAS 39 with an "expected credit loss" model. The changes from incurred to expected credit losses requires professional judgment over various factors used in the calculation of expected credit losses, such as how macroeconomic scenarios affect the calculation. The application of the IFRS 9 impairment requirements could increase volatility in profit and loss of the Group.

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

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

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

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

Given the relatively small size of the Icelandic economy and the short period of time since the financial crisis in 2008, Icelandic households and businesses may be reluctant to engage in new borrowing activities and, as a result, the Icelandic banks are not expected to grow significantly through domestic lending in the near term and may experience increased competition and consequently pressures on net interest income. In addition,

the Bank has limited funding opportunities in Icelandic krona, namely its ISK-denominated deposits and its covered bond facilities, neither of which is capable of fully funding the Bank's ISK corporate lending volumes. Consequently, the Bank's ability to increase its corporate lending is limited and will continue to be limited unless the Bank is able to find additional sources of funding in Icelandic krona. It is also unlikely that the Bank, Íslandsbanki or Landsbankinn will grow significantly through international operations in the near future. Iceland's economy remains vulnerable to renewed disruptions, cessation or reversal of growth and a return to recession. Moreover, the Icelandic banks could also be adversely affected if other developments in the Icelandic economy or internationally result in slowing of growth in Iceland's economy or trigger a recession, any of which could in turn have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Covered Bonds.

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

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

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

The Bank is exposed to competition, and expects competition will increase as Iceland's economy recovers and the Capital Controls continue to be eased

The Icelandic banking sector is dominated by the Bank, Íslandsbanki and Landsbankinn (the latter two being wholly owned by the Icelandic government, and each of which is classified as a systemically important financial institution), but also includes other commercial banks and savings banks, the Housing Financing Fund (Íbúðalánasjóður) (a provider of financing for residential housing in Iceland and also a systemically important financial institution) and pension funds, which have increased their mortgage lending to individuals at aggressive interest rates, partially as a result of the fact that they are not subject to the Bank Levy. Pension funds in Iceland also provide competition for the Bank's deposits, as a vast proportion of individuals' savings in Iceland are held in pensions rather than in bank deposits, and a significant portion of payments to pension funds, representing a proportion of salary and a contribution by employers, are required by law. Pension funds also represent a significant source of the Bank's funding in Icelandic Krona as purchasers of the Bank's covered bonds. In addition, the Icelandic government has recently introduced legislation in order to facilitate customers switching banks in an effort to promote competition, for example, by abolishing the stamp fee on collateral which has had the effect of increasing the rate of refinancings, and

there can be no assurance that the Bank will be able to obtain funding at similarly low interest rates in order to maintain net interest margin.

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

The Bank is subject to considerable regulatory scrutiny that can hinder its competitiveness. At the same time, fintech companies and initiatives, which are not subject to the same regulatory burden, also pose an emerging source of competition for the Bank. Furthermore, the Bank is currently classified as a systemically important financial institution in Iceland, adding to its regulatory burden. For example, the Bank, Íslandsbanki and Landsbankinn were for some time under investigation by the Icelandic Competition Authority (*Samkeppniseftirlitið*) (the ICA) in relation to alleged abuse of the alleged collective dominant position of these three banks relating to their mortgage loan arrangements. That investigation was concluded with a settlement with the ICA in which the Bank has agreed to take certain measures which have the objective of stimulating competition in retail banking services for individuals and small businesses. The measures have the objective of reducing switching costs in financial services, promoting active competition among banks toward individuals and small businesses and negating circumstances that could enforce tacit co-ordination in the market for retail banking services in Iceland. According to the Icelandic Competition Act, a failure to implement or comply with measures agreed to in a settlement can lead to administrative fines being administered pending an investigation by the ICA.

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

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

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

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

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

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

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

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

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

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

- *Legal proceedings on disclosure requirements for borrowers:* In October 2017, the Supreme Court of Iceland ruled against Íslandsbanki in a case concerning disclosure requirements vis-à-vis borrowers, which lenders must fulfil when a loan agreement allows adjustable interest rates. The disclosure requirement calls on lenders to inform consumers of the condition under which the annual rate of interest may be amended. The proceedings were initiated by Íslandsbanki which submitted that an earlier ruling by the Consumer Rights Appeal Committee, where it was concluded that said disclosure requirements as set out in the Consumer Credit Act (No 121/1994) had not been fulfilled and as a result Íslandsbanki could not unilaterally raise the applicable rate, should be annulled. According to the Supreme Court, the terms and conditions of the loan agreement did not meet the aforementioned disclosure requirements. In accordance with a statutory obligation, a lender was obliged to specify in the loan agreement what conditions would allow for unilateral changes to the annual rate. Whereas Íslandsbanki had merely stipulated that the rate might be amended every five years, the Supreme Court rejected Íslandsbanki's submission. The Bank has reviewed the potential impact on its own loan portfolio. In 2012 and 2013, the Bank amended the applicable terms and conditions vis-à-vis interest rates for mortgage credit. As a result, no agreements concluded post-2013 are viewed as purportedly lacking. In the Bank's view, uncertainty remains concerning the legality of potential reimburse claims, with issues of indifference on behalf of claimants and statutory time limitations still unresolved.
- *Claim for alleged violations of the Competition Act:* With a writ issued in June 2013, Kortathjonustan claimed damages in the amount of up to ISK 1.2 billion plus interest in aggregate from the Bank, Íslandsbanki, Landsbankinn, Borgun hf. and Valitor as a result of losses that Kortathjonustan contends the five parties caused by violations of the Competition Act. The case was dismissed on procedural grounds rather than the merits by the District Court of Reykjavík by a ruling in March 2017. The ruling was confirmed by the Supreme Court on 2 June 2017, citing in particular that the plaintiff had not met with requirements related to standing. In September 2017, Kortathjonustan brought proceedings against the Bank and the other defendants on the same grounds, this time claiming damages in the amount of ISK 922 million plus interest. The case was again dismissed on procedural grounds by the District Court of Reykjavík by a ruling in March 2018, which was confirmed by the Court of Appeal in May 2018. Kortathjonustan has appealed the Court of Appeal's ruling to the Supreme Court which upheld the Court of Appeal's ruling. A new party which took over Kortathjonustan's claim issued a new writ in the case in November 2018 claiming acknowledgement of the duty of the five defendants in the first court case to pay damages. The Bank is evaluating the new writ. If the defendants would be ordered to pay damages, they would be jointly responsible for the payment of damages. The Bank has not recorded any provision in respect of this matter;
- *Legal proceedings regarding conduct in bankruptcy of BM Valla and Artun:* Lindarflot ehf. (**Lindarflot**) and the former chairman of the board of directors of BM Valla hf. (**BM Valla**) have claimed damages from the Bank as a result of losses Lindarflot and the former chairman contend that the Bank caused them losses by its conduct in relation to the bankruptcy of BM Valla and Artun ehf. (**Artun**) in 2010. Lindarflot and the chairman claim that the Bank, at the time a lender to BM Valla and Artun, rejected their proposal for the financial restructuring of BM Valla and Artun on illegitimate grounds, forcing the companies into insolvency proceedings and therefore causing them losses. The dispute is currently over recognition of liability and not the amount of damages, which will follow in the event that the Bank is found liable. Lindarflot and the former chairman had earlier claimed losses of approximately ISK 4 billion. In September 2018, the District Court of Reykjavík

acquitted the Bank. The plaintiffs appealed the judgment to the Court of Appeal. The Bank believes that it will be acquitted of the plaintiffs' claims in both cases and has therefore not recorded any provision in respect of this matter;

- *Legal proceedings in relation to Valitor's rescission of a vendor agreement:* Datacell ehf. (**Datacell**) and Sunshine Press Productions ehf. (**Sunshine Press Productions**) have claimed damages in the amount of approximately ISK 8.1 billion from Valitor in relation to Valitor's rescission of a vendor agreement with Datacell in 2011. The Supreme Court of Iceland had ruled in an earlier case that the rescission by Valitor was unlawful, as a result of which the companies have now commenced proceedings seeking damages from Valitor for the losses allegedly incurred by Datacell and Sunshine Press Productions due to the unlawful rescission. A court-appointed evaluators' report assessing damages was presented in March 2016. Valitor disagreed with the assessment stated in the report and filed a motion to appoint three court evaluators to re-evaluate the plaintiffs' alleged losses. The District Court of Reykjanes granted this motion. The reassessment has been completed, but will not be filed with the District Court. Recently Datacell and Sunshine Press Production claimed a freezing of Valitor's assets on the basis of the aforementioned claim of compensatory damages but the district magistrate declined the claim. Datacell and Sunshine Press Productions upheld the district magistrate's decision. Sunshine Press Production has appealed the ruling to the Court of Appeal;
- *Disputes relating to United Silicon:* United Silicon was granted a moratorium on payments on 14 August 2017 and filed for bankruptcy on 22 January 2018. The Bank had collateral in United Silicon's assets and the estate conveyed the assets to the Bank. The bankruptcy trustee has approved the Bank's collateral claims but two unsecured creditors have contested that approval and the dispute has been referred to the District Court. The Bank has examined these challenges and believes they are without merit. However, the Bank and the estate have agreed that if the Bank's collateral claims are judged invalid by the District Court, the Bank will refund the estate the amount of the invalidated bond; and
- *Possible criminal complaint and related correspondence:* In 2017 and 2018, the Bank received a series of correspondence from a former customer of the Bank's predecessor Kaupthing. The correspondence alleged that the Bank had not conducted sufficient internal due diligence to ensure that its management and directors are fit and proper to carry on the operations of a financial institution, on the basis that certain individuals who are employed by the Bank were employed by its predecessor Kaupthing or the other Icelandic banks at the time of the financial crisis in 2008. The Bank received further correspondence from this individual, which stated that he had filed a criminal complaint with the prosecutor in Iceland concerning Kaupthing's alleged wrongful appropriation of assets during the "winding up" process of Kaupthing. The individual alleges that the complaint involves both the Bank and certain of its employees. To date, there has been no indication from authorities in Iceland that any criminal proceedings will be brought against Kaupthing, the Bank or any of its employees in connection with this allegation. Included in the correspondence described above was information which the individual claimed supports his allegations against the Bank and those employees named in the correspondence. The Bank has considered the allegations in this correspondence, along with the related materials, and has conducted its own review of these allegations and related materials, including with support of external counsel, and it remains of the view that the allegations are without merit and that those employees named in the correspondence are indeed fit and proper.

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

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

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

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

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

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

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

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

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

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

The Icelandic Central Bank intends to continue to gradually ease the Capital Controls, subject to satisfaction of three conditions: macroeconomic stability, an adequate level of foreign reserves and a sound financial system. Even since the most recent reforms in March and June of 2017, certain transactions continue to be restricted, and as a result, there continues to be a certain degree of risk of abnormal pricing and financial bubbles. The reforms introduced by the Icelandic Central Bank in March and June of 2017 provide for general exemptions to most of the restrictions pursuant to the Foreign Exchange Act, with restrictions remaining on (i) derivatives trading for purposes other than hedging; (ii) foreign exchange transactions carried out between residents and non-residents without the intermediation of a financial undertaking; (iii) in certain instances, lending by residents to non-residents; (iv) cross-border movement of domestic

currency/financial instruments in domestic currency in certain instances; (v) settlement in foreign currency of transactions with financial instruments issued in domestic currency in certain instances; and (vi) certain other restrictions in relation to special reserve requirements due to new inflows of foreign currency in further specified cases.

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

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

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

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

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

The Bank could experience credit rating downgrades

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

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

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

The Bank is exposed to operational risks

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

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

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

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

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

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

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

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

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

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

The Group relies on third party service providers

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

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

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

The Bank is subject to laws regarding money laundering and the financing of terrorism as well as laws that prohibit the Bank or its employees or intermediaries from making improper payments or offers of payment to

foreign governments and their officials and political parties for the purpose of obtaining or retaining business. Compliance with anti-money laundering and anti-bribery regulations can place a significant financial burden on banks and other financial institutions and requires significant technical capabilities. The Icelandic government is in the process of implementing the Fourth Money Laundering Directive (2015/849/EU), pursuant to which Parliament presented bill 314 on 5 December 2018 and enacted it into law on 13 December 2018. The Bank is currently making preparations to comply with the new regulations. However, the Bank cannot predict the nature, scope or effect of future regulatory requirements to which it might be subject or the manner in which existing laws might be administered or interpreted. Although the Bank believes that its current policies and procedures are sufficient to comply with applicable anti-money laundering, anti-bribery and sanctions rules and regulations, it cannot guarantee that such policies completely prevent situations of money laundering or bribery, including actions by the Bank's employees, for which the Bank might be held responsible. Any such events may have severe consequences, including sanctions, fines and reputational consequences, which could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Covered Bonds.

Application of CRD IV could adversely affect the Bank

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

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

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

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

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

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

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

The Bank and Stefmir manage assets for retail and institutional investors, corporations and high net worth individuals in a broad range of asset classes. Certain of these asset classes may be viewed more or less favourably by potential customers at different times and in different markets with different regulatory and fiscal frameworks. Moreover, the overall proportion of customer assets across the asset management industry sector that is dedicated to actively managed funds of the type managed by the Bank and Stefmir is decreasing in favour of passively managed funds such as index funds, trackers and other similar low-fee alternatives, such as robo-advisers. In addition, new asset classes and categories of actively managed funds may be developed by competitors, some of which might not be among the principal products and services offered by the Bank and Stefmir. The entry into new products and services with potentially higher margins could also subject the Bank and Stefmir to potential losses, as a result of lack of experience with such products and services, greater inherent risk in the products and services or otherwise. The reduction in the number of

pension funds in Iceland, and the recent trend on the part of certain Icelandic pension funds to bring asset management responsibilities back in-house rather than relying on third-party asset managers like the Bank, has had an impact on the fund management market in Iceland and is expected to have a negative effect on the fund management industry, especially in traditional funds, for the foreseeable future. Other imminent changes in the asset management industry include the arrival of new competition in the form of fintech companies, leading to more intense competition and putting pressure on commissions in various financial services. Responding to these changes will require the Bank to incur additional costs, hire employees with new expertise and change its business processes and services.

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

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

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

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

insolvency of the seller, legal technicalities, such as the relevant jurisdiction or evidence requirements, or expiry of claim periods for such warranties or indemnities.

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

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

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

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

On 2 July 2014, Directive 2014/59/EU providing for the establishment of an EU-wide framework for the recovery and resolution of credit institutions and investment firms (the **Bank Recovery and Resolution Directive** or **BRRD**) entered into force. Iceland, Liechtenstein, Norway and Switzerland are members of the EFTA and Iceland, together with Liechtenstein and Norway (the **EEA EFTA States**) is also a party to the EEA Agreement by which the EEA EFTA States participate in the internal market of the European Union (the **EU**). The BRRD was incorporated into the EEA Agreement on 9 February 2018 with Decision No 21/2018 of the EEA Joint Committee. A committee has been established, charged with the task of preparing new legislation implementing the BRRD in Iceland. The BRRD has been partly implemented in Iceland through Act No 54/2018. This act implements the BRRD provisions relating to recovery planning, early intervention and intra-group financial support. The objective is to submit another bill during the next legislative parliament to provide for the further implementation of the BRRD in Iceland.

The BRRD is designed to provide authorities with a credible set of tools to intervene sufficiently early and quickly in an unsound or failing relevant entity so as to ensure the continuity of the relevant entity's critical financial and economic functions, while minimising the impact of a relevant entity's failure on the economy and financial system. The BRRD was applied by Member States from 1 January 2015, except for the general bail-in tool (see below) which 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) a relevant entity is failing or likely to fail, (b) there is no reasonable prospect that any alternative private sector measures would prevent the failure of such a relevant entity within a reasonable timeframe, and (c) a resolution action is in the public interest: (i) sale of business - which enables resolution authorities to direct the sale of the a relevant entity or the whole or part of its business on commercial terms; (ii) bridge institution - which enables resolution authorities to transfer all or part of the business of the a relevant entity to a "bridge institution" (an entity created for this purpose that is wholly or partially in public control), which may limit the capacity of the a relevant entity to meet its repayment obligations; (iii) asset separation - which enables resolution authorities to transfer impaired or problem assets to one or more publicly owned asset management vehicles to allow them to be managed with a view to maximising their value through eventual sale or orderly wind-down (this can be used together with another resolution tool only); and (iv) bail-in - which gives resolution authorities the power to write down certain claims of unsecured creditors of a failing a relevant entity (which write-down may result in the

reduction of such claims to zero) and to convert certain unsecured debt claims to equity (the **general bail-in tool**), which equity or other instruments could also be subject to any future cancellation, transfer or dilution.

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

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

Although the "bail-in" powers are not intended to apply to secured debt (such as the rights of Covered Bondholders in respect of the Cover Pool), there remains significant uncertainty regarding the ultimate nature and scope of these powers and how they would affect the Bank and the Covered Bondholders. Accordingly, it is not yet possible to assess the full impact of the BRRD on the Bank and on Covered Bondholders, and there can be no assurance that, once it is implemented, the manner in which it is implemented or the taking of any actions by the relevant resolution authority currently contemplated in the BRRD would not adversely affect the rights of Covered Bondholders, the price or value of an investment in the Covered Bonds and/or the Issuer's ability to satisfy its obligations under the Covered Bonds. The exercise of any bail-in power or any suggestion of such exercise could, therefore, adversely affect the value of the Covered Bonds. Relevant claims for the purposes of the bail-in tool would include the claims of holders in respect of any Covered Bonds issued under the Programme if and only to the extent that the Covered Bond liability exceeded the value of the Cover Pool against which it is secured.

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 judgment to ascertain the valuations of assets, liabilities, commitments and contingencies. See note 32 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 judgments 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 judgments 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.

Legal and regulatory risks relating to the Covered Bonds

Set out below is a brief description of certain legal and regulatory risks relating to Covered Bonds.

Legal risks

The Issuer's business operations are governed by law and regulations and are subject to authority supervision. Any changes to the current legislation might affect the Issuer's business operations and its operating results. Furthermore, competition and other factors might also affect the Issuer's business. The Icelandic Covered Bond Act No. 11/2008 provides that the FME may issue rules providing for the types of assets in a Cover Pool, methods for appraisal of collateral of bonds, terms and conditions for derivative agreements and conditions for the calculation of risk and interest payments. FME has issued such rules, i.e. Rules No. 528/2008 on Covered Bonds that concern, among other things, the conditions for being granted a licence to issue Covered Bonds, appraisal and revaluation of the assets in the cover pool, matching rules, derivative agreements, the covered bond register and the eligibility and reporting of the independent inspector (the **Rules**). Any changes to the Icelandic Covered Bond Act and/or the Rules as well as other current legislation might affect the legal and regulatory risks relating to the Covered Bonds.

The Icelandic Covered Bond Act entered into force on 4 March 2008; only three licences to issue covered bonds have to date been granted under the Act, and there are limited precedents on how its provisions will be interpreted or applied by Icelandic courts or administrative authorities. The preparatory works to the Act are limited and the system of Covered Bonds secured by the Cover Pool lacks any clear analogues in Icelandic law that would allow for robust arguments in respect of the Icelandic Covered Bond Act, the Covered Bonds or the Cover Pool based on analogy from such analogues.

Credit risks relating to the Issuer's collateral

Given that the Issuer's loans are granted with mortgages on residential real estate as collateral, the credit risk is driven in part by performance of the real estate and housing market in Iceland. There can be no assurance regarding the future development of the value of this collateral. Should the prices of real property and the housing market substantially decline, this could adversely affect the Issuer's results of operations, financial condition and business prospects and its ability to perform its obligations under the Covered Bonds.

There are many circumstances that affect the level of credit loss, including early repayments, withdrawals and final payments of interest and principal amounts, such as changes in the economic climate, both nationally and internationally, changes regarding taxation, interest rate developments, inflation and political changes. Borrowers may default as a result of interest rate increases or as a result in changes in their own personal circumstances (e.g. following redundancy or divorce).

Default in respect of the Issuer's assets that comprise the Cover Pool could jeopardise the Issuer's ability to make payments in full or on a timely basis on the Covered Bonds. If a material amount of assets in the Cover Pool were to default, there is no guarantee that the required level of assets within the Cover Pool could be maintained or that the Issuer would be able to substitute non-defaulting assets for the defaulting assets. Any such failure could adversely affect the Issuer's results of operations, financial condition and business prospects and its ability to perform its obligations under the Covered Bonds.

Regulatory initiatives may have an adverse impact on the regulatory treatment of the Covered Bonds

In Europe, the U.S. and elsewhere, there is significant focus on fostering greater financial stability through increased regulation of financial institutions, and their corresponding capital and liquidity positions. This has resulted in a number of regulatory initiatives which are currently at various stages of implementation and which may have an impact on the regulatory position for certain investors in covered bond exposures and/or on the incentives for certain investors to hold covered bonds, and may thereby affect the liquidity of such securities. Investors in the Covered Bonds are responsible for analysing their own regulatory position and none of the Issuer, the Guarantor, the Lead Managers or the Arrangers makes any representation to any prospective investor or purchaser of the Covered Bonds regarding the treatment of their investment on the Closing Date or at any time in the future.

In particular, it should be noted that the Basel Committee on Banking Supervision (**BCBS**) has approved significant changes to the Basel regulatory capital and liquidity framework (such changes being commonly referred to as **Basel III**). Basel III provides for a substantial strengthening of existing prudential rules, including new requirements intended to reinforce capital standards (with heightened requirements for global systemically important banks) and to establish a leverage ratio "backstop" for financial institutions and certain minimum liquidity standards (referred to as the Liquidity Coverage Ratio (**LCR**) and the Net Stable Funding Ratio (**NSFR**)). BCBS member countries agreed to implement Basel III from 1 January 2013, subject to transitional and phase-in arrangements for certain requirements (e.g. the LCR requirements refer to implementation from the start of 2015, with full implementation by January 2019, and the NSFR requirements refer to implementation from January 2018). As implementation of Basel III requires national legislation, the final rules and the timetable for its implementation in each jurisdiction, as well as the treatment of covered bonds (e.g. as LCR eligible assets or not), may be subject to some level of national variation. It should also be noted that changes to regulatory capital requirements have been made for insurance and reinsurance undertakings through participating jurisdiction initiatives, such as the Solvency II framework in Europe.

Prospective investors should therefore make themselves aware of the requirements described above (and any corresponding implementing rules of their regulator), where applicable to them, in addition to any other applicable regulatory requirements with respect to their investment in the Covered Bonds. No predictions can be made as to the precise effects of such matters on any investor or otherwise.

The European Commission, European Parliament and the European Council have proposed legislation (in the form of draft regulation and directives) to harmonise the regulation of the Covered Bond market in the European Union. No assurances can be given as to what the final language of any draft regulation and directive will contain or the timing of any implementation of any legislation.

Foreign Account Tax Compliance Act withholding may affect payments on the Covered Bonds

Whilst the Covered Bonds are held within Euroclear, Clearstream, Luxembourg or the ISD (the **ICSDs**), in all but the most remote circumstances, it is not expected that FATCA will affect the amount of any payment received by the ICSDs. However, FATCA may affect payments made to custodians or intermediaries in the subsequent payment chain leading to the ultimate investor if any such custodian or intermediary generally is unable to receive payments free of FATCA withholding. It also may affect payment to any ultimate investor that is a financial institution that is not entitled to receive payments free of withholding under FATCA, or an ultimate investor that fails to provide its broker (or other custodian or intermediary from which it receives payment) with any information, forms, other documentation or consents that may be necessary for the payments to be made free of FATCA withholding. Investors should choose their custodians or intermediaries with care (to ensure each is compliant with FATCA or other laws or agreements related to FATCA) and provide each custodian or intermediary with any information, forms, other documentation or consents that may be necessary for such custodian or intermediary to make a payment free of FATCA withholding. The Issuer's obligations under the Covered Bonds are discharged once it has made payment to, as to the order of, the common depository or the common safekeeper for the ICSDs, and the Issuer has therefore no responsibility for any amount thereafter transmitted through the ICSDs and custodians or intermediaries. Further, foreign financial institutions in a jurisdiction which has entered into an intra governmental agreement with the United States (an **IGA**) are generally not expected to be required to withhold under FATCA or an IGA (or any law implementing an IGA) from payments they make. Prospective investors should refer to the section "*Taxation – Foreign Account Tax Compliance Act.*"

Change of law and establishment of case law

The Terms and Conditions of the Covered Bonds (the **Conditions**) are governed by English law and, in respect of Condition 3, Icelandic law, in each case as in effect as at the date of this Offering Circular. No assurance can be given as to the impact of any possible judicial decision or change to English law, Icelandic law and/or administrative practice after the date of this Offering Circular.

In particular, the Icelandic Covered Bond Act is new legislation in Iceland, having been adopted by the Icelandic Parliament on 4 March 2008, and relatively there is no available case law on it. It is uncertain how the Icelandic Covered Bond Act will be interpreted or whether changes or amendments will be made to it which will affect Covered Bonds issued under the Programme. This same risk applies to the Rules.

No gross-up

Under the Terms and Conditions of the Covered Bonds, all payments in respect of the Covered Bonds will be made without deduction for or on account of withholding taxes imposed by the Republic of Iceland (**Iceland**) or any political subdivision or any authority thereof or therein having power to tax unless such withholding or deduction is required by law, in which case such deduction will be made by the Issuer.

In the event that any such withholding or deduction is required by law, the Terms and Conditions require the Issuer to pay additional amounts in respect of such withholding or deduction subject to customary exceptions (see Condition 9 (*Taxation*)). If the withholding or deduction arises as a result of one of the circumstances described in paragraphs (a) to (f) of Condition 9, the Issuer will not be required to pay such additional amounts and affected investors will receive interest payments net of such withholding. If however the Issuer is required to pay additional amounts, it will have the option under Condition 8.2 (*Redemption for Tax Reasons*) to redeem the relevant Covered Bonds early.

Paragraph (f) of Condition 9 deals with the Article 3(8) of the Income Tax Act no. 90/2003 (**ITA**) (as amended by Act no. 70/2009) and Act no. 107/2015, which imposes withholding tax on payments of Icelandic sourced interest to a foreign bondholders at a rate of 12%, unless the issue is exempt on the grounds that the bonds are registered with a securities depository within the EEA or OECD and has been registered as such or bonds issued by the estates of previously operating financial institutions as part of a composition agreement. Further exemptions are available to the relevant bondholders in their home countries or under a double taxation treaty with Iceland.

In April 2013 the Icelandic Parliament adopted an amendment to Article 3(8) of the ITA exempting from taxation the interest earned on income by non-domestic entities, from certain debt instruments issued by financial institutions. This exemption includes bonds registered with a securities depository within the EEA or OECD such as those issued under this programme. Furthermore, the Parliament adopted an amendment in November 2015 exempting from taxation interest on bonds that are issued in connection to the obligations under composition agreements and in the own name of a legal entity previously operating as a financial institution but are under a winding up proceeding or have completed such proceedings. The exception is subject to general registration of the programme with the Director of Revenue (*Ríkisskattstjóri*).

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 No. 87/1992, as amended, (the **Foreign Exchange Act**) granting the Icelandic Central Bank powers to intervene in the currency-market with the view of stabilizing 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**) which were subject to review every six months. The Foreign Exchange Rules were codified with the adoption of Act no 127/2011 in 2011. The Foreign Exchange Act has since been amended several times, first in March 2012, March 2013, May 2014 June 2015, July 2015, June 2016 and in October 2016. In addition, new rules were adopted in March 2017, later amended in June 2017, implementing extensive exemptions to the restrictions of the Foreign Exchange Act. The general regime on currency restrictions is set out in Article 13 of the Act.

The Foreign Exchange Act as codified with certain minor amendments effectively prohibited the outflow of foreign currency from Iceland unless it was a payment for goods or services. Therefore all financial transactions leading to currency outflow were prohibited unless explicitly allowed for in the future. More specifically the Foreign Exchange Act included 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 nominated in foreign currency. Furthermore, the Foreign Exchange Act makes it compulsory for Icelanders and Icelandic companies to “repatriate” all their foreign currency back into the country.

The Foreign Exchange Act provided for several general exceptions. Commercial banks were 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, were exempt from restrictions on borrowing and lending between national and foreign parties, restriction on assuming liability for payments between national and foreign parties, and requirement to repatriate all foreign currency. Payments by the Bank of interest on interest payment dates and of principal on the maturity dates were and still are, therefore, exempt from the restrictions of the Foreign Exchange Act under the general exemption. However, only limited exemption was provided for prepayments and, therefore, payments of an early redemption or an optional redemption under the Covered Bonds.

With the adoption of rules no. 200/2017, adopted in March 2017 and amended in June 2017, most of the restriction of the capital controls have been lifted with the new rules. The rules provide for general exemptions to nearly all of the restrictions pursuant to the Foreign Exchange Act, with restrictions remaining on (i) derivatives trading for purposes other than hedging; (ii) foreign exchange transactions carried out between residents and non-residents without the intermediation of a financial undertaking; (iii) in certain instances, lending by residents to non-residents; (iv) cross-border movement of domestic currency/financial instruments in domestic currency in certain instances; (v) settlement in foreign currency of transactions with financial instruments issued in domestic currency in certain instances; and (vi) certain other restrictions in relation to special reserve requirements due to new inflows of foreign currency in further specified cases.

In addition to the general exemptions, the Foreign Exchange Act provides for specific exemptions from the restrictions of the legislation, subject to the Central Bank’s approval. Such exemptions have to be applied for to the Central Bank where the process is estimated to take a minimum of 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 Covered Bonds, 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. Payments under winding-up, bankruptcy or insolvency could consequently be due in Icelandic krona.

The amendments in March 2012, with act no 17/2012, imposed further restrictions on the outflow of foreign currency. This entailed two amendments to the capital controls regime, inter alia, in response to a perceived increase in circumvention of the capital controls. Before these amendments, an investor could change principal payment, amortization and the indexation share of a CPI indexed annuity bond into foreign currency and transfer out of the economy. The legislation removed the previous exemption provided for the principal payment, amortization and indexation share of bond payments which are now subject to the general capital controls regime. Furthermore, the wide exemptions for payments of the winding-up committees of the failed Icelandic banks to their 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 changes to the capital control regime, including the removal of the expiration date from the Act, making them continuous. Moreover the amendments imposed limits on the exemptions which the Central Bank can apply and may now be subject to prior consultation with the relevant ministry. This primarily relates 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 has substantial effect on the debt position of the economy and 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 authorizations for the Central Bank. The amendments enhanced the

Central Bank's surveillance on foreign exchange, including in relation to payments of interest, indexation, dividends and contractual maturities. This includes authorization to collect information, which may extend to any relevant third party and to impose fines.

Further changes were made to the Foreign Exchange in May 2014 with the adoption of Act no 67/2014. The exemption on cross-border payment of dividend was further clarified, just applying to dividend on the basis of profit from operations of companies, excluding e.g. profit from sale of assets and any payments of deriving from decrease in share capital or liquidation of companies.

Amendments were made to the Act in June and July 2015. The amendments mainly aimed at the winding-up proceedings of the estates of Glitnir, Landsbanki, Kaupthing and other smaller bankrupt banks. With the adoption of Act No. 27/2015 several amendments were made restricting the operations of the estates and withdrawing of the general exemption that previously applied to the estates. 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 security unless with regards to the purchase of goods and services or loans that are generally exempt. Also, restrictions were adopted on repayments of loans, the granting of security as well as certain payments of the estates no longer qualify as allowed repayments under the Act no. 27/2015. Investments in derivatives or claims on the estates no longer qualify as new investments under the Central Bank's new investment regime. Several amendments applied to other legal entities, for example with respect to intra group loans, where limits were adopted on repayments of intra group loans and the purchase of currency for such repayment. Furthermore, 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.

Furthermore amendments were adopted with Act no. 60/2015 granting the estates exemption from some of the restrictions of the Foreign Exchange Act provided that payment of stability contribution or a 39% stability tax according to Act no. 60/2015 has been made.

On 25 March 2011, the Central Bank announced a new strategy for the gradual removal of remaining capital controls in phases. Further steps for such removal have been awaited since, with little development, until June 2015 when the Icelandic government and the Central Bank announced its action plan to that effect. The estates of Glitnir, Landsbanki, Kaupthing and other smaller bankrupt banks were given a timeframe to finalize a composition agreement and payment of stability contribution. This part of the strategy has now been completed.

The Icelandic government and the Central Bank have been active in taking further steps in 2016 towards the easing of the Capital Controls, aimed at individuals and the investments of legal entities.

A new act no 37/2016 on the Treatment of Króna-Denominated Assets Subject to Special Restrictions (the Króna Asset Act), was enacted on 23 May 2016. The act was a step in the liberalisation of the Capital Controls and implemented reserve requirements and prohibition on hypothecation of offshore króna assets.

The Foreign Exchange Act was amended further in June and October 2016, with the same aim. The amendments from June provide permission for reinvesting following investments through the new investment regime permitted under the Foreign Exchange Act, as well as a temporary provision in relation to the Króna Asset Act. The October 2016 amendments provided further relaxation of provisions relating to individuals and investors, the most significant amendment being new exemptions from the general prohibition on cross-border capital movements and foreign exchange transactions, including unlimited direct foreign investments by domestic parties. Furthermore other foreign investments by domestic parties, repayments and retirement of loans and investments of securities are subject to limitations on amounts.

The capital controls constitute protective measures under Article 44 of the EEA Agreement and have as such been notified to the EFTA Standing Committee under the procedures provided for in Protocol 18 of that agreement in conjunction with Protocol 2 to the Surveillance and Court Agreement. Following a referral by

the District Court of Reykjavík, the EFTA Court issued a reasoned opinion on 14 December 2011, whereby the Court ruled that it had competence under the EEA Agreement and the Surveillance and Court Agreement to review the rules on currency restrictions inter alia in light of the general principle of proportionality. The Court further declared that at the time in question the rules in question were proportionate. However, this ruling of the EFTA Court does not preclude further scrutiny of the above 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 Listed Covered Bonds.

No events of default

The Terms and Conditions of the Covered Bonds do not include any events of default relating to the Issuer, the occurrence of which would entitle Covered Bondholders to accelerate the Covered Bonds, and Covered Bondholders will only be paid the scheduled interest payments under the Covered Bonds as and when they fall due under the Terms and Conditions of the Covered Bonds.

Maintenance of the Register

The Issuer must also maintain a Register in respect of the Covered Bonds, the Cover Pool and any derivative agreements. If the Register or the value of the Cover Pool are not maintained in accordance with the Act, the FME may revoke the Issuer's license to issue Covered Bonds. Mortgage Bonds in a Cover Pool must be endorsed showing they are part of a Cover Pool and have been entered in a Register as provided for in the Icelandic Covered Bond Act. The endorsement must also indicate that the debt instrument is to secure priority rights of a specific class of Covered Bonds. The Icelandic Covered Bond Act does not stipulate to what extent it is necessary to register a security in respect of the other assets in the Cover Pool.

If the Issuer fails to enter the assets in the Cover Pool and payments received therefrom (**Cover Pool Revenue**) in the Register, the Covered Bondholders and Swap Providers will not have priority claims to the Cover Pool and Cover Pool Revenue and will rank with the Issuer's unsecured creditors in the event the Issuer is subject to winding up proceedings.

Conflicting interests of other creditors

The rights of the Covered Bondholders rank junior to counterparties to derivatives agreements included in the Cover Pool, though they have preferential right with respect to other creditors against the Cover Pool. Further, in the event of the winding up of the Issuer, they will rank junior to costs incurred in connection with the operation, management, collection and realisation of the Cover Pool, as well as the claims due to derivative agreements concluded in accordance with the provisions of the Icelandic Covered Bond Act (as mentioned above), which will be covered before the claims of the Covered Bondholders.

To the extent that Covered Bondholders are not fully paid from the proceeds of the liquidation of the assets comprising the Cover Pool, they will be able to apply for the balance of their claims as unsecured creditors of the Issuer and will be entitled to receive payment from the proceeds of the liquidation of the other assets of the Issuer not comprising the Cover Pool. The Covered Bondholders would in such case rank *pari passu* with the other unsecured, unsubordinated creditors of the Issuer and, as a result, may not receive all amounts owed by the Issuer to such Covered Bondholders. Please note that as a result of the enactment of Act No. 125/2008 on the Authority for Treasury Disbursements Due to Special Financial Market Circumstances etc. (the **Emergency Act**), should the Issuer enter into winding-up proceedings, such claims of Covered Bondholders would be subordinated to claims of the Issuer's depositors.

Liquidity

If the Issuer is wound up neither the Issuer nor its estate would be allowed to issue further Covered Bonds. It would therefore not be possible for a winding up committee to raise finance in the market by the issuance of further Covered Bonds following the winding up of the Issuer. Further, neither the Icelandic Covered Bond Act nor the Rules stipulate that the winding up committee or the Issuer's estate may contract debt obligations of any kind in order to service the timely payment under the terms of the Covered Bonds. There is no legislation in place that states that the winding up committee managing the Issuer's estate can raise loans or enter into any such agreements in order to service the timely payment of interest and principal on the Covered Bonds. Article 17(1) of the Icelandic Covered Bond Act states that the winding up committee shall fulfil an issuer's commitments under the covered bonds and derivative agreements using the mortgage bonds and other assets in the cover pool and payments received on such assets, provided that the assets are listed in the register. However, neither the Icelandic Covered Bond Act nor the Rules on Covered Bonds include guidelines as to whether liquidity could be raised by selling the Mortgage Bonds and other assets registered to the Cover Pool in the market.

The Issuer is also subject to liquidity requirements in its capacity as a commercial bank supervised by the FME, including a statutory requirement to maintain sufficient liquidity to enable it to discharge its obligations as they fall due. The FME has issued guidelines on liquidity, which are not binding on the Issuer. However, any serious or systematic deviations from such guidelines may lead to the FME determining that the Issuer's business does not satisfy the statutory soundness requirement for commercial banks and result in the FME imposing sanctions against the Issuer.

Risks related to the Cover Pool

Non-compliance with matching rules

The Icelandic Covered Bond Act contains matching rules which, *inter alia*, require that the total current value of the assets registered to the Cover Pool as collateral for a specific class of Covered Bonds must always exceed the total current value of the principal of the Covered Bonds of that same class. The Icelandic Covered Bond Act also requires that the instalments and other payment flows accruing on assets in the Cover Pool and from derivative agreements are in such a manner that all commitments towards the Covered Bondholders and derivative agreements can be met. See "*Overview of the Icelandic Legislation Regarding Covered Bonds – Matching Rules*" below for further details.

A breach of the matching requirements prior to the winding up of the Issuer in the circumstances where no additional assets are available to the Issuer or the Issuer lacks the ability to acquire additional assets could cause the FME to revoke the Issuer's license to issue Covered Bonds. The same applies in the event that the Issuer does not comply with other requirements prescribed in the Icelandic Covered Bond Act.

If the matching requirements are breached following the winding up of the Issuer, the winding up committee would not be permitted to add more assets to the Cover Pool. The Icelandic Covered Bond Act does not provide any further guidance as to the consequences of a breach of the matching rules following the winding up of the Issuer.

The explanatory memorandum for the Act on Covered Bonds states that assets can be removed from the cover pool and replaced with same kind of assets without limitations. If assets are replaced with substitute collateral there are limitations in the law on how much can be replaced with such collateral. This can, however, be subject to contract.

No Specified Overcollateralisation

The Icelandic Covered Bond Act requires the value of the assets in the cover pool to at all times exceed the value of the claims on the cover pool. However, the Icelandic Covered Bond Act does not require that the

value of such assets exceeds the value of such claims by any specific amount. Failure to maintain sufficient assets in the cover pool could result in the Bank being unable to issue further Covered Bonds or refinance existing Covered Bonds.

The Bank intends to overcollateralise the Cover Pool at all times by at least 5 per cent. of the aggregate value of the principal amount outstanding of the Covered Bonds.

The Cover Pool consists of limited assets

The Cover Pool consists of loans which are secured on interests in residential property, industrial, office or commercial property, and agricultural property, claims which the Issuer holds, or may acquire, against providers of Covered Bond swaps and certain substitute assets. All assets in the Cover Pool must comply with the terms of the Icelandic Covered Bond Act and Rules. See "*Overview of the Icelandic Legislation Regarding Covered Bonds – Eligible Cover Pool Assets*" below for a description of the assets that can constitute the Cover Pool. At the date of this Offering Circular, all of the properties over which mortgages are created are in Iceland. The value of the Cover Pool may therefore decline in the event of a general downturn in the value of property in Iceland, which could adversely affect the Issuer's results of operations, financial condition and business prospects and its ability to perform its obligations under the Covered Bonds.

Limited Description of the Cover Pool

Save as contemplated by each Final Terms, holders of the Covered Bonds will not receive detailed statistics or information in relation to the assets contained or to be contained in the Bank's cover pool, as it is expected that the constitution of the cover pool may change from time to time due to, for example, the purchase or origination of further residential mortgages by the Bank from time to time. Although an independent inspector appointed under the Icelandic Covered Bond Act will monitor the Bank's compliance with some of the requirements of the Icelandic Covered Bond Act, the report of such inspector is not publicly available.

Geographic Concentration Risks

Certain geographic regions of Iceland from time to time will experience weaker regional economic conditions and housing markets or be directly or indirectly affected by natural disasters or civil disturbances. Mortgage loans in such areas will experience higher rates of loss and delinquency than mortgage loans generally.

The ability of borrowers to make payments on the mortgage loans may also be affected by factors which do not necessarily affect property values, such as adverse economic conditions generally in particular geographic areas or industries, or affecting particular segments of the borrowing community (such as borrowers relying on commission income and self-employed borrowers). Such occurrences may accordingly affect the actual rates of delinquencies and losses with respect to the mortgage loans in the cover pool.

The mortgage loans underlying certain series of Covered Bonds may be concentrated in certain regions. Such concentration may present the risk considerations described above in addition to those generally present for similar securities without such concentration.

Appraisals

In accordance with the Icelandic Covered Bond Act, appraisals or valuation of the properties securing the mortgage loans may be undertaken by the Issuer, and takes account of the following: (a) The selling price of a property on the day the transaction is made; or (b) an independent appraisal conducted by a licensed estate agent; or (c) an acquisition offer, signed on behalf of both the seller and the buyer; or (d) the rateable value

of the property, made by the Icelandic Property Registry. Appraisals based on the selling price of a property shall be valid for a period of 12 months from the day the transaction was made.

Such appraisal undertaken by the Issuer will be verified by the independent inspector as being based on an accepted methodology.

No assurance can be given that values of the properties underlying the mortgage loans have remained or will remain at the levels which existed on the dates of appraisal (or, where applicable, on the dates of appraisal updates) of the related mortgage loans.

The appraisal relates both to the land and to the structure; in fact, a significant portion of the appraised value of a property may be attributable to the value of the land rather than to the residence. Because of the unique locations and special features of certain properties, identifying comparable properties in nearby locations may be difficult. The appraised values of such properties will be based to a greater extent on adjustments made by the appraisers to the appraised values of reasonably similar properties rather than on objectively verifiable sales data. As a result, such appraisals could be more likely to overvalue certain properties and therefore overstate the value of the collateral underlying the cover pool.

Audit of the Cover Pool

Other than any interim financial statements or annual audited financial statements incorporated by reference in this Offering Circular, the Bank does not publish any separate reviews or audits of the cover pool. However, in accordance with the requirements of the Icelandic Covered Bond Act and the FME the Bank is monitored by an independent inspector appointed licensed by the FME who monitors that the register is maintained in a correct manner. Furthermore, none of the Arranger and any Dealer have conducted any audit of the Cover Pool.

Factors that may affect the realisable value of the Cover Pool

The Cover Pool Revenue or the realisable value of Cover Pool, in the event of the winding up of the Issuer, may be reduced, which may affect the ability of the Issuer (or the winding up committee in the event of the winding up of the Issuer) to make payments on the Covered Bond as a result of:

- default by Borrowers in payment of amounts due on their Mortgage Bonds;
- changes to the lending criteria of the Issuer (the **Lending Criteria**);
- no representations or warranties being given by the Issuer;
- set-off risks in relation to some types of Mortgage Bonds in the Cover Pool; and
- possible regulatory changes by regulatory authorities in Iceland.

Each of these factors is considered in more detail below. However, it should be noted that the matching rules under the Icelandic Covered Bond Act are intended to ensure that the value of the Cover Pool will be sufficient to enable the Issuer to meet its obligations under the Covered Bonds and the derivative agreements.

Default by Borrowers in paying amounts due on their Mortgage Bonds

Borrowers may default on their obligations under the Mortgage Bonds in the Cover Pool. Defaults may occur for a variety of reasons. The Mortgage Bonds are affected by credit, liquidity and interest rate risks. Various factors influence mortgage delinquency rates, prepayment rates, repossession frequency and the ultimate payment of interest and principal, such as changes in the national or international economic climate,

regional economic or housing conditions, changes in tax laws, interest rates, inflation, the availability of financing, yields on alternative investments, political developments and government policies. Other factors in Borrowers' individual, personal or financial circumstances may affect the ability of Borrowers to repay the Mortgage Bonds. Loss of earnings, illness, divorce and other similar factors may lead to an increase in delinquencies by and bankruptcies of Borrowers, and could ultimately have an adverse impact on the ability of Borrowers to repay the Mortgage Bonds. In addition, the ability of a Borrower to sell a property given as security for a Mortgage Bond at a price sufficient to repay the amounts outstanding under that Mortgage Bond will depend upon a number of factors, including the availability of buyers for that property, the value of that property and property values in general at the time.

The Icelandic Covered Bond Act provides that no Mortgage Bond may be registered in the Cover Pool if payment on it is in arrears of 90 days or more.

Changes to the Lending Criteria of the Issuer

Each of the Mortgage Bonds originated by the Issuer will have been originated in accordance with its Lending Criteria at the time of origination. It is expected that the Issuer's Lending Criteria will generally consider type of property, term of loan, age of applicant, the loan-to-value ratio, status of applicants and credit history. The Issuer retains the right to revise its Lending Criteria from time to time but would do so only to the extent that such a change would be acceptable to a Reasonable, Prudent Mortgage Lender. If the Lending Criteria change in a manner that affects the creditworthiness of the Mortgage Bonds, that may lead to increased defaults by Borrowers and may affect the Cover Pool Revenue or the realisable value of the Cover Pool.

In accordance with the Icelandic Covered Bond Act the Issuer may only include in the Cover Pool Mortgage Bonds issued against Mortgages secured by real property if the loan-to-value (LTV) ratio does not exceed 80% for residential property, 60% for industrial, office or commercial property, and 70% for agricultural property. Moreover, as noted above, Mortgage Bonds in arrears for 90 days or more may not be registered in the Cover Pool.

Set-off risks in relation to some types of Mortgage Bonds may adversely affect the value of the Cover Pool or any part thereof

The registration of assets in the Cover Pool will not affect rights of Borrowers. Therefore, the Borrowers will continue to have independent set-off rights against the Issuer (such as, for example, set-off rights associated with Borrowers holding deposits with the Issuer).

The exercise of set-off rights by Borrowers may adversely affect the realisable value of the Cover Pool and/or the ability of the winding up committee to meet in full the Issuer's obligation under the Covered Bond. In order to mitigate this risk the Issuer currently intends that it shall include additional assets in the Cover Pool up to a value that is equal to the set-off risk as calculated periodically as may be required or agreed from time to time with the Rating Agencies.

No representations or warranties to be given by the Issuer if Cover Pool to be sold

In the event of the winding up of the Issuer, the winding up committee shall fulfil the Issuers' obligations under the Covered Bonds and Swap Agreements using the assets in the Cover Pool and the Cover Pool Revenue. In respect of any sale of assets in the Cover Pool to third parties, the Issuer may not be permitted to give representations and warranties or indemnities in respect of the assets in the Cover Pool. Accordingly, there is a risk that the realisable value of the Cover Pool could be adversely affected by the lack of representations and warranties or indemnities which in turn could adversely affect the ability of the administrator to meet in full all the Issuer's obligations under the Covered Bonds.

Reliance on Swap Providers

A brief description of certain risks relating to the Swaps is set out below. As of the date of this Offering Circular, the Issuer has not entered into any Swaps in connection with this programme and any issuances thereunder.

Reliance on Currency Swaps

Subject to currency restrictions in place at each time, the Issuer may rely on the Currency Swap Providers under the Currency Swaps to provide payments on Covered Bonds denominated in currencies other than ISK. If the Issuer fails to make timely payments of amounts due or certain other events occur in relation to the Issuer under a Currency Swap and any applicable grace period has expired, then the Issuer will have defaulted under that Currency Swap. If the Issuer defaults under a Currency Swap due to non-payment or otherwise, the relevant Currency Swap Provider will not be obliged to make further payments under that Currency Swap and may terminate that Currency Swap. If a Currency Swap Provider is not obliged to make payments, or if it exercises any right of termination it may have under the relevant Currency Swap Agreement, or if it defaults in its obligations to make payments under a Currency Swap, the Issuer will be exposed to changes in currency exchange rates and in the associated interest rates on the currencies. Unless a replacement swap is entered into, the Issuer may have insufficient funds to make payments due on the Covered Bonds.

Reliance on Interest Rate Swaps

Subject to currency restrictions in place at each time, in order to hedge the Issuer's interest rate risks in ISK and/or other currencies to the extent that these have not already been hedged by the Cover Pool Swap or a Currency Swap, the Issuer may enter into Interest Rate Swaps. If the Issuer fails to make timely payments of amounts due or certain other events occur in relation to the Issuer under an Interest Rate Swap and any applicable grace period has expired, then the Issuer will have defaulted under that Interest Rate Swap. If the substitute assets available to the Issuer on a payment date are insufficient to make the payment ordinarily required in full, the payment obligations of both the Issuer and the swap counterparty on that payment date may be reduced accordingly and may be deferred should the Issuer introduce deferral of payment mechanics into the interest rate swaps. If the Issuer defaults under an Interest Rate Swap due to non-payment or otherwise, the relevant Interest Rate Swap Provider will not be obliged to make further payments under that Interest Rate Swap and may terminate that Interest Rate Swap. If an Interest Rate Swap Provider is not obliged to make payments, or if it exercises any right of termination it may have under the relevant Interest Rate Swap Agreement, or if it defaults in its obligations to make payments under an Interest Rate Swap, the Issuer will be exposed to changes in interest rates. Unless a replacement swap is entered into, the Issuer may have insufficient funds to make payments due on the Covered Bonds.

Reliance on Indexed Currency Swaps

Subject to currency restrictions in place at each time, the Issuer may rely on the Indexed Currency Swap Providers under the Currency Swaps to provide payments on Covered Bonds denominated in currencies other than ISK and not indexed linked. If the Issuer fails to make timely payments of amounts due or certain other events occur in relation to the Issuer under an Indexed Currency Swap and any applicable grace period has expired, then the Issuer will have defaulted under that Currency Swap. If the Issuer defaults under an Index Currency Swap due to non-payment or otherwise, the relevant Indexed Currency Swap Provider will not be obliged to make further payments under that Indexed Currency Swap and may terminate that Indexed Currency Swap. If an Indexed Currency Swap Provider is not obliged to make payments, or if it exercises any right of termination it may have under the relevant Indexed Currency Swap Agreement, or if it defaults in its obligations to make payments under an Indexed Currency Swap, the Issuer will be exposed to changes in currency exchange rates, the associated interest rates on the currencies and inflation. Unless a replacement swap is entered into, the Issuer may have insufficient funds to make payments due on the Covered Bonds.

Reliance on Cover Pool Swap

In order to hedge the possible variance between the rates of interest payable on the Covered Bonds and the various rates of interest payable in respect of certain assets registered to the Cover Pool, the Issuer will enter into the Cover Pool Swap. If the Issuer fails to make timely payments of amounts due or certain other events occur in relation to the Issuer under the Cover Pool Swap and any applicable grace period has expired, then the Issuer will have defaulted under that Cover Pool Swap. If the Issuer defaults under the Cover Pool Swap due to non-payment or otherwise, the Cover Swap Provider will not be obliged to make further payments under the Cover Pool Swap and may terminate the Cover Pool Swap. If the Cover Pool Swap Provider is not obliged to make payments, or if it exercises any right of termination it may have under the Cover Pool Swap Agreement, or if it defaults in its obligations to make payments under the Cover Pool Swap, the Issuer will be exposed to changes in interest rates. Unless a replacement swap is entered into, the Issuer may have insufficient funds to make payments due on the Covered Bonds.

Termination payments for Swaps

If any of the Interest Rate Swaps, Currency Swaps or Cover Pool Swap are terminated, the Issuer may as a result be obliged to make a termination payment to the relevant Swap Provider. The amount of the termination payment will be based on the cost of entering into a replacement Interest Rate Swap, Currency Swap or Cover Pool Swap, as the case may be. Any termination payment to be made by the Issuer to a Swap Provider will rank *pari passu* with payments due to the Covered Bondholders.

Potential amendments to the swap agreements

If and when the Issuer enters into a swap agreement in the context of an issue of Covered Bonds, the terms of the swap agreement will be negotiated with the relevant swap provider. As a result of such negotiations, the terms of a swap agreement may contain terms that adversely affect the Issuer's results of operations, financial condition and business prospects and its ability to perform its obligations under the Covered Bonds.

Risks related to the structure of a particular issue of Covered Bonds

A wide range of Covered Bonds may be issued under the Programme. A number of these Covered Bonds may have features which contain particular risks for potential investors. Set out below is a description of the most common such features:

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

An optional redemption feature of Covered Bonds is likely to limit their market value. During any period when the Issuer may elect to redeem Covered Bonds, the market value of those Covered Bonds generally will not rise substantially above the price at which they can be redeemed. This also may be true prior to any redemption period.

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

There are particular risks associated with an investment in Inflation Linked Covered Bonds and Inflation Linked Non-Amortising Covered Bonds. In particular, an investor might receive less interest than expected or no interest in respect of such Covered Bonds and may lose some or all of the principal amount invested by it

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

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

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

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

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

Inverse Floating Rate Covered Bonds will have more volatile market values than conventional Floating Rate Covered Bonds

Inverse Floating Rate Covered Bonds have an interest rate equal to a fixed rate minus a rate based upon a reference rate such as LIBOR. The market values of those Covered Bonds typically are more volatile than market values of other conventional floating rate debt securities based on the same reference rate (and with otherwise comparable terms). Inverse Floating Rate Covered Bonds are more volatile because an increase in

the reference rate not only decreases the interest rate of the Covered Bonds, but may also reflect an increase in prevailing interest rates, which further adversely affects the market value of these Covered Bonds.

If the Issuer has the right to convert the interest rate on any Covered Bonds from a fixed rate to a floating rate, or vice versa, this may affect the secondary market and the market value of the Covered Bonds concerned

Fixed/Floating Rate Covered Bonds may bear interest at a rate that converts from a fixed rate to a floating rate, or from a floating rate to a fixed rate. Where the Issuer has the right to effect such a conversion, this will affect the secondary market and the market value of the Covered Bonds since the Issuer may be expected to convert the rate when it is likely to produce a lower overall cost of borrowing. If the Issuer converts from a fixed rate to a floating rate in such circumstances, the spread on the Fixed/Floating Rate Covered Bonds may be less favourable than then prevailing spreads on comparable Floating Rate Covered Bonds tied to the same reference rate. In addition, the new floating rate at any time may be lower than the rates on other Covered Bonds. If the Issuer converts from a floating rate to a fixed rate in such circumstances, the fixed rate may be lower than then prevailing market rates on its Covered Bonds.

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

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

Extendable obligations under the Covered Bonds

Following the failure by the Issuer to pay the Final Redemption Amount of a Series of Covered Bonds on their Maturity Date, payment of such amounts shall be automatically deferred. This will occur if the Final Terms for a relevant Series of Covered Bonds (the **Relevant Series of Covered Bonds**) provides that such Covered Bonds are subject to an extended final maturity date on which the payment of all or (as applicable) part of the Final Redemption Amount payable on the Maturity Date will be deferred in the event that the Final Redemption Amount is not paid in full on the Maturity Date (the **Extended Final Maturity Date**).

To the extent that the Issuer has sufficient moneys available to pay in part the relevant Final Redemption Amount in respect of the relevant Series of Covered Bonds, the Issuer shall make partial payment of the relevant Final Redemption Amount as described in Condition 7.10. Payment of all unpaid amounts shall be deferred automatically until the applicable Extended Final Maturity Date, provided that any amount representing the Final Redemption Amount due and remaining unpaid on the Maturity Date may be paid by the Issuer on any Interest Payment Date thereafter up to (and including) the relevant Extended Final Maturity Date.

The Issuer is not required to notify the Covered Bondholders of such automatic deferral. The Extended Final Maturity Date will be specified in the relevant Final Terms. Interest will continue to accrue on any unpaid amount and be payable on each Interest Payment Date falling after the Maturity Date up to (and including) the Extended Final Maturity Date. In these circumstances, failure by the Issuer to make payment in respect of the Final Redemption Amount on the Maturity Date shall not constitute a default in payment by the Issuer. However, failure by the Issuer to pay the Final Redemption Amount or the balance thereof on the Extended Final Maturity Date and/or interest on such amount on any Interest Payment Date falling after the Maturity Date up to (and including) the Extended Final Maturity Date shall constitute a default in payment by the Issuer.

Furthermore, in relation to all amounts constituting accrued interest due and payable on each Interest Payment Date falling after the Maturity Date up to (and including) the Extended Final Maturity Date, as

provided in the applicable Final Terms, the Issuer may pay such interest pursuant to the Floating Rate set out in the applicable Final Terms notwithstanding that the relevant Covered Bond was a Fixed Rate Covered Bond as at its relevant Issue Date.

In addition, following deferral of the Maturity Date, the Interest Payment Dates and Interest Periods may change as set out in the applicable Final Terms.

Risks related to Covered Bonds generally

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

The Covered Bonds may not be a suitable investment for all investors

Each potential investor in the Covered Bonds must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- (a) have sufficient knowledge and experience to make a meaningful evaluation of the Covered Bonds, the merits and risks of investing in the Covered Bonds and the information contained or incorporated by reference in this Offering Circular or any applicable supplement;
- (b) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Covered Bonds and the impact the Covered Bonds will have on its overall investment portfolio;
- (c) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Covered Bonds, including Covered Bonds with principal or interest payable in one or more currencies, or where the currency for principal or interest payments is different from the potential investor's currency;
- (d) understand thoroughly the terms of the Covered Bonds and be familiar with the behaviour of any relevant indices and financial markets; and
- (e) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for legislative, economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

Some Covered Bonds are complex financial instruments. Sophisticated institutional investors generally do not purchase complex financial instruments as stand-alone investments. They purchase complex financial instruments as a way to reduce risk or enhance yield with an understood, measured, appropriate addition of risk to their overall portfolios. A potential investor should not invest in Covered Bonds which are complex financial instruments unless it has the expertise (either alone or with a financial adviser) to evaluate how the Covered Bonds will perform under changing conditions, the resulting effects on the value of the Covered Bonds and the impact this investment will have on the potential investor's overall investment portfolio.

Covered Bonds are obligations of the Issuer only

The Covered Bonds will constitute obligations of the Issuer only which have the benefit of a statutory preference under the Icelandic Covered Bond Act on the Cover Pool maintained by the Issuer. An investment in the Covered Bonds involves a reliance on the creditworthiness of the Issuer. The Covered Bonds are not guaranteed by any other person. In addition, an investment in the Covered Bonds involves the risk that subsequent changes in the actual or perceived creditworthiness of the Issuer may adversely affect

the market value of the relevant Covered Bonds. There can be no assurance that the Cover Pool will be sufficient to pay in full the amounts payable under the Covered Bonds.

Covered Bonds issued under the Programme

Covered Bonds issued under the Programme (save in respect of the first issue of Covered Bonds) will either be fungible with an existing Series of Covered Bonds or have different terms to an existing Series of Covered Bonds (in which case they will constitute a new Series). All Covered Bonds issued from time to time will rank *pari passu* with each other in all respects and will rank *pari passu* with any other Covered Bonds which may be issued by the Issuer in accordance with the Icelandic Covered Bond Act.

Covered Bondholder Meetings

The conditions of the Covered Bonds contain provisions for calling meetings of Covered Bondholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Covered Bondholders including Covered Bondholders who did not attend and vote at the relevant meeting and Covered Bondholders who voted in a manner contrary to the majority. As a result, Covered Bondholders can be bound by the result of a vote they voted against. Certain significant modifications may be made following approval of a quorum of one or more persons holding or representing not less than two-thirds in aggregate nominal amount of the Covered Bonds for the time being outstanding, including modifying the date of maturity of the Covered Bonds or any date for payment of interest thereof, reducing or cancelling the amount of principal or the rate of interest payable in respect of the Covered Bonds or altering the currency of payment of the Covered Bonds.

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

The conditions of the Covered Bonds are governed by English law (or, in respect of Condition 3, Icelandic law) in effect as at the date of this Offering Circular. No assurance can be given as to the impact of any possible judicial decision or change to English law or Icelandic law or administrative practice after the date of this Offering Circular and any such change could materially adversely impact the value of any Covered Bonds affected by it.

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

In relation to any issue of Covered Bonds which have denominations consisting of a minimum Specified Denomination plus one or more higher integral multiples of another smaller amount, it is possible that such Covered Bonds may be traded in amounts in excess of the minimum Specified Denomination that are not integral multiples of such minimum Specified Denomination. In such a case a holder 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 Covered Bonds 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 Covered Bond in respect of such holding (should definitive Covered Bonds be printed) and, in order to receive a definitive Covered Bond, would need to purchase a principal amount of Covered Bonds at or in excess of the minimum Specified Denomination such that its holding amounts to a Specified Denomination.

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

Reliance on Euroclear and Clearstream, Luxembourg procedures

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

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

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

Risks related to the market generally

Set out below is a 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 Covered Bonds may never be established or may be illiquid and this would adversely affect the value at which an investor could sell his Covered Bonds

Covered Bonds may have no established trading market when issued, and one may never develop. If a market does develop, it may not be very liquid. Additionally, the market places concerned may be closed, or temporary restrictions may be imposed. Therefore, investors may not be able to sell their Covered Bonds easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. This is particularly the case for Covered Bonds that are especially sensitive to interest rate, currency or market risks, are designed for specific investment objectives or strategies or have been structured to meet the investment requirements of limited categories of investors. These types of Covered Bonds generally would have a more limited secondary market and more price volatility than conventional debt securities. Illiquidity may have a severely adverse effect on the market value of Covered Bonds.

The Covered Bonds have not been, and will not be, registered under the Securities Act or any other applicable securities laws and they are subject to certain restrictions on the resale and other transfer thereof as set forth under "*Subscription and Sale and Selling Restrictions*".

Lack of liquidity in the secondary market may adversely affect the market value of the Covered Bonds

Generally weak global credit market conditions could contribute to a lack of liquidity in the secondary market for instruments similar to the Covered Bond. In addition, the difficult market conditions which have prevailed since mid-September 2008 have limited the primary market for a number of financial products including instruments similar to the Covered Bonds. While some measures have been taken by governments, there can be no assurance that the market for securities similar to the Covered Bonds will recover at the same time or to the same degree as such other recovering global credit market sectors.

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

The Issuer will pay principal and interest on the Covered Bonds in the Specified Currency. Subject to currency restrictions in place at each time, if Covered Bonds are issued in currencies other than ISK, this presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the **Investor's Currency**) other than the Specified Currency. These include the risk that exchange rates may significantly change (including changes due to devaluation of the Specified Currency or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to the Specified Currency would decrease (1) the Investor's Currency-equivalent yield on the Covered Bonds, (2) the Investor's Currency-equivalent value of the principal payable on the Covered Bonds and (3) the Investor's Currency-equivalent market value of the Covered Bonds.

Icelandic 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 Issuer to make payments in respect of the Covered Bonds. As a result, investors may receive less interest or principal than expected, or no interest or principal.

Exchange rate risk will be mitigated by the use of the Currency Swaps and by matching interest rate flow with the maturity of loan and other assets of the Issuer.

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

Interest rate risks occur when fixed interest periods or interest basis for assets and liabilities do not coincide. Investment in Fixed Rate Covered Bonds involves the risk that if market interest rates subsequently increase above the rate paid on the Fixed Rate Covered Bonds, this will adversely affect the value of the Fixed Rate Covered Bonds. Investments in Floating Rate Covered Bonds will involve a risk of interest rate changes.

The Issuer will enter into the Cover Pool Swap and Interest Rate Swaps to ensure that the risks do not exceed the limit values approved by its board of directors and to ensure that matching is maintained in accordance with the Icelandic Covered Bond Act.

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

Various interest rate benchmarks (including the London Inter-Bank Offered Rate (LIBOR)) and the Euro Interbank Offered Rate (EURIBOR) are the subject of recent national and international regulatory guidance and proposals for reform. Some of these reforms are already effective whilst others are still to be implemented.

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

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

The EU Benchmark Regulation (Regulation (EU) 2016/1011) (the **Benchmarks Regulation**) was published in the Official Journal of the European Union on 29 June 2016 and applies from 1 January 2018. The Benchmarks Regulation applies to the provision of benchmarks, the contribution of input data to a benchmark and the use of a benchmark within the European Union. It will, among other things, (i) require benchmark administrators to be authorised or registered (or, if non-European Union based, to be subject to an equivalent regime or otherwise recognised or endorsed) and (ii) prevent certain uses by European Union supervised entities of "benchmarks" of administrators that are not authorised or registered (or, if non-European Union based, not deemed equivalent or recognised or endorsed).

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

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

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

Fallback arrangements

Investors should be aware that in the case of Floating Rate Covered Bonds, the Conditions of the Covered Bonds provide for certain fallback arrangements in the event that a published Benchmark, including an inter-bank offered rate such as LIBOR, EURIBOR or other relevant reference rates ceases to exist or be published or another Benchmark Event occurs. These fallback arrangements include the possibility that the Rate of

Interest could be determined by reference to a Successor Rate or an Alternative Rate and that an Adjustment Spread may be applied to such Successor Rate or Alternative Rate to reduce or eliminate, to the fullest extent reasonably practicable in the circumstances, any economic prejudice or benefit (as the case may be) to Noteholders as a result of the replacement of the relevant benchmark or screen rate (as applicable) originally specified with the Successor Rate or the Alternative Rate (as the case may be), together with the making of certain Benchmark Amendments to the Conditions of such Covered Bonds, which in the case of any Alternative Rate, any Adjustment Spread unless formally recommended or provided for and any Benchmark Amendments shall be determined by the Bank (acting in good faith, in a commercially reasonable manner and by reference to such sources as it deems appropriate, which may include consultation with an Independent Adviser).

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

If LIBOR or EURIBOR or any other relevant interest rate benchmark is discontinued there can be no assurance that the applicable fallback provisions under the Swap Agreements would operate to allow the transactions under the Swap Agreements to effectively mitigate interest rate risk in respect of the Covered Bonds.

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

Judicial considerations may restrict certain investments

The investment activities of certain investors are subject to rules and regulations and/or review or regulation by certain authorities. Each potential investor should consult its legal advisers or responsible supervisory authority in order to determine whether and to what extent the investor has the opportunity to invest in Covered Bonds.

Credit ratings assigned to the Covered Bonds may not reflect all the risks associated with an investment in those Covered Bonds

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

In general, European regulated investors are restricted under Regulation (EC) No. 1060/2009 (as amended) (the **CRA Regulation**) from using credit ratings for regulatory purposes, unless such ratings are issued by a credit rating agency established in the European Union and registered under the CRA Regulation (and such registration has not been withdrawn or suspended), subject to transitional provisions that apply in certain circumstances. Such general restriction will also apply in the case of credit ratings issued by non-European Union credit rating agencies, unless the relevant credit ratings are endorsed by an European Union-registered

credit rating agency or the relevant non-European Union rating agency is certified in accordance with the CRA Regulation (and such endorsement action or certification, as the case may be, has not been withdrawn or suspended, subject to transitional provisions that apply in certain circumstances). The list of registered and certified rating agencies published by ESMA on its website in accordance with the CRA Regulation is not conclusive evidence of the status of the relevant rating agency included in such list, as there may be delays between certain supervisory measures being taken against a relevant rating agency and the publication of the updated ESMA list. Certain information with respect to the credit rating agencies and ratings will be disclosed in the Final Terms, and is set out on the cover of this Offering Circular.

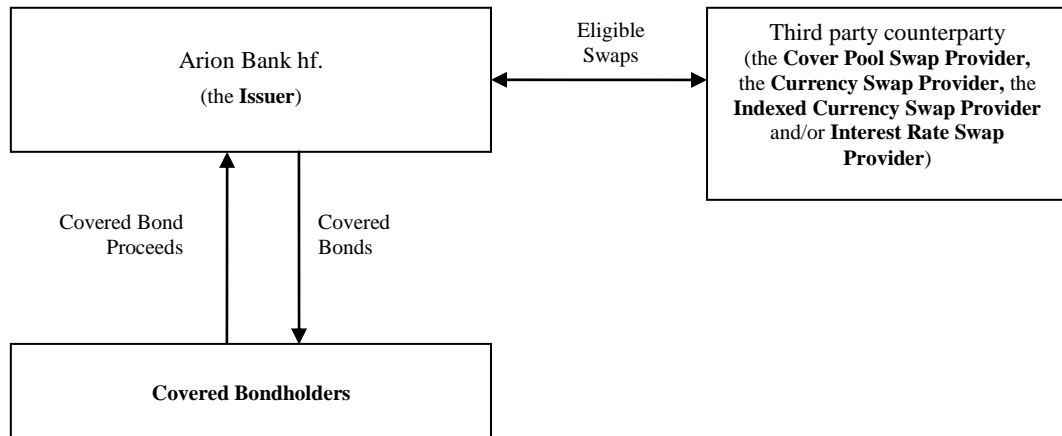
Legal investment considerations may restrict certain investments

The investment activities of certain investors are subject to legal 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) Covered Bonds are legal investments for it, (2) Covered Bonds can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of any Covered Bonds. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of Covered Bonds under any applicable risk-based capital or similar rules.

OVERVIEW OF THE PROGRAMME

The following is a brief overview only and should be read in conjunction with the rest of this Offering Circular and, in relation to any Covered Bond, in conjunction with the applicable Final Terms and, to the extent applicable, the Terms and Conditions of the Covered Bonds set out herein. Any decision to invest in the Covered Bonds should be based on a consideration of the Offering Circular as a whole, including the documents incorporated by reference.

*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 Directive**).*



Words and expressions defined in "Form of the Covered Bonds" and "Terms and Conditions of the Covered Bonds" below shall have the same meanings in this overview. A glossary of certain defined terms is contained at the end of this Offering Circular.

Description: €1,500,000,000 Covered Bond Programme

1. THE PARTIES

Legal Entity Identifier (LEI): RIL4VBPDB0M7Z3KXSF19

Issuer: Arion Bank hf. (**Arion**), a leading universal Icelandic bank, whose business includes mortgage lending in Iceland, with total assets at 31 December 2017 of €9,218 million (ISK 1,147,754 million) and net profit of €115.8 million (ISK 14,419 million) for the financial year ended 31 December 2017.

The Issuer holds a licence from the Icelandic Financial Supervisory Authority (**FME**) to conduct financing business as a commercial bank and a licence to issue Covered Bonds in accordance with the Icelandic Act on Covered Bonds no. 11/2008 (the **Icelandic Covered Bond Act**).

Arranger: Barclays Bank PLC, acting through its investment bank (**Barclays**).

Dealers: Barclays, UBS Limited, Deutsche Bank Aktiengesellschaft (**Deutsche Bank**), Arion and any other Dealers appointed in accordance with the Programme Agreement.

Independent Inspector
(*Sjálfstæður skoðunarmaður*): The Issuer is required to appoint an independent inspector, and this appointment must be approved by the FME. The Independent Inspector will monitor the Register in accordance with the Icelandic Covered Bond Act and the Rules and verify that the valuation of collateral for debt instruments in the cover pool is based on the prescribed methodology. The independent inspector shall report regularly to the FME on his or her observations, and immediately inform the FME of any circumstances he or she becomes aware of, that could affect the FME's assessment of the Issuer. The initial independent inspector has been appointed pursuant to an agreement with KPMG ehf. (**KPMG**).

Cover Pool Swap Provider: The Issuer may enter into swaps from time to time with third party counterparties to convert ISK interest payments received by the Issuer in respect of assets registered to the Cover Pool (other than derivative agreements with qualified counterparties which are registered to the Cover Pool (the **Eligible Swaps**)) into floating payments linked to the rate of interest under the Covered Bonds (the **Cover Pool Swap**).

Currency Swap Providers: The Issuer may enter into currency swaps (each a **Currency Swap**) from time to time with third party counterparties (each, a

Currency Swap Provider), subject to currency restrictions in place at each time, in order to hedge currency risks arising from (a) Covered Bonds which are issued in currencies other than ISK and (b) assets (other than bonds as defined in Article 2 of the Icelandic Covered Bond Act which are issued by borrowers and as described in Article 5 of the Icelandic Covered Bond Act (**Mortgage Bonds**) and Eligible Swaps) which are registered to the Cover Pool and are denominated in currencies other than ISK.

Indexed Currency Swap Providers:

The Issuer may enter into indexed currency swaps (each an **Indexed Currency Swap**) from time to time with third party counterparties (each, an **Indexed Currency Swap Provider**) in order to hedge currency risks arising from (a) Covered Bonds which are issued in currencies other than ISK and (b) assets which are registered to the Cover Pool and are denominated in ISK and inflation linked.

Interest Rate Swap Providers:

The Issuer may enter into single currency interest rate swaps (each, an **Interest Rate Swap**) from time to time with third party counterparties (each, an **Interest Rate Swap Provider**) in order to hedge the Issuer's interest rate risks in ISK and/or other currencies to the extent that they have not been hedged by the Cover Pool Swap or a Currency Swap.

The Cover Pool Swap Provider, the Currency Swap Providers and the Interest Rate Swap Providers are together referred to as the **Swap Providers**. The Cover Pool Swap, each Currency Swap and each Interest Rate Swap are together referred to as the **Swaps**.

Fiscal Agent and Transfer Agent:

The Bank of New York Mellon, London Branch.

Listing Agent and Registrar:

The Bank of New York Mellon SA/NV Luxembourg Branch

ISD Agent:

Arion Bank hf.

2. KEY FEATURES

FME Licensing:

The Issuer is required to hold a licence from the FME to conduct financing business as a commercial bank as well as a licence to issue Covered Bonds in accordance with the Icelandic Covered Bond Act.

Status of the Covered Bonds:

The Covered Bonds constitute direct, unconditional and unsubordinated obligations of the Issuer to pay a specified amount and have been issued in accordance with the Icelandic Covered Bond Act. Claims in respect of the Covered Bonds and any other securities issued by the Issuer, subject to any claims due to derivative agreements concluded in accordance with the Icelandic Covered Bond Act which will rank senior, and shall have the benefit of priority of claims to a cover pool of certain registered eligible assets pursuant to the Icelandic Covered Bond Act (the **Cover Pool**).

References to **Covered Bondholders** are to the Covered Bondholders and the holders of any other securities issued by the Issuer in accordance with the Icelandic Covered Bond Act. The Covered Bonds will be endorsed to show that they have the benefit of priority of claims to the Cover Pool (junior to costs incurred in connection with the operation, management, collection and realisation of the Cover Pool, and claims due to derivative agreements concluded in accordance with the provisions of the Icelandic Covered Bond Act) and have been registered in the Register.

The Register:

The rights of priority that covered bondholders and swap providers have with respect to the Covered Bonds arise from a registration being made in a register kept by the Issuer, containing details of the Covered Bonds and the assets in the cover pool.

Certain Restrictions:

Each issue of Covered Bonds 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.

Composition of the Cover Pool:

The Cover Pool will consist primarily of loans which are secured on interests in residential property, industrial, office or commercial property, agricultural property, claims which the Issuer holds, or may acquire, against providers of Covered Bond swaps and certain substitute assets. The assets comprising the Cover Pool will comply with requirements set out in the Icelandic Covered Bond Act. See "*Overview of the Icelandic Legislation Regarding Covered Bonds – Eligible Cover Pool Assets*" below.

Programme Size:

Up to €1,500,000,000 (or its equivalent in other currencies) outstanding at any time. The Issuer may increase the amount of the Programme in accordance with the terms of the Programme Agreement.

Distribution:

Covered Bonds may be distributed by way of private or public placement and in each case on a syndicated or non-syndicated basis.

Currencies:

Subject to any applicable legal or regulatory restrictions including the rules on foreign exchange issued by the Central Bank of Iceland (the **Central Bank**), any currency agreed between the Issuer and the relevant Dealer including but not limited to U.S. Dollars, Euro, Sterling, Japanese Yen, Danish Krone, Norwegian Krone and Icelandic Krona.

Form of Covered Bonds:

The Covered Bonds will be issued either (i) in bearer form, (ii) in registered form or (iii) in the case of ISD Covered Bonds, in uncertificated and dematerialised book entry form registered in the ISD.

ISD Covered Bonds will not be evidenced by any physical note or document of title. Entitlements to ISD Covered Bonds will be evidenced by registration in the registers between the direct and indirect accountholders at the ISD.

Terms of the Covered Bonds:

The terms of the Covered Bonds will be set out in the Terms and Conditions of the Covered Bonds, as completed by the applicable Final Terms.

Redenomination:

Subject to any applicable legal or regulatory restrictions, the applicable Final Terms may provide that certain Covered Bonds may be redenominated in euro. The relevant provisions applicable to such redenomination are contained in Condition 5 of the Terms and Conditions of the Covered Bonds.

Maturities:

Such maturities as may be agreed between the Issuer 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 Issuer or the relevant Currencies.

Issue Price:

Covered Bonds may be issued on a fully-paid and at an issue price which is at par or at a discount to, or premium over, par.

Interest:

The following types of Covered Bond may be issued: (a) Covered Bonds which bear interest at a fixed rate or a floating rate; (b) Covered Bonds which do not bear interest; and (c) Covered Bonds which bear interest, and/or the redemption amount of which is, calculated by reference to a specified factor such as movements in an index or a currency exchange rate, changes in share or commodity prices or changes in the credit of an underlying entity. In addition, Covered Bonds which have any combination of the foregoing features may also be issued.

Interest periods, rates of interest and the terms of and/or amounts payable on redemption may differ depending on the Covered Bonds being issued and such terms will be specified in the applicable Final Terms.

Fixed Rate Covered Bonds:

Fixed interest will be payable on such date or dates as may be agreed between the Issuer 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 Issuer and the relevant Dealer.

Floating Rate Covered Bonds:

Floating Rate Covered Bonds will bear interest at a rate determined:

- (a) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the 2006 ISDA Definitions (as published by the International Swaps and Derivatives Association, Inc.,

and as amended and updated as at the Issue Date of the first Tranche of the Covered Bonds of the relevant Series); or

- (b) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or
- (c) on such other basis as may be agreed between the Issuer and the relevant Dealer.

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

Inflation Linked Non-Amortising Covered Bonds:

Inflation Linked Non-Amortising Covered Bonds will bear interest adjusted for inflation and payable on such date or dates as may be agreed with the Issuer. Inflation Linked Non-Amortising Covered Bonds will be redeemed by payment of one or more amounts adjusted for inflation in accordance with the provisions set out in Condition 8.4, constituting payments of principal in relation to such Inflation Linked Non-Amortising Covered Bonds.

Inflation Linked Covered Bonds:

Inflation Linked Covered Bonds will bear interest which will be payable on such date or dates as may be agreed with the Issuer. Inflation Linked Covered Bonds will be redeemed by payment of one or more amounts, adjusted for indexation in accordance with the provisions set out in Conditions 6.4 and 8.3, on such date or dates as may be agreed between the Issuer and the relevant Dealer.

Other provisions in relation to Floating Rate Covered Bonds, Inflation Linked Covered Bonds and Inflation Linked Non-Amortising Covered Bonds:

Floating Rate Covered Bonds may also have a maximum interest rate, a minimum interest rate or both or a maximum interest amount. Interest on Floating Rate Covered Bonds in respect of each Interest Period, as agreed prior to issue by the Issuer and the relevant Dealer, will be payable on the relevant Interest Payment Dates, and will be calculated on the basis of such Day Count Fraction, as may be agreed between the Issuer and the relevant Dealer.

Inflation Linked Covered Bonds and Inflation Linked Non-Amortising Covered Bonds may have variable interest amounts and principal amounts. Interest on Inflation Linked Covered Bonds and Inflation Linked Non-Amortising Covered Bonds in respect of each Interest Period, as agreed prior to issue by the Issuer and the relevant Dealer, will be payable on the relevant Interest Payment Dates. The interest payable will be calculated in accordance with the formula set out in Condition 6.4 for Inflation Linked Covered Bonds, and Condition 6.5 for Inflation Linked Non-Amortising Covered Bonds.

Zero Coupon Covered Bonds:

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

Instalment Covered Bonds:	Instalment Covered Bonds may be issued on an instalment basis in which case such Covered Bonds will be redeemed in the Instalment Amounts and on the Instalment Dates specified in the applicable Final Terms.
Redemption:	<p>The applicable Final Terms will indicate either that the relevant Covered Bonds cannot be redeemed prior to their stated maturity (other than in specified instalments, if applicable, or for taxation reasons) or that such Covered Bonds will be redeemable at the option of the Issuer and/or the Covered Bondholders. The terms of any such redemption, including notice periods, any relevant conditions to be satisfied and the relevant redemption dates and prices will be indicated in the applicable Final Terms.</p> <p>The applicable Final Terms may provide that Covered Bonds are redeemable in two or more instalments of such amounts and on such dates as are indicated in the applicable Final Terms.</p>
Benchmark Discontinuation:	In the case of Floating Rate Covered Bonds, if the Bank determines that a Benchmark Event has occurred, the relevant benchmark or screen rate may be replaced by a Successor Rate or, if there is no Successor Rate but the Bank determines there is an Alternative Rate (acting in good faith, in a commercially reasonable manner and by reference to such sources as it deems appropriate, which may include consultation with an Independent Adviser), such Alternative Rate. An Adjustment Spread may also be applied to the Successor Rate or the Alternative Rate (as the case may be), together with any Benchmark Amendments (which in the case of any Alternative Rate, any Adjustment Spread unless formally recommended or provided for and any Benchmark Amendments shall be determined by the Bank, acting in good faith, in a commercially reasonable manner and by reference to such sources as it deems appropriate, which may include consultation with an Independent Adviser). This is further described in Condition 3.4.
Denomination of Covered Bonds:	The Covered Bonds will be issued in such denominations as may be agreed between the Issuer and the relevant Dealer save that the minimum denomination of each Covered Bond 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, and save that the minimum denomination of each Covered Bond admitted to trading on a regulated market within the EEA or offered to the public in a Member State of the EEA in circumstances which require the publication of a prospectus under the Prospectus Directive will be €100,000 (or, if the Covered Bonds are denominated in a currency other than euro, the equivalent amount in such currency).
Taxation:	All payments in respect of the Covered Bonds will be made

without deduction for or on account of withholding taxes imposed by any relevant tax jurisdiction. In the event that any such deduction is made, the Issuer will, save in certain limited circumstances detailed in Condition 9 of the Terms and Conditions of the Covered Bonds, be required to pay additional amounts to cover the amounts so deducted.

Following insolvency of the Issuer:

In the event of insolvency of the Issuer, the Covered Bonds of each Series will not become due and payable according to the Icelandic Covered Bond Act. The winding up committee shall continue to fulfil the Issuer's commitments from the cover pool of assets. The Covered Bondholders will have priority recourse to the assets in the Cover Pool (junior to costs incurred in connection with the operation, management, collection and realisation of the Cover Pool, and claims due to derivative agreements concluded in accordance with the provisions of the Icelandic Covered Bond Act), and rights to proceed directly against, amongst others, the Issuer.

Use of Proceeds:

The net proceeds from each issue of Covered Bonds will be applied by the Issuer for its general corporate purposes, which include making a profit. If, in respect of any particular issue of Covered Bonds there is a particular identified use of proceeds, this will be stated in the applicable Final Terms.

Rating:

The Covered Bonds issued under the Programme may or may not have a rating by any of Moody's Investors Service Limited (**Moody's**), Fitch Ratings Ltd. (**Fitch**) and Standard & Poor's Credit Market Services Europe Limited (**S&P**) and this will be stated in the applicable Final Terms. Whether or not each credit rating applied for in relation to relevant Series of Covered Bonds will be issued by a credit rating agency established in the European Union and registered under Regulation (EC) No. 1060/2009 (as amended) will be disclosed in the Final Terms. A security rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency.

Clearing Systems:

The Covered Bonds issued under the Programme will be cleared through Euroclear, Clearstream, Luxembourg or the ISD, and/or any other clearing system as may be specified in the relevant Final Terms.

Approval, 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 to the Luxembourg Stock Exchange for Covered Bonds 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.

Covered Bonds may be listed or admitted to trading, as the case may be, on other or further stock exchanges or markets agreed between the Issuer and the relevant Dealer in relation to the Series. Covered Bonds 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 Covered Bonds are to be listed and/or admitted to trading and, if so, on which stock exchanges and/or markets.

Passporting:

Once this Offering Circular has been approved by the CSSF in Luxembourg, it can be passported into Iceland and thereafter used for the admission to trading of the Covered Bonds in Iceland.

Governing Law:

The Covered Bonds (other than the ISD Covered Bonds) and any non-contractual obligations arising out of or in connection with them, will be governed by, and construed in accordance with, English law, except for provisions relating to the Condition 3 (*Status of the Covered Bonds*). Condition 3 of the Covered Bonds and the ISD Covered Bonds will be governed by Icelandic law.

Selling Restrictions:

There are restrictions on the offer, sale and transfer of the Covered Bonds in the United States, Japan, Hong Kong and the EEA (including the United Kingdom, the Republic of Italy, Iceland and Belgium) and such other restrictions as may be required in connection with the offering and sale of a particular Tranche of Covered Bonds. See "*Subscription and Sale and Selling Restrictions*" below.

Risk Factors:

There are certain factors that may affect the Issuer's ability to fulfil its obligations under Covered Bonds issued under the Programme, including the exposure of the Issuer to credit risk, market risk, operational risk and liquidity risk. In addition, there are certain factors which are material for the purpose of assessing the risks associated with Covered Bonds issued under the Programme such as the fact that the Covered Bonds may not be a suitable investment for all investors, certain risks relating to the structure of particular Series of Covered Bonds and certain market risks.

ISSUE OF COVERED BONDS FROM THE PROGRAMME

Under the Programme, and subject to currency restrictions in place at each time, the Issuer may from time to time issue Covered Bonds denominated in any currency, subject as set out herein. An overview of the terms and conditions of the Programme and the Covered Bonds appears above. The applicable terms of any Covered Bonds will be agreed between the Issuer and the relevant Dealer prior to the issue of the Covered Bonds and will be set out in the Terms and Conditions of the Covered Bonds endorsed on, attached to, or incorporated by reference into, the Covered Bonds, as completed by the applicable Final Terms attached to, or endorsed on, such Covered Bonds (except in the case of ISD Covered Bonds), and (in the case of the ISD Covered Bonds) which are deposited with the ISD and the ISD Agent as more fully described under "*Form of the Covered Bonds*" below.

This Offering Circular and any supplement to the Offering Circular will only be valid for the admission to trading of Covered Bonds on the regulated market of the Luxembourg Stock Exchange during the period of 12 months from the date of the approval of this Offering Circular in an aggregate nominal amount which, when added to the aggregate nominal amount then outstanding of all Covered Bonds previously or simultaneously issued under the Programme, does not exceed €1,500,000,000 or its equivalent in other currencies. For the purpose of calculating the euro equivalent of the aggregate nominal amount of Covered Bonds issued under the Programme from time to time:

- (d) the euro equivalent Covered Bonds denominated in another Specified Currency (as specified in the applicable Final Terms in relation to the relevant Covered Bonds, described under "*Form of the Covered Bonds*", below) shall be determined, at the discretion of the Issuer, either as of the date on which agreement is reached for the issue of Covered Bonds or on the preceding day on which commercial banks and foreign exchange markets are open for general business in London, in each case on the basis of the spot rate for the sale of the euro against the purchase of such Specified Currency in the London foreign exchange market quoted by any leading international bank selected by the Issuer on the relevant day of calculation;
- (e) subject to any existing legal or regulatory restrictions in Iceland, the euro equivalent of Inflation Linked Covered Bonds and Inflation Linked Non-Amortising Covered Bonds (each as specified in the applicable Final Terms in relation to the relevant Covered Bonds, described under "*Form of the Covered Bonds*", below) shall be calculated in the manner specified above by reference to the original nominal amount on issue of such Covered Bonds; and
- (f) the euro equivalent of Zero Coupon Covered Bonds (as specified in the applicable Final Terms in relation to the relevant Covered Bonds, described under "*Form of the Covered Bonds*", below) and other Covered Bonds issued at a discount or a premium shall be calculated in the manner specified above by reference to the net proceeds received by the Issuer for the relevant issue.

DOCUMENTS INCORPORATED BY REFERENCE

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

- (a) the auditors' reports and audited consolidated annual financial statements of the Issuer for the financial years ended 31 December 2016 and 31 December 2017 including the information set out at the following pages in particular:

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

The information incorporated by reference that is not included in the cross-reference list, is considered as additional information and is not required by the relevant schedules of Commission Regulation (EC) No 809/2004;

- (b) the interim unaudited consolidated financial statements of the Issuer for the nine month period ended 30 September 2018 including the information set out at the following pages in particular:

Condensed Consolidated Interim Statement of Comprehensive Income.....	Page 9
Condensed Consolidated Interim Statement of Financial Position.....	Page 10
Condensed Consolidated Interim Statement of Changes in Equity.....	Page 11
Condensed Consolidated Interim Statement of Cash Flows.....	Pages 12 to 13
Significant Accounting Policies.....	Pages 65
Notes to Condensed Consolidated Interim Financial Statements.....	Pages 16 to 75

The information incorporated by reference that is not included in the cross-reference list, is considered as additional information and is not required by the relevant schedules of Commission Regulation (EC) No 809/2004;

- (c) On 31 October 2018 the Bank published the "Arion Bank Factbook – 30.9.2018" (the **Q3 2018 Factbook**).

the following information contained in the Q3 2018 Factbook, and set out at the pages below, is incorporated by reference in, and forms part of, this Base Prospectus:

KFI – 5 years..... Page 2

The information incorporated by reference that is not included in the cross-reference list, is considered as additional information and is not required by the relevant schedules of Commission Regulation (EC) No 809/2004;

A copy of each of the Q3 2018 Interim Financial Statements and the Q3 2018 Factbook has been filed with the Commission de Surveillance du Secteur Financier.

- (d) the terms and conditions of the Covered Bonds set out on pages 70 to 102 (inclusive) of the Prospectus dated 9 February 2012 and prepared by the Issuer in connection with the Programme;
- (e) the terms and conditions of the Covered Bonds set out on pages 64 to 100 (inclusive) of the Prospectus dated 23 August 2013 and prepared by the Issuer in connection with the Programme;
- (f) the terms and conditions of the Covered Bonds set out on pages 65 to 101 (inclusive) of the Prospectus dated 5 December 2014 and prepared by the Issuer in connection with the Programme;
- (g) the terms and conditions of the Covered Bonds set out on pages 66 to 101 (inclusive) of the Prospectus dated 18 December 2015 and prepared by the Issuer in connection with the Programme;
- (h) the terms and conditions of the Covered Bonds set out on pages 73 to 108 (inclusive) of the Prospectus dated 23 December 2016 and prepared by the Issuer in connection with the Programme; and
- (i) the terms and conditions of the Covered Bonds set out on pages 84 to 119 (inclusive) of the Prospectus dated 5 January 2018 and prepared by the Issuer in connection with the Programme

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

Following the publication of this Offering Circular, a supplement to the Offering Circular may be prepared by the Issuer 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 Offering Circular or in a document which is incorporated by reference in this Offering Circular. Any statement so modified or superseded shall not, except as so modified or superseded, constitute a part of this Offering Circular.

Copies of documents incorporated by reference in this Offering Circular can be obtained from the Luxembourg Stock Exchange's website at www.bourse.lu and from the registered office of the Issuer and from the specified offices of the Agents for the time being in Luxembourg.

Any documents themselves incorporated by reference in the documents incorporated by reference in this Offering Circular shall not form part of this Offering Circular. In each case, where only certain sections of a document referred to (in item (c) above) are incorporated by reference in this Offering Circular, the parts of the document which are not incorporated by reference are either not relevant to prospective investors in the Covered Bonds or covered elsewhere in this Offering Circular.

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

FORM OF THE COVERED BONDS

The Covered Bonds of each Series will be either (i) in bearer form, with or without interest coupons attached, or (ii) in registered form, without interest coupons attached, or (iii) in uncertificated book entry form cleared through the ISD. Bearer Covered Bonds and ISD Covered Bonds will be issued outside the United States in reliance on Regulation S under the Securities Act (**Regulation S**) and Registered Covered Bonds will be issued outside the United States in reliance on the exemption from registration provided by Regulation S.

Bearer Covered Bonds

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

- (a) if the Global Covered Bonds are intended to be issued in new global note (**NGCB**) 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, société anonyme (**Clearstream, Luxembourg**); and
- (b) if the Global Covered Bonds are not intended to be issued in NGCB form, be delivered on or prior to the original issue date of the Tranche to a common depository (the **Common Depository**) for Euroclear and Clearstream, Luxembourg.

Bearer Covered Bonds will be issued outside the United States in reliance on Regulation S under the Securities Act (**Regulation S**).

Covered Bonds 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.

Where the Global Covered Bonds issued in respect of any Tranche are in NGCB form, the applicable Final Terms will also indicate whether or not such Global Covered Bonds are intended to be held in a manner which would allow Eurosystem eligibility. Any indication that the Global Covered Bonds are to be so held does not necessarily mean that the Covered Bonds 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 NGCBs 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 Covered Bond is represented by a Temporary Global Covered Bond, payments of principal, interest (if any) and any other amount payable in respect of the Covered Bonds due prior to the Exchange Date (as defined below) will be made (against presentation of the Temporary Global Covered Bond if the Temporary Global Covered Bond is not intended to be issued in NGCB form) only to the extent that certification (in a form to be provided) to the effect that the beneficial owners of interests in such Covered Bond 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 the Temporary Global Covered Bond is issued, interests in such Temporary Global Covered Bond will be exchangeable (free of charge) upon a request as described therein either for (a) interests in a Permanent Global Covered Bond of the same Series or (b) for definitive Covered Bonds of the same Series with, where applicable, receipts, interest coupons and talons attached (as indicated in the applicable Final Terms and subject, in the case of definitive Covered Bonds, 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 Covered Bond 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 Covered Bond for an interest in a Permanent Global Covered Bond or for definitive Covered Bonds is improperly withheld or refused.

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

The applicable Final Terms will specify that a Permanent Global Covered Bond will be exchangeable (free of charge), in whole but not in part, for definitive Covered Bonds with, where applicable, receipts, interest coupons and talons attached upon either (a) not less than 60 days' written notice given at any time from Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Bearer Global Covered Bond) to the Fiscal Agent as described therein or (b) only upon the occurrence of an Exchange Event or (c) at any time at the request of the Issuer.

For these purposes, **Exchange Event** means that (a) the Issuer has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and no successor clearing system is available or (b) the Issuer has or will become subject to adverse tax consequences which would not be suffered were the Covered Bonds represented by the Permanent Global Covered Bond in definitive form. The Issuer will promptly give notice to Covered Bondholders in accordance with Condition 14 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg or the common depositary or the common safekeeper for Euroclear and Clearstream, Luxembourg, as the case may be, on their behalf (acting on the instructions of any holder of an interest in such Permanent Global Covered Bond) may give notice to the Fiscal Agent requesting exchange and, in the event of the occurrence of an Exchange Event as described in (b) above, the Issuer 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 Bearer Covered Bonds (other than Temporary Global Covered Bonds) and on all receipts and interest coupons relating to such Covered Bonds where TEFRA D is specified in the applicable Final Terms, as the case may be:

"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 Bearer Covered Bonds, receipts 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 such Bearer Covered Bonds, receipts or interest coupons.

Covered Bonds which are represented by a Bearer Global Covered Bonds 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.

Registered Covered Bonds

The Registered Covered Bonds of each Tranche offered and sold in reliance on Regulation S, which will be sold to non-U.S. persons outside the United States, will initially be represented by a global note in registered form (a Regulation S Global Covered Bonds or Registered Global Covered Bonds). Prior to expiry of the distribution compliance period (as defined in Regulation S) applicable to each Tranche of Covered Bonds, beneficial interests in a Regulation S Global Covered Bonds may not be offered or sold to, or for the account or benefit of, a U.S. person save as otherwise provided in Condition 2 (*Transfers of Registered Covered Bonds*) and may not be held otherwise than through Euroclear or Clearstream, Luxembourg and such Regulation S Global Covered Bonds will bear a legend regarding such restrictions on transfer.

Registered Global Covered Bonds will either (i) be deposited with a common depository or common safekeeper, as the case may be for Euroclear and Clearstream, Luxembourg, and registered in the name of a common nominee of, Euroclear and Clearstream, Luxembourg or in the name of a nominee of the common safekeeper, as specified in the applicable Final Terms. Persons holding beneficial interests in Registered Global Covered Bonds will be entitled or required, as the case may be, under the circumstances described below, to receive physical delivery of definitive Covered Bonds in fully registered form.

Payments of principal, interest and any other amount in respect of the Registered Global Covered Bonds will, in the absence of provision to the contrary, be made to the person shown on the Registered Covered Bond Register (as defined in Condition 7.5 (*Payments - Payments in respect of Registered Covered Bonds*)) as the registered holder of the Registered Global Covered Bonds. None of the Issuer, any Paying Agent or the Registrar will have any responsibility or liability for any aspect of the records relating to or payments or deliveries made on account of beneficial ownership interests in the Registered Global Covered Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Payments of principal, interest or any other amount in respect of the Registered Covered Bonds in definitive form will, in the absence of provision to the contrary, be made to the persons shown on the Registered Covered Bond Register on the relevant Record Date (as defined in Condition 7.5 (*Payments - Payments in respect of Registered Covered Bonds*)) immediately preceding the due date for payment in the manner provided in that Condition.

Interests in a Registered Global Covered Bonds will be exchangeable (free of charge), in whole but not in part, for definitive Registered Covered Bonds without receipts, interest coupons or talons attached only upon the occurrence of an Exchange Event. For these purposes, **Exchange Event** means that (i) in the case of Covered Bonds registered in the name of a nominee for a common depository for Euroclear and Clearstream, Luxembourg, the Issuer has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and, in any such case, no successor clearing system is available or (ii) the Issuer has or will become subject to adverse tax consequences which would not be suffered were the Covered Bonds represented by the Registered Global Covered Bond in definitive form. The Issuer will promptly give notice to Covered Bondholders in accordance with Condition 14 (*Notices*) if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg or any person acting on their behalf (acting on the instructions of any holder of an interest in such Registered Global Covered Bond) may give notice to the Registrar requesting exchange and, in the event of the occurrence of an Exchange Event as described in (ii) above, the Issuer may also give notice to the Registrar requesting exchange. Any such exchange shall occur not later than 10 days after the date of receipt of the first relevant notice by the Registrar.

Transfer of Interests

Interests in a Registered Global Covered Bonds may, subject to compliance with all applicable restrictions, be transferred to a person who wishes to hold such interest in another Registered Global Covered Bonds. No beneficial owner of an interest in a Registered Global Covered Bond will be able to transfer such interest, except in accordance with the applicable procedures of Euroclear and Clearstream, Luxembourg, in each case to the extent applicable. Registered Covered Bonds are also subject to the restrictions on transfer set forth therein and will bear a legend regarding such restrictions, see "*Subscription and Sale and Selling Restrictions*".

ISD Covered Bonds

Each Tranche of ISD Covered Bonds will be issued in uncertificated book entry form cleared through the ISD. On the issue of such ISD Covered Bonds, the Issuer (if it is not the ISD Agent) will send a copy of the applicable Final Terms to the ISD Agent. On delivery of the applicable Final Terms by the ISD Agent to the ISD and notification to the ISD of the subscribers and their ISD account details by the relevant Dealer, the ISD Agent acting on behalf of the Issuer will credit each subscribing account holder with the ISD with a nominal amount of ISD Covered Bonds equal to the nominal amount thereof for which it has subscribed and paid.

Settlement of sale and purchase transactions in respect of ISD Covered Bonds in the ISD will take place in accordance with the market practice at the time of the transaction.

Title to the ISD Covered Bonds will pass by registration in the registers between the direct accountholders at the ISD in accordance with the rules and procedures of the ISD. The holder of an ISD Covered Bond will be the person evidenced as such by a book entry in the records of the ISD. The person evidenced (including any nominee) as a holder of the ISD Covered Bonds shall be treated as the holder of such ISD Covered Bonds for the purposes of payment of principal and interest on such ISD Covered Bonds. The expressions **Covered Bondholders** and **holder of Covered Bonds** and related expressions shall be construed accordingly.

General

Pursuant to the Agency Agreement (as defined under "*Terms and Conditions of the Covered Bonds*"), the Agent shall arrange that, where a further Tranche of Covered Bonds (not being ISD Covered Bonds) is issued which is intended to form a single Series with an existing Tranche of Covered Bonds at a point after the Issue Date of the Further Tranche, the Covered Bonds of such further Tranche shall be assigned a common code and ISIN which are different from the common code and ISIN assigned to Covered Bonds 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 Covered Bonds of such Tranche.

For so long as any of the Covered Bonds (other than a ISD Covered Bonds) is represented by a Global Covered Bond held on behalf of Euroclear and/or 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 Covered Bonds (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the nominal amount of such Covered Bonds standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Issuer and its agents as the holder of such nominal amount of such Covered Bonds for all purposes other than with respect to the payment of principal or interest on such nominal amount of such Covered Bonds, for which purpose the bearer of the relevant Global Covered Bond shall be treated by the Issuer and its agents as the holder of such nominal amount of such Covered Bonds in accordance with and subject to the terms of the relevant Global Covered Bond and

the expressions **Covered Bondholders** and **holder of Covered Bonds** and related expressions shall be construed accordingly.

Any reference herein to Euroclear and/or Clearstream, Luxembourg and/or the ISD 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.

The Issuer may agree with any Dealer that Covered Bonds may be issued in a form not contemplated by the Terms and Conditions of the Covered Bonds herein, in which event a new Offering Circular or a supplement to the Offering Circular, if appropriate, will be made available which will describe the effect of the agreement reached in relation to such Covered Bond.

FORM OF FINAL TERMS

PROHIBITION OF SALES TO EEA RETAIL INVESTORS – The Covered Bonds are not intended to be offered, sold or otherwise made available to and should not be offered, sold or otherwise made available to any retail investor in the European Economic Area (**EEA**). For these purposes, a retail investor means a person who is one (or more) of: (i) a retail client as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, **MiFID II**); or (ii) a customer within the meaning of Directive 2002/92/EC (as amended, the **Insurance Mediation Directive**), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or (iii) not a qualified investor as defined in Directive 2003/71/EC (as amended, the **Prospectus Directive**). Consequently no key information document required by Regulation (EU) No 1286/2014 (as amended, the **PRIIPs Regulation**) for offering or selling the Covered Bonds or otherwise making them available to retail investors in the EEA has been prepared and therefore offering or selling the Covered Bonds or otherwise making them available to any retail investor in the EEA may be unlawful under the PRIIPs Regulation.

MIFID II product governance / Professional investors and ECPs only target market – Solely for the purposes of [the/each] manufacturer’s product approval process, the target market assessment in respect of the Covered Bonds has led to the conclusion that: (i) the target market for the Covered Bonds is eligible counterparties and professional clients only, each as defined in MiFID II; and (ii) all channels for distribution of the Covered Bonds to eligible counterparties and professional clients are appropriate. [Consider any negative target market]¹ Any person subsequently offering, selling or recommending the Covered Bonds (a "distributor") should take into consideration the manufacturer[’s/s’] target market assessment; however, a distributor subject to MiFID II is responsible for undertaking its own target market assessment in respect of the Covered Bonds (by either adopting or refining the manufacturer[’s/s’] target market assessment) and determining appropriate distribution channels.

FINAL TERMS

[Date]

ARION BANK HF

Legal Entity Identifier (LEI): RIL4VBPDB0M7Z3KXSF19

**Issue of [Aggregate Nominal Amount of Tranche] [Title of Covered Bonds]
under the €1,500,000,000
Covered Bond Programme**

PART A – CONTRACTUAL TERMS

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions set forth in the Offering Circular dated 8 January 2019 [and the supplement[s] to it dated [date] [and [date]] which [together] constitute[s] a base prospectus for the purposes of the Prospectus Directive (Directive 2003/71/EC) (the **Prospectus Directive**). This document constitutes the Final Terms of the Covered Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with the Offering Circular. Full information on the Issuer and the offer of the Covered Bonds is only available on the basis of the combination of these Final Terms and the Offering Circular. The Offering Circular and the Final Terms are available for viewing at Borgartún 19, 105 Reykjavík, Iceland and on the

¹ To be considered on a case-by-case basis. If a negative target market is deemed necessary, wording along the following lines could be included: "The target market assessment indicates that Notes are incompatible with the needs, characteristics and objectives of clients which are [details to be inserted]."

Luxembourg Stock Exchange's website at www.bourse.lu and from the registered office of the Issuer and from the specified office of the Agent in London.

[The following alternative language applies if the first tranche of an issue which is being increased was issued under an Offering Circular 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 Offering Circular dated 9 February 2012, 23 August 2013, 5 December 2014, 18 December 2015, 23 December 2016 and 5 January 2018 which are incorporated by reference in the Offering Circular dated 8 January 2019. This document constitutes the Final Terms of the Covered Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive (Directive 2003/71/EC) (the **Prospectus Directive**) and must be read in conjunction with the Offering Circular dated 8 January 2019 [and the supplement to it dated [date]] which [together] constitute[s] a base prospectus for the purposes of the Prospectus Directive, including the Conditions incorporated by reference in the Offering Circular. Full information on the Issuer and the offer of the Covered Bonds is only available on the basis of the combination of these Final Terms and the Offering Circular dated 8 January 2019. Copies of such Offering Circulars and Final Terms are available for viewing at Borgartúni 19, 105 Reykjavík, Iceland and on the Luxembourg Stock Exchange's website at www.bourse.lu and copies may be obtained from the registered office of the Issuer and from the specified office of the Agent in London.]

1. (a) Series Number: []

(b) Tranche Number: []

(c) Series which Covered Bonds will be consolidated and form a single Series with: [●]/[Not Applicable]

(d) Date on which the Covered Bonds will be consolidated and form a single Series with the Series specified above: [●]/[Issue Date]/[Not Applicable]
2. Specified Currency or Currencies: []
3. Aggregate Nominal Amount:

 Tranche: []

 Series: []
4. Issue Price: [] % of the Aggregate Nominal Amount [plus accrued interest from [●]]
5. (a) Specified Denominations: []

(N.B. Covered Bonds 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 Covered Bonds in definitive form will be issued with a denomination above €[199,000].”)

- (b) Calculation Amount []
6. (a) Issue Date: []
- (b) Interest Rate: [Fixed Rate/ Floating Rate/ Zero Coupon/ Inflation Linked]
- (c) Interest Commencement Date: []/[Issue Date]/[Not Applicable]
7. Maturity Date: [●]/[Interest Payment Date falling in or nearest to ●]
8. Extended Final Maturity Date: [●]/[Interest Payment Date falling in or nearest to ●]/[Not Applicable]
- (If an Extended Final Maturity Date is specified and the Final Redemption Amount is not paid in full on the Maturity Date, payment of the unpaid amount will be automatically deferred until the Extended Final Maturity Date, provided that any amount representing the Final Redemption Amount due and remaining unpaid on the Maturity Date may be paid by the Issuer on any Interest Payment Date occurring thereafter up to (and including) the relevant Extended Final Maturity Date. See Condition 8.1)*
9. Interest Basis: [[]% Fixed Rate]
[[LIBOR/EURIBOR] +/- []% Floating Rate]
[Zero Coupon]
[See paragraphs [16/17/18/19/20] below]
10. Redemption/Payment Basis:
- [Subject to any purchase or cancellation or early redemption, the Covered Bonds will be redeemed on the Maturity Date at [100] per cent. of their nominal amount.]/[Inflation linked redemption in accordance with item 16 below, and Conditions 6.3 and 8.3]/ [Inflation linked redemption in accordance with Condition 8.4]
11. Change of Interest Basis: [In accordance with paragraph [17]/[18] below]/[Not applicable]

12. Put/Call Options: [Investor Put]
[Issuer Call]
[Not Applicable]
13. [Date of [Board] approval for issuance of Covered Bonds obtained:] [●] [and [●], respectively]
14. Method of distribution: [Syndicated/Non-syndicated]
15. Name and address of the Calculation Agent []

PROVISIONS RELATING TO INFLATION LINKED COVERED BONDS

16. [Inflation Linked Covered Bond Provisions] [Applicable /Not Applicable]
- (a) Rate(s) of Interest: [] per cent. per annum [payable [annually/semi-annually/quarterly/other (specify)] in arrear]
- (b) Interest Payment Date(s): [The [] day in each month]/[] in each year] up to and including the Final Maturity Date
- (c) Number of Interest payments in a year: []
- (d) Total number of annuity payments on the relevant Covered Bonds: []
- (e) Base Index: [●], being the value of the CPI on [●]
- (f) Day Count Fraction: [30/360 or Actual/360 or Actual/Actual (ICMA)]

PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE

17. **Fixed Rate Covered Bond Provisions** [Applicable/Not Applicable]
- (a) Rate(s) of Interest: []% 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 or the Extended Final Maturity Date, as applicable]
- (c) Fixed Coupon Amount[(s)]: [] per Calculation Amount
(Applicable to Covered Bonds in definitive form.)
- (d) Broken Amount(s): [[] per Calculation Amount, payable on the Interest Payment Date falling [in/on] []]/[Not Applicable]
(Applicable to Covered Bonds in definitive form.)
- (e) Day Count Fraction: [30/360 or Actual/Actual (ICMA)]
- (f) Determination Date(s): [] in each year / [Not Applicable]

18. **Floating Rate Covered Bond Provisions** [Applicable/Not Applicable]
- (a) Specified Period(s)/Specified Interest Payment Dates: []
- (b) Business Day Convention: [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention]
- (c) Additional Business Centre(s): [[]/Not Applicable]
- (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: [Applicable/ Not Applicable]
- Reference Rate: []
Reference Rate: [●] month [LIBOR/EURIBOR/●]
- Interest Determination Date(s): []
- Relevant Screen Page: []
- (g) ISDA Determination: [Applicable/ Not Applicable]
- Floating Rate Option: []
- Designated Maturity: []
- Reset Date: []
- (N.B. The fallback provisions applicable to ISDA Determination under the 2006 ISDA Definitions are reliant upon the provision by reference banks of offered quotations for LIBOR and/or EURIBOR which, depending on market circumstances, may not be available at the relevant time)*
- (h) Margin(s): [+/-] []% per annum
- (i) Minimum Rate of Interest: []% per annum
- (j) Maximum Rate of Interest: []% per annum
- (k) Day Count Fraction: [Actual/Actual (ISDA)
Actual/365 (Fixed)]

Actual/365 (Sterling)

Actual/360

30/360

30E/360

30E/360 (ISDA)]

19. **Zero Coupon Covered Bond Provisions²** [Applicable/Not Applicable]
- (a) Accrual Yield: []% per annum
- (b) Reference Price: []
- (c) Day Count Fraction in relation to Early Redemption Amounts and late payment: [Condition 8.7 applies/30/360 or Actual/Actual (ICMA) *r*]

(Consider applicable day count fraction if not U.S. dollar denominated)

20. **Inflation Linked Non-Amortising Covered Bond Provisions** [Applicable /Not Applicable]
- (a) Rate(s) of Interest: [] per cent. per annum [payable [annually/semi-annually/quarterly/other (specify)] in arrear]
- (b) Interest Payment Date(s): [The [] day in each month]/[[] in each year] up to and including the Final Maturity Date
- (c) Base Index: [●], being the value of the CPI on [●]
- (d) Day Count Fraction: [30/360 or Actual/Actual (ICMA)]

PROVISIONS RELATING TO REDEMPTION

21. **Issuer Call** [Applicable/Not Applicable]
- (a) Optional Redemption Date(s): []
- (b) Optional Redemption Amount of each Covered Bond: [] per Covered Bond of [] Specified Denomination
- (c) If redeemable in part:
- (i) Minimum Redemption Amount: []
- (ii) Maximum Redemption Amount: []
- (d) Notice period (if other than as set out in the Conditions): []

22. **Investor Put:** [Applicable/Not Applicable]

² Zero Coupon Covered Bonds not to be issued with an Extended Final Maturity Date unless otherwise agreed with the Dealers.

- (a) Optional Redemption Date(s):
- (b) Optional Redemption Amount: per Calculation Amount
- (c) Notice period (if other than as set out in the Conditions):
23. Final Redemption Amount of each Covered Bond per Covered Bond of Specified Denomination/ for the Inflation Linked Covered Bonds/ In accordance with Condition 8.4 per Covered Bond of Specified Denomination/ Not Applicable
24. Early Redemption Amount of each Covered Bond payable on redemption for taxation reasons: /[As set out in Condition 8.7(b)]
25. Relevant Percentage: As at the Issue Date, per cent.

GENERAL PROVISIONS APPLICABLE TO THE COVERED BONDS

26. Form of Covered Bonds: Bearer Covered Bonds
- [Temporary Global Covered Bond exchangeable for a Permanent Global Covered Bond which is exchangeable for definitive Covered Bonds [on 60 days' notice given at any time/only upon an Exchange Event.]]
- [Temporary Global Covered Bond exchangeable for definitive Covered Bonds on and after the Exchange Date.]
- [Permanent Global Covered Bond which is exchangeable for definitive Covered Bonds [on 60 days' notice given at any time/ only upon an Exchange Event/at any time at the request of the Issuer].]
- (Ensure that this is consistent with the wording in the "Form of Covered Bonds" section of the Offering Circular and the Covered Bonds themselves.*
- N.B. The exchange upon notice/at any time at the request of the Issuer options should not be expressed to be applicable if the Specified Denomination of the Covered Bonds in paragraph 6 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 Covered Bonds which is to be represented on issue by a Temporary*

Global Covered Bond exchangeable for Definitive Covered Bonds.)

[Registered Covered Bonds

[Regulation S Global Covered Bond (U.S.\$[] nominal amount) registered in the name of a common depository for Euroclear and Clearstream, Luxembourg/a common safekeeper for Euroclear and Clearstream, Luxembourg]]

[ISD Covered Bonds

ISD Covered Bonds issued in uncertificated and dematerialised book entry form. See further item [7] of Part B below.]

27. New Global Covered Bond:

[Yes] [No]

(If ISD Covered Bonds, insert "No")

28. Additional Financial Centre(s):

[●]/[Not Applicable]

29. Talons for future Coupons or Receipts to be attached to definitive Covered Bonds in bearer form (and dates on which such Talons mature):

[Yes, as the Covered Bonds have more than 27 coupon payments, Talons may be required if, on exchange into definitive form, more than 27 coupons payments are still to be made /No.]

30. Details relating to Instalment Covered Bonds; amount of each instalment, date on which each payment is to be made:

[Applicable/Not Applicable]

[[For Instalment Covered Bonds:]

Instalment Amount = [●]

Instalment Date(s) = [●]]

31. Redenomination:

[Redenomination not applicable/ The provisions of Condition 5 apply]

DISTRIBUTION

32. (a) If syndicated, names of Managers:

[Not Applicable/give names]

(If the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies, include names of entities agreeing to underwrite the issue on a firm commitment basis and names of the entities agreeing to place the issue without a firm commitment or on a "best efforts" basis if such entities are not the same as the Managers.)

(b) Date of [Subscription] Agreement:

[]/ [Not Applicable]

(The above is only relevant if the Covered Bonds are

derivative securities to which Annex XII of the Prospectus Directive Regulation applies.)

- (c) Stabilisation Manager(s) (if any): [Not Applicable/give name]
33. If non-syndicated, name of Dealer: [Name]
34. U.S. Selling Restrictions: [Reg. S Category 1/2/3; TEFRA D/TEFRA C/TEFRA not applicable]
35. Prohibition of Sales to Belgian Consumers: [Applicable/Not Applicable]
- (N.B. advice should be taken from Belgian counsel before disapplying this selling restriction)*
36. Relevant Benchmark: [[LIBOR/EURIBOR/[]] is provided by [ICE Benchmark Administration Limited/European Money Markets Institute/[]]. As at the date hereof, [LIBOR/EURIBOR/[]] [[appears]/[does not appear]] in the register of administrators and benchmarks established and maintained by the European Securities and Markets Authority pursuant to Article 36 of Regulation (EU) No. 2016/1011 (the **Benchmarks Regulation**).] [[As far as the Bank is aware, as at the date hereof, the transitional provisions in Article 51 of the Benchmarks Regulation apply, such that [[ICE Benchmark Administration Limited]/[European Money Markets Institute]/[]] is not currently required to obtain authorisation/registration (or, if located outside the European Union, recognition, endorsement or equivalence)] OR [[] does not fall within the scope of the Benchmarks Regulation]]/[Not Applicable]

PART B – OTHER INFORMATION

1. ADMISSION TO TRADING

[Application has been made by the Issuer (or on its behalf) for the Covered Bonds to be admitted to trading on [*specify relevant regulated market (for example the Bourse de Luxembourg and, if relevant, listing on an official list)*] with effect from [].]

[Application is expected to be made by the Issuer (or on its behalf) for the Covered Bonds to be admitted to trading on [*specify relevant regulated market (for example the Bourse de Luxembourg and, if relevant, listing on an official list)*] with effect from [].] [Not Applicable.]

Estimate of total expenses related to admission to trading:

2. RATINGS

Ratings:

The Covered Bonds to be issued have [not] been rated:

[S & P: []]
[Moody's: []]
[Fitch: []]
[[Other]: []]

[The Covered Bonds to be issued [[have been]/[are expected to be]] rated [*insert details*] by [*insert credit rating agency name(s)*].]

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 Covered Bonds 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 [Manager[s]/Dealer[s]], so far as the Issuer is aware, no person involved in the issue of the Covered Bonds has an interest material to the offer. The [Manager[s]/Dealer[s]] and [their/its] 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 Issuer and its affiliates in the ordinary course of business]

4. REASONS FOR THE OFFER, ESTIMATED NET PROCEEDS AND TOTAL EXPENSES

(i) Reasons for the offer [] / [Not Applicable]

(ii) Estimated net proceeds: [] / [Not Applicable]

(iii) Estimated total expenses: [] / [Not Applicable]

(N.B.: Delete unless the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies, in which case (i) above is required where the reasons for the offer are different from making profit and/or hedging certain risks and, where such reasons are inserted in (i), disclosure of net proceeds and total expenses at (ii) and (iii) above are also required.)

5. YIELD (FIXED RATE COVERED BONDS ONLY)

Indication of yield: [] / [Not Applicable]

6. PERFORMANCE OF FORMULA/CPI, EXPLANATION OF EFFECT ON VALUE OF INVESTMENT AND ASSOCIATED RISKS AND OTHER INFORMATION CONCERNING THE UNDERLYING (*INFLATION LINKED COVERED BONDS AND INFLATION LINKED NON AMORTISING COVERED BONDS ONLY*)

[Not Applicable]

[Need to include details of where past and future performance and volatility of the formula/CPI can be obtained.]

The Covered Bonds are linked to the performance of the Icelandic Consumer Price Index (CPI) produced based on data from Statistics Iceland

Information about the CPI can be obtained from the website of Statistics of Iceland being [<http://www.statice.is/Statistics/Prices-and-consumption/Indices-overview>]

The Issuer [intends to provide post-issuance information [*specify what information will be reported and where it can be obtained*]] [does not intend to provide post-issuance information]

(N.B. This paragraph only applies if the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies.)

7. OPERATIONAL INFORMATION

(i) ISIN Code: []

(ii) Common Code: []

(iii) CFI: [] [Not Applicable]

(iv) FISN: [] [Not Applicable]

(If the Classification of Financial Instruments code (CFI) and/or the Financial Instrument Short Name (FISN) is not required, requested or available, it/they should be specified to be "Not Applicable")

(v) Any clearing system(s) other than Euroclear Bank S.A./N.V. and [Not Applicable]/[Icelandic Securities Depository Ltd., Iceland]

Clearstream Banking, société anonyme (together with the address of each such clearing system) and the relevant identification number(s):

- (vi) Delivery: Delivery [against/free of] payment
- (vii) Names and addresses of additional Paying Agent(s) (if any) or, in the case of ISD Covered Bonds, the ISD Agent: []
- (viii) Deemed delivery of clearing system notices for the purposes of Condition 14 (*Notices*): Any notice delivered to Covered Bondholders through the clearing systems will be deemed to have been given on the [second] [business] day after the day on which it was given to Euroclear, and Clearstream, Luxembourg and ISD.
- (ix) Intended to be held in a manner which would allow Eurosystem eligibility: [Yes. Note that the designation "yes" simply means that the Covered Bonds are intended upon issue to be deposited with one of the ICSDs as common safekeeper [, and registered in the name of a nominee of one of the ICSDs acting as common safekeeper, that is, held under the NSS,] *[include this text for Registered Covered Bonds which are to be held under the NSS]* and does not necessarily mean that the Covered Bonds will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon the ECB being satisfied that Eurosystem eligibility criteria have been met.]
- [No. Whilst designation is specified as "no" at the date of these Final Terms, should the Eurosystem eligibility criteria be amended in the future such that the Covered Bonds are capable of meeting them the Covered Bonds may then be deposited with one of the ICSDs as common safekeeper (and registered in the name of a nominee of one of the ICSDs acting as common Safekeeper). Note that this does not necessarily mean that the Covered Bonds will then be recognised as eligible collateral for Eurosystem monetary policy and intra day credit operations by the Eurosystem at any time during their life. Such recognition will depend upon the ECB being satisfied that Eurosystem eligibility criteria have been met.]]

Signed on behalf of the Issuer:

By:

Duly authorised signatory

TERMS AND CONDITIONS OF THE COVERED BONDS

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

The Covered Bonds are bonds issued by Arion Bank hf. (the **Issuer**) in accordance with the Icelandic Act on Covered Bonds no. 11/2008 (the **Icelandic Covered Bond Act**) and the Rules No. 528/2008 on covered bonds (the **Rules**). The Covered Bonds will be issued in compliance with any applicable legal or regulatory restrictions including the rules on foreign exchange issued by the Central Bank, and any reference to currencies other than ISK, and to Inflation Linked Covered Bonds and related expressions shall be construed as taking effect subject to such restrictions being lifted.

This Covered Bond is one of a Series (as defined below) of Covered Bonds issued by the Issuer.

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

- (a) in relation to any Covered Bonds represented by a global Covered Bond (a **Global Covered Bond**), units of the lowest denomination specified in the relevant Final Terms (**Specified Denomination**) in the currency specified in the relevant Final Terms (**Specified Currency**);
- (b) any Global Covered Bond; and
- (c) any definitive Covered Bonds in bearer form (**Bearer Covered Bonds**) issued in exchange for a Global Covered Bond in bearer form; and
- (d) any definitive Covered Bonds in registered form (**Registered Covered Bonds**) (whether or not issued in exchange for a Global Covered Bond in registered form); and
- (e) any Covered Bonds issued in uncertificated book entry form cleared through the Icelandic Securities Depository (the **ISD Covered Bonds** and the **ISD**, respectively). ISD Covered Bonds are in dematerialised form. Any references in these Terms and Conditions (the **Conditions**) to Receipts, Coupons and Talons shall not apply to ISD Covered Bonds and no global or definitive Covered Bonds will be issued in respect of ISD Covered Bonds.

The Covered Bonds (other than the ISD Covered Bonds), the Receipts (as defined below) and the Coupons (as defined below) have the benefit of an Agency Agreement dated 10 February 2012, as amended and restated on 23 December 2016 and on 8 January 2019 (such Agency Agreement as amended and/or supplemented and/or restated from time to time, the **Agency Agreement**), and made between the Issuer and The Bank of New York Mellon, London Branch as fiscal agent (the **Fiscal Agent**) and transfer agent (the **Transfer Agent**, which expression shall include any additional or successor transfer agents), and The Bank of New York Mellon Luxembourg S.A. as paying agent (the **Paying Agent**, which expression shall include any successor paying agent) and as registrar (the **Registrar**, which expression shall include any successor registrar). In relation to the ISD Covered Bonds, Arion Bank hf. will act as the ISD system account manager (the **ISD Agent**, which expression shall include any additional agent appointed by the Issuer from time to

time in relation to the ISD Covered Bonds). The Fiscal Agent, the Registrar the, other Paying Agents, the ISD Agent and the other Transfer Agents are together referred to as the **Agents**.

Interest bearing definitive Covered Bonds have interest coupons (**Coupons**) and, if indicated in the applicable Final Terms, talons for further Coupons (**Talons**) attached on issue. Any reference herein to Coupons or coupons shall, unless the context otherwise requires, be deemed to include a reference to Talons or talons. Definitive Covered Bonds repayable in instalments have receipts (**Receipts**) for the payment of the instalments of principal (other than the final instalment) attached on issue. Global Covered Bonds do not have Receipts, Coupons or Talons attached on issue.

The Final Terms for this Covered Bond (or the relevant provisions thereof), as set out in Part A of the Final Terms which are (except in the case of ISD Covered Bonds) attached to or endorsed on this Covered Bond, complete the Conditions for the purposes of this Covered Bond. References to the **applicable Final Terms** are to Part A of the Final Terms (or the relevant provisions thereof) which are (except in the case of ISD Covered Bonds) attached to or endorsed on this Covered Bond and (in the case of the ISD Covered Bonds) which are deposited with the ISD and the ISD Agent. The expression **Prospectus Directive** means Directive 2003/71/EC (and amendments thereto, including the **2010 PD Amending Directive**) to the extent implemented in the relevant Member State of the European Economic Area and includes any relevant implementing measure in the relevant Member State and the expression 2010 PD Amending Directive means Directive 2010/73/EU.

Any reference to **Covered Bondholders** or **holders** in relation to any Covered Bonds shall mean (in the case of Bearer Covered Bonds) the holders of the Covered Bonds, (in the case of Registered Covered Bonds) the persons in whose name the Covered Bonds are registered and (in the case of ISD Covered Bonds) the persons who are for the time being shown in the records of the ISD as the holders of the Covered Bonds, and shall, in relation to any Covered Bonds represented by a Global Covered Bond and any ISD Covered Bonds, be construed as provided below. Any reference herein to **Receiptholders** shall mean the holders of the Receipts and any reference herein to **Couponholders** shall mean the holders of the Coupons and shall, unless the context otherwise requires, include the holders of the Talons.

As used herein, **Tranche** means Covered Bonds which are identical in all respects (including as to listing and admission to trading) and **Series** means a Tranche of Covered Bonds together with any further Tranche or Tranches of Covered Bonds 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 Covered Bondholders (except in the case of ISD Covered Bonds), the Receiptholders and the Couponholders are entitled to the benefit of the Deed of Covenant (the **Deed of Covenant**) dated 5 December 2014 and made by the Issuer. The original of the Deed of Covenant is held by the common depositary for Euroclear and Clearstream, Luxembourg (each 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 Fiscal Agent and the Registrar. Copies of the applicable Final Terms are available for viewing at the registered office of the Issuer and of the Fiscal Agent and on the Luxembourg Stock Exchange's website (www.bourse.lu) and copies may be obtained from those offices save that, if this Covered Bond is neither admitted to trading on a regulated market in the European Economic Area nor offered in the European Economic Area in circumstances where a prospectus is required to be published under the Prospectus Directive (Directive 2003/71/EC), the applicable Final Terms will only be obtainable by a Covered Bondholder holding one or more unlisted Covered Bonds of that Series and such Covered Bondholder must produce evidence satisfactory to the Issuer and (except in the case of ISD Covered Bonds) the relevant Paying Agent as to its holding of such Covered Bonds and identity. The Covered Bondholders, the Receiptholders 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.

1. FORM, DENOMINATION AND TITLE

The Covered Bonds are in bearer form (**Bearer Covered Bonds**) or registered form (**Registered Covered Bonds**) or, in the case of ISD Covered Bonds, uncertificated book entry form, as specified in the applicable Final Terms, and, in the case of definitive Covered Bonds, in the Specified Currency and the Specified Denomination(s) and (other than ISD Covered Bonds) serially numbered. Covered Bonds of one Specified Denomination may not be exchanged for Covered Bonds of another Specified Denomination and Bearer Covered Bonds may not be exchanged for Registered Covered Bonds and *vice versa*. Neither Bearer Covered Bonds nor Registered Covered Bonds may be exchanged for ISD Covered Bonds and *vice versa*.

This Covered Bond may be a Fixed Rate Covered Bond, a Floating Rate Covered Bond, a Zero Coupon Covered Bond, an Inflation Linked Covered Bond, an Inflation Linked Non-Amortising Covered Bonds or a combination of any of the foregoing, depending upon the Interest Basis shown in the applicable Final Terms and may be an Instalment Covered Bond.

This Covered Bond may be an Inflation Linked Covered Bond or an Inflation Linked Non-Amortising Covered Bonds depending on the Redemption/Payment Basis shown in the applicable Final Terms.

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

Subject as set out below, title to the Bearer Covered Bonds, Receipts and Coupons will pass by delivery, title to the Registered Covered Bonds will pass upon registration of transfers in accordance with the provisions of the Agency Agreement and title to ISD Covered Bonds will pass by registration in the registers between the direct or indirect accountholders at the ISD in accordance with the rules and procedures of the ISD. The Issuer and any Agent will (except as otherwise required by law) deem and treat the bearer of any Bearer Covered Bond, Receipt or Coupon and the registered holder of any Registered Covered Bond or ISD Covered Bond 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 Covered Bond, without prejudice to the provisions set out in the next succeeding paragraph, and the expressions **Covered Bondholders** or **holders of Covered Bonds** and related expressions shall be construed accordingly.

For so long as any of the Covered Bonds is represented by a Global Covered Bond held on behalf of Euroclear Bank SA/NV (**Euroclear**) and/or Clearstream Banking, société anonyme (**Clearstream, Luxembourg**) or so long as any of the Covered Bonds is an ISD Covered Bond each person (other than Euroclear, Clearstream, Luxembourg or the ISD) who is for the time being shown in the records of Euroclear or of Clearstream, Luxembourg or the ISD, as the case may be, as the holder of a particular nominal amount of such Covered Bonds (in which regard any certificate or other document issued by Euroclear, Clearstream, Luxembourg or the ISD, as the case may be, as to the nominal amount of such Covered Bonds standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Issuer and the relevant Agents as the holder of such nominal amount of such Covered Bonds for all purposes other

than (in the case only of Covered Bonds not being ISD Covered Bonds) with respect to the payment of principal or interest on such nominal amount of such Covered Bonds, for which purpose, in the case of Covered Bonds represented by a bearer Global Covered Bond, the bearer of the relevant Global Covered Bond, or, in the case of Covered Bonds represented by Registered Global Covered Bonds, the registered holder shall be treated by the Issuer and any Agent as the holder of such nominal amount of such Covered Bonds in accordance with and subject to the terms of the relevant Global Covered Bond and the expressions **Covered Bondholder** and **holder of Covered Bonds** and related expressions shall be construed accordingly. Covered Bonds which are represented by a Global Covered Bond 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.

The Issuer shall be entitled to obtain certain information from the register maintained by the ISD for the purpose of performing its obligations under the issue of ISD Covered Bonds. The ISD Agent shall be entitled to obtain such information as is required to perform its duties under the Terms and Conditions of the Covered Bonds and rules and regulations of, and applicable to, the ISD.

References to the ISD, 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 or as may otherwise be approved by the Issuer.

2. TRANSFERS OF REGISTERED COVERED BONDS

2.1 Transfers of interests in Registered Global Covered Bonds

Transfers of beneficial interests in Registered Global Covered Bonds will be effected by Euroclear or Clearstream, Luxembourg, as the case may be, and, in turn, by other participants and, if appropriate, indirect participants in such clearing systems acting on behalf of transferors and transferees of such interests. A beneficial interest in a Registered Global Covered Bond will, subject to compliance with all applicable legal and regulatory restrictions, be transferable for Covered Bonds in definitive form or for a beneficial interest in another Registered Global Covered Bond only in the authorised denominations set out in the applicable Final Terms and only in accordance with the rules and operating procedures for the time being of Euroclear or Clearstream, Luxembourg, as the case may be, and in accordance with the terms and conditions specified in the Agency Agreement.

2.2 Transfers of Registered Covered Bonds in definitive form

Subject as provided in paragraphs 2.5 and 2.6 below, upon the terms and subject to the conditions set forth in the Agency Agreement, a Registered Covered Bond in definitive form may be transferred in whole or in part (in the authorised denominations set out in the applicable Final Terms). In order to effect any such transfer (a) the holder or holders must (i) surrender the Registered Covered Bond for registration of the transfer of the Registered Covered Bond (or the relevant part of the Registered Covered Bond) at the specified office of any Transfer Agent, with the form of transfer thereon duly executed by the holder or holders thereof or his or their attorney or attorneys duly authorised in writing and (ii) complete and deposit such other certifications as may be required by the relevant Transfer Agent and (b) the relevant Transfer Agent must, after due and careful enquiry, be satisfied with the documents of title and the identity of the person making the request. Any such transfer will be subject to such reasonable regulations as the Issuer and the Registrar may from time to time prescribe (the initial such regulations being set out in Schedule 8 to the Agency Agreement). Subject as provided above, the relevant Transfer Agent will, within three business days (being for this purpose a day on which banks are open for business in the city where the specified office of the relevant Transfer Agent is located) of the request (or such longer period as may be required to comply with any applicable fiscal or other laws or regulations), authenticate and deliver, or procure the authentication and delivery of, at its specified office to the transferee or (at the risk of the transferee) send by uninsured mail, to such address as the transferee may request, a new Registered

Covered Bond in definitive form of a like aggregate nominal amount to the Registered Covered Bond (or the relevant part of the Registered Covered Bond) transferred. In the case of the transfer of part only of a Registered Covered Bond in definitive form, a new Registered Covered Bond in definitive form in respect of the balance of the Registered Covered Bond not transferred will be so authenticated and delivered or (at the risk of the transferor) sent to the transferor.

2.3 Registration of transfer upon partial redemption

In the event of a partial redemption of Covered Bonds under Condition 8, the Issuer shall not be required to register the transfer of any Registered Covered Bond, or part of a Registered Covered Bond, called for partial redemption.

2.4 Costs of registration

Covered Bondholders will not be required to bear the costs and expenses of effecting any registration of transfer as provided above, except for any costs or expenses of delivery other than by regular uninsured mail and except that the Issuer may require the payment of a sum sufficient to cover any stamp duty, tax or other governmental charge that may be imposed in relation to the registration.

2.5 Transfers of interests in Regulation S Global Covered Bonds

Prior to expiry of the applicable Distribution Compliance Period, transfers by the holder of, or of a beneficial interest in, a Regulation S Global Covered Bond to a transferee in the United States or who is a U.S. person will only be made upon receipt by the Registrar of a written certification substantially in the form set out in the Agency Agreement, amended as appropriate (a **Transfer Certificate**), copies of which are available from the specified office of any Transfer Agent, from the transferor of the Covered Bond or beneficial interest therein to the effect that such transfer is being made pursuant to the Securities Act or an exemption therefrom, subject to receipt by the Issuer of such satisfactory evidence as the Issuer may reasonably require, which may include an opinion of U.S. counsel, that such transfer is in compliance with any applicable securities laws of any State of the United States, and, in each case, in accordance with any applicable securities laws of any State of the United States or any other jurisdiction.

2.6 Exchanges and transfers of Registered Covered Bonds generally

Holders of Registered Covered Bonds in definitive form may exchange such Covered Bonds for interests in a Registered Global Covered Bond of the same type at any time.

2.7 Definitions

In this Condition, the following expressions shall have the following meanings:

Distribution Compliance Period means the period that ends 40 days after the completion of the distribution of each Tranche of Covered Bonds, as certified by the relevant Dealer (in the case of a non-syndicated issue) or the relevant Lead Manager (in the case of a syndicated issue);

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 and, 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 each case selected by the Agent;

Regulation S means Regulation S under the Securities Act;

Regulation S Global Covered Bond means a Registered Global Covered Bond representing Covered Bonds sold outside the United States in reliance on Regulation S;

Securities Act means the United States Securities Act of 1933, as amended.

3. STATUS OF THE COVERED BONDS

The Covered Bonds and any related Receipts and Coupons constitute direct, unilateral, unconditional and unsubordinated obligations of the Issuer to pay the Final Redemption Amount and rank *pari passu* among themselves and with all other outstanding unsubordinated obligations of the Issuer that have been provided equivalent priority of claim to Covered Bonds issued in accordance with the terms of the Icelandic Covered Bond Act.

On the winding up or voluntary or involuntary liquidation of the Issuer, the Covered Bondholders will, by virtue of the Icelandic Covered Bond Act, have certain rights of priority over and be senior to other creditors of the Issuer to the Cover Pool and the payments received with respect to the Cover Pool, but junior to claims due to derivative agreements concluded or issued in accordance with the terms of the Icelandic Covered Bond Act.

4. COMPLIANCE WITH THE ICELANDIC COVERED BOND ACT

So long as any of the Covered Bonds, Receipts or Coupons remains outstanding the Issuer undertakes that with respect to the Covered Bonds and the related Cover Pool, it will comply with all provisions of the Icelandic Covered Bond Act, and the related Rules, as amended from time to time.

5. REDENOMINATION

5.1 Redenomination

Where redenomination is specified in the applicable Final Terms as being applicable, the Issuer may, without the consent of the Covered Bondholders, the Receiptholders and the Couponholders, on giving prior notice to the Fiscal Agent, Euroclear and Clearstream, Luxembourg (in the case of Covered Bonds other than ISD Covered Bonds) or to the ISD Agent and the ISD (in the case of ISD Covered Bonds) and at least 30 days' prior notice to the Covered Bondholders in accordance with Condition 14, elect that, with effect from the Redenomination Date specified in the notice, the Covered Bonds with a Specified Currency other than euro shall be redenominated in euro.

The election will have effect as follows:

- (a) the Covered Bonds and the Receipts shall be deemed to be redenominated in euro in the denomination of euro 0.01 with a nominal amount for each Covered Bond and Receipt equal to the nominal amount of that Covered Bond or Receipt in the Specified Currency, converted into euro at the Established Rate, provided that, if the Issuer determines, with the agreement of the Fiscal Agent in the case of Covered Bonds other than ISD Covered Bonds, that the then market practice in respect of the redenomination in euro of internationally offered securities is different from the provisions specified above, such provisions shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Covered Bondholders, the stock exchange (if any) on which the Covered Bonds may be listed and the Agents of such deemed amendments;
- (b) save to the extent that an Exchange Notice has been given in accordance with paragraph (d) below, the amount of interest due in respect of the Covered Bonds will be calculated by reference to the aggregate nominal amount of Covered Bonds presented (or, as the case may

be, in respect of which Coupons are presented) for payment by the relevant holder and the amount of such payment shall be rounded down to the nearest €0.01;

- (c) if definitive Covered Bonds are required to be issued after the Redenomination Date, they shall be issued at the expense of the Issuer (i) in the case of Relevant Covered Bonds in the denomination of euro 100,000 and/or such higher amounts as the Fiscal Agent (in the case of Covered Bonds other than ISD Covered Bonds) or the Issuer (in the case of ISD Covered Bonds) may determine and notify to the Covered Bondholders and any remaining amounts less than euro 100,000 shall be redeemed by the Issuer and paid to the Covered Bondholders in euro in accordance with Condition 7 (*Payments*); and (ii) in the case of Covered Bonds which are not Relevant Covered Bonds, in the denominations of €1,000, €10,000, €100,000 and (but only to the extent of any remaining amounts less than €1,000 or such smaller denominations as the Agent may approve) €0.01 and such other denominations as the Fiscal Agent (in the case of Covered Bonds other than ISD Covered Bonds) or the Issuer (in the case of ISD Covered Bonds) shall determine and notify to the Covered Bondholders;
- (d) if issued prior to the Redenomination Date, all unmatured Coupons denominated in the Specified Currency (whether or not attached to the Covered Bonds) will become void with effect from the date on which the Issuer gives notice (the **Exchange Notice**) that replacement euro-denominated Covered Bonds, Receipts and Coupons are available for exchange (provided that such securities are so available) and no payments will be made in respect of them. The payment obligations contained in any Covered Bonds and Receipts so issued will also become void on that date although those Covered Bonds and Receipts will continue to constitute valid exchange obligations of the Issuer. New euro-denominated Covered Bonds, Receipts and Coupons will be issued in exchange for Covered Bonds, Receipts and Coupons denominated in the Specified Currency in such manner as the Fiscal Agent (in the case of Covered Bonds other than ISD Covered Bonds) or the Issuer (in the case of ISD Covered Bonds) may specify and as shall be notified to the Covered Bondholders in the Exchange Notice. No Exchange Notice may be given less than 15 days prior to any date for payment of principal or interest on the Covered Bonds;
- (e) after the Redenomination Date, all payments in respect of the Covered Bonds, the Receipts and the Coupons, other than payments of interest in respect of periods commencing before the Redenomination Date, will be made solely in euro as though references in the Covered Bonds to the Specified Currency were to euro. 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 or, at the option of the payee, by a euro cheque;
- (f) if the Covered Bonds are Fixed Rate Covered Bonds and interest for any period ending on or after the Redenomination Date is required to be calculated for a period ending other than on an Interest Payment Date, it will be calculated:
 - (i) in the case of the Covered Bonds represented by a Global Covered Bond or ISD Covered Bonds, by applying the Rate of Interest to the aggregate outstanding nominal amount of the Covered Bonds; and
 - (ii) in the case of definitive Covered Bonds, by applying the Rate of Interest to 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 Covered Bond in definitive form is a multiple of the Calculation Amount, the amount of interest payable in respect of

such Fixed Rate Covered Bond shall be the product of the amount (determined in the manner provided above) for each the Calculation Amount and the amount which the Calculation Amount is multiplied to reach the Specified Denomination without any further rounding;

- (g) if the Covered Bonds are Floating Rate Covered Bonds, the applicable Final Terms will specify any relevant changes to the provisions relating to interest; and
- (h) such other changes shall be made to this Condition as the Issuer may decide, after consultation with the Fiscal Agent in the case of Covered Bonds other than ISD Covered Bonds), and as may be specified in the notice, to conform it to conventions then applicable to instruments denominated in euro.

5.2 Definitions

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

Established Rate means the rate for the conversion of the Specified Currency (including compliance with rules relating to roundings in accordance with applicable European Union regulations) into euro established by the Council of the European Union pursuant to Article 140 of the Treaty;

euro means the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty;

Redenomination Date means (in the case of interest bearing Covered Bonds) any date for payment of interest under the Covered Bonds or (in the case of Zero Coupon Covered Bonds) any date, in each case specified by the Issuer in the notice given to the Covered Bondholders pursuant to paragraph 5.1 above and which falls on or after the date on which the country of the Specified Currency first participates in the third stage of European economic and monetary union;

Relevant Covered Bonds means all Covered Bonds where the applicable Final Terms provide for a minimum Specified Denomination in the Specified Currency which is equivalent to at least euro 100,000 and which are admitted to trading on a regulated market in the European Economic Area; and

Treaty means the Treaty on the Functioning of the European Union, as amended.

6. INTEREST

6.1 Interest on Fixed Rate Covered Bonds

Each Fixed Rate Covered Bond bears interest from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest. Interest will be payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Maturity Date or, if the applicable Final Terms specifies that an Extended Final Maturity Date applies, the Extended Final Maturity Date or any earlier Interest Payment Date on which the Covered Bonds are redeemed in full, provided that any amounts representing interest payable after the Maturity Date shall be paid at such rate and on such dates specified in the applicable Final Terms.

If the Covered Bonds 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 Covered Bonds 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 Covered Bonds which are represented by a Global Covered Bond or Fixed Rate Covered Bonds which are ISD Covered Bonds, the aggregate outstanding nominal amount of the Fixed Rate Covered Bonds; or
- (b) in the case of Fixed Rate Covered Bonds 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 Covered Bond in definitive form is a multiple of the Calculation Amount, the amount of interest payable in respect of such Fixed Rate Covered Bond 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 6.1:

- (i) if "**Actual/Actual (ICMA)**" is specified in the applicable Final Terms:
 - (A) in the case of Covered Bonds where the number of days in the relevant period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (the **Accrual Period**) is equal to or shorter than the Determination Period during which the Accrual Period ends, the number of days in such Accrual Period divided by the product of (1) the number of days in such Determination Period and (2) the number of Determination Dates (as specified in the applicable Final Terms) that would occur in one calendar year; or
 - (B) in the case of Covered Bonds where the Accrual Period is longer than the Determination Period during which the Accrual Period ends, the sum of:
 - (1) 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
 - (2) 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

- (ii) 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.

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.

6.2 Interest on Floating Rate Covered Bonds

(a) Interest Payment Dates

Each Floating Rate Covered Bond bears interest from (and including) the Interest Commencement Date and such interest will be payable in 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 (which expression shall, in the Conditions, mean the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date).

If a Business Day Convention is specified in the applicable Final Terms and (x) if there is no numerically corresponding day on 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 6.2(a)(ii) above, the Floating Rate Convention, such Interest Payment Date (i) in the case of (x) above, shall be the last day that is a Business Day in the relevant month and the provisions of (b) below shall apply *mutatis mutandis* or (ii) 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 (1) such Interest Payment Date shall be brought forward to the immediately preceding Business Day and (2) 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:

- I. a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in London and any Additional Business Centre specified in the applicable Final Terms; and
- II. either (1) 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 (2) in relation to any sum payable in euro, a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET2) System (the **TARGET2 System**) is open.

(b) Rate of Interest

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

(i) ISDA Determination for Floating Rate Covered Bonds

Where ISDA Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will be the relevant ISDA Rate plus or minus (as indicated in the applicable Final Terms) the Margin (if any). For the purposes of this subparagraph (i), **ISDA Rate** for an Interest Period means a rate equal to the Floating Rate that would be determined by the Fiscal Agent or the ISD Agent, as the case may be, under an interest rate swap transaction if that 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 Covered Bonds (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 either (I) if the applicable Floating Rate Option is based on the London inter-bank offered rate (**LIBOR**) or on the Euro-zone inter-bank offered rate (**EURIBOR**), the first day of that Interest Period or (II) in any other case, as 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.

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

(ii) Screen Rate Determination for Floating Rate Covered Bonds

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

(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 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, or Brussels time, in the case of EURIBOR) on the Interest Determination Date in question plus or minus (as indicated in the applicable Final Terms) the Margin (if any), all as determined by the Fiscal Agent or the Calculation 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, or Brussels time, in the case of EURIBOR), 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 at 11.00 a.m. (London time, in the case of LIBOR, or Brussels time, in the case of EURIBOR) 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, or Brussels time, in the case of EURIBOR) 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) or the Euro-zone inter-bank market (if the Reference Rate is EURIBOR) 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, or Brussels time, in the case of EURIBOR) on the relevant Interest Determination Date, any one or more banks (which bank or banks is or are in the opinion of the Issuer 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) or the Euro-zone inter-bank market (if the Reference Rate is EURIBOR) 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).

In the case of Floating Rate Covered Bonds which are ISD Covered Bonds:

- I. 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 the Specified Time, the Calculation Agent shall request each of the Reference Banks to provide the Calculation Agent with its offered quotation (expressed as a percentage rate per annum) for the Reference Rate at approximately the Specified Time on the Interest Determination Date in question. If two or more of the Reference Banks provide the Calculation 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 Calculation Agent.
- II. If on any Interest Determination Date one only or none of the Reference Banks provides the Calculation 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 Calculation 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 Calculation Agent by the Reference Banks or any two or more of them, at which such banks were offered, at approximately the Specified Time 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) or the Euro-zone inter-bank market (if the Reference Rate is EURIBOR) plus or minus (as appropriate) the Margin (if any) or, if fewer than two of the Reference Banks provide the Calculation 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 the Specified Time on the relevant Interest Determination Date, any one or more banks (which bank or banks is or are in the opinion of the Issuer suitable for the purpose) informs the Calculation Agent it is quoting to leading banks in the London inter-bank market (if the Reference Rate is LIBOR) or the Euro-zone inter-bank market (if the Reference Rate is EURIBOR) 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).

If the Reference Rate from time to time in respect of Floating Rate Covered Bonds is specified in the applicable Final Terms as being other than LIBOR or EURIBOR, the Rate of Interest in respect of such Covered Bonds will be determined as provided in the applicable Final Terms.

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

If the applicable Final Terms 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.

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

The Fiscal Agent, in the case of Floating Rate Covered Bonds other than ISD Covered Bonds, and the Calculation Agent, in the case of Floating Rate Covered Bonds which are ISD Covered Bonds, 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 (in the case of Covered Bonds other than ISD Covered Bonds) and the Calculation Agent (in the case of ISD Covered Bonds) will calculate the amount of interest (the **Interest Amount**) payable on the Floating Rate Covered Bonds for the relevant Interest Period by applying the Rate of Interest to:

- (i) in the case of Floating Rate Covered Bonds which are represented by a Global Covered Bond or a ISD Covered Bond, the aggregate outstanding nominal amount of the Covered Bonds; or
- (ii) in the case of Floating Rate Covered Bonds 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 Covered Bond in definitive form is a multiple of the Calculation Amount, the Interest Amount payable in respect of such Covered Bond 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 6.2:

- (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) Maximum Interest Amounts

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

(f) Notification of Rate of Interest and Interest Amounts

The Fiscal Agent or, where the relevant Floating Rate Covered Bonds are ISD Covered Bonds, the Calculation 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 Issuer and any stock exchange on which the relevant Floating Rate Covered Bonds are for the time being listed (by no later than the first day of each Interest Period (or, where the relevant Floating Rate Covered Bonds are not ISD Covered Bonds and the Calculation Agent is other than the Fiscal Agent, as soon as reasonably practicable after the Calculation Agent has notified the Fiscal Agent of such)) and notice thereof to be published

in accordance with Condition 14 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 be promptly notified to each stock exchange on which the relevant Floating Rate Covered Bonds are for the time being listed and to the Covered Bondholders in accordance with Condition 14. 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 6.2, whether by the Fiscal Agent or, if applicable, the Calculation Agent shall (in the absence of wilful default, bad faith or manifest error) be binding on the Issuer, the Agent, the Calculation Agent (if applicable), the other Paying Agents, the ISD Agent (in the case of ISD Covered Bonds) and all Covered Bondholders, Receiptholders and Couponholders and (in the absence of wilful default or bad faith) no liability to the Issuer, the Covered Bondholders, the Receiptholders or the Couponholders shall attach to the Fiscal Agent or, if applicable, the Calculation Agent in connection with the exercise or non-exercise by it of its powers, duties and discretions pursuant to such provisions.

6.3 Benchmark Discontinuation

Notwithstanding the provisions in 6.2, as the case may be, above, if the Bank determines that a Benchmark Event has occurred in relation to an Original Reference Rate when any Rate of Interest (or any component part thereof) remains to be determined by reference to that Original Reference Rate, then the following provisions of this Condition 6.3 shall apply.

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

If there is a Successor Rate, then the Bank shall promptly notify the Fiscal Agent and, in accordance with Condition 14, the Covered Bondholders of such Successor Rate and that Successor Rate shall (subject to adjustment as provided in Condition 6.3(b)) subsequently be used by the Fiscal Agent in place of the Original Reference Rate to determine the relevant Rate(s) of Interest (or the relevant component part(s) thereof) for all relevant future payments of interest on the Covered Bonds (subject to the further operation of this Condition 6.3).

If there is no Successor Rate but the Bank, acting in good faith, in a commercially reasonable manner and by reference to such sources as it deems appropriate, which may include consultation with an Independent Adviser, determines that there is an Alternative Rate, then the Bank shall promptly notify the Fiscal Agent and, in accordance with Condition 14, the Covered Bondholders of such Alternative Rate and that Alternative Rate shall (subject to adjustment as provided in Condition 6.3(b)) subsequently be used in place of the Original Reference Rate to determine the relevant Rate(s) of Interest (or the relevant component part(s) thereof) for all relevant future payments of interest on the Covered Bonds (subject to the further operation of this Condition 6.3).

(b) **Adjustment Spread**

If, in the case of a Successor Rate, an Adjustment Spread is formally recommended, or formally provided as an option for parties to adopt, in relation to the replacement of the

Original Reference Rate with the Successor Rate by any Relevant Nominating Body, then the Bank shall promptly notify the Fiscal Agent and, in accordance with Condition 14, the Covered Bondholders of such Adjustment Spread and the Fiscal Agent shall apply such Adjustment Spread to the Successor Rate for each subsequent determination of a relevant Rate of Interest (or a component part thereof) by reference to such Successor Rate.

If, in the case of a Successor Rate where no such Adjustment Spread is formally recommended or provided as an option by any Relevant Nominating Body, or in the case of an Alternative Rate, the Bank, acting in good faith, in a commercially reasonable manner and by reference to such sources as it deems appropriate, which may include consultation with an Independent Adviser, determines that there is an Adjustment Spread in customary market usage in the international debt capital markets for transactions which reference the Original Reference Rate, where such rate has been replaced by the Successor Rate or the Alternative Rate (as the case may be), then the Bank shall promptly notify the Fiscal Agent and, in accordance with Condition 14, the Covered Bondholders of such Adjustment Spread and the Fiscal Agent shall apply such Adjustment Spread to the Successor Rate and the Alternative Rate (as the case may be) for each subsequent determination of a relevant Rate of Interest (or a component part thereof) by reference to such Successor Rate or Alternative Rate (as applicable).

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

- (i) the Adjustment Spread determined by the Bank, acting in good faith, in a commercially reasonable manner and following consultation with an Independent Adviser, as being the Adjustment Spread recognised or acknowledged as being the industry standard for over-the-counter derivative transactions which reference the Original Reference Rate, where such rate has been replaced by the Successor Rate or the Alternative Rate (as the case may be); or
- (ii) if there is no such industry standard recognised or acknowledged, such Adjustment Spread as the Bank, acting in good faith, in a commercially reasonable manner and following consultation with an Independent Adviser, determines to be appropriate.

Following any such determination of the Adjustment Spread, the Bank shall promptly notify the Fiscal Agent and, in accordance with Condition 14, the Covered Bondholders of such Adjustment Spread and the Fiscal Agent shall apply such Adjustment Spread to the Successor Rate or the Alternative Rate (as the case may be) for each subsequent determination of a relevant Rate of Interest (or a component part thereof) by reference to such Successor Rate or Alternative Rate (as applicable).

(c) **Benchmark Amendments**

If any Successor Rate, Alternative Rate or Adjustment Spread is determined in accordance with this Condition 6.3 and the Bank, acting in good faith, in a commercially reasonable manner and by reference to such sources as it deems appropriate, which may include consultation with an Independent Adviser, determines in its discretion (A) that amendments to these Conditions and/or the Agency Agreement are necessary to ensure the proper operation of such Successor Rate, Alternative Rate and/or Adjustment Spread (such

amendments, the **Benchmark Amendments**) and (B) the terms of the Benchmark Amendments, then the Bank and the Fiscal Agent shall, subject to the Bank having to give notice thereof to the Covered Bondholders in accordance with Condition 14, without any requirement for the consent or approval of Covered Bondholders, agree to the necessary modifications to these Conditions and/or the Agency Agreement, as determined by the Bank, to give effect to such Benchmark Amendments with effect from the date specified in such notice.

In connection with any such modifications in accordance with this Condition 6.3(c), the Bank shall comply with the rules of any stock exchange on which the Covered Bonds are for the time being listed or admitted to trading.

Any Benchmark Amendments determined under this Condition 6.3(c) shall be notified promptly by the Bank to the Fiscal Agent and, in accordance with Condition 14, the Covered Bondholders. Such notice shall be irrevocable and shall specify the effective date of such Benchmark Amendments.

(d) **Independent Adviser**

In the event the Bank is to consult with an Independent Adviser in connection with any determination to be made by the Bank pursuant to this Condition 6.3, the Bank shall use its reasonable endeavours to appoint an Independent Adviser, as soon as reasonably practicable, for the purposes of any such consultation.

An Independent Adviser appointed pursuant to this Condition 6.3 shall act in good faith, in a commercially reasonable manner and (in the absence of fraud or wilful default) shall have no liability whatsoever to the Bank or the Covered Bondholders for any determination made by it or for any advice given to the Bank in connection with any determination made by the Bank pursuant to this Condition 6.3 or otherwise in connection with the Covered Bonds.

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

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

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

Without prejudice to the obligations of the Bank under this Condition 6.3, the Original Reference Rate and the fallback provisions provided for in Conditions 6.2, the Agency Agreement and the applicable Final Terms, as the case may be, will continue to apply unless and until the Bank has determined the Successor Rate or the Alternative Rate (as the case may be), and any Adjustment Spread and Benchmark Amendments, in accordance with the relevant provisions of this Condition 6.3.

(f) **Definitions**

In this Condition 6.3:

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

Alternative Rate means an alternative benchmark or screen rate which the Bank determines in accordance with this Condition 6.3 is used in place of the Original Reference Rate in customary market usage in the international debt capital markets for the purposes of determining rates of interest (or the relevant component part thereof) for a commensurate interest period and in the same Specified Currency as the Covered Bonds;

Benchmark Event means:

- (i) the Original Reference Rate ceasing to exist or be published;
- (ii) the later of (A) the making of a public statement by the administrator of the Original Reference Rate that it will, by a specified date, cease publishing the Original Reference Rate permanently or indefinitely (in circumstances where no successor administrator has been appointed that will continue publication of the Original Reference Rate) and (B) the date falling six months prior to such specified date;
- (iii) the making of a public statement by the supervisor of the administrator of the Original Reference Rate that the Original Reference Rate has been permanently or indefinitely discontinued or is prohibited from being used or that its use is subject to restrictions or adverse consequences or, where such discontinuation, prohibition, restrictions or adverse consequences are to apply from a specified date after the making of any public statement to such effect, the later of the date of the making of such public statement and the date falling six months prior to such specified date; or
- (iv) it has or will prior to the next Interest Determination Date or Reset Determination Date, as applicable, become unlawful for the Calculation Agent, any Paying Agent or the Bank to determine any Rate of Interest and/or calculate any Interest Amount using the Original Reference Rate (including, without limitation, under Regulation (EU) No. 2016/1011, if applicable).

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

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

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

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

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

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

6.4 Interest on Inflation Linked Covered Bonds

Each Inflation Linked Covered Bond bears interest from (and including) the Interest Commencement Date at the rate per annum equal to the Rate of Interest payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Final Maturity Date.

If interest is required to be calculated for a period other than an Interest Period such interest shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction (as defined in Condition 6.2(d) (*Determination of Rate of Interest and calculation of Interest Amounts*)), and rounding the resultant figure to the nearest sub-unit (as defined in Condition 6.2(d) (*Determination of Rate of Interest and calculation of Interest Amounts*)) of the relevant Specified Currency, half of any such sub unit being rounded upwards or otherwise in accordance with applicable market convention.

6.5 Interest on Inflation Linked Non-Amortising Covered Bonds

Each Inflation Linked Non-Amortising Covered Bond bears interest from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest multiplied by the Index Ratio (as defined in Condition 7.1(b) (*Payments in respect of Inflation Linked Covered Bonds*)) below. Interest will be payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Final Maturity Date or, if the applicable Final Terms specifies that an Extended Final Maturity Date applies, the Extended Final Maturity Date or any earlier Interest Payment Date on which the Covered Bonds are redeemed in full, provided that any amounts representing interest payable after the Final Maturity Date shall be paid at such rate and on such dates specified in the applicable Final Terms.

If interest is required to be calculated for a period other than an Interest Period, such interest shall be calculated in respect of any period by applying the Rate of Interest multiplied by the Index Ratio (as defined in Condition 7.1(b) (*Payments in respect of Inflation Linked Covered Bonds*)) to:

- (a) in the case of Inflation Linked Non-Amortising Covered Bonds which are represented by a Global Covered Bond or Inflation Linked Non-Amortising Covered Bonds which are ISD Covered Bonds, the aggregate outstanding nominal amount of the Inflation Linked Non-Amortising Covered Bonds; or
- (b) in the case of Inflation Linked Non-Amortising Covered Bonds in definitive form, the Calculation Amount,

and, in each case, multiplying such sum by the applicable Day Count Fraction (as defined in Condition 6.1), 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 an Inflation Linked Non-Amortising Covered Bond in definitive form is a multiple of the Calculation Amount, the amount of

interest payable in respect of such Inflation Linked Non-Amortising Covered Bond 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.

As used in these 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.

6.6 Accrual of interest

Each Covered Bond (or in the case of the redemption of part only of a Covered Bond, that part only of such Covered Bond) will cease to bear interest (if any) from the date for its redemption unless, upon due presentation thereof, 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 Covered Bond have been paid; and
- (b) five days after the date on which the full amount of the moneys payable in respect of such Covered Bond has been received by the Fiscal Agent or the ISD Agent or the Registrar, as the case may be, and notice to that effect has been given to the Covered Bondholders in accordance with Condition 14.

7. PAYMENTS

7.1 Payments in respect of Inflation Linked Covered Bonds

If this is an Inflation Linked Covered Bond, the Issuer shall, on each relevant Interest Payment Date, make a combined payment of principal due under Condition 8.3, interest due under Condition 6.4 and any indexation amount (together, the **Annuity Amount**) as calculated by the Calculation Agent in accordance with the following formula.

$$P = \frac{r}{1 - (1 + r)^{-n}} \times IR \times d$$

where:

P = The combined payment of principal, interest and indexation amount of the relevant Covered Bonds;

$r = \frac{c}{[\textit{insert number of interest payments per year}]}$;

c = The Rate of Interest applicable to the relevant Covered Bonds;

d = The Specified Denomination of the relevant Covered Bonds;

n = *[Insert total number of annuity payments on the relevant Covered Bonds]*; and

IR = The Index Ratio as determined in accordance with subparagraph (b) below

- (b) The value of the Index Ratio (**Index Ratio** or **IR**) on the relevant Interest Payment Date shall be the value of the Reference Index (**RI**) applicable to the relevant Interest Payment Date divided by the value of the Base Index (**BI**) as calculated by the Calculation Agent

$$\text{being IR} = \frac{\text{RI}}{\text{BI}}$$

where:

Reference Index or **RI** means:

- (i) for the first day of the relevant calendar month, the value of the Consumer Price Index (the **CPI**) for the relevant month as calculated by Statistics Iceland pursuant to the Consumer Price Index Act of 1995 (*lög um vísitölu neysluverðs nr. 12/1995*) and published monthly in the Legal Gazette (*Lögbirtingarblaðið*);
- (ii) for each day in the relevant calendar month other than the first day:
 - (A) if the CPI for the calendar month immediately succeeding the month in which the relevant Interest Payment Date falls (the **Succeeding Month CPI**) has been published as at the relevant Interest Payment Date:

$$RI = CPI_t + (CPI_{t+1} - CPI_t) \frac{d}{30}$$

- (B) if the Succeeding Month CPI has not been published as at the relevant Interest Payment Date:

$$RI = CPI_t \times (1+i)^{\frac{d}{360}}$$

where:

RI = Reference Index;

CPI_t = CPI value for the first day of the relevant calendar month;

CPI_{t+1} = Succeeding Month CPI;

d = number of days since the first day of the month; and

i = annualised inflation forecast of the Central Bank of Iceland

and

Base Index means the value specified in the Final Terms of the relevant Tranche of Covered Bonds, being the value of the CPI on the relevant date specified in such Final Terms.

If at any time a new index is substituted for the CPI, as of the calendar month from and including that in which such substitution takes effect:

- (i) the Reference Index shall be deemed to refer to the new index; and
- (ii) the new Base Index shall be the product of the old Base Index prior to the change and the new Reference Index immediately following such substitution, divided by the old Reference Index immediately prior to such substitution.

7.2 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 (which, in the case of a payment in Japanese yen to a non-resident of Japan, shall be a non-resident account) maintained by the payee with, or,

at the option of the payee, by a cheque in such Specified Currency drawn on, 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 in euro will be made by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by a euro cheque.

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 9 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 9 (Taxation)) any law implementing an intergovernmental approach thereto (**FATCA**).

7.3 Presentation of definitive Covered Bonds, Receipts and Coupons

Payments of principal in respect of definitive Bearer Covered Bonds will (subject as provided below) be made in the manner provided in paragraph 7.1 above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of definitive Covered Bonds, and payments of interest in respect of definitive Covered Bonds will (subject as provided below) be made as aforesaid only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of Coupons, in each case at the specified office of any Paying Agent outside the United States (which expression, as used herein, means the United States of America (including the States and the District of Columbia and its possessions)).

Payments of instalments of principal (if any) in respect of definitive Bearer Covered Bonds, other than the final instalment, will (subject as provided below) be made in the manner provided in paragraph 7.1 above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Receipt in accordance with the preceding paragraph. Payment of the final instalment will be made in the manner provided in paragraph 7.1 above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Covered Bond in accordance with the preceding paragraph. Each Receipt must be presented for payment of the relevant instalment together with the definitive Bearer Covered Bond to which it appertains. Receipts presented without the definitive Bearer Covered Bond to which they appertain do not constitute valid obligations of the Issuer. Upon the date on which any definitive Bearer Covered Bond becomes due and repayable, unmatured Receipts (if any) relating thereto (whether or not attached) shall become void and no payment shall be made in respect thereof.

Fixed Rate Covered Bonds and Inflation Linked Covered Bonds in definitive bearer form (other than Long Maturity Covered Bonds (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 9) in respect of such principal (whether or not such Coupon would otherwise have become void under Condition 10) or, if later, five years from the date on which such Coupon would otherwise have become due, but in no event thereafter.

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

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

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

7.4 Payments in respect of Bearer Global Covered Bonds

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

7.5 Payments in respect of Registered Covered Bonds

Payments of principal (other than instalments of principal prior to the final instalment) in respect of each Registered Covered Bond (whether or not in global form) will be made against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the Registered Covered Bond at the specified office of the Registrar or any of the Paying Agents. Such payments will be made by transfer to the Designated Account (as defined below) of the holder (or the first named of joint holders) of the Registered Covered Bond appearing in the register of holders of the Registered Covered Bonds maintained by the Registrar (the **Registered Covered Bond Register**) (i) where in global form, at the close of the business day (being for this purpose a day on which Euroclear and Clearstream, Luxembourg are open for business) before the relevant due date, and (ii) where in definitive form at the close of business on the third business day (being for this purpose a day on which banks are open for business in the city where the specified office of the Registrar is located) before the relevant due date. Notwithstanding the previous sentence, if (a) a holder does not have a Designated Account or (b) the principal amount of the Covered Bonds held by a holder is less than U.S.\$250,000 (or its approximate equivalent in any other Specified Currency), payment will instead be made by a cheque in the Specified Currency drawn on a Designated Bank (as defined below). For these purposes, **Designated Account** means the account (which, in the case of a payment in Japanese yen to a non-resident of Japan, shall be a non-resident account) maintained by a holder with a Designated Bank and identified as such in the Registered Covered Bond Register and Designated Bank means (in the case of payment in a Specified Currency other than euro) a bank in the principal financial centre of the country of such Specified Currency (which, if the Specified

Currency is Australian dollars or New Zealand dollars, shall be Sydney and Auckland, respectively) and (in the case of a payment in euro) any bank which processes payments in euro.

Payments of interest and payments of instalments of principal (other than the final instalment) in respect of each Registered Covered Bond (whether or not in global form) will be made by a cheque in the Specified Currency drawn on a Designated Bank and mailed by uninsured mail on the business day in the city where the specified office of the Registrar is located immediately preceding the relevant due date to the holder (or the first named of joint holders) of the Registered Covered Bond appearing in the Registered Covered Bond Register (i) where in global form, at the close of the business day (being for this purpose a day on which Euroclear and Clearstream, Luxembourg are open for business) before the relevant due date, and (ii) where in definitive form, at the close of business on the fifteenth day (whether or not such fifteenth day is a business day) before the relevant due date (the Record Date) at his address shown in the Registered Covered Bond Register on the Record Date and at his risk. Upon application of the holder to the specified office of the Registrar not less than three business days in the city where the specified office of the Registrar is located before the due date for any payment of interest in respect of a Registered Covered Bond, the payment may be made by transfer on the due date in the manner provided in the preceding paragraph. Any such application for transfer shall be deemed to relate to all future payments of interest (other than interest due on redemption) and instalments of principal (other than the final instalment) in respect of the Registered Covered Bonds which become payable to the holder who has made the initial application until such time as the Registrar is notified in writing to the contrary by such holder. Payment of the interest due in respect of each Registered Covered Bond on redemption and the final instalment of principal will be made in the same manner as payment of the principal amount of such Registered Covered Bond.

Holders of Registered Covered Bonds will not be entitled to any interest or other payment for any delay in receiving any amount due in respect of any Registered Covered Bond as a result of a cheque posted in accordance with this Condition arriving after the due date for payment or being lost in the post. No commissions or expenses shall be charged to such holders by the Registrar in respect of any payments of principal or interest in respect of the Registered Covered Bonds.

None of the Issuer or the Agents will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Registered Global Covered Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

7.6 General provisions applicable to payments

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

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

- (a) the Issuer 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 Covered Bonds 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 Issuer, adverse tax consequences to the Issuer.

7.7 Payments in respect of ISD Covered Bonds

Payments of principal and interest in respect of ISD Covered Bonds will be made to the Covered Bondholders shown in the relevant records of the ISD in accordance with and subject to the rules and regulations from time to time governing the ISD.

7.8 Payment Day

If the date for payment of any amount in respect of any Covered Bond, Receipt or Coupon is not a Payment Day, the holder thereof shall not be entitled to payment 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 10) is:

- (a) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in:
 - (i) in the case of Covered Bonds in definitive form only, the relevant place of presentation; and
 - (ii) each Additional Financial Centre specified in the applicable Final Terms; and
- (b) either (1) 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 (2) in relation to any sum payable in euro, a day on which the TARGET2 System is open.

7.9 Interpretation of principal and interest

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

- (a) any additional amounts which may be payable with respect to principal under Condition 9;
- (b) the Final Redemption Amount of the Covered Bonds;
- (c) the Early Redemption Amount of the Covered Bonds;
- (d) the Optional Redemption Amount(s) (if any) of the Covered Bonds;
- (e) in relation to Covered Bonds redeemable in instalments, the Instalment Amounts;

- (f) in relation to Zero Coupon Covered Bonds, the Amortised Face Amount (as defined in Condition 8.7); and
- (g) any premium and any other amounts (other than interest) which may be payable by the Issuer under or in respect of the Covered Bonds.

Any reference in the Conditions to interest in respect of the Covered Bonds shall be deemed to include, as applicable, any additional amounts which may be payable with respect to interest under Condition 9.

7.10 Partial Payment

If on the Maturity Date of a Series of Covered Bonds where an Extended Final Maturity Date is specified in the applicable Final Terms the Issuer has insufficient moneys to pay the Final Redemption Amount on that Series of Covered Bonds and any other amounts due and payable by the Issuer in respect of Covered Bonds on such date, then the Issuer shall apply available moneys, after having made payment of all other amounts due and payable by the Issuer in respect of Covered Bonds on such date, to redeem the relevant Series of Covered Bonds in part at par together with accrued interest *pro rata* and *pari passu* with any other Series of Covered Bonds for which an Extended Final Maturity Date is specified in the Final Terms.

8. REDEMPTION AND PURCHASE

8.1 Redemption at maturity

Unless previously redeemed or purchased and cancelled as specified below, each Covered Bond will be redeemed by the Issuer at the Final Redemption Amount specified in, or determined in the manner specified in, the applicable Final Terms in the relevant Specified Currency on the Maturity Date.

If an Extended Final Maturity Date is specified as applicable in the Final Terms for a Series of Covered Bonds and the Issuer has failed to pay the Final Redemption Amount on the Maturity Date specified in the Final Terms, then (subject as provided below) payment of the unpaid amount by the Issuer shall be deferred until the Extended Final Maturity Date, provided that any amount representing the Final Redemption Amount due and remaining unpaid on the Maturity Date may be paid by the Issuer on any Interest Payment Date occurring thereafter to the extent that funds are available in the Cover Pool up to (and including) the relevant Extended Final Maturity Date.

The Issuer shall confirm to the Rating Agencies (if applicable), any relevant Swap Provider and the Fiscal Agent as soon as reasonably practicable and in any event at least 4 business days in London prior to the Maturity Date of any inability of the Issuer to pay in full the Final Redemption Amount in respect of a Series of Covered Bonds on that Maturity Date.

Where the applicable Final Terms for a relevant Series of Covered Bonds provides that such Covered Bonds are subject to an Extended Final Maturity Date, such failure to pay by the Issuer on the Maturity Date shall not constitute a default in payment.

8.2 Redemption for tax reasons

- (a) The Covered Bonds may, subject to Condition 8.2(b) below, be redeemed at the option of the Issuer in whole, but not in part, at any time (if this Covered Bond is neither a Floating Rate Covered Bond, an Inflation Linked Covered Bond nor an Inflation Linked Non-Amortising Covered Bond) or on any Interest Payment Date (if this Covered Bond is either a Floating Rate Covered Bond, an Inflation Linked Covered Bond or an Inflation Linked Non-

Amortising Covered Bond), on giving not less than 30 nor more than 60 days' notice to the Agent and, in accordance with Condition 14, the Covered Bondholders (which notice shall be irrevocable), if:

- (i) on the occasion of the next payment due under the Covered Bonds, the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 9 as a result of any change in, or amendment to, the laws or regulations of the Republic of Iceland (**Iceland**) or any political subdivision of, or any authority in, or of, Iceland having power to tax, 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 Covered Bonds; and
- (ii) such obligation cannot be avoided by the Issuer 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 Issuer would be obliged to pay such additional amounts were a payment in respect of the Covered Bonds then due.

- (b) Prior to the publication of any notice of redemption pursuant to this Condition, the Issuer shall deliver to the Fiscal Agent a certificate signed by two Directors of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred, and an opinion of independent legal advisers of recognised standing to the effect that the Issuer has or will become obliged to pay such additional amounts as a result of such change or amendment.
- (c) Each Covered Bond redeemed pursuant to this Condition 8.2 will be redeemed at the Early Redemption Amount.

8.3 Calculation of principal payments in respect of Inflation Linked Covered Bonds

Unless previously redeemed or purchased and cancelled, each Inflation Linked Covered Bond will, subject to Condition 7.1 (*Payments in respect of Inflation Linked Covered Bonds*), be redeemed in one or more amounts constituting payments of principal in relation to such Inflation Linked Covered Bond, in the relevant Specified Currency on the relevant Interest Payment Dates, calculated in accordance with the following formula:

$$A = \frac{r(1+r)^{k-1}}{(1+r)^n - 1} \times d$$

where:

A = The amount of each instalment of the relevant Covered Bonds;

$r = \frac{c}{[\text{insert number of interest payments per year}]}$

c = The Rate of Interest applicable to the relevant Covered Bonds;

- d = The Specified Denomination of the relevant Covered Bonds;
- n = [Insert total number of [annuity] payments on the relevant Covered Bonds]; and
- k = The number of payments that have already taken place + 1 (*k = 1 for the first payment, k = 2 for the second payment, etc*)

For the avoidance of doubt, this formula does not link the principal amount calculated to inflation.

8.4 Calculation of principal payments in respect of Inflation Linked Non-Amortising Covered Bonds

Unless previously redeemed or purchased and cancelled, each Inflation Linked Non-Amortising Covered Bond will be redeemed in one or more amounts constituting payments of principal in relation to such Inflation Linked Non-Amortising Covered Bond, in the relevant Specified Currency on the relevant Interest Payment Dates, calculated in accordance with the following formula:

$$\underline{P} = N \times IR$$

where:

P = the Final Redemption Amount per Specified Denomination of each Inflation Linked Non-Amortising Covered Bond;

N = the Specified Denomination (as specified in the relevant Final Terms) for each Inflation Linked Non-Amortising Covered Bond; and

IR = the Index Ratio as set out in Condition 7.1(b), above.

8.5 Redemption at the option of the Issuer (Issuer Call)

If Issuer Call is specified in the applicable Final Terms, the Issuer may, having given:

- (a) not less than 15 nor more than 30 days' notice to the Covered Bondholders in accordance with Condition 14; and
- (b) not less than 15 days before the giving of the notice referred to in notice to the Fiscal Agent and, (in the case of a redemption of Registered Covered Bonds) the Registrar;

(which notices shall be irrevocable and shall specify the date fixed for redemption), redeem all or some only of the Covered Bonds then outstanding on any Optional Redemption Date and at the Optional Redemption Amount(s) specified in 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 or not more than the Maximum Redemption Amount, in each case as may be specified in the applicable Final Terms. In the case of a partial redemption of Covered Bonds, the Covered Bonds to be redeemed (**Redeemed Covered Bonds**) will be selected individually by lot, in the case of Redeemed Covered Bonds represented by definitive Covered Bonds, and 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 Covered Bonds represented by a Global Covered Bond, and in accordance with the rules of the ISD in the case of the ISD Covered Bonds, in each case not more

than 30 days prior to the date fixed for redemption (such date of selection being hereinafter called the **Selection Date**). In the case of Redeemed Covered Bonds represented by definitive Covered Bonds, a list of the serial numbers of such Redeemed Covered Bonds will be published in accordance with Condition 14 not less than 15 days prior to the date fixed for redemption. No exchange of the relevant Global Covered Bond will be permitted during the period from (and including) the Selection Date to (and including) the date fixed for redemption pursuant to this paragraph 8.3 and notice to that effect shall be given by the Issuer to the Covered Bondholders in accordance with Condition 14 at least five days prior to the Selection Date.

8.6 Redemption at the option of the Covered Bondholders (Investor Put)

If Investor Put is specified in the applicable Final Terms, upon the holder of any Covered Bond giving to the Issuer in accordance with Condition 14 not less than 15 nor more than 30 days' notice the Issuer will, upon the expiry of such notice, redeem, subject to, and in accordance with, the terms specified in the applicable Final Terms, such Covered Bond on the Optional Redemption Date and at the Optional Redemption Amount together, if appropriate, with interest accrued to (but excluding) the Optional Redemption Date. Registered Covered Bonds may be redeemed under this Condition in any multiple of their lowest Specified Denomination. It may be that before an Investor Put can be exercised, certain conditions and/or circumstances will need to be satisfied. Where relevant, the provisions will be set out in the applicable Final Terms.

To exercise the right to require redemption of this Covered Bond the holder of this Covered Bond must, if this Covered Bond is in definitive form and held outside Euroclear and Clearstream, Luxembourg, deliver, at the specified office of any Paying Agent (in the case of Bearer Covered Bonds) or the Registrar (in the case of Registered Covered Bonds) at any time during normal business hours of such Paying Agent or, as the case may be, the Registrar falling within the notice period, a duly completed and signed notice of exercise in the form (for the time being current) obtainable from any specified office of any Paying Agent or, as the case may be, the Registrar (a **Put Notice**) and in which the holder must specify a bank account (or, if payment is required to be made by cheque, an address) to which payment is to be made under this Condition and, in the case of Registered Covered Bonds, the nominal amount thereof to be redeemed and, if less than the full nominal amount of the Registered Covered Bonds so surrendered is to be redeemed, an address to which a new Registered Covered Bond in respect of the balance of such Registered Covered Bonds is to be sent subject to and in accordance with the provisions of Condition 2. If this Covered Bond is in definitive bearer form, the Put Notice must be accompanied by this Covered Bond or evidence satisfactory to the Paying Agent concerned that this Covered Bond will, following delivery of the Put Notice, be held to its order or under its control.

If the Covered Bond is represented by a Global Covered Bond or is in definitive form and held through Euroclear or Clearstream, Luxembourg, to exercise the right to require redemption of this Covered Bond the holder of this Covered Bond must, within the notice period, give notice to the Fiscal Agent of such exercise in accordance with the standard procedures of Euroclear and Clearstream, Luxembourg (which may include notice being given on his instruction by Euroclear or Clearstream, Luxembourg or any common depositary for them to the Fiscal Agent by electronic means) in a form acceptable to Euroclear and Clearstream, Luxembourg from time to time and, if this Covered Bond is represented by a Global Covered Bond, at the same time present or procure the presentation of the relevant Global Covered Bond to the Agent for notation accordingly.

If the Covered Bond is an ISD Covered Bond, to exercise the right to require redemption of this Covered Bond the holder of this Covered Bond must, within the notice period, give notice to the ISD Agent of such exercise in accordance with the standard procedures of the ISD from time to time.

Any Put Notice or other notice given in accordance with the standard procedures of Euroclear and Clearstream, Luxembourg or, in the case of ISD Covered Bonds, the ISD given by a holder of any Covered Bond pursuant to this paragraph shall be irrevocable.

8.7 Early Redemption Amounts

For the purpose of sub-clause 8.2 above (*Redemption for Tax Reasons*):

- (a) each Covered Bond (other than a Zero Coupon Covered Bond) will be redeemed at its Early Redemption Amount; and
- (b) each Zero Coupon Covered Bond, will be redeemed at an amount (the **Amortised Face Amount**) calculated in accordance with the following formula:

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

where:

RP means the Reference Price;

AY means the Accrual Yield expressed as a decimal; and

x is a fraction the numerator of which is equal to the number of days (calculated on the basis of a 360-day year consisting of 12 months of 30 days each) from (and including) the Issue Date of the first Tranche of the Covered Bonds to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Covered Bond becomes due and repayable and the denominator of which is 360,

or on such other calculation basis as may be specified in the applicable Final Terms.

8.8 Instalments

Instalment Covered Bonds will be redeemed at the lesser of the Instalment Amounts and the Maximum Instalment Amounts and on the Instalment Dates. In the case of early redemption, each Instalment Covered Bond will be redeemed at the Early Redemption Amount.

8.9 Purchases

The Issuer or any subsidiary of the Issuer may at any time purchase Covered Bonds (provided that, in the case of definitive Covered Bonds, all unmatured Receipts, Coupons and Talons appertaining thereto are purchased therewith) at any price in the open market or otherwise. Such Covered Bonds may be held, reissued, resold or, at the option of the Issuer, surrendered to any Paying Agent and/or the Registrar for cancellation.

8.10 Cancellation

All Covered Bonds which are redeemed or surrendered for cancellation pursuant to paragraph 8.9 above will forthwith be cancelled (together with all unmatured Receipts, Coupons and Talons attached thereto or surrendered therewith at the time of redemption). All Covered Bonds so cancelled (together with all unmatured Receipts, Coupons and Talons cancelled therewith) shall be forwarded to the Fiscal Agent and cannot be reissued or resold.

8.11 Late payment on Zero Coupon Covered Bonds

If the amount payable in respect of any Zero Coupon Covered Bond upon redemption of such Zero Coupon Covered Bond pursuant to paragraph 8.1, 8.2, 8.3 or 8.6 above is improperly withheld or refused, the amount due and repayable in respect of such Zero Coupon Covered Bond shall be the amount calculated as provided in paragraph 8.7(b) above as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon Covered Bond becomes due and payable were replaced by references to the date which is the earlier of:

- (a) the date on which all amounts due in respect of such Zero Coupon Covered Bond have been paid; and
- (b) five days after the date on which the full amount of the moneys payable in respect of such Zero Coupon Covered Bonds has been received by the Fiscal Agent or the Registrar and notice to that effect has been given to the Covered Bondholders in accordance with Condition 14.

9. TAXATION

All payments of principal and interest in respect of the Covered Bonds, Receipts and Coupons by or on behalf of the Issuer will be made without withholding or deduction for or on account of any present or future taxes or duties, assessments or government charges of whatever nature imposed or levied by or on behalf of any Tax Jurisdiction, unless such withholding or deduction is required by law. In such event, the Issuer will pay such additional amounts as shall be necessary in order that the net amounts received by the holders of the Covered Bonds, Receipts 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 Covered Bonds, Receipts or Coupons, as the case may be, in the absence of such withholding or deduction; except that no such additional amounts shall be payable with respect to any Covered Bond, Receipt or Coupon:

- (a) presented for payment in Iceland;
- (b) the holder of which is liable for such taxes or duties in respect of such Covered Bond, Receipt or Coupon by reason of his having some connection with a Tax Jurisdiction other than the mere holding of such Covered Bond, Receipt 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 7.8); or
- (d) [RESERVED]
- (e) [RESERVED]
- (f) where such withholding or deduction is required to be made based on provisions of the Act on Withholding of Public Levies at Source No 45/1987, as amended, the Act on Withholding of Tax on Financial Income No 94/1996, as amended, and Article 3 of the Income Tax Act no. 90/2003 (ITA), and any other legislation, laws or regulations, replacing or supplementing the same.

As used herein:

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

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 or the Registrar or, in the case of ISD Covered Bonds, the ISD Agent, as the case may be, on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Covered Bondholders in accordance with Condition 14.

10. PRESCRIPTION

The Covered Bonds (whether in bearer, registered or dematerialised form), Receipts 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 9) 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 7.3) or any Talon which would be void pursuant to Condition 7.3.

11. REPLACEMENT OF COVERED BONDS, RECEIPTS, COUPONS AND TALONS

Should any Covered Bond, Receipt, Coupon or Talon be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Fiscal Agent (in the case of Bearer Covered Bonds, Receipts or Coupons) or the Registrar (in the case of Registered Covered Bonds) 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 Issuer may reasonably require. Mutilated or defaced Covered Bonds, Receipts, Coupons or Talons must be surrendered before replacements will be issued.

12. AGENTS

The names of the initial Agents and their initial specified offices are set out below.

The Issuer 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 and a Registrar;
- (b) so long as the Covered Bonds are listed on any stock exchange or admitted to trading by any other relevant authority, there will at all times be a Paying Agent (in the case of Bearer Covered Bonds) which may be the Fiscal Agent and a Transfer Agent (in the case of Registered Covered Bonds) with a specified office in such place as may be required by the rules and regulations of the relevant stock exchange (or any other relevant authority);
- (c) [RESERVED]; and
- (d) there will at all times be a Paying Agent in a jurisdiction within Europe, other than the jurisdiction in which the Issuer is incorporated; and
- (e) in the case of ISD Covered Bonds, there will at all times be an ISD Agent authorised to act as an account holding institution with the ISD and one or more calculation agent(s) where the Terms and Conditions of the relevant ISD Covered Bonds so require.

In addition, the Issuer shall forthwith appoint a Paying Agent having a specified office in New York City in the circumstances described in Condition 7.6. Any variation, termination, appointment or

change shall only take effect (other than in the case of winding up or, from the effective date of withholding on "passthru payments," where the Paying Agent is an FFI and does not become, or ceases to be, exempt from withholding under FATCA, when it shall be of immediate effect) after not less than 30 nor more than 45 days' prior notice thereof shall have been given to the Covered Bondholders in accordance with Condition 14.

In acting under the Agency Agreement, the Agents act solely as agents of the Issuer and do not assume any obligation to, or relationship of agency or trust with, any Covered Bondholders, Receiptholders 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.

13. 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 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 Covered Bond to which it appertains) a further Talon, subject to the provisions of Condition 10.

14. NOTICES

(a) Covered Bonds other than ISD Covered Bonds

All notices regarding the Bearer Covered Bonds 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 Bearer Covered Bonds are admitted to trading on the regulated market of the Luxembourg Stock Exchange and listed on the Official List of the Luxembourg Stock Exchange, a daily newspaper of general circulation in Luxembourg and/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 in the Luxemburger Wort or the Tageblatt in Luxembourg. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules and regulations of any stock exchange or any other relevant authority on which the Bearer Covered Bonds are for the time being listed or by which they have been admitted to trading. Any such notice will be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers.

All notices regarding the Registered Covered Bonds will be deemed to be validly given if sent by first class mail or (if posted to an address overseas) by airmail to the holders (or the first named of joint holders) at their respective addresses recorded in the Registered Covered Bond Register and will be deemed to have been given on the fourth day after mailing and, in addition, (a) for so long as any Registered Covered Bonds are admitted to trading on the regulated market of the Luxembourg Stock Exchange and listed on the Official List of the Luxembourg Stock Exchange, a daily newspaper of general circulation in Luxembourg and/or the Luxembourg Stock Exchange's website (www.bourse.lu), and (b) 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.

Until such time as any definitive Covered Bonds are issued, there may, so long as any Global Covered Bonds representing the Covered Bonds are held in their entirety on behalf of Euroclear and/or Clearstream, Luxembourg, be substituted for such publication in such newspaper(s) or such mailing the delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg for communication by them to the holders of the Covered Bonds and, in addition, for so long as any

Covered Bonds 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 the rules of that stock exchange the Luxembourg Stock Exchange's website (www.bourse.lu). Any such notice shall be deemed to have been given to the holders of the Covered Bonds on the third day after the day on which the said notice was given to Euroclear and/or Clearstream, Luxembourg.

(b) *ISD Covered Bonds*

All notices regarding the ISD Covered Bonds will be valid if published in a manner which complies with the rules and regulations of the relevant act which apply to publicly listed securities and/or any stock exchange and/or any other relevant authority on which the ISD Covered Bonds are for the time being listed or by which they have been admitted to trading. Any such notice will be deemed to have been given on the date of the first publication. Where the Covered Bonds are ISD Covered Bonds, the Issuer can additionally at its own discretion obtain information from the ISD on the Covered Bondholders in order to send notices to each Covered Bondholder directly.

(c) *Notices given by Covered Bondholders*

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

15. MEETINGS OF COVERED BONDHOLDERS, MODIFICATION AND WAIVER

(a) *Covered Bonds other than ISD Covered Bonds*

The Agency Agreement contains provisions for convening meetings of the Covered Bondholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of the Covered Bonds, the Receipts, the Coupons or any of the provisions of the Agency Agreement. Such a meeting may be convened by the Issuer and shall be convened by the Issuer if required in writing by Covered Bondholders holding not less than 5% in nominal amount of the Covered Bonds 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% in nominal amount of the Covered Bonds for the time being outstanding, or at any adjourned meeting one or more persons being or representing Covered Bondholders whatever the nominal amount of the Covered Bonds so held or represented, except that at any meeting the business of which includes the modification of certain provisions of the Covered Bonds, the Receipts or the Coupons (including modifying the date of maturity of the Covered Bonds 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 Covered Bonds or altering the currency of payment of the Covered Bonds, the Receipts or the Coupons or amending the Deed of Covenant in certain respects)), the quorum shall be one or more persons holding or representing not less than two-thirds in nominal amount of the Covered Bonds 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 Covered Bonds for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Covered Bondholders shall be binding on all the Covered Bondholders, whether or not they are present at the meeting, and on all Receiptholders and Couponholders.

The Issuer may agree, without the consent of the Covered Bondholders, Receiptholders or Couponholders, to:

- (a) any modification (except as mentioned above) of the Covered Bonds, the Receipts, the Coupons or Agency Agreement which is not prejudicial to the interests of the Covered Bondholders; or
- (b) any modification of the Covered Bonds, the Receipts, the Coupons or the Agency Agreement which is of a formal, minor or technical nature or is made to correct a manifest or proven error or to comply with mandatory provisions of the law.

Any such modification shall be binding on the Covered Bondholders, the Receiptholders and the Couponholders and any such modification shall be notified to the Covered Bondholders in accordance with Condition 14 as soon as practicable thereafter.

In relation to modifications made pursuant Condition 15(a)(a) and 15(a)(b) above, the Issuer shall consider the interest of the Covered Bondholders and in the event that the Issuer proposes any modification to the Agency Agreement, the Agents are (i) not obliged to consider the interests of the Covered Bondholder and (ii) entitled to assume without further enquiry that the conditions set out in this Condition have been satisfied.

(b) *ISD Covered Bonds*

The Issuer may, in its capacity as ISD Agent, convene meetings of the holders of ISD Covered Bonds to consider any matter affecting their interests, including sanctioning by a majority of votes a modification of the ISD Covered Bonds. Such a meeting may be convened by the Issuer or by the holders of not less than 10 per cent. of the Voting ISD Covered Bonds. For the purpose of this Condition, **Voting ISD Covered Bonds** means the aggregate nominal amount of the total number of ISD Covered Bonds not redeemed or otherwise deregistered in the ISD, less the ISD Covered Bonds owned by the Issuer, any party who has decisive influence over the Issuer or any party over whom the Issuer has decisive influence.

The quorum at a meeting for passing a resolution is one or more persons holding at least one half of the Voting ISD Covered Bonds or at any adjourned meeting one or more persons being or representing holders of Voting ISD Covered Bonds whatever the nominal amount of the ISD Covered Bonds so held or represented, except that at any meeting the business of which includes the modification of certain provisions of the ISD Covered Bonds (including modifying the date of maturity of the ISD Covered Bonds or any date for payment of interest thereof, reducing or cancelling the amount of principal or the rate of interest payable in respect of the ISD Covered Bonds or altering the currency of payment of the ISD Covered Bonds), the quorum shall be one or more persons holding or representing not less than two-thirds in aggregate nominal amount of the Voting ISD Covered Bonds for the time being outstanding, or at any adjourned such meeting one or more persons holding or representing not less than one-third in aggregate nominal amount of the Voting ISD Covered Bonds. A resolution passed at any meeting of the holders of ISD Covered Bonds shall be binding on all the holders, whether or not they are present at such meeting. If and whenever the Issuer has issued and has outstanding ISD Covered Bonds of more than one Series, (i) a resolution which affects the ISD Covered Bonds of only one Series shall be deemed to have been duly passed if passed at a separate meeting of the holders of the ISD Covered Bonds of that Series; (ii) a resolution which affects the ISD Covered Bonds of more than one Series but does not give rise to a conflict of interest between the holders of ISD Covered Bonds of any of the Series so affected shall be deemed to have been duly passed if passed at a single meeting of the holders of the ISD Covered Bonds of all the Series so affected; and (iii) a resolution which affects the ISD Covered Bonds of more than one Series and gives or may give rise to a conflict of interest between the holders of the ISD Covered Bonds of one Series or group of Series so affected and the holders of the

ISD Covered Bonds of another Series or group of Series so affected shall be deemed to have been duly passed only if it is duly passed at separate meetings of the holders of the ISD Covered Bonds of each Series or group of Series so affected.

The Issuer, in its capacity as ISD Agent, may in certain circumstances, without the consent of the holders of the ISD Covered Bonds, make decisions binding on all holders relating to the Conditions which are not in its opinion, materially prejudicial to the interests of the holders of the ISD Covered Bonds. The Issuer shall consider the interest of the holders of ISD Covered Bonds while making such decisions.

16. FURTHER ISSUES

The Issuer shall be at liberty from time to time without the consent of the Covered Bondholders, the Receiptholders or the Couponholders to create and issue further covered bonds having terms and conditions the same as the Covered Bonds or the same in all respects save for the amount and date of the first payment of interest thereon and the date from which interest starts to accrue and so that the same shall be consolidated and form a single Series with the outstanding Covered Bonds.

17. THE CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

No person shall have any right to enforce any term or condition of this Covered Bond 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.

18. GOVERNING LAW AND SUBMISSION TO JURISDICTION

18.1 Governing law

The Agency Agreement, the Deed of Covenant, the Covered Bonds (except for Condition 3 and for ISD Covered Bonds, respectively), the Receipts and the Coupons and any non-contractual obligations arising out of or in connection with the aforementioned, are governed by, and shall be construed in accordance with, English law. Condition 3 of the Covered Bonds and the ISD Covered Bonds are governed by, and shall be construed in accordance with, Icelandic law.

18.2 Submission to jurisdiction

The Issuer irrevocably agrees, for the benefit of the Covered Bondholders, the Receiptholders and the Couponholders, that the courts of England are to have jurisdiction to settle any disputes which may arise out of or in connection with the Covered Bonds (other than the ISD Covered Bonds), the Receipts and/or the Coupons (including a dispute relating to any non-contractual obligations arising out of or in connection with the Covered Bonds, the Receipts and/or the Coupons) and accordingly submits to the exclusive jurisdiction of the English courts. The Issuer irrevocably agrees that any dispute arising out of the ISD Covered Bonds shall be subject to the exclusive jurisdiction of the District Court of Reykjavik. Legal action taken in respect of the ISD Covered Bonds under this Condition 18 may be proceeded with in accordance with the Act on Civil Procedure No. 91/1991, chapter 17.

The Issuer waives any objection to the courts of England on the grounds that they are an inconvenient or inappropriate forum. The Covered Bondholders, the Receiptholders and the Couponholders, may take any suit, action or proceedings (together referred to as **Proceedings**) arising out of or in connection with the Covered Bonds, the Receipts and the Coupons (including any Proceeding relating to any non-contractual obligations arising out of or in connection with the Covered Bonds, the Receipts and/or the Coupons) against the Issuer in any other court of competent jurisdiction and concurrent Proceedings in any number of jurisdictions.

18.3 Appointment of Process Agent

The Issuer 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 England, and undertakes that, in the event of Law Debenture Corporate Services Limited ceasing so to act or ceasing to be registered in England, it will appoint another person as its agent for service of process in England in respect of any Proceedings. Nothing herein shall affect the right to serve proceedings in any other manner permitted by law.

18.4 Waiver of immunity

The Issuer hereby irrevocably and unconditionally waives with respect to the Covered Bonds, the Receipts and the Coupons any right to claim sovereign or other immunity from jurisdiction or execution and any similar defence and irrevocably and unconditionally consents to the giving of any relief or the issue of any process, 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 Proceedings.

18.5 Other documents

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

19. DEFINITIONS

In these Conditions the following words shall have the following meanings:

Cover Pool Swap Agreement means the ISDA Master Agreement, schedule and confirmation(s) (as amended and supplemented from time to time) relating to the Cover Pool Swap entered into from time to time between the Issuer and the Cover Pool Swap Provider;

Cover Pool Swap Provider means the third party counterparties in their respective capacities as cover pool swap provider under a Cover Pool Swap Agreement;

Cover Pool Swap means the Cover Pool swap which enables the Issuer to convert ISK interest payments (less a client margin) received by the Issuer in respect of assets (other than Swaps) registered to the Cover Pool into floating or fixed payments (as the case may be) payments linked to the interest rate payable on the Covered Bonds;

Cover Pool means the pool of eligible assets recorded in the Register maintained by the Issuer in accordance with the Icelandic Covered Bond Act;

Currency Swap Agreement means the ISDA Master Agreement, schedule and confirmation(s) (as amended and supplemented from time to time) relating to the Currency Swap(s) entered into from time to time between the Issuer and each Currency Swap Provider;

Currency Swap Provider means the third party counterparties in their respective capacities as currency swap provider under a Currency Swap Agreement;

Currency Swap means each currency swap which enables the Issuer to hedge currency risks arising from (a) Covered Bonds which are issued in currencies other than ISK and (b) assets (other than Mortgage Bonds) which are registered to the Cover Pool and are denominated in currencies other than ISK;

Indexed Currency Swap Agreement means the ISDA Master Agreement, schedule and confirmation(s) (as amended and supplemented from time to time) relating to the Indexed Currency Swap(s) entered into from time to time between the Issuer and each Indexed Currency Swap Provider;

Indexed Currency Swap Provider means the third party counterparties in their respective capacities as indexed currency swap provider under an Indexed Currency Swap Agreement;

Indexed Currency Swap means each currency swap which enables the Issuer to hedge currency and inflation risks arising from (a) Covered Bonds which are issued in currencies other than ISK and not indexed linked and (b) assets which are registered to the Cover Pool and are denominated in ISK and indexed linked;

Interest Rate Swap Agreement means the ISDA Master Agreement, schedule and confirmation(s) (as amended and supplemented from time to time) relating to the Interest Rate Swap(s) entered into from time to time between the Issuer and each Interest Rate Swap Provider;

Interest Rate Swap Provider means the third party counterparties in their respective capacities as interest rate swap provider under an Interest Rate Swap Agreement;

Interest Rate Swap means each single currency interest rate swap which enables the Issuer to hedge the Issuer's interest rate risks in ISK and/or other currencies to the extent that they have not been hedged by the Cover Pool Swap or a Currency Swap;

records of Euroclear, Clearstream, Luxembourg and the ISD means the records that each of Euroclear, Clearstream, Luxembourg and the ISD holds for its customers which reflect the amount of such customer's interest in the Covered Bonds;

Relevant Percentage means, from time to time, the proportion which the outstanding principal amount of the relevant Series of Covered Bonds bears to the aggregate of the outstanding principal amounts of all series of Covered Bonds outstanding;

Register has the meaning given to it in the Icelandic Covered Bond Act; and

Swap Providers means the Cover Pool Swap Provider, each Currency Swap Provider, each Interest Rate Swap Provider and each Indexed Currency Swap Provider.

USE OF PROCEEDS

The net proceeds from each issue of Covered Bonds will be applied by the Issuer for general funding purposes, which include making a profit and/or hedging certain risks.

OVERVIEW OF THE ICELANDIC LEGISLATION REGARDING COVERED BONDS

Introduction

The Icelandic Act on Covered Bonds No. 11/2008 (as amended with Act No. 35/2008) (the **Icelandic Covered Bond Act**) was adopted by the Icelandic Parliament on 4 March 2008. This legislation enables Icelandic commercial banks, savings banks and credit undertakings which have been licensed to issue covered bonds as defined therein.

The following summary contains a general summary of the Icelandic Covered Bond Act, and does not entirely apply to the Covered Bonds issued pursuant to the proposed Programme, and should not be construed as being an exhaustive presentation or description of all aspects regarding the Icelandic Covered Bond Act.

Covered Bonds

The Icelandic Covered Bond Act defines "covered bonds" as bonds and other unilateral, unconditional, written debt obligations which enjoy a right of priority over the cover pool of the issuer and which are issued in compliance with the Icelandic Covered Bond Act.

Cover Pool

The Icelandic Covered Bond Act defines a "cover pool" as the collection of bonds, substitute collateral and other assets that have been registered on a register in accordance with Chapter VI of the Icelandic Covered Bond Act and covered bondholders and counterparties of the Issuer under derivative agreements have a priority claim to seek enforcement in respect of such assets in accordance with the Icelandic Covered Bond Act.

A cover pool will consist primarily of mortgage bonds secured against residential property; industrial, office or commercial property; agricultural property; debt instruments including those issued by the Icelandic government or other member state, municipality in Iceland or in another member state, or guaranteed by such member state within the EEA and certain substitute collateral (**Substitute Collateral**) up to a specific limit of the value of the relevant cover pool. These assets are to be kept separate from the other business operations of the issuer, as further described under "*The Register*" below. The Icelandic Covered Bond Act defines a bond as a written debt instrument whereby an issuer recognises unilaterally and unconditionally its obligations to make specific monetary payments.

The Icelandic Covered Bond Act requires that the total current value (in Icelandic "*uppreiknuð heildarfjárhæð höfuðstóls*") of the mortgage bonds and other assets in the cover pool that is to serve as collateral for a specific class of covered bonds shall always exceed the total current value (in Icelandic "*uppreiknuð heildarfjárhæð höfuðstóls*") of the principal of the same class of covered bonds (see further "*Matching rules*" below).

The Financial Supervisory Authority

The issue of covered bonds requires a licence from the Icelandic Financial Supervisory Authority (**FME**), which is also the supervisory authority for the business operations of the Issuer conducted in connection with the issue of covered bonds. A licence from the FME requires, *inter alia*, that the issuance complies with the Icelandic Covered Bond Act and that a certified public accountant certifies that the Issuer's budget and accounts demonstrate that its financial situation is stable enough not to jeopardise the interests of other creditors. Furthermore, the FME may grant the licence subject to specified conditions.

Subject to FME's authorisation, previously issued bonds and other comparable debt instruments which were issued for the purpose of financing the assets in a cover pool may be converted to covered bonds under the Icelandic Covered Bond Act.

The FME has issued Rules No. 528/2008 on covered bonds that concern among other things the conditions for being granted a licence to issue covered bonds, appraisal and revaluation of the assets in the cover pool, matching rules, derivative agreements, the cover bond register and the eligibility and reporting of the independent inspector (the **Rules**). The Rules are issued with reference to the Icelandic Cover Bond Act and elaborate on the provisions of the Act.

The Register

The rights of priority that covered bondholders have over the cover pool, which rank junior to swap providers in respect of the derivative agreements related to the covered bonds or the cover pool, arise from a registration being made in a register kept by the issuer (referred to herein as the **Register**). The Register shall always show, among other things, (1) the nominal value, interest terms, and final maturity dates of the covered bonds (2) the types of assets in the cover pool, and (3) in respect of each mortgage bond in the cover pool, the name of the underlying borrowers, their ID no., the nominal value of the loan, date of issue, maturity, terms of instalments and interest. Furthermore, the Register shall show the appraisal of the collateral security in the cover pool, when the appraisal was made and the premises used. Mortgage bonds in a cover pool must be endorsed showing they are part of a cover pool and have been entered in the Register as provided in Chapter VI of the Icelandic Covered Bond Act. The endorsement shall also indicate that the mortgage bond is to secure priority rights of a specific class of covered bonds.

Independent Inspector ("Sjálfstæður skoðunarmaður")

The FME shall supervise the Issuer to ensure that the Issuer acts in accordance with the Icelandic Covered Bond Act and other applicable legislation and regulations that govern the Issuer's operations. The Issuer must appoint an independent inspector, and this appointment must be approved by the FME. The independent inspector is assigned the task of monitoring that the Register is maintained in accordance with the provisions of the Icelandic Covered Bond Act and verifying that the valuation of collateral for debt instruments in the cover pool is based on the prescribed methodology. The independent inspector shall report regularly to the FME on his observations, and immediately inform the FME of any circumstances he becomes aware of, that could affect the FME's assessment of the Issuer.

Eligible Cover Pool Assets

The cover pool consists primarily of mortgage bonds issued by borrowers against collateral in the form of real property or public credit (i.e. loans to creditors with high credit worthiness, such as the State of Iceland, Icelandic municipalities and foreign central banks). Collateral for mortgage bonds shall consist of (a) pledged real property designated for residential purposes; (b) pledged real property designated for industrial, office or business purposes, and (c) pledged real property designated for agricultural purposes. The collateral may form part of the cover pool only to the extent that the ratio of the principal balance of the mortgage bond compared to the Market Value (the **LTV**) in relation to the collateral does not exceed (a) 80% of the Market Value for real property designated for residential purposes, (b) 70% of the Market Value for real property designated for agricultural purposes and (c) 60% of the Market Value for real property designated for industrial office or commercial purposes. Furthermore, the mortgage bonds issued against mortgages in residential, industrial, office, commercial or agricultural purposes may not be registered in the cover pool if payment is in arrears for 90 days or more.

The cover pool may also include a limited proportion of Substitute Collateral. The Substitute Collateral may constitute no more than 20% of the cover pool. The FME may, however, approve that the Substitute Collateral constitutes as much as 30% of its value.

The **Market Value** of real properties is assessed by an appraisal which must be based on the selling price in recent transactions with comparable properties. The Issuer shall regularly monitor the development of such selling prices. If the Market Value of collateral in the cover pool (i.e. the underlying mortgaged real estate) substantially decreases, the amount of the value of the assets in the cover pool shall be decreased to ensure that the LTV lies within the limits described above.

Matching Rules

The Issuer must ensure that the total current value of the cover pool which is to serve as collateral for a specific class of covered bonds always exceeds the aggregate total current value of that class of covered bonds. Moreover, instalments and other cash flows accruing on the assets in the cover pool and from derivative agreements shall be in such a manner that at any given time the issuer can meet all its financial obligations to covered bondholders and counterparties to derivative agreements.

In order to maintain a suitable balance between the cover pool and the corresponding class of covered bonds, the issuer (a) must ensure that the assets in the cover pool (including Substitute Collateral) are valued having proper regard to currency exchange rates, interest rates, maturity dates, and other relevant factors; and (b) may enter into derivative agreements for the purpose of achieving this balance.

Rights of Priority

In the event of winding up of the issuer, covered bondholders and derivative agreement counterparties are entitled to rights of priority to the assets in the cover pool that are registered in the Register, as well as over the funds that originate from those assets.

Handling of assets in the event of winding up of the Issuer

If an Issuer enters into winding up proceedings, any issued covered bonds do not fall due unless it was specifically agreed otherwise. Furthermore, any derivative agreements entered into by the Issuer in relation thereto shall not accelerate upon the winding of the Issuer and such agreements may not include provisions on automatic closing of contracts under such circumstances. In case of the winding up of the issuer, the winding up committee shall keep the covered bonds, Substitute Collateral and other assets in the cover pool segregated from other assets of the Issuer's estate. The same shall apply to funds and other assets substituted for the covered bonds, Substitute Collateral and other assets in the cover pool, or paid in respect of such assets. Such separation shall be maintained until claims arising from the covered bonds have been paid in full.

The winding up committee shall also keep derivative agreements, and funds returned by such assets or which must be paid from the cover pool to the counterparties to those derivative agreements, separate from other assets of the Issuer's estate.

Payments received by the Issuer after the date of a winding up order in respect of funds and other assets substituted for the covered bonds, Substitute Collateral and other assets in the cover pool intended for payment of claims, including fulfilment of derivative agreements, shall be entered in the Register by the winding up committee.

However, Article 17(1) of the Icelandic Covered Bond Act states that the winding up committee shall fulfil the Issuer's commitments under the covered bonds and derivative agreements using mortgage bonds and other assets in the cover pool and payments received on such assets provided these assets are listed in the register.

The separation of the cover pool shall be maintained until claims arising from the covered bonds have been paid in full. The general rule is that to the extent that a cover pool is not sufficient to cover the covered bonds and derivative agreements, the covered bondholders may continue to file claims as non-preferential

creditors of the Issuer and to receive dividends from the other assets of the Issuer and be ranked *pari passu* with other, general and non-prioritised non-preferential creditors of the Issuer.

Under the act on Bankruptcy etc. no. 21/1991 (the **Bankruptcy Act**), the covered bondholders' priority rights to the cover pool rank third after (1) third party's assets held by the Issuer, provided that the third party can prove his entitlement to the asset (no such third party's assets should be a part of the cover pool); (2) (i) certain bankruptcy costs, (ii) third party claims incurred after the date of the winding up order due to agreements made on behalf of the bankruptcy estate by the winding up committee or to liability for losses incurred by third parties as a result of any negligent act of the bankruptcy estate; and (iii) lawful third party claims, including claims due to derivative agreements concluded in accordance with the provisions of the Icelandic Covered Bond Act, incurred by the estate after the date of a moratorium order or a composition proceedings order, if applicable.

Where the Issuer seeks composition with creditors, the composition arrangement will not affect claims which benefit from security (such as the claims of Covered Bondholders), to the extent the security is sufficient to pay the claim and the security interest will not cease to exist as a result of the composition arrangements. However, according to article 60(4) of the Bankruptcy Act, if the creditor values the collateral as being insufficient to meet his claim, he may (in order to increase the chances of recovery) partly waive his right to a secured claim and thereby partly obtain a contractual claim on the debtor, to the extent of such waiver.

The part of the winding up costs that concerns the covered bonds, the cover pool, and payments with respect to the covered bonds, cover pool or derivative agreements shall be paid from the cover pool. Payments received by the issuer after the date of the winding up order in accordance with the terms and conditions governing the cover pool should be entered in the Register.

Notwithstanding the provisions of Chapter XX of the Bankruptcy Act actions taken by the Issuer in accordance with the Icelandic Covered Bond Act, including the delivery of funds or Substitute Collateral to the cover pool, payments on the cover pool, or disposal of funds from the cover pool to fulfil obligations under a covered bond or a derivative agreement concluded in accordance with the Icelandic Covered Bond Act and in connection with the cover pool, shall not be subject to annulment or claw-back.

In relation to specific risk factors of the Icelandic Covered Bond Act that have been identified, please see the section on *Risk Factors* above.

The Rules

The Rules provide further detail on a few issues described in the Icelandic Covered Bond Act. Below is a short summary of the main sections of the Rules:

The Rules list the documents to be submitted to the FME by the issuer when the issuer seeks FME's license to issue covered bonds. Such documents include, i.e., approvals, descriptions of the proposed programme, the issuer's budget, information on data systems, etc.

The Rules describe the assets which are eligible to be registered to the cover pool and how such asset's eligibility shall be evaluated.

The Rules provide further clarifications with respect to the matching requirements described above and provide a method of calculating the present value of assets/liabilities in relation thereto. The Rules prescribe that the Issuer shall complete such calculations as often as deemed necessary and at least on a weekly basis.

The Rules provide for certain restrictions to the provisions and counterparties of derivative agreements. Such agreements may not include provisions on automatic closing of contracts upon the winding up of the issuer. Furthermore, the counterparties to derivative agreements must have a financial strength rating from a fully accredited rating agency and such a rating may not fall below the limits listed in the table below. If another

rating agency has given the respective counterparty a lower rating, it has to receive ratings from at least two accredited rating agencies giving it equal or higher rating than listed in the following table:

Rating agency	Minimum rating	
	Long term	Short term
Moody's	A3	P2
Standard & Poor's	A-	A2
Fitch	A-	F2

The Rules provide further detail on the Register. The Register shall be kept in a secure manner and updated on a daily basis. The FME shall have access to the Register.

Furthermore, the Rules provide further detail on the obligations of the independent inspector to be appointed by the issuer. The independent inspector shall ensure that the Register is properly maintained and updated and shall therefore verify that bonds and derivative agreements are correctly registered, only eligible assets and Substitute Collateral are included in the cover pool, the value of the assets registered in the cover pool and the valuation thereof is in accordance with the Icelandic Covered Bond Act and the Rules, that LTV calculations are correctly updated upon significant decrease in the Market Value of mortgaged assets, and that the matching rules are complied with.

The independent inspector shall once a year provide the FME with a written report regarding his/her surveillance. Furthermore, the independent inspector shall as soon as possible notify the FME should he/she become aware of any matters which could affect the FME's assessment of the Issuer's position in general.

DESCRIPTION OF THE ISSUER

OVERVIEW

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

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

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

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

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

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

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

In the nine month period ended 30 September 2018, the Bank's net interest income was ISK 21.96 billion (compared to ISK 22.6 billion in the nine month period ended 30 September 2017), its operating income was ISK 40.3 billion (compared to ISK 38.7 billion in the nine month period ended 30 September 2017) and its net earnings were ISK 6.2 billion (compared to ISK 10.4 billion in the nine month period ended 30 September 2017). As at 30 September 2018, the Bank's total assets were ISK 1,219 billion.

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

HISTORY

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

2010-2012: Restructuring of the Bank and its customers

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

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

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.

2013-2014: Streamlining and building of the business

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

better services and increase staff productivity. Digitalisation also allowed the Bank to strengthen its customer focus and decentralise credit decisions.

During this period, the Bank began to build up its Icelandic market leadership in its core products. The Investment Banking division also established itself as an innovator in the Icelandic capital markets through its involvement in three out of five initial public offerings during 2013 and 2014. The Bank adopted a first mover approach as exemplified by its early adoption of next generation personal banking technology, which led to the Bank becoming an innovator in personal online and mobile banking. The Bank also took an innovative approach to mortgage loan products, being the first Icelandic bank to introduce the fixed rate non-CPI-linked mortgage loans, a strategy which it supported through selective portfolio acquisitions.

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

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

Since 2015, the Bank has been able to focus on growing and improving its business by strengthening its presence and leadership in key markets, including capital markets, project financing and asset management. The Bank managed all of the three initial public offerings in 2015 as well as provided the project financing for a new five star hotel in Reykjavík, a deal worth USD 110 million. The Bank is also in the process of optimising its capital structure and improving its risk-weighted assets profile. It continued with its first mover approach in 2015, being the first Icelandic bank to issue a benchmark eurobond since 2008. In its business divisions, the Bank has continued to drive commercial excellence in its markets and is actively exploring new business opportunities.

The Bank has also worked to improve its operational efficiency. For example, the Bank has scaled its digitalisation initiatives and continues to invest in its IT infrastructure. In addition, the Bank acquired Vörður, a universal insurance company in 2016, which it expects will lead to increased commercial, financial and operational synergies between its banking and insurance operations as well as commercial opportunities for cross-selling. See “- Strategy”.

KAUPTHING

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

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

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

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

The Kaupthing Resolution Committee was dissolved on 1 January 2012 and the Winding-up Committee 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 Icelandic Central Bank has granted Kaupthing certain exemptions from Icelandic foreign capital controls on the basis that Kaupthing, among other things, has made a "stability contribution" to the Icelandic Central Bank.

As part of a refinancing of the Bank's debt position undertaken in connection with the "stability contribution", on 11 January 2016 the Bank issued USD747,481,000 Resetable Notes due 2023 (the **Resetable 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 Resetable Notes against the Bank's obligation to make payment of all amounts outstanding under a foreign currency loan provided to the Bank by the Icelandic Central Bank on 22 January 2010 (such loan having been purchased by Kaupthing from the Icelandic Central Bank) and to return certain foreign currency deposits held by the Bank for Kaupthing. The Resetable Notes are subject to mandatory prepayment in the event of certain further issues of debt securities the Resetable Notes have been fully prepaid as of the date of this Base Prospectus.

SHAREHOLDERS OF THE BANK

Arion Bank's shares were listed in Iceland and Sweden in June 2018. The shareholder base grew considerably, although there were no major changes to the largest shareholding.

Kaupthing, through its subsidiary Kaupskil, is the largest shareholder in the Bank and holds a 32.67 per cent. stake. 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. Taconic Capital Advisors is the next largest shareholder in the Bank with a stake of 10.00 per cent. A list of shareholders holding over 1% of the Bank's share capital are published on the Bank's website www.arionbanki.is

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

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

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

STRATEGY

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

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

Build long-term business relationships

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

Increase operational efficiency

The Bank has recently implemented and expects to implement additional operational efficiency initiatives, which are expected to have bottom-line impact, in line with its medium-term target to reduce its cost-to-income ratio to approximately 50 per cent. (56.1 per cent. for nine months ended 30 September 2017). The lean banking initiative aims to implement effective processes to help meet customers’ needs by eliminating waste, instability and inflexibility in the Bank’s infrastructure with the overall goal of improving customers’ experiences. In addition, the Bank plans to increasingly pursue its digitalisation initiatives in several areas, particularly onboarding for private banking and capital markets and also focusing on the corporate lending process. These initiatives are expected to enhance customer satisfaction and experience, ultimately increasing the value of the Bank’s brand, and to have bottom-line effect by reducing salary expenses and increasing customer demand and sales by streamlining product and loan delivery. The Bank has also announced cost cutting measures and plans to implement operational improvements and streamline its operations through outsourcing of non-core functions to reduce overhead and administrative costs. In March 2018, the Bank announced plans to merge certain branches and focus on optimising the branch network by reducing square metres occupied and to have digital branches, resulting in closing three branches.

Strengthen the core business

The Bank expects its core banking business (particularly with respect to net interest income, net fee and commission income and net insurance income) to benefit in the coming years from strong underlying market growth fuelled by anticipated growth in the Icelandic economy. For instance, the growth of private consumption in Iceland is expected to increase opportunities for mortgage lending. The Bank also expects to harness this growth to help bolster its leading position across businesses and increase its share in lending to small- to medium-sized enterprise customers of the Bank and/or its subsidiaries, defined as corporates with loans up to ISK 2.0 billion (SMEs) as well as in leasing and insurance businesses. The Bank further anticipates that it will be able to capitalise on its broad revenue base to maintain the levels of fee and

commission income with potential for growth, contributing to a positive outlook for the Bank's core business development. The Bank also expects its cost of risk to decrease in the future through a focus on collateralisation and closer relationships with its customers, allowing the Bank to encourage improved lending practices and early intervention should customers face financial difficulties.

Pursue value creation opportunities

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

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

BUSINESS

The Bank comprises the following operating segments:

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

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

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

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

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

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

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

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

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

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

Nine month period ended 30 September 2018								
	Retail banking ⁽¹⁾	Corporate banking	Investment banking ⁽²⁾	Asset management ⁽³⁾	Treasury ⁽⁴⁾	Other divisions and subsidiaries ⁽⁵⁾	Headquarters and elimination ⁽⁶⁾	Total
	<i>(ISK in millions)</i>							
Operating income	17,204	4,895	1,531	3,159	3,805	9,027	687	40,308
Earnings before tax	6,969	(1,617)	378	1,284	1,892	1,525	(1,305)	9,126
Total assets	577,633	283,734	17,796	76,371	531,876	94,739	(362,620)	1,219,529

(1) Includes Arion Bank Mortgages Institutional Investor Fund (the **ABMIIF**).

(2) Includes Arion Bank's share of operating income, earnings before tax and assets from BG12 slhf., EAB 1 ehf. and Kolufell, in which the Bank sold a majority of its shareholding in July 2016.

(3) Includes Stefmir.

(4) The "Treasury" reporting segment includes internal interest income and internal expense (which are eliminated upon consolidation) as well as interest income on the Group's cash, cash equivalents and other liquid assets held as a liquidity buffer.

(5) Includes Valitor, Vörður Life Insurance, Landey and Vörður.

(6) "Headquarters and elimination" reporting segment includes the netting out of intragroup accounts, dividends paid in respect of the Bank's holdings in listed equity and valuation changes. "Headquarters" include overhead and the following support divisions: Risk Management, Finance (excluding Treasury), Legal, IT and Operations.

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

(1) Includes Arion Bank Mortgages Institutional Investor Fund (the **ABMIIF**).

(2) Includes Stefmir.

(3) The "Treasury" reportable segment includes internal interest income and internal expense (which are eliminated upon consolidation) as well as interest income on the Group's cash, cash equivalents and other liquid assets held as a liquidity buffer.

(4) Includes Valitor, Landey and Vörður (including what was formerly Okkar Life Insurance).

- (5) "Headquarters and elimination" includes the netting out of intragroup accounts, dividends paid in respect of the Bank's holdings in listed equity and valuation changes. "Headquarters" include overhead and the following support divisions: Risk Management, Finance (excluding Treasury), Legal, IT and Operations.

As of and for the year ended 31 December 2016								
	Retail banking ⁽¹⁾	Corporate banking	Investment banking ⁽²⁾	Asset management ⁽³⁾	Treasury ⁽⁴⁾	Other divisions and subsidiaries ⁽⁵⁾	Headquarters and elimination ⁽⁶⁾	Total
	<i>(ISK in millions)</i>							
Operating income.....	18,670	7,798	3,746	4,345	6,160	12,310	410	53,439
Earnings before tax ...	18,093	7,226	4,511	2,923	5,978	5,184	(16,652)	27,263
Total assets	476,369	251,822	16,835	5,302	190,418	68,750	26,528	1,036,024

(1) Includes Arion Bank Mortgages Institutional Investor Fund (the **ABMIF**).

(2) Includes Arion Bank's share of operating income, earnings before tax and assets from BG12 slhf., EAB 1 ehf. and Kolufell, in which the Bank sold a majority of its shareholding in July 2016.

(3) Includes Stefmir.

(4) The "Treasury" reporting segment includes internal interest income and internal expense (which are eliminated upon consolidation) as well as interest income on the Group's cash, cash equivalents and other liquid assets held as a liquidity buffer.

(5) Includes Valitor, Vörður Life Insurance, Landey and Vörður. The operating income of Valitor, Vörður and Vörður Life Insurance was ISK 9,429 million, ISK 847 million and ISK 725 million, respectively; the earnings before tax of Valitor, Vörður and Vörður Life Insurance were ISK 3,590 million, ISK 454 million and ISK 191 million, respectively; and total assets of Valitor, Vörður and Vörður Life Insurance were ISK 38,588 million, ISK 12,436 million and ISK 4,434 million, respectively.

(6) "Headquarters and elimination" reporting segment includes the netting out of intragroup accounts, dividends paid in respect of the Bank's holdings in listed equity and valuation changes. "Headquarters" include overhead and the following support divisions: Risk Management, Finance (excluding Treasury), Legal, IT and Operations.

RETAIL BANKING DIVISION

Overview

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

Operations and Distribution Capabilities

The Retail Banking division generates operating income through the provision of financial products and services to retail customers, on which the Bank earns interest income and fee and commission income. Operating income for the Retail Banking division was ISK 17,204, ISK 21,151 million and ISK 19,702 for the nine months ended 30 September 2018, the year ended 31 December 2017 and 2016, respectively. As of 31 December 2017 and 31 December 2016, the Retail Banking division's customer loan portfolio amounted to ISK 500,442 million and ISK 460,420 million, respectively, and the total amount of deposits with the Retail Banking division amounted to ISK 341,797 million and ISK 299,912 million, respectively.

The Retail Banking division serves its customers through its branch network and other points of contact, such as ATMs, a call centre, internet banking and the Arion Bank app, focusing on customer relationships to address different areas with different needs.

Branches

In recent years, the focus has been on making the branch network even more efficient and convenient for customers. The overall branch experience has been redefined, moving from traditional branches to more flexible units by adding new service formats. In the last four years, the Bank has opened a flagship branch in the Borgartún financial area, an airport branch in Keflavík airport and a digital branch in Kringlan shopping mall. New, flexible micro branch units have been designed and will open in new locations in 2018. In addition, the Bank has opened self-service areas which are open 24/7, remote bank services with extended opening hours and has operated a mobile ATM van.

This strategy has resulted in a flexible and optimised branch network with stronger individual branches, which the Retail Banking division believes are better suited to meet the needs of its customers. To maximise operational efficiency, the branch network is divided into five regions, each of which has its own business manager. The branches in the Reykjavík area have been merged into a single region instead of the previous two. This change makes it easier to coordinate services and to combine employees' expertise in order to meet customers' demands. This change also reduces the overall costs of operating the branch network and boosts efficiency. Smaller branches capitalise on the strength of larger branches within each cluster. This organisation of the branch network transfers more executive authority and responsibility to the branches, which are closer to the needs and concerns of the customers, thereby bringing the decision-making power closer to the customers and enhancing customer satisfaction and experience.

Owing to the Bank being an indirect successor of the Agricultural Bank, which was an old agricultural bank of Iceland, the Bank's branches are strategically situated in key tourism areas as well as in agricultural areas. As of 30 September 2018, the Bank had 21 branches throughout Iceland, of which 6 branches were located in the greater Reykjavík area and 15 branches were located in rural areas in light of their agricultural heritage background. In addition, nine of the Bank's branches were located in major tourist towns or by the main road in Iceland and the Bank was the only bank in the area in 11 locations. The Bank has also launched the only branch at the Keflavík international airport.

Internet Banking, Arion Bank App and ATMs

The Retail Banking division has continuously endeavoured to be a market leader in digital solutions to banking, increasing channel diversification to improve efficiency. Accordingly, the Retail Banking division has taken advantage of the major changes in customer behaviour in recent years, as customers have transitioned away from branches to internet and mobile banking as the preferred channel, by successfully implementing the Arion Bank app in August 2012. Internet banking enables customers to access the majority of the most utilised services available at a traditional branch, while the increasingly popular Arion Bank app allows customers to keep track of their finances with a single click. In addition, the new generation of ATMs enables customers to save time by allowing them to deposit and withdraw cash as well as pay their bills without assistance from a cashier.

The Retail Banking division plans to steadily reduce the volume of low value transactions handled at branches by putting greater emphasis on customers' experience, through the Arion Bank app and other digital solutions. By focusing on digitalisation of various processes, the Bank has reduced the internal lead time for customer onboarding by approximately 88 per cent. and launched a new digital initiative with respect to the mortgage loan application process, credit cards, leasing SME onboarding, mortgage refinancing and other services. The public response to these digital initiatives has been very positive, with the majority of credit assessments and mortgage applications being performed digitally and payment plans for credit cards, overdrafts and other functions are set up almost entirely by using the Arion Bank app.

Customers

As of 31 December 2017, the Retail Banking division had an estimated 130,291 active customers (defined as customers of the Retail Banking division who either (i) have a product in force (such as a loan, mortgage or insurance policy) or (ii) have made a customer-initiated financial transaction (excluding any automated payments such as direct debits) in the preceding six months on an account-based product (such as a current

account, credit card or debit card); or (iii) have a balance of more than EUR 250 or equivalent in a current account or term deposit account), of which 87.6 per cent. were individuals and 12.4 per cent. were SMEs. The Retail Banking division enjoys a loyal and relatively stable customer base in Iceland, with its customers accounting for 27.9 per cent. of individual customers in Iceland and 27.4 per cent. of SMEs in Iceland for the year ended 31 December 2017 (*source: active customers definition based on Finalta, McKinsey; Capacent Gallup*). The Bank measures customer satisfaction on the basis of net promoter scores for its most important customer services.

Products and Services

The Retail Banking division offers a comprehensive range of financial products and services, including mortgage loans, savings and checking accounts, vehicle and equipment financing, payment cards, pension services, insurance and funds. The Retail Banking division also offers factoring, or trade financing which is used by SMEs, both importers and exporters. In particular, the Bank uses factoring in connection with trade finance, where inventory financing is linked with the financing of receivables which suits the needs of exporters, such as seafood companies. The Bank also offers SME loans in cooperation with the European Investment Fund.

The Retail Banking division's goal is to provide personalised services to distinct customer segments and SME market sectors to meet its customers' needs. In addition, the Retail Banking division seeks to establish multi-product relationships with its customers by offering various financial products and services offered by the Bank's divisions through diversified delivery channels.

To increase product penetration and increase the number of products per customer, the Retail Banking division has also developed more proactive methods with respect to its product and services offering, including exploring new opportunities with Vördur's current customers (e.g. offering the Retail Banking division's mortgage loans), as well as the use of the branch network to sell Vördur's insurance products as a registered insurance intermediary.

Mortgage Loans

The Retail Banking division provides a full range of products and services relating to mortgage loans and has historically introduced innovative products and services designed for the evolving needs of its customers. This has enabled the Retail Banking division to maintain or increase its market share in an increasingly competitive market. The Bank was the first to introduce fixed five-year interest rates on non-CPI-linked mortgage loans in 2011. The Retail Banking division further strengthened its first mover advantage and competitive position in the market by offering mixed CPI-linked and non-CPI-linked mortgage loans, allowing customers to select the type of mortgage loan that best suits their risk appetite and ability to repay. Recent product developments include a mortgage product designed to temporarily lower the borrower's debt repayments during parental leave and a mortgage product for first-time home buyers with an up to 85 per cent. loan-to-value ratio. When mortgage loans are issued, the Retail Banking division strives to improve its product and services offering by implementing digitalisation initiatives.

Loans to SMEs

The Retail Banking division has significantly grown its portfolio of loans to SMEs in recent years, which has traditionally been relatively small, as compared to its competitors. In November 2017, the Retail Banking division established a new unit for SMEs to further enhance the Bank's market position in that sector. The new unit is responsible for loans, sales and quality management to SMEs. Loans to SMEs increased from ISK 127,275 million as of 31 December 2016 to ISK 138,685 million as of 31 December 2017, mainly driven by the increase in the volume of loans to SMEs in the real estate and construction industry sector, wholesale and retail trade industry sector and the seafood industry sector.

Customer Deposits

The Retail Banking division seeks to leverage its base of mortgage loans customers to achieve further growth in its market share of customer deposits, which is currently smaller than the market share of other large banks. The Retail Banking division's share of individual deposits increased from 27.0 per cent. as of 31 December 2016 to 27.2 per cent. as of 31 December 2017 (*source: Icelandic Central Bank*). (*source: Icelandic Central Bank*).

As customers in Iceland are accustomed to keeping deposits with their main bank and because CPI-linked deposits of individual customers are generally thought to be less likely to move from bank to bank due to regulations which limit the time periods during which such deposits can be withdrawn, there is a relatively stable market for deposits from individual customers, with deposits from SME customers being more price sensitive. However, the Retail Banking division believes that there is an opportunity to attract deposits from customers who have their mortgage loans with the Retail Banking division but deposits with another bank. The cooperation of the Retail Banking division with the Asset Management division has enabled many cross-selling opportunities, including combining the product and services offering of the Retail Banking division with insurance and pension products. Higher levels of SME activity in Iceland also provide cross-selling opportunities for the Retail Banking division. In addition, the Bank believes that its new digital customer onboarding platform together with the comprehensive digital offering will become a catalyst for attracting new customers to the Retail Banking division. In addition, a new role was created in November 2017 for a product manager for deposits, who is authorised to manage prices and interest rates on deposits as well as promote deposits within the branch network and via digital channels.

Credit Cards

The Bank offers its customers a selection of payment cards from both Visa and MasterCard. It offers standard, gold and platinum, as well as the Bank's flagship card, the World Elite MasterCard. Two types of prepaid cards are also available: the gift card for Icelandic customers and the currency card for travellers visiting Iceland.

Regulation (EU) 2015/751 on interchange fees for card-based payment transactions (the **EU Interchange Fee Regulation**) has not been implemented in Iceland yet, but according to information from the Ministry of Finance it is expected to be implemented in the course of 2019. The EU Interchange Fee Regulation will not generally affect debit card income as the cap is already set at 0.2 per cent. in Iceland. However, it will affect the Bank's revenue from domestic credit card turnover. The domestic interchange rate fee cap is now set at 0.6 per cent. but is expected to be lowered to 0.3 per cent. upon implementation of the EU Interchange Fee Regulation, resulting in revenue loss. The Bank budgeted for this expected revenue loss and has taken certain steps to mitigate the effect, mostly by reducing cost associated with the cards, simplifying the card product portfolio, reducing the number of third-party processors and increasing card related revenues other than interchange fees.

CORPORATE BANKING DIVISION

Overview

The Corporate Banking division is a full service Icelandic corporate bank, providing a range of financial products and services to larger corporate customers across all industry sectors through dedicated industry sector teams. The primary focus of the Corporate Banking division is to maintain long-term relationships with its existing customers and to deliver integrated solutions as well as personalised services to achieve revenue diversification. The Bank believes that its long-term relationships with leading corporate customers enable the Corporate Banking division to maintain its strong competitive position. In addition, the Corporate Banking division's relationship-based model benefits from and provides synergies across the other divisions of the Bank, in particular the Investment Banking division and the Private Banking subdivision of the Asset Management division.

The Corporate Banking division's proactive approach has significantly improved its market position in recent years. Since 2013, there has been material margin pressure in high quality credits due to increased competition from pension funds (typically investors in real estate asset-backed securities, rather than as direct corporate lenders), as yields on government bonds decreased and the credit quality of companies gradually improved due to deleveraging and the improving economy. In addition, following the financial crisis, local banks had imposed accelerated repayment schedules on corporate borrowers, resulting in shortening maturity profiles in the Bank's corporate loan portfolio. The Corporate Banking division managed to stabilise its margins and to extend maturity profiles in 2015 and onwards realigning operations in 2013 and returning to a proactive approach in 2014. This proactive approach included reducing recovery efforts and increasing focus on the competitive landscape to identify new business opportunities, improving the mix of margins and maturity profiles and originating new loans to existing and new customers.

In the aftermath of the financial crisis in 2008 and the sharp depreciation of Icelandic Krona, many customers of the Corporate Banking division were overleveraged. The loans of almost all of the customers in this position have either been restructured or refinanced, and the loan portfolio of the Corporate Banking division is currently well-diversified and balanced.

Furthermore, the Corporate Banking division has placed an increased emphasis on customer retention and relationship development by organising into industry sector teams and focusing further on the relationship management role in the Corporate Banking division.

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

Market share in Icelandic corporate lending (including corporate bond issuance).....	21% ⁽¹⁾
Number of large customers serviced from the branch at Bank headquarters.....	191 ⁽²⁾
Total number of branches supporting distribution.....	13 ⁽³⁾
Number of FTEs.....	15 ⁽⁴⁾
Total loans and bonds outstanding to corporate banking customers.....	ISK 270,897 million ⁽⁵⁾
Deposits.....	ISK 21,169 million

- (1) Management belief based on internal analysis of competitors' public disclosures, based on book value of loans to corporates at period end. SMEs are covered by the Retail Banking division but are included in the market share of Corporate Banking.
- (2) Counted by customer groups (as opposed to customer identification number).
- (3) Represents branches with a dedicated corporate services presence.
- (4) Represents the number of FTEs in the Corporate Banking division working out of the Bank's headquarters.
- (5) Consists of loans to customers and bond instruments issued by customers but held by the Corporate Banking division.

Operations and Commercial Capabilities

The Corporate Banking division generates operating income through the provision of credit products and services to corporate customers, on which the Corporate Banking division earns interest income and fee and commission income. Operating income for the Corporate Banking division was ISK 4,895 million, ISK 8,543 million and ISK 7,874 million for the nine months ended 30 September 2018, the year ended 31 December 2017 and the year ended 31 December 2016, respectively. As of 31 December 2017 and 31 December 2016, the Corporate Banking division's loan portfolio amounted to ISK 270,897 million and ISK 248,222 million, respectively.

The Corporate Banking division is organised into three customer facing units and a small operations unit. A special recovery unit, which was responsible for the Bank's debt recovery, existed until the end of 2013 within the Corporate Banking division. The recovery unit was primarily involved in restructuring companies that experienced payment difficulties. During the restructuring process, the Bank acquired assets previously owned by the restructured companies. These assets were transferred into separate holding companies under

the control of the Bank and most have already been divested. The restructuring process is now overseen by the Legal division of the Bank.

The Corporate Banking division comprises teams of experienced account managers working out of the Bank's headquarters, who specialise in specific industry sectors to ensure strong expertise and with a focus on key performance indicators. The account managers are each responsible for specific customers, ensuring personal services and a clear overview of each customer's financial and service requirements. Each account manager also relies on the assistance of staff in a range of the Bank's support function divisions, including the Credit Office trade finance and guarantees, legal and documentation.

The Corporate Banking division relies on a relationship based model with a sales approach driven by key performance indicators. There are twelve designated business relationship managers in three expert sector teams in key industry sectors (i.e., trade and services, seafood and real estate and energy). Eight designated credit managers reporting to the Chief Credit Officer, support credit quality through the structuring and analysis team which allows the account managers to focus on sales and loan portfolio growth as well as cross-selling and building relationships. The direct relationships of the key account managers with existing customers ensure tailored lending solution offerings. Sales targets are driven by a compensation plan and the division's management focus on monthly targets based on key performance indicators, which are aligned with the Bank's strategic goals.

Customers

The Corporate Banking division provides products and services to large corporate customers. The Corporate Banking division's loan portfolio principally comprises large corporate customers and is well-diversified across all the main Icelandic industry sectors, with emphasis on the top 100 companies in Iceland. In addition, the Corporate Banking division acquires new customers through senior account managers of individual sector teams, industry relations and events as well as through active involvement of senior and/or executive management of the Bank.

Products and Services

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

Loans to Corporate Customers

Loans to corporate customers are the core product that drives the operating income of the Corporate Banking division, with net interest income from loans to corporate customers amounting to ISK 4,215 million, ISK 6,002 million and ISK 6,436 million for the nine months ending 30 September 2018, the year ended 31 December 2017 and the year ended 31 December 2016, respectively, amounting to 86.1 per cent., 70.3 per cent. and 82.5 per cent., respectively, of the total operating income of the Corporate Banking division, with the remainder derived from financial services as fee and commission income and other operating income, as described below.

Financial Services

In addition to generating income from loans to corporate customers, the Corporate Banking division also generates fee and commission income from provision of financial services, including guarantees, transaction / arrangement services and electronic services, which complement loans to corporate customers and have grown in recent years. The net fee and commission income from financial services amounted to ISK 825 million ISK 1,171 million and ISK 1,082 million for the nine months ending 30 September 2018, the year ended 31 December 2017 and the year ended 31 December 2016, respectively.

Term Loans

The Corporate Banking division has a diversified loan portfolio, with term loans being the highest volume product in all customer sectors and the key driver of both operating income and net interest margin. The Corporate Banking division had ISK 235,354 million and ISK 210,264 million of term loans outstanding as of 31 December 2017 and 31 December 2016, respectively.

Revolving Credit Facilities

Revolving credit facilities are a lower volume and lower margin product of the Corporate Banking division, with ISK 32,369 million and ISK 31,001 million of revolving credit facilities outstanding as of, the year ended 31 December 2016 and the year ended 31 December 2015, respectively. The revolving credit facilities are characterised by seasonality and high price sensitivity, with the seafood industry sector being the key source of demand, and the most significant seasonal drawdown period typically beginning in September/October, peaking in February and ending April/May. The Corporate Banking division provides current accounts, overdrafts and trade finance services in connection with the credit revolving facilities.

INVESTMENT BANKING DIVISION

Overview

The Investment Banking division provides a full range of investment banking products and services, including equity and fixed income brokerage, initial public offerings, capital markets and M&A advisory to a broad range of customers, including corporate customers, professional investors, asset management companies and pension funds. In addition, the Investment Banking Division holds a strong position in foreign exchange brokerage and bond issuances. The Investment Banking division was chosen by Global Finance magazine as the best Investment Bank in Iceland in 2017. As of 31 December 2017, the Investment Banking division had 30 FTEs organised across the three subdivisions: Capital Markets, Corporate Finance and Research.

The Investment Banking division is recognised as a leader in equity brokerage and initial public offerings, having managed all four initial public offerings listed on the Main Market of NASDAQ Iceland in 2015 and 2016, as well as eight out of 13 initial public offerings in Iceland since 2011. Furthermore, the Investment Banking division managed the only listing on NASDAQ Iceland First North in 2017.

The Investment Banking division benefits from the Bank's developed infrastructure and has implemented the Bank's lean banking principles in its operations, allowing it to focus on acquiring and developing customer relationships and deal flow. The Investment Banking division enjoys a large and solid customer base featuring strong and trusted relationships with Icelandic and international investors, which is the key component of the Investment Banking division's placement power and transaction capabilities. Leveraging the Bank's relative size, strong balance sheet and infrastructure enables the Investment Banking division to support its customers, for example by providing underwriting capabilities through the Corporate Finance subdivision and offering forward contracts in capital markets. The Investment Banking division further benefits from the significant cooperation among the various divisions of the Bank by leveraging customer relationships and the bank's broad product range.

The table below sets forth certain operational data for the Investment Banking division as of and for the year ended 31 December 2017, unless noted otherwise.

Net fee and commission income.....	ISK 1,298 million
Number of initial public offerings in 2015/2016/2017	3/1/0 ⁽¹⁾
Number of initial public offerings since 2011	8(2)
Market share in equities brokerage on NASDAQ Iceland.....	24.3%

Market share in fixed income brokerage on NASDAQ Iceland	16.5%
Number of FTEs	30

⁽¹⁾ Out of three initial public offerings in Iceland in 2015, one in 2016.

⁽²⁾ Out of 13 initial public offerings on the Main Market of NASDAQ Iceland since 2011.

Operations and Distribution Capabilities

The Investment Banking division generates operating income through specialist services, such as M&A and capital markets advisory as well as equity and debt brokerage and research. The operating income of the Investment Banking division was ISK 1,467 million (of which ISK 1,298 million was fee and commission income) and ISK 3,746 million for the years ended 31 December 2017 and 2016, respectively.

Customers

The Corporate Finance and Capital Markets subdivisions provide products and services predominantly to corporate customers, institutional investors, insurance companies and investment companies as well as high net worth individuals and families. The Research subdivision supports and provides services to customers of other fee-generating divisions of the Bank, such as Corporate Banking and Asset Management. The Research subdivision also conducts introductory customer meetings for other divisions of the Bank.

Customer relationship management of the Investment Banking division plays an important role in monitoring business relationships and opportunities as well as tracking customer communications and product initiatives. For example, existing and potential customers are contacted on a regular basis depending on potential deal flow and business relationship potential. The list of customers is based on previous business relationships of the Investment Banking division. In addition, the key companies of Iceland's 300 largest companies and various prominent institutional and private investors are contacted. The frequency of contacts varies based on the nature of previous business transactions, pending potential activity and the prospect of tapping into emerging opportunities.

Products and Services

The Bank leverages its universal banking service offerings, infrastructure and balance sheet to enable projects that generate diversified income from a broad customer base, including product offerings and services in relation to initial public offerings and equity issues, foreign exchange, M&A, restructurings and refinancings, bonds brokerage and issuance, equity brokerage, derivatives and money markets.

Corporate Finance

The Corporate Finance subdivision provides advisory services in relation to M&A and capital markets transactions. In particular, the M&A advisory services of the Corporate Finance subdivision include advice on acquisitions, takeovers, divestitures, mergers, corporate restructurings, spin-offs and leveraged buyouts. The capital markets advisory services of the Corporate Finance subdivision include advice on initial public offerings and stock exchange listings, follow-on offerings, private placements, block trades, share buybacks, delistings and bond issues.

Capital Markets

The Capital Markets subdivision provides securities brokerage and foreign exchange sales. The Capital Markets subdivision is a market leader in equity brokerage and enjoys a strong position in foreign exchange brokerage and bond issuances. In addition, the Capital Markets subdivision has been a leading player in restoring the equity markets in Iceland. The Capital Markets subdivision also benefits from strong relationships with all major investors in the domestic capital markets. The Capital Markets subdivision focuses on providing its growing customer base with a comprehensive range of capital markets services and

access to expert knowledge. The focus in the medium term is expected to shift towards development of products and services as investors seek more opportunities to invest and distribute risk.

Research

The Research subdivision publishes macro research on the Icelandic economy and its developments and equity research on individual companies and industry sectors. The Research subdivision also publishes regular forecasts and updates on key economic issues and covers companies listed on NASDAQ Iceland. In addition, the Research subdivision holds regular conferences and presentations, at which new research and reports produced by the Research subdivision are presented. These include economic forecasts, analyses of the real estate market and analyses of the finances of various municipalities as well as various other industry sectors.

The Research subdivision provides support to the Capital Markets, Asset Management and Corporate Finance teams by providing their customers with research reports, presentations, opinions, memoranda or data analysis on listed companies and companies planning to go public in the near future. It also provides analysis on specific economic issues and assists with sales meetings with customers. The Research subdivision is independent in its research and analysis. It had 6 analysts as of 31 December 2017.

ASSET MANAGEMENT

Overview

The asset management operations of the Bank had ISK 950,971 million of assets under management as of 30 September 2018. The asset management operations of the Bank are composed of two distinct legal entities, the Asset Management division and the Bank's independent subsidiary Stefmir, a fund management company. The asset management operations offer a full range of investment products and services to customers with varying investment objectives, with a core focus on pension funds, institutional investors, high net worth individuals and digital distribution for retail customers, and are dedicated to establishing long-term relationships with its customers. The strong team and track record as well as good reputation make the asset management operations well-positioned to participate in the local transactions. In addition, the Bank believes that the asset management operations could benefit from leveraging the Bank's broader infrastructure to meet increasing risk management, transparency and regulatory requirements.

The table below sets forth the assets under management of the Asset Management division and Stefmir as of the dates indicated.

	As of 31 December				
	2017	2016	2015	2014	2013
	<i>ISK in millions</i>				
Asset Management division	637,688	646,471	596,809	519,531	481,828
Stefmir	346,965	408,288	399,839	404,069	413,628
Total	984,653	1,054,759	996,648	923,599	895,457

As of 31 December 2017, the asset management operations of the Bank had 52 FTEs, with 34 FTEs at the Asset Management division and 18 FTEs at Stefmir.

Asset Management Division

The Asset Management division has offered asset management to clients, with a full range of financial products and services to pension funds starting in 1994. The Asset Management division also offers private banking services to high net worth individuals, family offices and legal entities. It has a strong relationship with the other divisions of the Bank. In addition to being the main distributor of Stefmir funds, the Asset Management division has partnerships with three major global asset and fund managers.

The Asset Management division comprises the Private Banking subdivision, the Institutional Asset Management subdivision, the Investment Services subdivision and the Pension Funds Administration subdivision. As of 31 December 2017, the Asset Management division had more than 100,000 customers, the majority of which were retail customers in pension and mutual funds. Of assets under management as of 31 December 2017, 86.1 per cent. were assets of institutional investors and the remaining 13.9 per cent. were assets of high net worth individuals and other customers, such as pension fund members, mutual fund members and private banking customers.

Stefnir

Founded in 1996, Stefnir is Iceland's largest fund management company in terms of assets under management (*source: FME*), with ISK346,965 million in assets under management as of 31 December 2017 in more than 40 funds, which were sourced from the Asset Management division as well as from external investors. Its return on equity was 59 per cent. for the year ended 31 December 2017. Stefnir provides fund management services to the Asset Management division and external investors and offers a wide range of products, including products offered by ABMIIF, fixed income, equity, private equity and balanced funds.

As of 31 December 2017, Stefnir had approximately 10,600 customers with investments in mutual funds. Of Stefnir's assets under management as of 31 December 2017, 72.3 per cent. were assets of institutional investors and the remaining 27.7 per cent. were assets of retail and other investors. Stefnir has a very high market penetration with its key customers, providing services to all of the largest domestic pension funds and all major domestic universal insurance companies. Stefnir is an independent subsidiary of the Bank, which is regulated by the FME, and places special emphasis on its independence and corporate governance. Stefnir has obtained financial and market share growth as a result of long-term strategic planning by its board of directors, which was initially implemented in 2009. Stefnir emphasises a healthy revenue mix, with product development and diversification of assets under management resulting in new income sources and higher income yielding products.

Arion Bank Mortgages Institutional Investor Fund (the **ABMIIF**), initially called the Kaupthing Mortgages Institutional Investor Fund, was established by Kaupthing in 2006 as an institutional investment fund. In 2011, the fund changed its name to the Bank Mortgages Institutional Investor Fund and, in 2012, Kaupthing transferred all of its shares in ABMIIF to the Bank with the consent of the covered bondholders. The day-to-day operations of ABMIIF are managed by Stefnir pursuant to ABMIIF's articles of association. The business of ABMIIF is to acquire loans and their related collateral pursuant to the terms of mortgage sale agreements to guarantee the Bank's covered bonds. ABMIIF has not traded since its establishment date, except for those matters incidental to the covered bonds, and will not do so while the covered bonds or any term advance remains outstanding.

Operations and Distribution Capabilities

Each of the Asset Management division and Stefnir generates operating income through interest income and management fees, which are calculated as a percentage of assets under management and vary based on product type and other factors. In addition, Stefnir generates operating income through performance fees, which are based on the performance of its products above a certain benchmark and are reviewed bi-annually in connection with financial reporting. The performance fees are not recognised on the Bank's consolidated statement of comprehensive income until either realised or are considered highly likely to be realised.

Operating income for the Asset Management division and Stefnir was ISK 3,159 million, ISK 4,677 million and ISK 4,345 million for the nine months ended 30 September 2018, for the year ended 31 December 2017 and for the year ended 31 December 2016, respectively.

The assets under management of the Asset Management division and Stefnir decreased from ISK 1,029,267 million as of 30 September 2017 to ISK 950,971 million as of 30 September 2018.

The assets under management of the Asset Management division and Stefnir decreased from ISK 1,054,759 million as of 31 December 2016 to ISK 984,653 million as of 31 December 2017, with assets under management of the Asset Management division decreasing from ISK 646,471 million as of 31 December 2016 to ISK 637,688 million as of 31 December 2017. Assets under management of Stefnir were ISK 408,288 million as of 31 December 2016, decreasing to ISK 346,965 million as of 31 December 2017. The decrease in assets under management from 2016 to 2017 is primarily due to a decrease in the ABMIIF fund managed by Stefnir, as well as decreases in payments from alternative investments in connection with the closure of major investment projects and the loss of one institutional client for which the Asset Management division managed funds, due to the trend by certain pension funds in Iceland to bring asset management functions back in-house.

Customers

The customers of the asset management operations include institutional investors, corporations, high net worth individuals and retail investors. The Private Banking subdivision caters to individual customers with over ISK 15 million in assets under management. The Institutional Asset Management subdivision services pension funds, trade unions, insurance companies, government institutions and other institutional investors. The Pension Funds Administration subdivision offers full services to pension funds. The Investment Services subdivision distributes Stefnir funds, selling to individuals, companies, institutions and institutional investors, as well as offering funds of international fund managers.

Stefnir caters to both retail and professional customers, with the aim of managing its customers' assets in the best interests of such customers. Stefnir's dedication to long-term relationships with, and its focus on providing tailored solutions to, its customers make Stefnir a preferred partner of institutional customers.

Products and Services

The asset management operations offer a comprehensive range of investment products and services. In addition to mutual funds, alternative investment vehicles and pension plan schemes, the asset management operations offer customised asset allocation strategies and managed accounts designed to meet the diverse needs of investors. The asset management operations also offer funds from other leading global fund management companies.

Institutional Asset Management Subdivision

The Institutional Asset Management subdivision has also developed a clear investment process and service philosophy based on the principles of equality and transparency for institutional investors, which they view as a key to maintaining long-term relationships. Initially, investment opportunities are identified and analysed, with worthwhile investment opportunities being subsequently proposed to an investment committee. The investment committee evaluates the proposed opportunities in accordance with the investment policy statements and, if the evaluation is satisfactory, the trade is undertaken. The portfolios are subsequently supervised on a daily basis with periodic risk management assessments. Investment decisions for individual portfolios of institutional investors are made on a daily basis, investment policy statements are reviewed annually and long-term investment goals are reviewed every one to five years.

Pension Funds Administration Subdivision

The Pension Funds Administration subdivision has developed a unique product and services offering for pension funds, with extensive services in branches and service centres, own website and targeted marketing and sales. The Pension Funds Administration subdivision offers pension funds full service operations, including marketing, sales and services in branches and service centres and extensive resources to meet regulatory requirements. The ability to provide special services to pension funds has meant that, with the growth of the Icelandic pension system, the asset management operations have experienced comparable growth in their assets under management since 2009.

In addition, the success of individual funds that are managed by the Institutional Asset Management subdivision has also contributed to the growth of assets under management.

Private Banking Subdivision

The Private Banking subdivision seeks to provide highly personal financial services designed for the needs of individual customers with a special focus on high net worth individuals in Iceland with an account balance in excess of ISK 100 million. The Private Banking subdivision has specialised balanced portfolios and engages in both discretionary and non-discretionary asset management. The Private Banking subdivision relies on a team-based approach to investments and services, working closely with other divisions of the Bank, and has good access to local dealflow due to the size of the Asset Management division.

Each customer of the Private Banking subdivision has his own account manager, who provides personal service and financial advice suited to such customer's needs. The account managers of the Private Banking subdivision are highly experienced with an average of 21 years of experience in the financial markets.

The main emphasis of the Private Banking subdivision is to continue providing excellent services to its customers and achieving prudent investment results in accordance with risk levels.

Investment Services Subdivision

The Investment Services subdivision provides services to institutional and corporate customers. Retail services are provided mainly through digital channels and a call centre. The Investment services subdivision also distributes Stefnir funds as well as offering funds from international fund managers, together with overseeing sales of pension products. The emphasis of the Investment Services subdivision has been on increasing usage of digital channels. Transfer of retail sales and services to digital channels is expected to continue with opportunities to increase corporate customers' use of digital channels. The volume of customers' online sales into mutual funds has increased significantly from 2013 to 2017. Monthly subscriptions in funds have also increased over the same period of time. The pension products and services are primarily sold by the Retail Banking division and a subsidiary of Vörður, but going forward emphasis will be on increasing sales and services through digital channels.

Stefnir

Stefnir manages several funds which fall into the category of Undertakings for Collective Investment in Transferable Securities (UCITS), non-UCITS or institutional investor funds with total assets under management of ISK 347 billion as of 31 December 2017.

Stefnir also manages several private equity and real estate funds. Co-investors in the private equity funds comprise pension funds, insurance companies and other institutional investors, as well as high net worth individuals (based on their business expertise and active role in the proposed investment).

Other Divisions and Subsidiaries

Subsidiaries

The Bank is the parent company of a number of wholly owned and majority owned subsidiaries, the most significant of which are described below.

Valitor

Possible Valitor Disposal

The Bank is currently assessing a range of strategic alternatives with respect to its ownership of Valitor. The Board of Directors is of the opinion that, although a disposal of Valitor could be in the strategic interests of the Bank, the form of any such disposal requires further evaluation and may take the form of a sale of all or a portion of Valitor to a third party. The Board of Directors has resolved to examine the structural options with a view to disposing of Valitor in the medium term. However, no firm decision has been taken at this point in time with respect to a disposal of all or part of Valitor or with respect to the form or timing of any such transaction.

The Board of Directors has considered whether Valitor constituted a core operation of the Bank, in light of the fact that the Bank has focused in recent years on the development of its operations to serve the Icelandic market, while Valitor has expanded further internationally and intends to continue to do so, which will require considerable management and capital investment to undertake. Although the Board of Directors believes that Valitor's growth strategy would have long-term benefits for the Bank, the strategy could take a number of years to realise and may be different from the Bank's strategy of focusing on the Icelandic market.

Overview

Valitor, a wholly owned subsidiary of the Bank, is the largest card payments company in Iceland in terms of revenue (*source: Valitor, Borgun and Kortathjonustan annual reports*), providing both card acquiring and card issuing services in Iceland. Established in 1983, Valitor has a full and well-diversified product range, providing e-commerce and card-present acquiring services to merchants through direct and partner channels and card issuing services and payment processing solutions to domestic and international partners. Valitor has developed proprietary payment software solutions from an early stage, enabling it to employ a differentiation strategy in both card acquiring and card issuing services and to compete successfully in Iceland and internationally.

Valitor had 341 FTEs as of 31 December 2017. Valitor is included in the "Other Divisions and Subsidiaries" reporting segment of the Group.

Vörður

On 30 September 2016, the Bank acquired a 100 per cent. shareholding in Vörður, which is classified as a subsidiary of the Bank from the day of acquisition. Vörður had 85 FTEs as of 31 December 2017.

Vörður provides policies for motor vehicles, home protection, property and life and health products. Vörður is the fourth largest universal insurance company in Iceland based on insurance premiums and, after the merger of its life insurance subsidiary, Vörður líftryggingar hf, with Okkar Life Insurance, Vörður líftryggingar hf became the largest life insurance company in Iceland (*source: FME*).

Prior to the acquisition of Vörður, the Bank operated its insurance business under the name Okkar Life Insurance, which was a wholly owned subsidiary of the Bank, founded in 1966 and acquired by Kaupthing in 2005. For the years ended 31 December 2016 and 2015, the operating income of Okkar Life Insurance was ISK 850 million and ISK 1,012 million, respectively.

Each of Valitor, Vörður and Stefnir are independent entities regulated by, and reporting directly to, the FME. Each of the subsidiaries has its own independent risk management function, with the Bank exercising ownership through strategy and board memberships.

Other Divisions

The Bank has five support divisions:

Finance

The Finance division includes funding and treasury, which together form the Treasury reportable segment, market-making, as well as accounting, analysis and facilities and property management. The accounting unit is responsible for the Bank's financial reporting, both internally and to external stakeholders, including the FME and the Icelandic Central Bank. The analysis unit is responsible for short- and long-term budgeting and for benchmarking the Bank with comparable financial institutions, both local and international. The funding unit is responsible for the Bank's long-term funding, in both the domestic and international markets and relationships with credit rating agencies. The treasury unit is responsible for the Bank's liquidity, currency and interest rate management, the internal pricing of interest rates and currency and liaison with other financial institutions. Market-making is responsible for market making in domestic securities. Facilities and Property Management is responsible for managing and investing in the Bank's premises and is also responsible for managing and selling foreclosure assets. The Finance division had 99 FTEs as of 31 December 2017.

Risk Management

For information on the activities of the Risk Management division, see "*Risk Management*". The Risk Management division had 27 FTEs as of 31 December 2017.

Legal

The Legal division handles collection, appropriated assets and legal representation on behalf of the Bank as well as a range of other legal services for the Bank's other divisions. The Legal division had 43 FTEs as of 31 December 2017.

Information Technology

The IT division is responsible for developing, operating and advising on the Bank's information systems and solutions, including internet banking, websites, its internally developed and third party software and its hardware, such as data centres, telephone systems, ATMs and personal computers. The IT division had 86 FTEs as of 31 December 2017. For additional information on the IT division, see "*Information Technology*".

CEO Office

The CEO office includes human resources, marketing, credit office, communications and the investor relations officer. The CEO office had 61 FTEs as of 31 December 2017.

Human resources offers advice and support when recruiting employees, helps develop leadership skills and nurtures employees' abilities. The team includes the Bank's specialists in lean management.

The marketing department is responsible for brand management, coordinating marketing initiatives, marketing and tactical plans for products and services and market research, such as statistical analysis, focus groups, interviews and surveys. The marketing department is also responsible for developing the Bank's internet banking solutions, websites, online communications and electronic distribution channels.

The credit office oversees the Bank's lending process and loan portfolio and is responsible for the operation of the lending committees and updating the loan rules. The credit office also conducts credit analysis of the Bank's largest borrowers along with other work related to loan documentation and monitoring of loan book quality.

The communications department handles press releases, internal communications across various divisions of the Bank as well as communication with Icelandic stakeholders and media.

The investor relations officer (along with the CEO and CFO) is authorised as a spokesperson to communicate with capital markets participants. Other responsibilities of the investor relations officer are to provide relevant information about the operation of the Bank to the market, including communications required by applicable regulations (e.g. notifications to NASDAQ Iceland and NASDAQ Stockholm and the Luxembourg Stock Exchange's regulated market) and other publications to the market.

Asset Holding Companies

Eignarhaldsfélagid Landey ehf. (Landey)

Landey, a wholly owned subsidiary of the Bank, is a property development company, which manages properties that currently do not generate any revenue but which may do so in the future. Such assets include unfinished housing developments, building lots and the rights attached to them. Landey's objective is to maintain and increase the value of its properties through professional development, design and construction in collaboration with the planning authorities until a satisfactory price can be obtained for such properties. Landey had 2 FTEs as of 31 December 2017.

Eignabjarg

Eignabjarg was a wholly owned subsidiary of the Bank which was liquidated in 2015. Eignabjarg had been responsible for managing and selling shareholdings in companies, which the Bank has acquired through debt restructurings or other enforcement procedures. Its function was to maximise the value of the shareholdings held, to develop a strategy for each asset and to implement good business practices and good corporate governance in the transferred companies.

In 2018, the Bank established a new entity, also called Eignabjarg ehf., in order to hold the assets of United Silicon which the Bank acquired as a result of foreclosing on its collateral.

Asset Portfolio Disposals

The disposals made by the Bank in respect of its asset portfolio have also included the disposals set forth below.

Refresco Disposal

The Bank holds an indirect stake in Refresco Group B.V. (**Refresco**) through partial ownership in two holding companies, Stodir hf. (**Stodir**) and EAB 1 ehf. (**EAB 1**) In March 2015, following an initial public offering, Refresco was listed on the Euronext Amsterdam exchange at a price of €14.5 per share. At that time, the Bank's indirect stake in Refresco through Stodir and EAB 1 was 4.61 per cent. Since then, EAB 1 and Stodir have divested part of their shareholding in Refresco. The Bank currently holds a 2.98 per cent. indirect stake in Refresco. Since its listing, Refresco shares had traded at prices from €12.98 to €16.44 per share, until 12 April 2017, when Refresco rejected an unsolicited non-binding proposal from PAI Partners SAS to acquire all issued shares in the company. Later in the year, on 25 October 2017, Refresco and a consortium of PAI and bcIMC agreed on a recommended cash public offer of €20 per share. All necessary approvals were granted during the first three months of 2018 and Refresco shares were therefore sold before the end of the first quarter of 2018. However, the final payment between shareholders of Stodir and EAB 1 was not completed until the second quarter of 2018. The Bank was not a shareholder in Refresco, directly or indirectly as of 30 September 2018.

Kolufell Disposal

In July 2016, the Bank sold a majority of its shareholding in the subsidiary Kolufell ehf. (**Kolufell**). Kolufell's main asset was investment property. The sale, and the resulting valuation change on the Group's remaining interest in Kolufell, had a positive impact on the Group's other operating income, resulting in the

recognition of a gain in the amount of ISK 493 million for the year ended 31 December 2016. The Bank owned approximately 19.9 per cent. of Kolufell as of 30 September 2018 which is classified within financial instruments on the Group's consolidated statement of financial position.

Visa Europe Disposal

In June 2016, Valitor completed the sale of its shareholding in Visa Europe to Visa Inc., which had a positive impact on the Group's net financial income, resulting in the recognition of a gain in the amount of ISK 5,291 million for the year ended 31 December 2016.

Bakkavor Disposal

The Group, through the subsidiary BG12 slhf., revalued its 46.0 per cent. shareholding in Bakkavor Group Limited (**Bakkavor**), resulting in a change from a valuation according to the equity method (less impairment) to the sales value (less cost of sale) in anticipation of the disposal thereof. This revaluation had a positive impact on share of profit of associates in the Group's statement of comprehensive income, resulting in revised impairment in the amount of ISK 20,845 million for the year ended 31 December 2015 and profit from sale of ISK 733 million for the year ended 31 December 2016 when the disposal was completed, each of which in turn had a corresponding positive impact on the Group's operating income for both periods.

In January 2016, the Bank's subsidiary BG12 slhf. sold its entire shareholding in the subsidiary Bakkavor Group Ltd. The profit from the sale was ISK 498 million and was recognised in the statement of comprehensive income in 2016.

Síminn Disposal

In October 2015, Síminn hf. (**Síminn**), the largest telecommunications company in Iceland, was listed on the Main Market of NASDAQ Iceland. Following Síminn's initial public offering, the Bank sold approximately 22 per cent. of its shareholding in Síminn, which had a positive impact on the Group's net financial income, resulting in the recognition of a gain in the amount of ISK 4,185 million for the year ended 31 December 2015. The Bank was not a shareholder in Síminn as of 30 September 2017.

Reitir Disposal

In April 2015, Reitir fasteignafelag hf. (**Reitir**), the largest provider of commercial property for rent in Iceland, was listed on the Main Market of NASDAQ Iceland. Following Reitir's initial public offering, the Bank sold approximately 17 per cent. of its shareholding in Reitir, which had a positive impact on the Group's other income, resulting in a mark-to-market gain and a gain on disposal of a total amount of ISK 3,664 million for the year ended 31 December 2014 and a recognition of a one-off gain in the amount of ISK 4,224 million for the year ended 31 December 2015. The Bank was not a shareholder in Reitir as of 30 September 2017.

Compliance

According to Icelandic law, a financial institution is required to establish and maintain a permanent and effective compliance function, which operates independently and has the following responsibilities:

- to monitor and, on a regular basis, assess the adequacy and effectiveness of measures and procedures put in place to detect and minimise any risk of failure by the financial institution to comply with its obligations under the Securities Transactions Act as well as the associated risks;
- to monitor and assess the actions taken to address any deficiencies in the financial institution's compliance with its obligations under the Securities Transactions Act; and

- to advise and assist the relevant persons responsible for carrying out investment services and activities to comply with the financial institutions' obligations under applicable Icelandic law.

Furthermore, according to guidelines on internal governance issued by the FME, a financial institution is required to establish a compliance function to manage its compliance risk.

The Bank's compliance officer coordinates the Bank's compliance activities. The Bank's compliance division had 9 FTEs as of 31 December 2017.

The compliance officer works independently and reports directly to the CEO in accordance with the FME requirements. The compliance officer has monthly meetings with the CEO, during which the compliance officer presents a report on activities during the past month and refers certain matters to the CEO. The compliance officer also meets the chief risk officer and the internal auditor on a monthly basis. In addition, the compliance officer reports to the Board Audit Committee on a quarterly basis and to the Board of Directors on an annual basis.

The compliance officer is also responsible for coordinating and monitoring the Bank's compliance with applicable anti-money laundering and terrorist financing laws, regulations and guidelines, including monitoring of compliance with international sanctions, and investigating and reporting suspicious activities to appropriate authorities.

Competition

As Iceland's economy continues to recover and demand for new lending and other banking products and services increases, the Bank expects to face increased competition from the other large Icelandic banks, pension funds and smaller specialised institutions as well as foreign banks seeking to establish operations in Iceland. See "*Risk Factors - Factors that may affect the Bank's ability to fulfil its obligations under Covered Bonds issued under the Programme - The Bank is exposed to competition and expects competition will increase*". The Bank expects to compete on the basis of a number of factors, including transaction execution, its products and services, its ability to innovate, reputation and price. The main competitors of the Bank's divisions and subsidiaries in the provision of its various products and services are set forth below.

Retail Banking Division

The main competitors of the Retail Banking division in the deposits market are Landsbankinn and Íslandsbanki, both of which are government owned. Savings banks have largely disappeared since the financial crisis in 2008, although some smaller savings banks continue to operate in certain regions.

The Retail Banking division's strongest competition is in the mortgage loans market, in which the Retail Banking division's main competitors are Landsbankinn and Íslandsbanki. Pension funds have also become increasingly active in the mortgage loans market and, in 2017, gained market share through aggressive lending rates enabled, in part, by different regulatory requirements applicable to them (in particular, they are not subject to the Bank Levy). While the pension funds remain active in the mortgage loans market, the Bank expects their new lending to decrease as the ratio of mortgage loans in their portfolios has reached very high levels compared to historical averages, the Housing Financing Fund, an independent government institution that grants mortgage loans to individuals, municipalities, companies and organisations to finance housing purchases and construction, remains the largest player in the mortgage loans market for existing mortgage loans, although it has curtailed its origination of new mortgage loans, and its market share is expected to decrease as mortgage loans are refinanced or mortgaged properties are sold.

In addition, there is currently no meaningful foreign bank interest in the Icelandic retail banking market.

Corporate Banking Division

The Corporate Banking division's main competitors in the corporate banking market are Landsbankinn and Íslandsbanki, with a number of other participants active in the corporate banking market, such as pension funds (indirectly through investment in real estate asset-backed securities), public funds (e.g. the Housing Financing Fund), foreign lenders and smaller financial institutions (e.g. Kvika banki hf.). Pension funds, which compete with a cost structure very different from the cost structure of the banks, have also driven competition and increased margin pressure since 2013 as, although they are not direct corporate lenders, they provide funding through investment in real estate asset-backed securities. In addition, foreign banks increasingly consider entering the Icelandic corporate banking market.

Investment Banking Division

The Investment Banking division's main competitors in the investment banking market are Landsbankinn, Íslandsbanki and Kvika, although a few smaller boutiques also participate in the market. The investment banking market is characterised by intense competition on price and on transaction terms, which results in considerable pressure on margins, especially during times when fewer transactions are being concluded. The Bank's market share, measured by value of transactions during the first nine months of 2018 is 24.8 per cent. in equity brokerage and 14.6 per cent. in fixed income brokerage (*source: NASDAQ Iceland*).

Asset Management

The asset management industry sector is highly competitive and has only moderate barriers to entry. Competition in the asset management industry sector is largely based on investment performance, the level of fees, the quality and diversity of products and services, name recognition and reputation, the effectiveness of distribution channels and the ability to develop new investment strategies and products to meet the changing needs of investors. The main competitors of the fund management company Stefnir are Íslandssjódir (Íslandsbanki) and Landsbréf (Landsbankinn) in addition to smaller fund management companies such as GAMMA, Júpiter (Kvika) and ÍV.

The Asset Management division competes with wealth management firms such as VÍB (Íslandsbanki), Landsbankinn, Kvika and ÍV.

Valitor

The market for card and electronic payments is highly competitive and has many players, including dedicated payment processing companies, financial institutions and non-traditional payment processors, such as PayPal. Valitor's main competitor in the Icelandic card and electronic payments market is Borgun, a card issuing and acquiring subsidiary of Íslandsbanki, and also Kortathjonustan or Korti. As Valitor expands outside of Iceland, it also faces increasing competition from global card issuing and acquiring companies, such as Worldpay and Barclaycard (a division of Barclays Bank) which have an established presence in many markets where Valitor seeks to expand, including the United Kingdom, where Elevon, First Data, Wirecard, FIS and Raphaels Bank are also competitors. Valitor is the largest card payments company in Iceland in terms of revenue (*source: Valitor, Borgun and Kortathjonustan annual reports*).

Information Technology

The Bank's IT division is responsible for developing, operating and advising on its IT and Communication systems and solutions, including digital banking, internally developed and third party software, hardware such as data centres, telephones, ATMs and personal computers. The reliability of the IT and communications systems is a key factor in the Bank's activities as a financial enterprise. The IT division had 105 FTEs as of 31 December 2016.

The IT division had 86 FTEs as of 31 December 2017. The IT division consists of Software Development, IT Operations and the Project Office. Support functions focus on information security, quality management, and technical services management.

The Bank's IT infrastructure comprises two data centres in two different locations in Iceland, one owned by the Bank and the other outsourced by the Bank. Approximately 83 per cent. of the servers are virtual with a physical backup placed in a third location. The IT system serves all branches in the Retail Banking division's network.

The IT division maintains relationships with a wide range of blue chip suppliers, including Microsoft, SAP, Swift, Calypso, Reuters and Bloomberg. In addition, the IT division has substantial in-house expertise which allows for the development and integration of software internally.

Digital Banking

A key aspect of the Bank's business is customer satisfaction. The Bank is a leading digital bank in Iceland and believes that further digitalisation is essential to serving its customers in the future. Therefore, the Bank has initiated a strategic digital effort to expand digital access to the Bank's products and services, automate and simplify processes, make informed decisions based on accessible and reliable data and offer clever and creative digital solutions.

The IT division is focusing on digital initiatives in order to continue to put customers' needs at the heart of the business. With multiple ring-fenced, cross-functional teams working on digital projects, the Bank is now at the forefront of technology and innovation.

The Bank's new digital onboarding process completely reimagines the customer's banking experience and signifies the first milestone in the Bank becoming a leader in digital banking. The Bank launched its digital mortgage service early 2017, which has resulted in increased demand, and decreased manual input and repetitive work. Digital credit card services now include new credit cards, credit card bill split, and credit card limit adjustments. Other digital credit products include vehicle financing, consumer loans and overdraft limit adjustments. The latest addition to the Bank's digital service offerings is personal finance management services to help customers manage their finances every month and onboarding for businesses. The objective of the digitalisation initiatives is to increase customer satisfaction, create new sales channels, and reduce costs.

Another initiative is the eID login, which makes digital banking more accessible for customers. The eID login is a national authentication and signature, allowing authentication by internet or mobile phone. In addition, the Bank benefits from an enclosed market, which allows for quick adaptation of new digital initiatives. The Bank's digital initiatives have resulted in a steady increase in the number of customers using digital channels. As of 31 December 2017, 76,368 customers of the Bank were active users of internet banking and 53,717 customers of the Bank were active users of the Arion Bank app (in each case defined as customers active for 90 days and counted on 30 June of each year), as compared to 77,178 of active users of internet banking and 41,044 active users of the Arion Bank app as of 31 December 2016. The number of customers using the Arion Bank app increased by approximately 12,700 customers during the twelve months ended 31 December 2017, and 70 per cent. of customers using internet banking were also using the Arion Bank app.

Regulatory Compliance

The regulatory landscape is expanding significantly in financial services and a number of regulations impacting the financial market are pending in Iceland such as GDPR, the Fourth Money Laundering Directive, MiFID II and the Payment Services Directive 2. The IT division has launched a number of initiatives in order to close regulatory compliance gaps in the Bank's information systems in an efficient manner, and will launch other regulatory initiatives in the near future.

Security

Control of information security is an essential tool to achieve the IT division's objectives. The Bank's Information Security Policy forms the basis of the measures used by the Bank to ensure the security of information, data systems and communication systems. Through the implementation of this policy, the Bank aims to prevent the inappropriate use of information, to safeguard the secure and uninterrupted transfer of electronic data and communications and to integrate a risk management process into the work processes and daily tasks of all employees.

Legal and regulatory requirements relating to IT, particularly the secrecy of information relating to the Bank's customers, must be observed at all times when IT systems are used. The Bank operates two data centres in an active mode to ensure continuous system uptime and to minimise downtime in disaster scenarios.

Legal Proceedings

Litigation and other legal proceedings are a common occurrence in the banking industry due to the nature of the business. Due to the current public sentiment in Iceland, the likelihood of litigation against the Bank has increased. The Bank has formal controls and policies for managing legal claims. Once professional advice has been obtained and the amount of any possible loss has been reasonably estimated, the Bank takes appropriate steps to mitigate any adverse effects which a given claim may have on its financial standing.

Except as described below, there are no governmental, legal or arbitration proceedings (including such proceedings which are pending or threatened of which the Bank is aware) during the 12 months preceding the date of this Prospectus, which may have, or have had, a significant effect on the Bank's and/or the Group's financial position or profitability.

Claims for Damages due to Forced Bankruptcies

In June 2014, the former chairman of the board of directors of BM Valla hf., together with Lindarflot ehf., filed two cases against the Bank claiming damages in the amount of more than ISK 4 billion plus interest. The plaintiffs claim that the Bank caused them, as shareholders of BM Valla hf. and Fasteignafelagid Artun ehf., which had been customers of the Bank, damages by not allowing the companies to be financially restructured and thereby forcing the companies into bankruptcy, resulting in the sale of assets of the companies at values which the plaintiffs contend are lower than they would have been had the Bank permitted the companies to be financially restructured. In September 2018, the District Court of Reykjavík acquitted the Bank. The plaintiffs appealed the judgement to the Court of Appeal. The Bank believes that it will be acquitted of the plaintiffs' claims in both cases and has therefore not recorded any provision in respect of this matter.

Valitor Damages Assessment

In its judgement in case No. 612/2012 from 24 April 2013, the Supreme Court of Iceland ruled that Valitor had not been authorised to rescind an agreement it had entered into with Datacell. In January 2015, Datacell and Sunshine Press Productions brought legal action against Valitor for compensatory damages amounting to approximately ISK 8.1 billion relating to Valitor's termination of Datacell's vendor agreement. Court-appointed evaluators were subsequently asked to assess the damage in question at the request of the plaintiffs. The court-appointed evaluators announced their conclusions in March 2016. Valitor disagreed with the assessment stated in the report and filed a motion to appoint three court evaluators to re-evaluate the plaintiffs' alleged losses. The District Court of Reykjavík granted this motion. The reassessment has been completed, but it will not be filed with the District Court. Recently Datacell and Sunshine Press Production claimed a freezing of Valitor's assets on the basis of the aforementioned claim of compensatory damages but the district magistrate declined the claim. Datacell and Sunshine Press Productions submitted that decision to the District Court, which upheld the district magistrate's decision. Sunshine Press Production has appealed the ruling to the Court of Appeal.

The Group has not recorded any provision in this case.

When the Bank acquired a 39.22 per cent. holding in Valitor between 2014 and 2015, the Bank signed agreements with the sellers (Landsbankinn and two Icelandic savings banks) regarding potential losses of Valitor in relation to these compensatory damages. Therefore, the Group believes that it will have the basis for a claim against the sellers for their share in the potential loss should Valitor be required by the District Court to pay damages in this case.

Disputes relating to United Silicon

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

Possible Criminal Complaint and Related Correspondence

In 2017 and 2018, the Bank received a series of correspondence from a former customer of the Bank's predecessor Kaupthing. The correspondence alleged that the Bank had not conducted sufficient internal due diligence to ensure that its management and directors are fit and proper to carry on the operations of a financial institution, on the basis that certain individuals who are employed by the Bank were employed by its predecessor Kaupthing or the other Icelandic banks at the time of the financial crisis in 2008.

The Bank received further correspondence from this individual, which stated that he had filed a criminal complaint with the prosecutor in Iceland concerning Kaupthing's alleged wrongful appropriation of assets during the "winding up" process of Kaupthing. The individual alleges that the complaint involves both the Bank and certain of its employees. To date, there has been no indication from authorities in Iceland that any criminal proceedings will be brought against Kaupthing, the Bank or any of its employees in connection with this allegation.

Included in the correspondence described above was information which the individual claimed supports his allegations against the Bank and those employees named in the correspondence. The Bank has considered the allegations in this correspondence, along with the related materials, and has conducted its own review of these allegations and related materials, including with support of external counsel, and it remains of the view that the allegations are without merit and that those employees named in the correspondence are indeed fit and proper.

Claim for Alleged Violations of the Competition Act

With a writ issued in June 2013, Kortathjonustan claimed damages in the amount of up to ISK 1.2 billion plus interest in aggregate from the Bank, Íslandsbanki, Landsbankinn, Borgun hf. and Valitor as a result of losses that Kortathjonustan contends the five parties caused it due to violations of the Competition Act. The Bank has put forward its arguments in the case and has requested the rejection of Kortathjonustan's claims. Kortathjonustan's court-appointed evaluator has submitted its report relating to the market shares in the card payments services market and Kortathjonustan's alleged loss in June 2016. The Bank has contested the findings of the court-appointed evaluator set forth in the report and in September 2016 requested the court to appoint new evaluators to re-evaluate. The preparation of such report by the new court-appointed evaluators would be expected to take approximately 12 months after the appointment of such evaluators. However, before the appointment of evaluators, procedural issues were addressed by the court, which led to the case being dismissed. Because of the dismissal, a new report was not prepared. The case was dismissed on procedural grounds rather than the merits by the District Court of Reykjavík by ruling of 29 March 2017.

The ruling was confirmed by the Supreme Court on 2 June 2017, citing in particular that the plaintiff had not met with requirements related to standing. Kortafjónustan hf. issued a new writ in September 2017 regarding the same matter of dispute, this time claiming damages in the amount of ISK 922 million plus interest from the same defendants. The case was again dismissed on procedural grounds by the District Court of Reykjavík by a ruling in March 2018, which was confirmed by the Court of Appeal in May 2018. Kortathjonustan appealed the Court of Appeal's ruling to the Supreme Court, which upheld the Court of Appeal's ruling. A new party which took over Kortathjonustan's claim issued a new writ in the case in November 2018 claiming acknowledgement of the duty of the five defendants in the first court case to pay damages. The Bank is evaluating the new writ. The Bank has not recorded any provision in respect of this matter.

Resolved Legal Matters

Penalty Interest During Extension of Payments

In March 2018, the Supreme Court of Iceland issued a judgment in case no. 159/2017, which concluded that the Bank was not permitted to calculate penalty interest on customers' debts during the period in which the customer was granted an extension of payments under the law on debt mitigation. The Bank has examined how many customers have paid penalty interest on their debts to the Bank during such extension period and recalculated the interest payments of the relevant customers.

Dispute on Legacy Mortgage Loans Collateral

The Bank has been involved in several court proceedings where the Bank's claim as mortgagee to 100% of the value of a property pledged as collateral in a mortgage loan is under dispute, in circumstances where allegedly only one of the two owners has signed a document granting the property as collateral. In 2017 the Supreme Court, in respect of cases which did not involve the Bank, ruled in several cases regarding this issue. In the majority of those cases the Supreme Court found in favour of the mortgagor, holding that the bank in question was entitled to enforce with respect to only 50 per cent. of the value of the property. The district court has ruled in several court cases involving the Bank regarding the aforementioned dispute. In the majority of those cases the district court invalidated 50 per cent. of the collateral, and the Bank is awaiting further rulings to assess the borderline cases. In judicial decisions to date, invalidation of 50 per cent. of the collateral for a given pledge has not affected the remaining 50 per cent. of the collateral or the borrowers' obligation to repay the debt in full.

FME Sanctions

In January 2016, the FME published an announcement in relation to the Bank's sale of the shares in Síminn in October 2015, in which the FME concluded that the Bank had not taken reputational risk properly into account when selling the shares in Síminn to certain customers of the Bank. As a consequence, the FME concluded that, as a result of the sale, the Bank was in breach of the good business practices requirements of the Financial Undertakings Act. The Bank was not subject to any administrative fines in respect of these findings on the basis that the Bank had suffered reputational loss as a consequence of the transaction.

In November 2015, the FME concluded that the Bank had breached the insider trading provisions of the Securities Transactions Act when the Bank sold its interest in Hagar hf. The FME found that the Bank had been in possession of insider information at the time of the transaction and that the Bank had not proved that its counterparties had been in possession of the same information, as the Bank had claimed. As a consequence, the Bank received an administrative fine in the amount of ISK 30.0 million, which it paid in 2015.

In September 2015, following an inspection of certain loans made by the Bank, the FME published an announcement in which the FME concluded that the Bank had not followed its own internal rules, specifically in respect of the decision of a credit committee, or provisions of the loan agreements when it annulled and deregistered certain collateral, in breach of the good business practices requirements of the

Financial Undertakings Act. The Bank was not subject to any administrative fines in respect of these findings.

European Surveillance Authority State Aid Investigation

In May 2015, the European Free Trade Association (EFTA) Surveillance Authority (ESA) began an investigation into potentially unlawful state aid granted to Íslandsbanki and the Bank through allegedly preferential terms provided by the Icelandic Central Bank to Íslandsbanki and the Bank on two separate loan conversion agreements for the rescheduling of short-term collateral and securities loans from the Icelandic Central Bank to long-term loans.

ESA investigated whether these loan conversion agreements, which were concluded between the Icelandic Central Bank and Íslandsbanki and the Icelandic Central Bank and the Bank in September 2009 and November 2009, respectively, could be regarded as unlawful state aid within the meaning of the EEA rules.

In November 2016, ESA concluded that the terms agreed by the Icelandic Central Bank were in line with commercial conditions at the time the agreements were entered into and the Icelandic Central Bank acted in line with the conduct of a private creditor and, consequently, the loan agreements did not constitute state aid within the meaning of the EEA rules.

ICA Investigation into Mortgage Loans Arrangements

The Bank, Íslandsbanki and Landsbankinn had been under investigation by the ICA in relation to alleged abuse of their collective dominant position relating to mortgage loan arrangements, on the basis of separate complaints from BYR hf. and MP Banki hf. made in 2010. The Bank has concluded a settlement with the ICA which has the objective of stimulating competition in retail banking services for individuals and small businesses. The Bank has undertaken actions that have the objective of reducing switching costs in financial services, promoting active competition among banks toward individuals and small businesses and negating circumstances that could enforce tacit co-ordination in the market for retail banking services. With the settlement the ICA has closed its investigation with respect to the Bank.

RELATED PARTY TRANSACTIONS

The Bank has a related party relationship with Kaupskil, the board of directors of Kaupskil, Kaupthing, the Group's associates, the Board of Directors of the Bank, the key management personnel of the Bank and close family members of the directors and key management personnel. In addition, Taconic Capital Advisors UK LLP, through TCA New Sidecar III s.à r.l., and Sculptor Investments s.à r.l., an affiliated entity of Och-Ziff Capital Management Group, by virtue of their shareholdings in the Bank (which shareholdings are managed by Kaupskil), are defined as related parties. In addition, Trinity Investments Designated Activity Company (an investment entity managed by Attestor Capital LLP), and Goldman Sachs International, through ELQ Investors II Limited, each manage their own respective shareholdings in the Bank and are defined as related parties.

Transactions with all related parties have been conducted on an arm's length basis and are in the normal course of business. There have been no guarantees provided or received for related party receivables or payables during the aforementioned period

See note 39 to the Interim Financial Statements for the first nine months of the year 2018, note 39 to the Financial Statements 2017 and note 39 to the Financial Statements 2016 for further information in relation to the Bank's related party transactions.

RECENT DEVELOPMENTS

On 31 May 2018, the Bank completed an initial public offering of its shares. Upon completion of this initial public offering and the subsequent listing of the Bank's shares in Iceland and Sweden in June 2018, the Bank has expanded its shareholder base. As a result, Kaupthing, through its subsidiary Kaupskil remains the largest shareholder in the Bank (with a 32.67 per cent stake) together with Taconic Capital Advisors (with a 10.00 per cent. stake), Attestor Capital (with a 9.14 per cent. stake) and Och-Ziff Capital Management (with a 6.58 per cent. stake). The National Treasury of Iceland no longer holds a stake in the Bank.

In October 2018 Primera Air, a client of the Bank, filed for bankruptcy. Arion Bank had to make impairment and pay out guarantees which negatively affected the financial results of the Bank by ISK 1.8 billion in the third quarter of 2018.

KEY FINANCIAL INDICATORS

The following table includes certain of the Bank's key financial indicators for the nine month period ended 30 September 2018 and for the years ended 31 December 2017 and 31 December 2016. This information should not be considered in isolation from, or as a substitute for, financial information presented in the Q3 2018 Interim Financial Statements or the 2017 Year End Financial Statements (each of which is incorporated by reference into this Base Prospectus) and should be read in conjunction with the Q3 2018 Interim Financial Statements and the 2017 Year End Financial Statements, as applicable.

	As of and for the nine month period ended	As of and for the twelve month period ended	
	30 September 2018 %	31 December 2017 %	31 December 2016 %
Profitability			
Return on equity ³	3.9	6.6	10.5
Return on assets ⁴	0.7	1.3	2.1
Return on risk weighted assets ⁵	1.0	1.9	2.9
Net interest margin			
Net interest margin on interest bearing assets ⁶	2.7	2.9	3.1
Net interest margin on total assets ⁷	2.5	2.7	2.9
Efficiency			
Cost-to-income ratio ⁸	63.5	56.1	57.2
Cost-to-total assets ratio ⁹	2.9	2.7	3.0

³ Return on equity is net earnings for the period as a percentage of average total equity (calculated as the average of the opening, quarter-end and closing balances for the applicable period). Return on equity is used as an alternative measure of performance of the Bank based on returns generated relative to equity and is a measure of the profits generated by the Bank from the equity of its shareholders. The higher this figure, the greater the profits of shareholders relative to their equity for the relevant period.

⁴ Return on assets is net earnings for the period as a percentage of average total assets (calculated as the average of the opening, quarter-end and closing balances for the applicable period). Return on assets is used as an alternative measure of performance of the Bank based on returns generated relative to total assets and is a measure of the profits generated by the Bank from its assets. The higher this figure, the greater the profits from the Bank's assets for the relevant period.

⁵ Return on risk weighted assets is net earnings for the period as a percentage of average risk weighted assets (calculated as the average of the opening, quarter-end and closing balances for the applicable period). For the calculation of risk weighted assets see [Note 43 of the Q3 2018 Interim Financial Statements](#), Note 43 of the 2017 Year End Financial Statements and Note 44 of the 2016 Year End Financial Statements. Return on risk weighted assets is used as an alternative measure of performance of the Bank based on returns generated relative to risk weighted assets and is a measure of the profits generated by the Bank from its risk weighted assets (which is a prudential measure by which the assets of the Bank are adjusted to give different weight to certain risk based considerations as a means to assess those assets relative to such risks). The higher this figure, the greater the profits from the Bank's risk weighted assets for the relevant period, which can then be compared to return on assets above to assess the risk based return of the Bank relative to the total asset return.

⁶ Net interest margin on interest bearing assets is interest income on interest bearing assets less interest expense (i.e. net interest income) as a percentage of average interest bearing assets (calculated as the average of the opening, quarter-end and closing balances for the applicable period). Net interest income was **ISK 21,966 million** for the nine month period ended 30 September 2018, ISK 29,835 and ISK 29,900 million for the twelve month periods ended 31 December 2017 and 2016, respectively. "Interest bearing assets" means the sum of cash and balances with Central Bank, loans to credit institutions, loans to customers and interest bearing financial instruments (which is made up of bonds and debt instruments (ISK 64,256 million as at 30 September 2018, ISK 51,755 million as at 31 December 2017 and ISK 69,565 million as at 31 December 2016), derivatives (ISK 6,353 million as at 30 September 2018, ISK 7,624 million as at 31 December 2017 and ISK 5,159 million as at 31 December 2016) and listed bonds and debt instruments (ISK 9,247 million as at 30 September 2018, ISK 6,024 million as at 31 December 2017 and ISK 7,318 million as at 31 December 2016). See Note 22 of the Q3 2018 Interim Financial Statements, Note 22 of the 2017 Year End Financial Statements and Note 22 of the 2016 Year End Financial Statements). Net interest margin on interest bearing assets is used as an alternative measure of performance of the Bank based on the Bank's net interest margin relative to its interest bearing assets and is a measure of the difference in the interest income generated by the Bank's interest bearing assets and its interest expense by reference to the average interest bearing assets for the relevant period. The higher this figure, the greater the returns from the Bank's interest bearing assets for that period.

⁷ Net interest margin on total assets is net interest income as a percentage of average total assets (calculated as the average of the opening, quarter-end and closing balances for the applicable period). Net interest margin on total assets is used as an alternative measure of performance of the Bank based on the Bank's net interest margin relative to its total assets and is a measure of the difference in the interest income generated by the Bank's total assets and its interest expense by reference to the average total assets for the relevant period. The higher this figure, the greater the returns from the Bank's total assets for that period.

⁸ With respect to cost-to-income ratio, "cost" means salaries and related expense and other operating expense. "Income" means operating income. Cost-to-income ratio is used as an alternative measure of performance of the Bank based on the costs of the Bank relative to income generated and is a measure of the Bank's costs as compared with its income. The lower this figure, the lower the Bank's costs relative to its income. Excluding Valitor, the Bank's cost-to-income ratio for the year ended 31 December 2016 would have been 55.8%.

⁹ With respect to cost-to-total assets ratio, "cost" means salaries and related expense and other operating expense. "Total assets" means total assets of the Bank as set out in the financial statements of the Bank (calculated as the average of the opening, quarter-end and closing

balances for the applicable period). Cost-to-total assets ratio is used as an alternative measure of performance of the Bank based on the costs of the Bank relative to its total assets and is a measure of the Bank's costs as compared with its total assets. The lower this figure, the lower the Bank's costs relative to its total assets.

LOAN PORTFOLIO

The table below sets out details of the Bank's loans to customers as at 30 September 2018, 31 December 2017 and 31 December 2016 classified by type of loan.

	As at 30 September 2018					
	Individuals		Corporates		Total	
	Gross carrying amount	Book value	Gross Carrying amount	Book Value	Gross Carrying amount	Book value
Overdrafts.....	15,783	14,727	18,101	17,099	33,884	31,826
Credit cards	11,585	11,354	1,270	1,237	12,855	12,591
Loans to customers at fair value.....	-	-	6,344	6,344	6,344	6,344
Mortgage loans.....	338,059	337,401	22,598	22,559	360,657	359,960
Other loans	36,351	34,179	381,955	375,065	418,306	409,244
Loans and receivables to customers.....	401,778	397,661	430,268	422,304	832,046	819,965

	As at 31 December 2017					
	Individuals		Corporates		Total	
	Gross carrying amount	Book value	Gross Carrying amount	Book Value	Gross Carrying amount	Book value
Overdrafts.....	14,469	13,438	18,778	17,504	33,247	30,942
Credit cards	11,133	10,931	1,123	1,109	12,256	12,040
Mortgage loans.....	311,507	310,318	19,632	19,417	331,139	329,735
Other loans	33,629	30,600	368,312	361,784	401,941	392,384
Loans and receivables to customers.....	370,738	365,287	407,845	399,814	778,583	765,101

	As at 31 December 2016					
	Individuals		Corporates		Total	
	Gross carrying amount	Book value	Gross Carrying amount	Book Value	Gross Carrying amount	Book value

Overdrafts.....	14,805	13,381	19,314	17,630	34,119	31,011
Credit cards	11,363	11,099	1,180	1,151	12,543	12,250
Mortgage loans	285,784	282,996	16,298	15,975	302,082	298,971
Other loans	34,777	29,940	351,739	340,250	386,516	370,190
Loans and receivables to customers.....	346,729	337,416	388,531	375,006	735,260	712,422

The table below sets out details of the book value of the Bank's loans and receivables to customers as at 30 September 2018, 31 December 2017 and 31 December 2016 classified by customer sector.

	<u>30 September 2018</u>	<u>31 December 2017</u>	<u>31 December 2016</u>
Individuals.....	48.8%	47.7%	47.4%
Real estate activities and construction	16.6%	16.7%	16.1%
Fishing industry	10.1%	10.3%	10.7%
Information and communication technology	2.8%	3.0%	4.1%
Wholesale and retail trade	8%	7.5%	7.4%
Financial and insurance activities.....	3.7%	4.5%	4.9%
Industry, energy and manufacturing	4.0%	3.8%	4.0%
Transportation	2.1%	2.2%	0.9%
Services	2.1%	2.4%	2.4%
Public sector	0.7%	1.0%	1.2%
Agriculture and forestry	0.9%	0.9%	0.9%
Total	100%	100%	100.0%

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 30 September 2018, 31 December 2017 and 31 December 2016 classified by type of loan.

	<u>30 September 2018</u>	<u>31 December 2017</u>	<u>31 December 2016</u>
	<i>(ISK million)</i>		
Bank accounts.....	62,817	51,303	45,631
Money market loans	57,113	32,309	32,267
Other loans.....	3,516	2,997	2,218
Loans and receivables to credit institutions	123,446	86,609	80,116

The table below shows the credit quality of the Bank's financial assets, including its net loans and receivables, as at 30 September 2018, 31 December 2017 and 31 December 2016.

As at 30 September 2018

	Neither past due nor impaired	Past due but not impaired	Individually impaired	Total
	<i>(ISK million)</i>			
Cash and balances with Central Bank	139,819	-	-	139,819
Loans to credit institutions	86,609	-	-	86,609
Loans to customers				
Loans to corporates	385,197	13,655	962	399,814
Loans to individuals	344,829	18,929	1,529	365,287
Financial instruments	78,784	-	-	78,784
Other assets with credit risk	8,948	-	-	8,948
Credit quality of loans	1,044,186	32,584	2,491	1,079,261

As at 31 December 2017

	Neither past due nor impaired	Past due but not impaired⁽¹⁾	Individually impaired⁽²⁾	Total
	<i>(ISK million)</i>			
Cash and balances with Central Bank	139,819	-	-	139,819
Loans to credit institutions	86,609	-	-	86,609
Loans to customers				
Loans to corporates	385,197	13,655	962	399,814
Loans to individuals	344,829	18,929	1,529	365,287
Financial instruments	78,784	-	-	78,784
Other assets with credit risk	8,948	-	-	8,948
Credit quality by class of financial assets	1,044,186	32,584	2,491	1,079,261

(1) "Past due but not impaired" includes loans to customers which the Bank has reviewed but for which it has determined that it was not necessary to record a provision.

(2) Represents book value of individually impaired loans to customers after provision for impairment was recorded.

As at 31 December 2016

	Neither past due nor impaired	Past due but not impaired	Individually impaired	Total
	<i>(ISK million)</i>			
Cash and balances with Central Bank	87,634	-	-	87,634
Loans to credit institutions	80,116	-	-	80,116
Loans to customers				
Loans to corporates	358,709	14,251	2,046	375,006
Loans to individuals	312,259	21,854	3,303	337,416
Financial instruments	82,042	-	-	82,042
Other assets with credit risk	8,617	-	-	8,617
Credit quality of loans	929,377	36,105	5,349	970,831

The table below shows the ageing of the Bank's past due but not impaired loans and receivables by class as at 30 September 2018, 31 December 2017 and 31 December 2016.

30 September 2018	Up to 3 days	4 to 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
	<i>(ISK million)</i>					
Loans to corporates.....	4,361	4,221	1,774	1,339	1,960	13,655
Loans to individuals.....	3,065	8,149	4,387	350	2,978	18,929
Past due but not impaired loans.....	7,426	12,370	6,161	1,689	4,938	32,584
	<i>(ISK million)</i>					
31 December 2017	Up to 3 days	4 to 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
Loans to corporates.....	4,361	4,221	1,774	1,339	1,960	13,655
Loans to individuals.....	3,065	8,149	4,387	350	2,978	18,929
Past due but not impaired loans.....	7,426	12,370	6,161	1,689	4,938	32,584

31 December 2016	Up to 3 days	4 to 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
	<i>(ISK million)</i>					
Loans to corporates.....	5,388	4,282	1,589	1,211	1,781	14,251
Loans to individuals.....	3,196	8,708	4,989	391	4,570	21,854
Past due but not impaired loans.....	8,584	12,990	6,578	1,602	6,351	36,105

The table below sets out details of the Bank's impaired loans and receivables to customers as at 30 September 2018, 31 December 2017 and 31 December 2016 classified by customer sector.

As at 30 September 2018		
	Impairment amount	
	Gross carrying amount	
Individuals	4,010	5,539
Real estate activities and construction	467	762
Fishing industry	658	861
Information and communication technology	111	112
Wholesale and retail trade	490	702
Financial and insurance activities	297	314
Industry, energy and manufacturing	473	581
Transportation	1	1
Services	3,570	3,617
Public sector	45	45
Agriculture and forestry	165	244
Total	10,287	12,778

As at 31 December				
	2017	2016		
	Impairment amount	Gross carrying amount		
	amount	amount	Impairment amount	
	amount	amount	Gross carrying amount	
	<i>(ISK million)</i>			
Individuals	4,010	5,539	7,069	10,372
Real estate activities and construction	467	762	770	1,056
Fishing industry	658	861	966	1,648
Information and communication technology	111	112	179	182
Wholesale and retail trade	490	702	540	868
Financial and insurance activities	297	314	261	298
Industry, energy and manufacturing	473	581	786	878
Transportation	1	1	4,301	4,307
Services	3,570	3,617	3,145	3,624

	As at 31 December			
	2017		2016	
	Impair- ment amount	Gross carrying amount	Impair- ment amount	Gross carrying amount
	<i>(ISK million)</i>			
Public sector	45	45	89	113
Agriculture and forestry	165	244	175	284
Total	10,287	12,778	18,281	23,630

As at 31 December 2017, 8.8 per cent. of the book value of problem loans (defined as loans more than 90 days past due but not impaired and other problem (i.e. individually impaired) loans) was attributable to five customers and 15.5 per cent. to 10 customers.

FUNDING AND LIQUIDITY

Funding

The Bank is partially funded with domestic deposits. Its total deposit base at 30 September 2018 was ISK 484,569 million, or 47.5 per cent. of its total liabilities. In addition to deposits, the Bank's other funding comprises Covered Bonds issued under this Programme and its Euro Medium Term Note Programme, bills issued and other loans and equity.

The Bank issues bonds internationally under its EMTN Programme and covered bonds under its Covered Bond Programme. In recent years, the Bank has issued public bonds denominated in Euros, Swedish krona and Norwegian krone and covered bonds denominated in Icelandic krona.

The Bank is focused on maintaining a large and stable deposit base originated from its clients. Deposits are expected to continue to form the core of the Bank's funding in the future. However, there are external factors that might affect the Bank's deposit base in the short to medium term, such as the increased availability of other investment opportunities for investors who currently hold deposits with the Bank. The Bank intends to continue diversifying its funding profile by issuing bonds in the domestic and international bond market when conditions permit.

Liquidity

On 1 December 2013 new liquidity rules issued by the Icelandic Central Bank took effect, overriding the rules on liquidity and cash ratios that have previously been reported by the Group. The new rules are based on the liquidity standards introduced in the Basel III Accord which began to be implemented in 2015 on a global level. The standard defines the LCR, which is the balance between highly liquid assets and the expected net cash outflow of the Group in the next 30 days under stressed conditions.

The criteria for liquid assets used to meet unexpected outflow is stricter under these new liquidity measures. The assets must be non-pledged, liquid and easily priced on the market, repo-able at the Icelandic Central Bank and not issued by the Group or its related entities.

The Icelandic Central Bank has set a guideline for the minimum LCR. The requirement for foreign currency is 100 per cent. effective from 1 January 2017.

The LCR as at 30 September 2018 and 31 December 2017 is shown below:

	As at	
	30 September 2018	31 December 2017
Liquidity coverage ratio		
FX.....	295%	323%
Total	169%	221%

As per the LCR methodology, the Bank's deposit base is split into different categories depending on customer type. A second categorisation is used where term deposits refer to deposits with a residual maturity greater than 30 days. Deposits that can be withdrawn within 30 days are marked stable if the customer has a business relationship with the Bank and the amount is covered by the Deposit Insurance Scheme. Other deposit funds are considered less stable. A weight is attributed to each category, representing the expected outflow under stressed conditions.

The table below shows the breakdown of the Group's deposit base according to the LCR categorisation, with the associated expected stressed outflow weights as at 30 September 2018 and 31 December 2017. Some

similar categories are grouped together. The table contains deposits at the Bank and at banking subsidiaries. Thus, amounts due to Central Bank and amounts due to credit institutions at non-banking subsidiaries are excluded.

As at 30 September 2018						
Deposits maturing within 30 days						
	Less stable	Weight (%)	Stable	Weight (%)	Term deposits*	Total deposits
<i>(ISK million)</i>						
Retail	173,928	11%	50,302	5%	74,371	298,601
Corporations	52,963	40%	851	20%	7,060	60,874
Sovereigns, central-banks and PSE	17,784	40%	-	-	5,546	23,330
Pension funds	52,214	100%	-	-	12,318	64,532
Domestic financial entities	32,366	100%	-	-	15,634	48,000
Foreign financial entities	4,602	100%	-	-	-	4,602
Total	333,857		51,153		114,929	499,939

As at 31 December 2017						
Deposits maturing within 30 days						
	Less stable	Weight (%)	Stable	Weight (%)*	Term deposits* *	Total deposits
<i>(ISK million)</i>						
Retail	163,542	11%	52,401	5%	68,741	284,684
Corporations	51,968	40%	811	20%	5,757	58,536
Sovereigns, central-banks and PSE	14,583	40%	—	—	1,383	15,966
Pension funds	53,116	100%	—	—	15,391	68,507
Domestic financial entities	23,175	100%	—	—	15,949	39,124
Foreign financial entities	2,714	100%	—	—	—	2,714
Total	309,098		53,212		107,221	469,531

*“Weight” represents the proportion of deposits the Group considers to be expected to become unavailable to the Group under stressed conditions.

**“Deposits” in this context refer to deposits with maturities greater than 30 days

RISK MANAGEMENT

Overview

The Bank seeks to manage its risks through a process of ongoing risk identification, measurement and monitoring, using limits and other controls. This process of risk management and the ability to evaluate, manage and price the risks encountered is critical to the Bank's continuing profitability and its ability to ensure that the Bank's exposure to risk remains within acceptable levels.

The Board of Directors is ultimately responsible for the Bank's risk management framework and ensuring that satisfactory risk policies and governance for controlling the Bank's risk exposure are in place. The Board of Directors defines the overall risk appetite of the Bank which is translated into exposure limits and targets that are monitored by the Risk Management division, which reports its findings regularly to the CEO and the Board of Directors. Risk is measured, monitored and reported according to internal policies, principles and processes that are reviewed and approved by the Board of Directors at least annually. The Board of Directors is also responsible for the internal capital adequacy assessment process (the **ICAAP**) and internal liquidity adequacy assessment process (**ILAAP**). The Board of Directors has determined that management of risks encountered within subsidiaries should principally be carried out within each subsidiary.

The CEO is responsible for enforcement of the risk management policies established by the Board of Directors, sustaining an effective risk management framework, processes and controls as well as maintaining a high level of risk awareness among the Bank's employees.

The Bank operates the following committees to manage risk:

- *Board Risk Committee*, which is responsible for supervising the Bank's risk management framework, risk appetite and ICAAP/ILAAP. The Board Risk Committee regularly reviews reports on the Bank's risk exposures. The Board Risk Committee meets as often as required but at least five times annually.
- *Asset and Liability Committee* (the **ALCO**), which is responsible for managing any asset and liability mismatches, liquidity risk, market risk, interest rate risk and capital management. The ALCO meets as often as required but at least eight times annually.
- *Underwriting and Investment Committee* (the **UIC**), which decides on underwriting and principal investments. The UIC meets as often as required but at least quarterly.
- *Data Committee* (the **DC**), which is responsible for ensuring that data is managed properly. The DC meets ten times annually.
- *Security Committee* (the **SC**), which is responsible for security matters, both information security and physical security. The SC meets as often as required but at least quarterly.
- The Bank has four levels of *credit committees*:
 - the Board Credit Committee (the **BCC**), which decides on all major credit risk exposures (new exposures greater than 5 per cent. of the Bank's own funds and other major credit decisions that may materially increase the Bank's credit risk);
 - the Arion Credit Committee (the **ACC**), which operates within limits specified as a fraction of the Bank's capital (new exposures less than 5 per cent. of the Bank's own funds and other credit decisions if the exposure to a group of financially related parties is less than 10 per cent. of the Bank's own funds);
 - the Corporate Credit Committee (the **CCC**), which operates within tighter credit approval limits (new exposures less than or equal to ISK 750 million, refinancings up to ISK 1,000

million and other credit decisions if the total exposure to a group of financially related parties is less than 5 per cent. of the Bank's own funds); and

- the Retail Branch Credit Committee (the **RBC**), which also operates within tighter credit approval limits (new exposures less than or equal to ISK 100 million and other credit decisions if the total exposure to a group of financially related parties is less than ISK 500 million).

The BCC meets as often as required and each of the other three credit committees has scheduled meetings at least twice a week.

In addition, the Bank operates five Collateral Valuation Committees, which set guidelines on collateral assessment and valuation, and two Debt Cancellation Committees, which deal with applications to reach composition with debtors.

The Bank's internal audit division conducts independent reviews of the Bank's operations, risk management framework, processes, policies and measurements. Internal audits examine both the adequacy and completeness of the Bank's control environment and processes as well as the Bank's compliance with its procedures, internal rules and external regulations. Results of internal audits are discussed with the Bank's management and reported to the Board Risk Committee.

The Risk Management division is headed by the Chief Risk Officer. It is independent and centralised and reports directly to the CEO. The division is divided into four subdivisions: (i) Credit Control, which monitors weak and impaired credit exposures on a customer-by-customer basis and the loan portfolio credit risk; (ii) Balance Sheet Risk, which oversees all risks related to asset and liability mismatches, including capital, and is responsible for the Bank's ICAAP/ILAAP; and (iii) Operational Risk, which is a part of the Bank's second line of defence and monitors risks associated with the daily operations of the Bank. The Bank's Data Officer is part of the Risk Management Division.

The Bank's Data Officer is part of the CEO's office.

The Bank is exposed to four major areas of risk: credit risk, market risk, liquidity risk and operational risk. In addition, the Bank manages its capital position with the focus on optimising the capital structure in the medium term and maintaining the Group's capitalisation comfortably above the regulatory minimum, including capital buffer and the supervisory review and evaluation process (**SREP**) requirements.

Credit Risk

Credit risk is managed and controlled by setting limits on the amount of risk the Bank is willing to accept for individual counterparties and groups of connected customers and by monitoring exposures in relation to such limits. The main sources of credit risk are from the customer loan portfolio, commitments and guarantees, counterparty credit risk and equity risk in the banking book, which arises primarily from investment in positions that are not made for short-term trading purposes and assets repossessed as a result of credit recovery, *i.e.*, restructuring or collection.

The Bank's credit policy forms the basis for its credit strategy as integrated in the business plan, risk appetite towards credit exposure, credit rules and its credit procedures and controls. It contains high level criteria for the granting of credit and also outlines roles and responsibilities for further implementation and compliance. The emphasis of the credit policy is on keeping a high quality credit portfolio by maintaining a strict credit process and seeking business with financially strong parties with strong collateral and good repayment capacity. The risk level of each credit is considered in the pricing decision.

The Bank's main asset is its customer loan portfolio. Therefore, managing and analysing the customer loan portfolio is of utmost importance. Credit risk management entails diversification of risk, well-informed lending decisions, good oversight of the portfolio performance and a clear identification of any sign of weaknesses to conduct a timely recovery.

The Bank seeks to limit its total credit risk through diversification of the loan portfolio across industry sectors and by limiting large exposures to groups of connected customers. For additional information on the Bank's maximum exposure to credit risk by type of financial instrument and industry sector classification of customer, see the note titled "*Credit risk*" in the Annual Financial Statements.

Underwriting and Credit Approval Process

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

The BCC, which acts on behalf of the Board of Directors, is the Bank's top credit, investment and underwriting authority. The ACC, which has granting limits below those of the BCC's, has the right to delegate authority within its own credit limits and sets credit approvals rules and guidelines for the divisions of the Bank.

For each credit application, the Bank gathers information and evaluates certain elements that serve as a basis for the decision, for example the borrower's profile and financial analysis, evaluation of any proposed collateral, the borrower's credit rating and related parties' total exposure. The first stage is interaction between the borrower and an account manager in the relevant division, followed by the preparation of a credit application, which must contain the following minimum information about the borrower:

- credit rating (internal rating system);
- financial accounts;
- collateral;
- the borrower's request and the account manager's proposal;
- the borrower's ability to pay;
- general information about the borrower; and
- the rationale for the proposal.

When the loan application is submitted for approval to the relevant credit committee, it is first analysed by the Credit Office. The Credit Office prepares an opinion for all credit applications that are submitted to the BCC, the ACC and the CCC. The Credit Office also monitors the activities of the RBC. It ensures that credit decisions are within a committee's credit approval authority. The Chief Risk Officer or his designated representative has the right to attend all credit committee meetings and is authorised to escalate controversial credit decisions from one committee to a committee with a higher authority.

The Credit Office is also responsible for the approval of the corporate credit rating performed by account managers by challenging the qualitative input and verifying the quality of quantitative information used to produce the ratings.

The relevant credit committee then either approves or declines the loan application, and the decision is recorded in the minutes of the meeting, which are signed and registered. If the loan application has been approved, the account manager and the borrower then negotiate the terms and conditions of the loan, and the loan is documented by the Legal division in accordance with the approval of the relevant credit committee. When the back office receives the signed documents, it disburses the loan.

Collateral

The Bank generally requires collateral, but a central element in its assessment of a proposed borrower's creditworthiness is the borrower's ability to service debt. The main types of collateral obtained by the Bank include:

- retail loans to individuals are collateralised by mortgages on residential properties;

- corporate loans are collateralised by real estate, fishing vessels and other fixed and current assets, including inventory and trade receivables, cash and securities; and
- derivative exposures are collateralised by cash, treasury notes and bills, asset backed bonds, listed equity and funds that consist of eligible securities.

The Bank collects and stores collateral information, including information on collateral maintenance and valuation. In addition to collateral, other important credit risk mitigating techniques are pledges, guarantees and master netting agreements.

To ensure consistent collateral value assessment, the Bank has five collateral valuation committees. The committees set guidelines on collateral valuation techniques, collateral value and valuation parameters. The committees are divided by area of expertise as follows:

- agriculture;
- fishing vessels and fishing quotas;
- real estate;
- securities; and
- inventory and trade receivables.

The collateral value is monitored and additional collateral requested in accordance with the underlying agreement. The collateral value is reviewed in line with the adequacy of the allowance for impairment losses.

Portfolio Credit Quality

The Bank emphasises monitoring and reporting the quality of its loan portfolio. The credit portfolio quality is regularly aggregated and assessed in terms of industry concentration, single name concentration, product type and credit rating.

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

During the repayment phase, Risk Management monitors the credit portfolio. The Credit Control department aggregates the portfolio monthly, based on consistent criteria, to analyse the outstanding risk, the collateral level, as well as the portfolio quality. Credit Control analyses loans that have been classified at risk and maintains an independent and centralised overview of distressed credits. Credit Control, based on its analysis, suggests provisions and reviews write-offs. Monthly credit risk reports are sent to the ACC, the BRIC and the Board of Directors.

Impairment and Provisions

The Credit Control department is in charge of the Bank's provisioning process. Provisions for impairment are made both on a portfolio level and by individual assessment. All exposures to borrowers with loans that are considered impaired are moved to risk class 5 (DD rating), with the exception that impairment on prime mortgages to individuals do not trigger movement to risk class 5 for other exposures to the borrower, and vice versa.

On 1 January 2018, the Bank implemented IFRS 9 Financial instruments, and as part of the implementation, the process for provisioning for loss allowance has been split in to three stages. Stage 1 calculates one-year expected credit losses. Stage 2 calculates expected lifetime credit losses. Stage 3 calculates expected lifetime credit losses for impaired financial assets. Calculation of the loss allowance is performed for all loans, facilities and loan commitments carried at amortised cost or at fair value through other comprehensive

income (for these purposes, referred to as “loans”). For further information on the calculation methodology, see note 42 in the Interim Financial Statements.

Financial assets and financial liabilities – Classification and Measurement

Loss allowance for Performing Loans

Stage 1 loss allowance is calculated for all performing loans. Stage 1 assets are subject to one-year expected credit losses. The calculation is based on estimates of the borrower’s one year probability of default, loss given default and exposure at default. Assets classified as Stage 2 have encountered significant increase in credit risk as defined by the Bank and carry expected lifetime credit losses. The calculation is based on estimation of the borrower’s lifetime probability of default, loss given default and exposure at default. Probability of default, loss given default and exposure at default models for loans are based on the Bank’s internal models.

Individual Assessment

Loans classified as Stage 3 are impaired when objective evidence demonstrates that a loss event has occurred and that the loss event has an impact on the future cash flows of the asset or the asset is 90 days or more past due. The level of detail for credit monitoring depends on the size of the exposure, where factors such as delinquency by the borrower, forbearance measurements, and the internal credit rating are considered. For larger borrowers, interviews with account managers are also conducted. Loans are not classified as Stage 3 even if the value of collateral prudently covers the outstanding amount.

Portfolio Assessment

The provisioning process for prime mortgages and other exposures to individuals, where the amount of the exposure is within a predetermined and acceptable range, is made on a portfolio basis. The impairment is based on a 90 days delinquency status and a collateral allocation method where the collateral is usually the tax value of the pledged real estate property. For additional information on the Bank’s measurement of impairment, see the note titled “Financial assets and financial liabilities” in the Annual Financial Statements.

Counterparty Credit Risk

The Bank offers financial derivative instruments to professional investors. The table below sets forth the derivative trading products that are currently offered by the Bank to its customers classified according to the primary risk factor and type of derivative instrument.

Primary risk factor	Swaps	Forwards	Options
Interest rate	X		
Foreign exchange.....	X	X	X
Securities (equities and bonds).....		X	X
Commodities.....		X	X

Valuation changes are made in response to changes in interest rates, exchange rates, security prices and commodity prices.

The Bank sets limits on a customer's total exposure to control the Bank’s risk associated with derivatives trading. These limits are generally specific for each customer and may refer specifically to different categories of contract. Generally, collateral is required to cover potential losses on a contract. Should the net-negative position of the contract fall below a certain level, a call is made for additional collateral. If additional collateral is not supplied within a tightly specified deadline, the contract is closed. The margin call process is monitored by the Risk Management division.

Large Exposures

In accordance with applicable Icelandic regulations, a large exposure is defined as an exposure to a group of financially related borrowers, which exceeds 10.0 per cent. of the Group’s eligible capital. The legal maximum for individual large exposures is 25.0 per cent. of the Group’s eligible capital, net of eligible

collateral. As of 30 September 2018, the Group had one large exposure to a foreign financial institution. The exposure was 11% of the Group's eligible capital before and after taking into account of eligible credit risk mitigation.

The table below sets forth all gross exposures exceeding 10.0 per cent. of the Bank's eligible capital as of 30 September 2018 and 31 December 2017 and of the Bank's capital base as of 30 September 2018 and 31 December 2017, together with the net amount of each of those exposures after taking into account eligible collateral.

	As of 30 September 2018		As of 31 December 2017	
	Gross	Net	Gross	Net
Borrower 1.....	11%	11%	<10%	<10%
Sum of large exposure gross and net >10%.....	11%	11%	0%	0%

Market Risk

Market risk is the current or prospective risk that changes in financial market prices and rates will cause fluctuations in the value and cash flows of financial instruments. The risk arises from imbalances in the Group's balance sheet as well as in market making activities and position taking in bonds, equities, currencies, derivatives and other commitments which are marked to market.

The Group monitors market risk and separates its exposures for its trading book (which represents positions held with trading intent and associated hedging positions) and banking book (which represents exposures taken on account of its risk management activities). Market risk in the trading book arises from market-making activities and non-strategic derivatives positions arising from the Bank's customers' investments and risk management needs. Market risk in the banking book arises from various mismatches in assets and liabilities, principally in relation to currencies, maturities and interest rates. Market risk in the trading and banking books is managed separately by the Treasury division and Market Making.

The Bank's overall market risk allowance is set by the Board of Directors in the Bank's risk appetite, and the CEO or through the appropriate framework set up by the CEO, determines the limit framework for each trading desk and sets individual limits. The ALCO is responsible for managing the Bank's overall market risk. The Risk Management division is responsible for measuring and monitoring market risk exposure and reporting the exposure, usage and limit breaches.

The Group's strategy towards market risk is to seek to limit the risk exposure that arises in its banking book as a result of imbalances in the Group's balance sheet, but accept limited risk in its trading book in accordance with its strategic goals for net profit.

The Balance Sheet Risk subdivision is responsible for monitoring compliance with the limits that have been set in each of the trading and banking books. In respect of the trading book, it reviews exposures for potential shortfalls and analyses scenarios with traders. Any issues of concern are escalated to the relevant managing directors and the Chief Risk Officer, and performance, exposures and relevant risks are summarised and reported daily to relevant employees and managing directors and on a regular basis to the Board of Directors. In respect of the banking book, market risk exposure is monitored and reported on a monthly basis and measured against the risk limits set in terms of the Bank's risk appetite.

The elements of the Group's market risk are presented below.

Interest Rate Risk

Interest rate risk arises from the possibility that changes in market rates adversely affect net interest and fair value of interest-bearing instruments on the Balance Sheet. The Bank's operations are subject to interest rate risk due to mismatches in the fixing of interest rates between assets and liabilities, resulting in a repricing risk for the Bank. The Bank also faces interest basis risk between interest-bearing assets and interest-bearing liabilities due to different types of floating-rate indices in different currencies.

The Bank's interest rate risk for foreign currencies is limited as foreign denominated assets predominantly have short interest fixing periods (i.e., the period during which interest is payable at a fixed rate) and the Bank hedges its foreign denominated fixed rate borrowings. For domestic rates, longer fixing periods are more common, and this especially applies to indexed mortgages issued between 2004 and 2006. The profile of the interest fixing periods of indexed mortgages is however matched by that of the Bank's structured covered bonds issues, which serves as a hedge against repricing risk. The Bank has been able to manage relatively small gaps for interest fixing periods.

In the past few years domestic rates, nominal and real, have fallen considerably. Due to favorable refinancing spreads, prepayments and/or refinancing of loans have been considerable. Prepayment risk is mitigated by prepayment fees and the Bank's own prepayment options on its borrowings. The Bank prepays its structured covered bonds as the underlying mortgages prepay.

For additional information on the Bank's interest rate risk, see the note titled "*Market risk*" in the Annual Financial Statements.

Indexation Risk

A significant part of the Bank's balance sheet is linked to the Icelandic Consumer Price Index (CPI). Index-linked loans and borrowings are typically annuities, where the principal and monthly payments change in the same proportion as the CPI. The Bank is exposed to indexation risk as indexed assets exceed indexed liabilities. As of 30 September 2018, the total amount of the Bank's CPI-linked assets was ISK 364,615 million and the total amount of its CPI-linked liabilities was ISK 251,957 million. See the note titled "*Market risk*" in the Annual Financial Statements.

Currency Risk

Currency risk is the risk of loss due to adverse movements in foreign exchange rates. The Bank is exposed to currency risk through a currency mismatch between its assets and liabilities. Deposits denominated in Icelandic Krona are the primary source of funding for the Bank, whereas a substantial part of the Bank's assets consist of loans to customers denominated in foreign currency. Net exposures per currency are monitored centrally in the Bank.

The table below sets forth the currencies to which the Bank had significant exposure as of 30 September 2018. The analysis calculates the effect of a 10.0 per cent. movement of each indicated currency rate against Icelandic Krona on the Bank's income statement as a result of the change in fair value of currency sensitive non-trading monetary assets and liabilities. A negative amount reflects a potential net reduction in income statement or equity, while a positive amount reflects a potential net increase in income statement or equity. The table below assumes that all other variables remain constant.

	Year ended 30 September 2018	
	-10.0%	+10.0%
	<i>(ISK in millions)</i>	
EUR	(144)	144
USD	127	(127)
GBP	(274)	274
DKK	(277)	277
NOK	(17)	17
Other	(8)	8

(1) A +10.0 per cent. in the table denotes a depreciation of Icelandic Krona.

Equity Price Risk

Equity price risk is the risk that the fair value of equities held as financial instruments and investments in associates on the Group's consolidated balance sheet decreases as the result of changes in the level of equity

indices and individual stocks. In addition to equity price risk in the trading book, the non-trading equity price risk exposure is primarily due to restructuring of the Bank's assets, *i.e.*, restructuring of troubled companies which the Bank has taken over after the financial crisis in 2008. The associated risk has, however, been significantly reduced in recent years through successful divestment of such assets. For information on assets taken over by the Bank and held for sale and equity exposures, see the notes titled "Financial assets and financial liabilities" and "Other assets" in the Annual Financial Statements.

Derivatives

Derivatives are a part of the Bank's customer product offering. The types of derivatives currently offered are forward contracts, swaps and options. Eligible underlying market factors are interest rates, foreign exchange rates, equities and commodities. Exposure limits, hedging requirements and collateral requirements are determined in accordance with the Bank's risk appetite and monitored by Risk Management on a daily basis. The Bank also uses derivatives to reduce market risk on its balance sheet.

Prepayment Risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay, or request repayment of, loans earlier or later than expected, such as with respect to fixed rate mortgage loans when interest rates decline. Prepayment risk is mitigated by prepayment fees and the Bank's own prepayment options on its borrowings.

Liquidity and Funding Risk

Liquidity risk is defined as the risk that the Group, although solvent, either does not have sufficient financial resources available to meet its liabilities when they become due or can secure them only at excessive cost. Liquidity risk arises from the inability to manage unplanned decreases in available funding or changes in funding sources. The ALCO is responsible for managing liquidity risk within the risk appetite set by the Board of Directors, the Treasury division manages the liquidity positions on a day-to-day basis and the Balance Sheet Risk subdivision monitors the liquidity risk, with processes and reports regarding the liquidity status reviewed regularly by the executive management. The Treasury division provides the other divisions of the Bank with funds for their activities against a charge of internal interest.

The Bank's primary source of funding is deposits from individuals, businesses and financial institutions. The Bank's liquidity risk stems from the fact that the average maturity of its loans exceeds the average maturity of its deposits. As of 31 December 2009, over 90 per cent. of the Bank's deposits were on demand, as compared to 59.7 per cent. as of 31 December 2012, 52.2 per cent. as of 31 December 2013, 58.0 per cent. as of 31 December 2014, 57.3 per cent. as of 31 December 2015, 70.0 per cent. as of 31 December 2016, 71.8 per cent. as of 31 December 2017 and 71 per cent. as of 30 September 2018. As of 30 September 2018, approximately 71 per cent. of the Group's deposits were on demand, approximately 18 per cent. had a maturity of up to three months, approximately 9 per cent. had a maturity of between three and 12 months, approximately 3 per cent. had a maturity of between one and five years and approximately 0.5 per cent. had a maturity of more than five years.

See also "*Funding and Liquidity – Liquidity*" for a breakdown of the Group's deposit base according to the LCR categorisation and a description of that categorisation.

The Bank calculates the net stable funding ratio (**NSFR**), which measures the amount of available stable funding (**ASF**) at the Group against the required stable funding (**RSF**), as per the definition of the Icelandic Central Bank's Rules No. 1032/2014. Under NSFR, funding with maturity greater than one year is considered stable. Different weights are applied to funding with shorter maturities depending on the type of funding. In general, RSF is determined by applying different weights to the Group's on- and off-balance sheet items on the asset side depending on the level of maturity and liquidity. On the other hand, ASF is calculated by applying different weights to the Group's on- and off-balance sheet items on the liability side depending on the level of maturity and / or expected stickiness.

The ratio for foreign currency is required to exceed 100 per cent. effective from 1 January 2017. The purpose of the requirements with respect to the foreign exchange ratio is to prevent domestic financial institutions from accumulating short-term need for market funding in foreign currency, as the Icelandic Central Bank is not a lender of last resort in foreign currency.

The table below sets forth the Group's total NSFR as of the dates indicated based on consolidated figures for the Bank and ABMIIF.

	<u>30 September 2018</u>	<u>31 December 2017</u>
ISK	107%	115%
Foreign exchange ⁽¹⁾	164%	181%
Total NSFR	118%	125%

(1) The foreign exchange ratio is the calculation of NSFR for the Bank's consolidated statement of financial position restricted to foreign currency. When calculating the foreign exchange ratio, a negative foreign exchange imbalance is subtracted from the numerator and a positive foreign exchange imbalance is subtracted from the denominator.

The foreign exchange imbalance discrepancy between the Group's official foreign exchange imbalance and the imbalance reported in the NSFR is due to the fact that the Bank's subsidiaries have a substantial positive foreign exchange imbalance but are settled in Icelandic Krona. See "*Risk Factors - Factors that may affect the Bank's ability to fulfil its obligations under Notes issued under the Programme - The Bank is exposed to significant liquidity risk*".

The Group carries out an ongoing process for the ILAAP, with the aim of ensuring that the Group has in place sufficient risk management processes and systems to identify, manage and measure the Group's liquidity. As part of the ILAAP, main liquidity and funding risks are identified and stressed scenarios considered to provide senior management and regulators with a better understanding of the Group's liquidity and funding positions. The FME supervises the Group and reviews the Group's ILAAP.

Operational Risk

Operational risk is the risk of direct or indirect loss or damage to the Bank's reputation resulting from inadequate or failed internal processes or systems, from human error or external events that affect the Bank's image and operational earnings. The Bank assesses its primary sources of operational risk as IT risk, legal risk and reputational risk.

Operational risk is inherent in every activity undertaken within the Bank, in outsourced activities and in all interactions with external parties. The Bank aims to reduce the frequency and impact of operational risk events in a cost effective manner and seeks to do so with a selection of internal controls and quality management, along with sufficiently qualified staff.

Each division within the Bank is primarily responsible for taking and managing its own operational risk. Operational risk function is responsible for developing and maintaining tools for identifying, measuring, monitoring and reporting the Bank's operational risk. The Bank uses the Basel II standardised approach to the calculation of capital requirements for operational risk.

The Operational Risk subdivision serves as a partner to senior management and supports and challenges the senior management to align the business control environment with the Bank's strategy by measuring and mitigating risk exposure, with the view of contributing to optimal returns for the stakeholders.

The Bank's losses due to operational risk are registered in the Bank's loss database. Loss events are analysed to understand the cause of the event and any control failure, and changes to controls are made where applicable to reduce the risk of the event recurring. Losses are categorised according to the Basel II event categories for operational risk.

Capital Management

The Bank's capital ratios are calculated in accordance with the Financial Undertakings Act and Regulation No. 233/2017 on prudential requirements. Iceland has adopted the European Union Capital Requirements

Directive and Regulation (CRD IV/CRR), but has temporarily excluded Article 501 on capital requirements relief for small and medium enterprises. The Bank uses the standardised approach to calculate capital requirements for credit risk, credit valuation adjustment, market risk and operational risk.

As at 31 December 2017, the Bank's consolidated exposures as stipulated in CRR is the Bank's accounting consolidation without Vördur. As the full accounting consolidation has been applied in prior statements, figures for earlier dates are restated to reflect the defined consolidated exposures. The capital position and solvency requirements of Vördur should be viewed independently from capital adequacy for the Bank's consolidated exposures. An adjustment is made to the Bank's Pillar 2 requirements as the latest SREP result is based on the accounting consolidation which includes an add-on due to the solvency requirements of Vördur.

The Bank carries out an ongoing process, the ICAAP, with the aim of ensuring that the Bank has in place sufficient risk management processes and systems to identify, manage and measure the Bank's total risk exposure. The ICAAP is aimed at identifying and measuring the Bank's risk across all risk types and ensuring that the Bank has sufficient capital in accordance with its risk profile. The FME supervises the Bank, reviews the Bank's ICAAP and sets capital requirements for the Bank's consolidated exposures as a whole following the SREP. Stress tests constitute an important part of the ICAAP, because they demonstrate how the Group's capital could be affected by sharp macroeconomic changes, downturns in the Bank's core businesses or other major events.

Capital requirements according to Pillar 1 are based on the sum of risk-weighted assets for credit risk, credit valuation adjustment, market risk and operational risk, computed using formulas from CRD IV and the CRR. See *“Risk Factors - Factors that may affect the Bank's ability to fulfil its obligations under Notes issued under the Programme - Application of CRD IV could adversely affect the Bank's results”*. The Bank uses the standardised approach to calculate the capital requirements for credit risk, credit valuation adjustment, market risk and operational risk.

Banking operations are categorised as either trading book or banking book, and the calculation of risk-weighted assets is conducted differently for the assets in each book. Banking book exposures, including on-balance and off-balance sheet items, derivatives and repurchase agreements, give rise to credit risk and risk-weighted assets are measured by means of a hierarchy of risk weightings classified according to the nature of each asset and counterparty, taking into account eligible collateral or guarantees. Trading book risk-weighted assets are determined by taking into account market related risks, such as foreign exchange, interest rate risk and equity position risks. Operational risk also gives rise to risk-weighted assets, measured on the basis of the Bank's average operating income over three years.

To measure the Pillar 2 capital requirement, the Bank uses internal economic capital models. Capital add-ons under Pillar 2 are based on risks that are underestimated or not covered in Pillar 1, including credit risk, concentration risk, market position risk, interest rate risk in the banking book, indexation risk, reputational risk, legal and compliance risk, business risk and political risk. Capital is allocated to the Group's business units based on the capital requirements that arise due to their exposures and operations. The performance of the business units is then evaluated based on the return on allocated capital. The Bank is seeking to implement return on allocated capital as a management tool, such that, should capital scarcity arise, return on allocated capital will guide in aligning the business with available capital and the reallocation of capital.

The table below sets forth the implementation of the capital buffer requirements in accordance with the Financial Undertakings Act, as prescribed by the Financial Stability Council and approved by the FME.

Capital buffer requirement as a percentage of risk-weighted assets	Current	As of 1 May 2019
Capital conservation buffer	2.5%	2.5%
Capital buffer for systemically important institutions	2.0%	2.0%
Systemic risk buffer ⁽¹⁾	3.0%	3.0%
Countercyclical risk buffer ⁽¹⁾	1.25%	1.75%
Combined capital buffer requirement	8.75%	9.25%⁽²⁾

(1) The institution specific systemic risk buffer and the countercyclical risk buffer are determined using the weighted average of respective buffer levels in countries where the Bank has exposure, and weighting is determined by the percentage of risk-

weighted assets relating to credit risk. With the FME's possible recognition of systemic risk buffers and countercyclical buffers in other countries, those requirements will apply to the corresponding foreign exposures, resulting in a higher combined buffer requirement. The maximum countercyclical risk buffer which can be applied in Iceland is 2.5 per cent.; however, the FME is authorised to apply a higher countercyclical risk buffer on the basis of a recommendation from the Financial Stability Council. In April 2018, the Financial Stability Council proposed a 0.50 per cent. increase to the countercyclical capital buffer to take effect from 1 May 2019, as confirmed by the FME.

- (2) Because the systemic risk buffer and the countercyclical risk buffer apply on the to the domestic risk-weighted assets of the Group, the Group had the effective combined capital buffer requirement of 87.5% based on the Group's domestic exposures as of 30 September 2018.

The Bank's Pillar 2R capital add-on, which is the result of ICAAP / SREP, may be comprised of 56.25 per cent. CET1 capital, 18.75 per cent. AT1 capital and 25.00 per cent. Tier 2 capital. With the current capital structure of the Bank, the Pillar 2R requirement is solely met with CET1 capital.

The table below sets forth the CET1 regulatory capital requirement, as applied to the Group, as a percentage of risk-weighted assets as of 30 September 2018 and as of 1 November 2018 upon full implementation.

CET1 regulatory capital requirement as a percentage of risk-weighted assets	Current	Fully implemented
Pillar 1 CET1 requirement.....	4.5%	4.5%
Pillar 2R CET1 requirement	1.6%	1.6%
Combined buffer requirement.....	8.4	8.9%
Total CET1 regulatory capital requirement	14.6%	15.0%
Available CET1 capital	21.6%	21.6%

Stress Testing

Overview

The Bank's stress testing framework is aligned with the relevant FME guidelines, which in turn are based on the Guidelines on Stress Testing of the European Banking Authority. Stress testing at the Bank focuses on sensitivity and scenario analyses. The sensitivity analysis measures the potential impact of a specific single risk factor or simple multi-risk factors affecting capital or liquidity. In turn, scenario analysis measures the Bank's resilience to a given scenario, which comprises a set of risk factors that are aligned in an internally consistent way, presuppose the simultaneous occurrence of forward-looking events covering a range of risks and business areas and aims at revealing the nature of linked risks across the Bank and across time, system-wide interactions and feedback effects. The stress tests serve as an important management tool for the Bank and are incorporated into the review of the Bank's risk conditions and the Bank's limits framework, and raise risk awareness and improve general understanding of the Bank's operations. The Board of Directors and Board Risk Committee consider the results for strategic, capital and contingency planning.

The Bank's business plan is stress tested annually with at least two adverse economic scenarios. One of the two stressed scenarios carried out on the business plan is provided by the Central Bank in collaboration with the FME. The Bank's Economic Research department contributes an economic base case projection as well as stressed projections that are used in the Bank's capital planning and in preparation of the Bank's five year business plan. The design of the bank-wide internal stress test is challenged and reviewed by the Executive Committee and the Board of Directors. The impact is estimated on the Bank's earnings and the capital base as well as for the Bank's capital and liquidity ratios and other risk appetite metrics. In addition to the internal bank-wide stress test and the Central Bank stress test, the Bank performs both focused ad hoc stress tests and regular planned stress tests. The focused stress tests are used to estimate losses for example due to changes in regulations.

The table below sets forth the stress tests which the Bank regularly performs.

Stress Test	Frequency	Description
Icelandic Central Bank and FME stress tests.....	Annually	Stressed scenarios provided by the Icelandic Central Bank in collaboration with the FME
Internal stress tests on the Bank's business plan.....	Annually	Risks and stressed scenarios designed on the basis of input from each division, stressed macro-economic projections provided by the Research subdivision

Stress Test	Frequency	Description
ICAAP / ILAAP	Annually Daily /	Interest rate risk, value-at-risk on trading book, credit risk stress tests
Focused stress tests.....	Monthly	Liquidity and market risk, risk appetite for indirect equity positions

CAPITAL ADEQUACY

The Bank's capital policy is to maintain a strong capital base to support business development and to meet regulatory capital requirements, even in times of stress.

Capital requirements according to Pillar 1 are based on the sum of risk weighted assets (**RWA**) for credit risk, market risk and operational risk, computed using formulas from the EU's Capital Requirements Directives (the **CRD**).

- 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 standardised approach is used for operational risk.

The Basel Committee on Banking Supervision issued the first version of the Basel III framework in December 2010 and a revised version in June 2012. The Basel III framework is the new international regulatory framework for banks, which includes requirements regarding regulatory capital, liquidity, leverage ratio and counterparty credit risk measurements. On 26 June 2013, the European Parliament and the European Council adopted CRD IV for the implementation of the Basel III framework in the European Union with the goal of strengthening 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 the CRR.

The transposition of the CRD IV into Icelandic law is set to take place in separate amendments. The first amendment was introduced on 9 July 2015 by Act No. 57/2015, which amended the Financial Undertakings Act. This amendment includes CRD IV's provisions on capital buffers and adopts a regulation implementing the provisions of the CRR and related technical standards. The second amendment, which was introduced on 1 September 2016 by Act No. 96/2016 and further amended the Financial Undertakings Act, includes CRD IV's provisions on operating licences, initial capital, information obligations, leverage ratios, supervisory review and evaluation process. The timeframe for further implementation in Iceland has not yet been published, but two committees have been established as of the date of this Prospectus to draft a legislative bill covering what remains to be implemented of CRD IV. The latest bill no. 351, was presented before the Icelandic Parliament on 2 November 2018 and relates the number of directorships which may be held simultaneously, as well as further enhancing the duties of auditors under the Financial Undertakings Act. Further provisions are currently in the Icelandic government's consultation portal.

The remainder of the CRR was transposed into Icelandic law by the entry into force of Regulation No. 233/2017 on 6 March 2017.

Banking operations are categorised as either trading book or banking book and the calculation of RWA is conducted differently for the assets and off balance sheet items in different books. Banking book exposures, including on-balance and off-balance sheet items, derivatives and repurchase agreements, give rise to credit risk and RWA are measured by means of a hierarchy of risk weightings classified according to the nature of each exposure and counterparty, taking into account eligible collateral or guarantees. Trading book RWA are determined by taking into account market related risks such as foreign exchange, interest rate and equity position risks. Operational risk also gives rise to risk-weighted assets, measured on the basis of the Bank's average operating income over three years.

The Bank carries out an ongoing process, the ICAAP, with the aim of ensuring that the Bank has in place sufficient risk management processes and systems to identify, manage and measure the Bank's total risk exposure. The ICAAP is aimed at identifying and measuring the Bank's risk across all risk types and

ensuring that the Bank has sufficient capital in accordance to its risk profile. The FME supervises the Bank, reviews the Bank's ICAAP via the SREP and sets capital requirements for the Bank's consolidated exposures as a whole.

To measure the Pillar 2 capital requirement the Bank uses internal economic capital models for major risks and more elementary criteria for other risks. The Pillar 2 capital add-on can result from risks not covered under Pillar 1, i.e. credit risk, market position risk, concentration risk and interest rate risk in the banking book, indexation risk or risks for which the Pillar 1 capital requirement is deemed insufficient. The Bank's credit rating models and collateral allocation algorithms are key components in the Bank's internal assessment of credit risk. The credit rating models are also used to support the Bank's lending decisions, provision calculations and credit risk monitoring.

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.

The Bank's stress testing framework is aligned with the ICAAP. Stress tests are an important management tool at the Bank and show how the Bank's capital and/or liquidity could be affected by sharp macro-economic changes, downturns in the Bank's core business or other major events.

The Group is subject to capital requirements which are specified by the FME following a SREP. The Group's own funds exceeded the FME's requirements under the SREP in each of the years ended 31 December 2017 and 2016. Based on the FME's final SREP result delivered in October 2017, the Group's total regulatory capital requirement has been 19.8 per cent. with effect from 1 November 2017, including fully implemented capital buffer requirements, and based on the Bank's consolidated exposures.

As of 30 September 2018, the Group's capital base amounted to ISK 175,391 million (exceeding the FME's requirements under the SREP), as compared to ISK 183,958 million as of 31 December 2017. The Group's capital adequacy ratio, calculated in accordance with Icelandic requirements, was 21.7 per cent. as of 30 September 2018 (exceeding the minimum legal requirement of 8.0 per cent.), as compared to 24.0 per cent. as of 31 December 2017.

The table shows the Group's capital base as at 30 September 2018 and as at 31 December 2017.

	30 September 2018	31 December 2017
Capital Base	<i>(ISK million, except percentages)</i>	
Total Equity	200,056	225,734
Deductions related to the consolidated situation	(8,573)	(8,635)
Non-controlling interest not eligible for inclusion in CET1 capital*	(739)	(128)
Intangible assets	(11,445)	(11,125)
Tax Assets	(564)	(357)
Cash flow hedges	(999)	265
Additional value adjustments	(119)	(119)
Equity holdings in financial sector entities	(190)	-
Foreseeable dividend	(2,775)	(25,000)
Common equity Tier 1 capital	174,652	180,635
Non-controlling interest not eligible for inclusion in CET1 capital	739	128
Tier 1 capital	175,391	180,763
Subordinated liabilities		-
Regulatory adjustments to Tier 2 Capital**		-
Equity holdings in financial sector entities		-
General credit risk adjustments		3,195
Tier 2 capital		3,195
Total capital base	175,391	183,958

- (1) As of 31 December 2017 and 30 September 2018, the Group's capital adequacy is calculated on the basis of its prudential consolidation which excludes insurance subsidiaries. The figures as of 31 December 2016 have been adjusted accordingly.
- (2) As of 30 September 2018, the foreseeable dividend was 50 per cent. of the accumulated net earnings in 2018, which reflects the Bank's dividend policy. As of 31 December 2017, the foreseeable dividend was the amount of the equity reduction executed in the first quarter of 2018 through the purchase by the Bank of its own shares and the First Monetisation Dividend.
- (3) The Financial Undertakings Act No. 161/2002 states that the Bank's CET1 holdings of instruments in financial sector entities are to be deducted from CET1, while the CRR specifies a 10.0 per cent. threshold for such deductions. Such deductions were previously split between Tier 1 and Tier 2 capital, but currently apply to the corresponding type of capital instrument.
- (4) Straight-line amortisation for maturities within five years.
- (5) Under IAS 39, the Bank's general credit risk adjustments are considered part of Tier 2 capital as stipulated in the CRR. As per the EBA's opinion, all provisions under IFRS 9 are considered specific credit risk adjustments (SCRA), rather than general adjustments. The FME has adopted the EBA's opinion on this matter, and as a result, since adopting IFRS 9 on 1 January 2018, the Group's own funds no longer include general credit risk adjustments, and these are now treated as SCRA, effectively reducing the Group's risk-weighted assets.

INVESTMENTS

The Bank has a small portfolio of debt and equity investments. These instruments are classified either as trading assets (being assets which are held by the Bank with a view to generating profit from short-term changes in price) or as assets held at fair value through profit and loss. The Bank's shares and equity instruments include those shareholdings that the Bank has acquired in recent years through debt restructurings and other enforcement procedures. Since 2012, the Bank has made steady progress in the sale of companies acquired as a result of these collateral enforcement procedures (see "*Description of the Bank - Other Divisions and Subsidiaries - Asset Holding Companies*").

The table below shows the classification of the Bank's investment portfolio as at 30 September 2018 and 31 December 2017.

	As at 30 September 2018			Total
	Trading	Designated at fair value	Available to sale	
	<i>(ISK million)</i>			
Listed bonds and debt instruments	2,452	46,638		49,090
Unlisted bonds and debt instruments	23	2,642		2,665
Total bonds and debt instruments	2,475	49,280		51,755
Listed shares and equity instruments	1,677	5,380		7,057
Unlisted shares and equity instruments	1,303	10,397		11,700
Note funds with variable income	1,782	15,651		17,433
Total shares and equity instruments	4,762	31,428		36,190

MANAGEMENT AND EMPLOYEES

MANAGEMENT

Shareholders' meetings

The Bank's shareholders in general meetings are the supreme authority in the affairs of the Bank, within the limits established by the articles of association and statutory law. The Bank's annual general meeting is required to be held before the end of April each year.

Board of Directors

The Board is the supreme authority between shareholders' meetings, as further stipulated by law, regulations, and the Articles of Association.

The Board appoints the CEO. The Board also manages the Bank's affairs and ensures that its organisation and activities are at all times maintained in good order. The Board and the CEO undertake the administration of the Bank.

The Board is responsible for ensuring that the Bank's book-keeping and the handling of its funds is sufficiently supervised. The Board represents the Bank and may grant directors, the CEO or others authority to sign for the Bank.

The Board bears the principal responsibility for the Bank's daily operations and is required to regularly discuss the manner in which it discharges its duties, its substantive areas of focus and the main goals of its work.

The Board also bears the principal responsibility for the development and long-term success of the Bank. To that effect, individual directors must exercise their duties with due diligence and care, and with good faith in the best interests of the Bank and its shareholders. The Board confirms and bears the principal responsibility for the Bank's strategy.

The Board and the CEO are required to inform the FME without delay of any issues they become aware of that could affect the ongoing operation of the Bank.

The Board, which must be of a size and composition that makes it possible for the Board to discharge its duties efficiently and with integrity, currently comprises six members (one member of the Board having resigned since the Annual General Meeting held on 15 March 2018, to be replaced by an Alternate Director until the shareholders decide otherwise). All the members are nominated by Kaupskil except one, who was nominated by Attestor Capital LLP.

The Bank's Board comprises the following members:

Eva Cederbalk, Chairman

Born in 1952, Eva was first elected to the Board of Directors at a meeting of shareholders held on 23 June 2017 and elected as Chairman on 26 June 2017. Eva is Swedish and currently resides in Sweden. She is an independent member of the Board of Directors and is a shareholder of the Bank. Eva is the chairman of the Board Credit Committee.

Eva currently serves on the board of directors of Bilia AB, National Bank of Greece Group and Ikano Group S.A. She previously worked within Swedish financial services and until 2011 served as CEO of SBAB Bank AB (publ) and prior to that was CEO at payment service provider Netgiro Systems AB and held executive

positions within SEB AB (publ). Eva also previously served as chairman of the board of directors of Klarna AB and on the boards of directors of Gimi AB, Ticworks AB and Íslandsbanki.

Brynjólfur Bjarnason, Vice Chairman

Born in 1946, Brynjólfur was first elected as a Director at a shareholders' meeting on 20 November 2014. He is not a shareholder of the Bank and is an independent Director. Brynjólfur is a member of the Board Credit Committee and the chairman of the Board Audit Committee.

Brynjólfur graduated with an MBA from the University of Minnesota in 1973 and a cand. oecon. degree in business studies from the University of Iceland in 1971.

Brynjólfur was managing director of the Enterprise Investment Fund from 2012 to 2014. Between 2007 and 2010 he was the chief executive officer of Skipti. Brynjólfur was chief executive officer of Síminn from 2002 to 2007 and chief executive officer of Grandi hf. from 1984 to 2002. Between 1976 and 1983 he was managing director of the publisher AB bókaútgáfa. He was also head of the economics department of VSÍ from 1973 to 1976. Brynjólfur has broad experience as a director and has served on numerous boards, several of which as chairman. Brynjólfur has served on the board of Genís since 2011 and the board of the Reykjavík Dramatic Society Playwright Fund since 2009.

Herdís Dröfn Fjeldsted, Director

Born in 1971, Herdís was first elected to the Board of Directors at the Annual General meeting held on 15 March 2018. She is an independent member of the Board of Directors and is not a shareholder of the Bank. Herdís is a member of the Board Audit Committee and the Board Remuneration Committee.

Herdís was until recently the CEO of The Icelandic Enterprise Investment Fund (Framtakssjóður Íslands – FSÍ), a role in which she served for over four years. Previously she was Investment Manager at FSÍ from the year 2010. Herdís is a board member at The Icelandic-Canadian Chamber of Commerce. Before joining FSÍ, Herdís worked as a Senior Investment Analyst at Thule Investments from 2004 to 2010. Through the years she has served many companies as a member of a board of director and in various sectors, including as Chairman of Icelandic Group and VÍS hf., Vice-Chairman of Promens hf. and Director at Invent Farma, Icelandair Group and Copeinca ASA. Herdís graduated with a BSc in Business Administration with emphasis on International Marketing from the Technical University of Iceland in 2004 and a Master's degree in Corporate Finance from Reykjavík University in 2011. She is a Certified Securities Broker.

Benedikt Gíslason, Director

Benedikt was born in 1974. He was first elected as a Director at a shareholders' meeting on 5 September 2018. He is not a shareholder in Arion Bank and is a dependent Director. Benedikt is a member of the Board Risk Committee and the Board Remuneration Committee.

Benedikt gained a C.Sc. in mechanical and industrial engineering from the University of Iceland in 1998.

Benedikt works as a senior consultant for Kaupthing. He previously worked as a senior advisor for Iceland's Ministry of Finance and Economic Affairs and he has held a variety of managerial positions at Straumur- Burdarás, including managing director of securities and later CEO. Benedikt also worked as managing director of capital markets at FL Group and at proprietary trading and capital markets at Icelandic Investment Bank (FBA), later Íslandsbanki- FBA. Benedikt was also a board member at Kaupthing and VÍS Insurance. Benedikt is currently a consultant and on the board of Genís hf., EC Hugbúnadur ehf. and EC Software Sweden and an alternate board member of Brekkuás ehf.

Måns Höglund, Director

Born in 1951, Måns is Swedish and lives in Portugal. He was first elected at a shareholders' meeting on 24 March 2011. He is a shareholder of the Bank and is an independent Director. Måns is Chairman of the Board Risk Committee and is a member of the Board Credit Committee.

Måns graduated from Stockholm School of Economics in 1975 where he became a lecturer and researcher after completing his studies. He served in various posts at Hambros Bank in London between 1977 and 1984 and was regional director for Denmark and Iceland for two years. In 1984 he started working for Götabanken in London and was transferred to the Bank's Stockholm operation in 1989 where he was head of the international finance division until 1991. From 1991 to 1999 he worked for Swedbank, where his roles included director and head of the bank's large corporate business. In 1999 to 2002 he worked for both Unibank (as head of Sweden operation) and Nordea (as Head of Private Banking, Sweden).

From 2002 to 2011 Måns worked for Swedish Export Credit Corporation (**SEK**) as executive director and head of corporate and structured finance. He was also a member of SEK's Executive Committee.

Steinunn Kristín Thórdardóttir, Director

Born in 1972, Steinunn was first elected to the Board of Directors at a shareholders' meeting on 30 November 2017. She is not a shareholder of the Bank and is an independent Director. Steinunn is a member of the Board Credit Committee and the Board Risk Committee.

Steinunn was partner and CEO of Beringer Finance Norway in 2015-2016 and interim CEO of Beringer Finance in Iceland and global head of food and seafood until 2017. In 2010 she founded Akton AS, a management consulting company in Norway where she worked as a managing director until 2015. Steinunn worked at Íslandsbanki (later Glitnir) in Iceland from 2001 until 2005 when she became the managing director and head of the bank's UK operations and remained there until 2008. Before that Steinunn worked at Enron Corporation from 1999 to 2001. Steinunn was a board member of Silver Green AS and Silver Green TC AS in Norway from 2011 to 2013, Versobank AS in Estonia from 2012 to 2013, board member of the Icelandic State Financial Investment (ISFI) from March 2011 to October 2011 and alternate board member at Kredittbanken, later Glitnir Norway, from 2005 to 2008. Steinunn is a member of Exedra, a discussion forum for women in leadership in various sectors, as well as a board member of Cloud Insurance AS, an insurance tech company that provides solutions to traditional insurance companies, Acton Capital AS and Akton AS and a board member of the British-Icelandic Chamber of Commerce and vice chairman of the Norwegian-Icelandic Chamber of Commerce. Steinunn has a master's degree in international management from Thunderbird, Arizona and a BA in international business and politics from University of South Carolina.

Conflicts of Interest

John P. Madden III is an employee of Kaupthing. The Bank and Kaupthing, as owner of Kaupskil, may have different interests with respect to the financial reorganisations of customers who have obligations with both parties. According to the Rules of Procedure for the Board, a director is not permitted to attend Board meetings or participate in the discussion or the decision-making process if any conflicts of interest arise concerning that particular director.

There are no other conflicts of interest between the duties of the members of the Board listed above to the Bank and their private interests or other duties. The address of each member of the Board is Borgartún 19, 105 Reykjavík.

Alternate Directors

In the event that a Director resigns or is unable to attend a meeting of the Board, an alternate director attends such meeting. The Board's alternate directors are as follows:

Ólafur Örn Svansson, lawyer;

Sigurbjörg Ásta Jónsdóttir, lawyer

Thorarinn Thorgeirsson, managing director at Kaupthing's legal department;

Thorarinn Thorgeirsson is an employee of Kaupthing. The Bank and Kaupthing, as owner of Kaupskil, may have different interests with respect to the financial reorganisations of customers who have obligations with both parties. Accordingly, the Bank has implemented a procedure whereby Thorarinn Thorgeirsson is not permitted to act as an alternate director where such a conflict arises.

There are no other conflicts of interest between the duties of the Board's alternate directors listed above to the Bank and their private interests or other duties. The address of each of the Board's alternate directors is Borgartún 19, 105 Reykjavík.

Board's sub-committee members (other than Directors)

Heimir Thorsteinsson. Heimir is a member of the Board Audit Committee.

Senior Management

The Bank's senior management team comprises the following members:

Höskuldur H. Ólafsson, CEO

Höskuldur graduated with a degree in business administration from the University of Iceland in 1987. He joined the Bank as CEO in June 2010 from Valitor - VISA Iceland, where he was CEO from 2006. Prior to that he worked at the Icelandic transportation company, Eimskip, for almost 20 years and held a range of management positions, including that of deputy CEO. He has also served on the boards of directors of numerous companies and organisations in Iceland and abroad. Höskuldur is the chairman of the Icelandic Financial Services Association (SFF) and is also a board member of the Icelandic Chamber of Commerce.

Gísli S. Óttarsson, Chief Risk Officer and Managing Director

Gísli received a Ph.D. in mechanical engineering from the University of Michigan in 1994. Gísli worked as a software designer and adviser for various engineering software companies in the United States before he joined Kaupthing's risk management division as head of research and development in January 2006. In April 2009, Gísli became the chief risk officer of the Bank.

Íða Brá Benediktsdóttir, Managing Director of Retail Banking

Íða Brá was born in 1976 and was appointed managing director of Retail Banking in June 2017. 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. In 2013 Íða became the head of Private Banking and in 2016 was appointed as the managing director of the Investment Banking division. Before taking over Private Banking, 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.

Lýður Thór Thorgeirsson, Managing Director of Investment Banking

Lýður has a BSc in electronic and computer engineering from the University of Iceland and an MBA from MIT Sloan School of Management, and he is also a certified stock broker. Since 2010 he has been with GAMMA Capital Management hf, first as a fund manager of institutional investor funds and since 2013 as managing director of alternative investments. Lýður is married to Ragnheidur Hardardóttir and they have three sons.

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, Vörður 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 Information Technology

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. Rakel was temporarily appointed as chief operating officer of the Bank in December 2015, and was appointed managing director of Information Technology in July 2016. 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.

Rúnar Magni Jónsson, Managing Director of Corporate Banking

Rúnar Magni Jónsson was born in 1976. Rúnar was appointed managing director of Corporate Banking at Arion Bank in October 2018.

Rúnar Magni has been at the Bank and its predecessors for 15 years, mainly in Corporate Banking. He began as a securities broker at Kaupthing from 2000 to 2002 and then became an account manager in Corporate Banking in 2005. Rúnar then took over as head of department within Corporate Banking in 2014.

Rúnar Magni has an MSc in international marketing and management (IMM) from the Copenhagen Business School and a degree in business administration from the University of Iceland. He also has a diploma in securities trading.

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 Icelandic Central Bank for eight years. She established an accounting firm in Akureyri in 1986 and headed it for 13 years when it was sold to Deloitte. She is a member of the Institute of State Authorised Public Accountants and has served on the audit committee on behalf of the organisation. She also served on the audit committee of Icelandic Banks' Data Centre from 1998 to 2010, first on behalf of the Icelandic Central Bank and then the Bank. Lilja will retire 31 December 2018, and will be replaced by Sigríður Guðmundsdóttir. Sigríður has worked as Marel's internal auditor since 2010. Marel is an international company and is listed on the Iceland Stock Exchange. Prior to that she worked for Alcoa on risk-related matters and in internal audit at Landsbankinn. Sigríður is currently a member of the audit committee of Stefnir and Austurland Savings 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.

Sture Stölen, Head of Investor Relations

Born in 1967, Sture was appointed as the Head of Investor Relations in February 2017. Sture served as the head of investor relations at SAS AB in Sweden from 2001 to 2013. From 1993 to 2001, Sture held various positions in treasury and finance in SAS AB. Since 2013, Sture has been senior adviser and partner at Wildeco Ekonomisk Information AB in Sweden, a position he currently holds. Sture was a board member of

Forex Bank AB in Sweden from 2013-2014. He has served as head of investor relations in TF Bank AB (publ) since January 2016. Sture holds a Master of Science in Finance from the Norwegian School of Business in Oslo, Norway from 1993.

There are no conflicts of interest between the duties of the members of senior management listed above to the Bank and their private interests or other duties. The address of each member of senior management is Borgartún 19, 105 Reykjavík.

Corporate Governance

The Bank's Corporate Governance framework is based on law, the Bank's Articles of Association and the Guidelines on Corporate Governance issued by the Icelandic Chamber of Commerce, Nasdaq Iceland hf. and the Confederation of Icelandic Employers in accordance with the Bank's Corporate Governance Statement. The Bank is directed and controlled by this framework. By establishing rules on corporate governance, the Bank sets forth criteria of conduct in key areas, which complement statutory rules. The Bank believes that a strong governance culture enhances trust, reduces risk and increases economic benefit for the Bank and its shareholders in the long term. The Bank continually seeks to update its corporate governance framework in response to new events, changes in statutory law and developments in domestic and international standards.

Management

The CEO is appointed by the Board. He is in charge of the day-to-day operations of the Bank and represents it in all matters concerning normal operations. The CEO is assisted by an executive management committee, in which all nine managing directors hold a seat.

Customers' Ombudsman

The Customers' Ombudsman is appointed by, and responsible to, the CEO, in accordance with a government recommendation made at the end of 2008.

The role of the Ombudsman is to ensure that the business of customers is handled fairly and objectively when dealing with recovery cases, prevent discrimination between customers and to ensure that the process for handling cases is transparent and documented. In the case of companies, the Ombudsman must also ensure that competition perspectives are taken into account, viable companies are entered into the restructuring process and rules on financial restructuring are adhered to.

In order to achieve these objectives, the Ombudsman takes part in the formation of procedures and solutions for customers as appropriate. In addition, the Ombudsman reviews specific cases upon request from customers, the Bank's employees or at his own initiative. Such a review can take place both while cases are being processed and after they are closed. The Ombudsman has access to information and data on specific issues. The Ombudsman submits information about the outcome of cases to clients, employees and the Board as appropriate.

Internal Audit

The Internal Auditor is appointed by the Board and reports directly to the Board. The Board sets the Internal Auditor a charter which lays out the responsibilities associated with the position and the scope of work. Internal Audit is required to provide independent and objective assurance and consulting services designed to add value and improve the Bank's operations. The scope of the audit is the Bank, its subsidiaries and pension funds serviced by the Bank.

The internal audit is governed by the audit charter, an FME directive on the internal audit function in financial institutions and international standards on internal auditing. All internal audit work is completed by

issuing an audit report with deadlines for the implementation of audit findings. Implementations are followed up by Internal Audit every quarter.

With respect to 2016 and 2017, the Internal Auditor’s overall conclusion on the effectiveness of the Bank’s internal controls and the Bank’s risk and control culture was that they were unsatisfactory (Is. *ófullnægjandi*) and should be improved, particularly relating to controls and risk awareness in the Corporate Banking division (as evidenced by the matters relating to United Silicon) and anti-money laundering processes at the Bank generally. To address these conclusions, the Bank has been making improvements and is on target for implementing the recommended anti-money laundering controls and the Credit Office has been established in part to strengthen the lending process and control of the loan portfolio. See also “*The Bank is exposed to credit risk and its customer loan portfolio contains certain problem and impaired loans*”, “*The Bank is exposed to operational risks*” and “*The Bank must comply with anti-money laundering and anti-bribery regulations, and the violation of such regulations may have severe consequences*” in “*Risk Factors*”.

Employees

During the first nine months of 2018, the average number of FTEs at the Group was 1,305 (compared to 1,250 during the full year 2017). At 30 September 2018, the number of FTEs at the Group was 1,334.

The table below sets forth the information on the number of FTEs by division as of the dates indicated.

	As of 31 December 2017	As of 31 December 2016
Retail Banking	367	358
Corporate Banking	15	28
Investment Banking	30	30
Asset Management	52	54
Asset Management division	34	33
Stefnir	18	21
Finance ⁽¹⁾	99	51
Risk management	27	30
Legal	43	42
Operations ⁽²⁾	82	143
IT	86	105
CEO office ⁽³⁾	61	40
Other divisions and subsidiaries	422	303
Total	1,284	1,239

(1) Includes Treasury.

(2) As of 30 June 2017, the employees and functions of the former Operations division had been transferred to Finance and IT.

(3) Includes marketing.

FINANCIAL MARKETS IN ICELAND

General

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

The establishment of the new banks

After the Icelandic government took control of Kaupthing, Glitnir and Landsbanki in October 2008, certain assets and liabilities were transferred from the banks into new entities, which have now become the Bank, Íslandsbanki and Landsbankinn. Following an agreement between the Icelandic government and the resolution committee of Kaupthing (the **Kaupthing Resolution Committee**) in July 2009, the Kaupthing Resolution Committee announced that it intended to exercise its option to purchase 87 per cent. of the Bank's equity, and a subsequent capital injection took place on 8 January 2010. From January 2010 until March 2017, the Bank had two shareholders, Kaupthing, through its subsidiary Kaupskil, and the National Treasury of Iceland. Following private placements in March 2017 and in February 2018, the exercise of certain options in September 2017 and in February 2018, the buy-back of shares in March 2018 and the initial public offering of the shares in the Bank on 31 May 2018 and the subsequent listing of the Bank's shares in Iceland and Sweden in June 2018, the Bank has expanded its shareholder base. As of the date of this Base Prospectus, Kaupthing, through its subsidiary Kaupskil, remains the largest shareholder in the Bank and holds a 32.67 per cent. stake. The National Treasury of Iceland no longer holds a stake in the Bank. A similar agreement was reached between the Icelandic government and Íslandsbanki, and Glitnir's resolution committee, through ISB Holding, held 95 per cent. of the shares in Íslandsbanki and the Ministry of Finance and Economic Affairs held the remaining 5 per cent. However, as part of the Glitnir composition agreement, Íslandsbanki is now fully state-owned. Landsbankinn is 98.2 per cent. state-owned (with the shares held by Icelandic State Financial Investments on behalf of the National Treasury of Iceland), while the Bank holds 0.91 per cent. and employees and other investors hold the remaining 0.89 per cent.

The Icelandic financial sector before 2008

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

Before 2000 the Icelandic banking system mostly consisted of three investment banks, four commercial banks and 26 savings banks. By 2008, however, the financial market mainly consisted of three major international banks (Kaupthing, Glitnir and Landsbanki), while the number of savings banks had been reduced to 21. The total assets of the Icelandic banking system amounted to around ISK 9,739 billion at the end of December 2007.¹⁰

¹⁰ <http://sedlabanki.is/lisalib/getfile.aspx?itemid=848>

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 their position in the market for the financing of residential housing over the past four years, partly due to Icelandic banks starting to offer non-inflation-linked mortgage loans from 2011 onwards.

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

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

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

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

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

Through act no. 24/2017 on the European Financial Markets Surveillance System, Iceland has adopted regulation no 1093/2010 of the European Parliament and of the Council dated 24 November 2010 establishing the European Banking Authority, amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC; EU regulation No 1094/2010 of the European Parliament and of the Council dated 24 November 2010 establishing the European Insurance and Occupational Pensions Authority, amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC; EU regulation No. 1095/2010 of the European Parliament and of the Council dated 24 November 2010 establishing the European Securities and Markets Authority, amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC and EU regulation No 1092/2010 of the European Parliament and of the Council dated 24 November 2010 on European

Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board. Hence the European Banking Authority, European Insurance and Occupational Pensions Authority, European Securities and Markets Authority and European Systemic Risk Board have been given certain surveillance powers in Iceland as per the aforementioned regulations.

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

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

CAPITAL CONTROLS

Foreign Exchange Act

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

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

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

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

Statutory Exemptions and Amendments

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

requirement to repatriate all foreign currency. In addition to the statutory exemptions, the Foreign Exchange Act sets forth the mechanics for obtaining specific exemptions from the Capital Controls, upon application to, and subject to the approval of, the Icelandic Central Bank.

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

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

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

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

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

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

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

In June 2016 rules were adopted by the Central Bank on special requirements for new foreign currency inflows. The rules were later amended in November 2016 and March 2017. The rules implement special reserve requirements in relation to some investments using inflows of foreign currency, which include an obligation to hold a special reserve amount in a special reserve account over a holding period. The new inflows that are subject to the reserve requirements are; (i) new investment and reinvestment in bonds or bills electronically issued in domestic currency, or deposits of such reinvested funds to domestic currency deposit accounts, bearing annual interest of 3.00% or more; (ii) domestic currency deposits from listed transactions; (iii) new investments and reinvestment of new investment in unit share certificates of funds that invest in bonds or bills electronically issued in domestic currency or domestic currency deposits from such investment, bearing annual interest of 3.00% or more constitute 10% or more of the funds assets; (iv) new investments and reinvestment of such new investment in the equity of a company that is established for the purpose of investing, directly or indirectly, in bonds or bills electronically issued in domestic currency or that is established for the purpose of investing, directly or indirectly, in domestic currency deposits, bearing annual interest of 3.00% or more; and (v) loans granted to resident entities that are used for investments in domestic currency, for the benefit of the lender, in bonds or bills electronically issued in domestic currency or domestic currency deposits from such investment, bearing annual interest of 3.00% or more. The parties subject to the reserve requirements are the registered owners of such bonds or bills, deposits or unit share certificates and the reserve ratio is 40% for a 12-month holding period. All relevant investors should consider their position in relation to the scope of these rules.

Easing of Capital Controls

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

The Capital Controls constitute protective measures under Article 44 of the EEA Agreement and have as such been notified to the Standing Committee of the EFTA under the procedures provided for in Protocol 18 of the EEA Agreement as well as Protocol 2 of the Agreement between the EEA EFTA states on the Establishment of a Surveillance Authority and a Court of Justice (the **Surveillance and Court Agreement**). Following a referral by the District Court of Reykjavík, the Court of Justice of the EEA EFTA states (the **EFTA Court**) issued a reasoned opinion on 14 December 2011, whereby the EFTA Court ruled that it had competence under the Capital Controls and the Surveillance and Court Agreement to review the Capital Controls, among other things, in light of the general principle of proportionality. The EFTA Court further declared that at the time in question the Capital Controls were proportionate. However, this ruling of the

EFTA Court does not preclude further scrutiny of the Capital Controls by the relevant institutions of the EEA at any time.

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

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

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

In October 2016, in the adoption of Act No. 105/2016, which took effect on 1 January 2017, further amendments were made to begin to implement the third part in the plan for easing of the Capital Controls. Act no. 105/2016 was followed by the Exchange Rules in March and June 2017, further easing the Capital Controls to the point where few restrictions remain.

OVERVIEW OF TRANSACTION DOCUMENTS

Cover Pool Swap Agreement

The Issuer may enter into an interest rate swap transaction governed by an ISDA Master Agreement (including a schedule, a credit support annex and confirmation(s)) in respect of the assets registered to the Cover Pool (respectively, the **Cover Pool Swap** and the **Cover Pool Swap Agreement**) with a Cover Pool Swap Provider.

On each monthly payment date under the Cover Pool Swap, the Issuer may pay to the Cover Pool Swap Provider all revenue payments (i.e. excluding principal payments) received in respect of the assets (other than Eligible Swaps) registered to the Cover Pool (but excluding amounts corresponding to the client margin) and the Cover Pool Swap Provider may pay to the Issuer an amount calculated on the nominal amount of the assets (other than Eligible Swaps) which are registered to the Cover Pool, based on the applicable floating rate or fixed rate payable under the Covered Bonds plus a margin.

The matching requirements referred to in "*Overview of the Icelandic Legislation Regarding Covered Bonds-Matching Rules*" above will apply in respect of the Cover Pool Swap.

Ratings downgrade

Under the Cover Pool Swap Agreement, in the event that the relevant rating(s) of the Cover Pool Swap Provider are downgraded by a rating agency below the rating(s) specified in the Cover Swap Agreement (in accordance with the requirements of the rating agencies) for the Cover Pool Swap Provider, the Cover Pool Swap Provider will, in accordance with the Cover Pool Swap Agreement, be required to take certain remedial measures which may include providing additional collateral for its obligations under the Cover Pool Swap, arranging for its obligations under the Cover Pool Swap to be transferred to an entity with rating(s) required by the relevant rating agency as specified in the Cover Pool Swap Agreement (in accordance with the requirements of the relevant rating agency), procuring another entity with rating(s) required by the relevant rating agency as specified in the Cover Pool Swap Agreement (in accordance with the requirements of the relevant rating agency) to become a co-obligor or guarantor, as applicable, in respect of its obligations under the Cover Pool Swap or taking some other action as it may agree with the relevant rating agency.

Termination events

The Cover Pool Swap Agreement will or may be terminated under certain circumstances, including the following:

- at the option of the Cover Pool Swap Provider, if the Issuer is in breach of representations contained in the Cover Pool Swap Agreement to register the Cover Pool Swap Agreement and the Cover Pool Swap thereunder in the Cover Pool register;
- at the option of one party to the Cover Pool Swap Agreement, if there is a failure by the other party to pay any amounts due under the Cover Pool Swap Agreement and any applicable grace period has expired;
- at the option of the Issuer, upon the occurrence of an insolvency of the Cover Pool Swap Provider or its guarantor, or the merger of the Cover Pool Swap Provider without an assumption of its obligations under the Cover Pool Swap Agreement, or if a material misrepresentation is made by the Cover Pool Swap Provider under the Cover Pool Swap Agreement, or if the Cover Pool Swap Provider defaults under an over-the-counter derivatives transaction under another agreement between the Issuer and the Cover Pool Swap Provider or if a breach of a provision of the Cover Pool

Swap Agreement by the Cover Pool Swap Provider is not remedied within the applicable grace period;

- if a change in law results in the obligations of one party becoming illegal or if a *force majeure* event occurs;
- at the option of the Cover Pool Swap Provider, if withholding taxes are imposed on payments made by the Issuer or by the Cover Pool Swap Provider under the Cover Pool Swap due to a change in law;
- if the Cover Pool Swap Provider or its guarantor, as applicable, is downgraded and fails to comply with the requirements of the ratings downgrade provisions contained in the Cover Pool Swap Agreement and described above under *Ratings downgrade*; and
- at the option of the Cover Pool Swap Provider, upon the redemption, prepayment or purchase of the Covered Bonds in whole or in part.

Upon the occurrence of a swap early termination event, the Issuer or the Cover Pool Swap Provider may be liable to make a termination payment to the other. The amount of any termination payment will be based on a good faith determination of total losses and costs (or gains) as to entering into a swap with terms and conditions that would have the effect of preserving the economic equivalent of the respective full payment obligations of the parties (which may be determined following consideration of quotations sought from leading dealers, relevant market data and information from internal sources) and will include any unpaid amounts that became due and payable prior to termination. Any such termination payment could be substantial and may affect the funds available to pay amounts due to the Covered Bondholders.

Covered Bondholders will not receive extra amounts (over and above interest and principal payable on the Covered Bonds) as a result of the Issuer receiving a termination payment from the Cover Pool Swap Provider.

Transfer

The Cover Pool Swap Provider may, subject to certain conditions specified in the Cover Pool Swap Agreement, including the satisfaction of certain requirements of the rating agencies, transfer its obligations under the Cover Pool Swap to another entity.

Taxation

Either party may be obliged to gross up payments made by it to the other party if withholding taxes are imposed on payments made under a Swap. However, if due to a change in law, either the Issuer or the Swap Provider is required to gross up a payment under a Swap or to receive a payment under a Swap from which an amount has been deducted or withheld, either the Issuer or the relevant Swap Provider, as the case may be, may terminate the relevant Swap.

The Cover Pool Swap Provider will rank senior to the Covered Bondholders in respect of its claims against the Issuer in respect of assets registered to the Cover Pool.

The margins over the applicable floating rate or fixed rate applicable to the Cover Pool Swap will be determined on the effective date of such swap and may be varied from time to time by the Issuer and the Cover Pool Swap Provider, subject to written confirmation from the rating agencies that the proposed amendment will not adversely affect the then current ratings of the Covered Bonds.

The Cover Pool Swap Agreement will be governed by English law.

Interest Rate Swap Agreements

The Issuer may also, from time to time, enter into additional interest rate swaps with Interest Rate Swap Providers by executing an ISDA Master Agreement (including schedules, a credit support annex and confirmations) (each such agreement, an **Interest Rate Swap Agreement** and each of the transactions thereunder, an **Interest Rate Swap**), in order to hedge the Issuer's interest rate risks in ISK and/or other currencies to the extent that these have not already been hedged by the Cover Pool Swap, Currency Swap or an Indexed Currency Swap, subject always to the matching requirements as referred to in "*Overview of the Icelandic Legislation Regarding Covered Bonds- Matching Rules*" above.

Ratings downgrade

Under each of the Interest Rate Swap Agreements, in the event that the relevant rating(s) of an Interest Rate Swap Provider are downgraded by a rating agency below the rating(s) specified in the relevant Interest Rate Swap Agreement (in accordance with the requirements of the rating agencies) for such Interest Rate Swap Provider, the relevant Interest Rate Swap Provider will, in accordance with the relevant Interest Rate Swap Agreement, be required to take certain remedial measures which may include providing additional collateral for its obligations under the relevant Interest Rate Swap, arranging for its obligations under the relevant Interest Rate Swap to be transferred to an entity with rating(s) required by the relevant rating agency as specified in the relevant Interest Rate Swap Agreement (in accordance with the requirements of the relevant rating agency), procuring another entity with rating(s) required by the relevant rating agency as specified in the relevant Interest Rate Swap Agreement (in accordance with the requirements of the relevant rating agency) to become a co-obligor or guarantor, as applicable, in respect of its obligations under the relevant Interest Rate Swap or taking some other action as it may agree with the relevant rating agency.

Termination events

The Interest Rate Swap Agreements will or may be terminated under certain circumstances, including the following:

- at the option of each Interest Rate Swap Provider, if the Issuer is in breach of representations contained in the relevant Interest Rate Swap Agreement to register the relevant Interest Rate Swap Agreement and each Interest Rate Swap thereunder in the Cover Pool register;
- at the option of one party to the relevant Interest Rate Swap Agreement, if there is a failure by the other party to pay any amounts due under that Interest Rate Swap Agreement and any applicable grace period has expired;
- at the option of the Issuer, upon the occurrence of an insolvency of the relevant Interest Rate Swap Provider or its guarantor, or the merger of the relevant Interest Rate Swap Provider without an assumption of its obligations under the relevant Interest Rate Swap Agreement, or if a material misrepresentation is made by the relevant Interest Rate Swap Provider under the relevant Interest Rate Swap Agreement, or if the relevant Interest Rate Swap Provider defaults under an over-the-counter derivatives transaction under another agreement between the Issuer and such Interest Rate Swap Provider or if a breach of a provision of the relevant Interest Rate Swap Agreement by the Interest Rate Swap Provider is not remedied within the applicable grace period;
- if a change in law results in the obligations of one party becoming illegal or if a *force majeure* event occurs;
- at the option of the relevant Interest Rate Swap Provider, if withholding taxes are imposed on payments made by the Issuer or by the relevant Interest Rate Swap Provider under the relevant Interest Rate Swap due to a change in law;

- if the relevant Interest Rate Swap Provider, or its guarantor, as applicable, is downgraded and fails to comply with the requirements of the ratings downgrade provisions contained in the relevant Interest Rate Swap Agreement and described above under "*Ratings downgrade*"; and
- at the option of the relevant Interest Rate Swap Provider, upon the redemption, prepayment or purchase of the Covered Bonds in whole or in part.

Upon the occurrence of a swap early termination event, the Issuer or the relevant Interest Rate Swap Provider may be liable to make a termination payment to the other. The amount of any termination payment will be based on a good faith determination of total losses and costs (or gains) as to entering into a swap with terms and conditions that would have the effect of preserving the economic equivalent of the respective full payment obligations of the parties (which may be determined following consideration of quotations sought from leading dealers, relevant market data and information from internal sources), and will include any unpaid amounts that became due and payable prior to termination. Any such termination payment could be substantial and may affect the funds available to pay amounts due to the Covered Bondholders.

Covered Bondholders will not receive extra amounts (over and above interest and principal payable on the Covered Bonds) as a result of the Issuer receiving a termination payment from an Interest Rate Swap Provider.

Transfer

Each Interest Rate Swap Provider may, subject to certain conditions specified in the relevant Interest Rate Swap Agreement, including the satisfaction of certain requirements of the rating agencies, transfer its obligations under any Interest Rate Swap to another entity.

Taxation

Either party may be obliged to gross up payments made by it to the other party if withholding taxes are imposed on payments made under a Swap. However, if due to a change in law, either the Issuer or the Swap Provider is required to gross up a payment under a Swap or to receive a payment under a Swap from which an amount has been deducted or withheld, either the Issuer or the relevant Swap Provider, as the case may be, may terminate the relevant Swap.

The Interest Rate Swap Agreements will be governed by English law.

The Interest Rate Swap Providers will rank senior to the Covered Bondholders in respect of their claims against the Issuer in respect of assets registered to the Cover Pool.

Currency Swap Agreements

Subject to currency restrictions in place at each time, if Covered Bonds are issued in currencies other than ISK, the Issuer may enter into Currency Swaps from time to time with Currency Swap Providers by executing ISDA Master Agreements (including schedules, a credit support annex and confirmations) (each such agreement, a **Currency Swap Agreement** and each of the transactions thereunder, a **Currency Swap**), in order to hedge currency risks arising between (a) Covered Bonds issued in currencies other than ISK and (b) assets (other than Mortgage Bonds and Eligible Swaps) forming part of the Cover Pool but denominated in currencies other than ISK, subject always to the matching requirements as referred to in "*Overview of the Icelandic Legislation Regarding Covered Bonds- Matching Rules*" above.

Ratings downgrade

Under each of the Currency Swap Agreements, in the event that the relevant rating(s) of a Currency Swap Provider are downgraded by a rating agency below the rating(s) specified in the relevant Currency Swap

Agreement (in accordance with the requirements of the rating agencies) for such Currency Swap Provider, the relevant Currency Swap Provider will, in accordance with the relevant Currency Swap Agreement, be required to take certain remedial measures which may include providing additional collateral for its obligations under the relevant Currency Swap, arranging for its obligations under the relevant Currency Swap to be transferred to an entity with rating(s) required by the relevant rating agency as specified in the relevant Currency Swap Agreement (in accordance with the requirements of the relevant rating agency), procuring another entity with rating(s) required by the relevant rating agency as specified in the relevant Currency Swap Agreement (in accordance with the requirements of the relevant rating agency) to become a co-obligor or guarantor, as applicable, in respect of its obligations under the relevant Currency Swap or taking some other action as it may agree with the relevant rating agency.

Termination events

The Currency Swap Agreements will or may be terminated under certain circumstances, including the following:

- at the option of each Currency Swap Provider, if the Issuer is in breach of representations contained in the relevant Currency Swap Agreement to register the relevant Currency Swap Agreement and each Currency Swap thereunder in the Cover Pool register;
- at the option of one party to the relevant Currency Swap Agreement, if there is a failure by the other party to pay any amounts due under that Currency Swap Agreement and any applicable grace period has expired;
- at the option of the Issuer, upon the occurrence of an insolvency of the relevant Currency Swap Provider or its guarantor, or the merger of the relevant Currency Swap Provider without an assumption of its obligations under the relevant Currency Swap Agreement, or if a material misrepresentation is made by the relevant Currency Swap Provider under the relevant Currency Swap Agreement, or if the relevant Currency Swap Provider defaults under an over-the-counter derivatives transaction under another agreement between the Issuer and such Currency Swap Provider or if a breach of a provision of the relevant Currency Swap Agreement by the Currency Swap Provider is not remedied within the applicable grace period;
- if a change in law results in the obligations of one party becoming illegal;
- at the option of the relevant Currency Swap Provider, if withholding taxes are imposed on payments made by the Issuer or by the relevant Currency Swap Provider under the relevant Currency Swap due to a change in law;
- if the relevant Currency Swap Provider or its guarantor, as applicable, is downgraded and fails to comply with the requirements of the ratings downgrade provisions contained in the relevant Currency Swap Agreement and described above under "*Ratings downgrade*"; and
- at the option of the relevant Currency Swap Provider, upon the redemption, prepayment or purchase of the Covered Bonds in whole or in part.

Upon the occurrence of a swap early termination event, the Issuer or the relevant Currency Swap Provider may be liable to make a termination payment to the other. The amount of any termination payment will be based on a good faith determination of total losses and costs (or gains) as to entering into a swap with terms and conditions that would have the effect of preserving the economic equivalent of the respective full payment obligations of the parties (which may be determined following consideration of quotations sought from leading dealers, relevant market data and information from internal sources), and will include any unpaid amounts that became due and payable prior to termination. Any such termination payment could be substantial and may affect the funds available to pay amounts due to the Covered Bondholders.

Covered Bondholders will not receive extra amounts (over and above interest and principal payable on the Covered Bonds) as a result of the Issuer receiving a termination payment from a Currency Swap Provider.

Transfer

Each Currency Swap Provider may, subject to certain conditions specified in the relevant Currency Swap Agreement, including the satisfaction of certain requirements of the rating agencies, transfer its obligations under any Currency Swap to another entity.

Taxation

Either party may be obliged to gross up payments made by it to the other party if withholding taxes are imposed on payments made under a Swap. However, if due to a change in law, either the Issuer or the Swap Provider is required to gross up a payment under a Swap or to receive a payment under a Swap from which an amount has been deducted or withheld, either the Issuer or the relevant Swap Provider, as the case may be, may terminate the relevant Swap.

The Currency Swap Agreements will be governed by English law.

The Currency Swap Provider will rank senior to the Covered Bondholders in respect of their claims against the Issuer in respect of assets registered to the Cover Pool.

Where the Issuer enters into both interest rate swap transactions and currency swap transactions with the same counterparty these may be entered into under the same ISDA Master Agreement.

Indexed Currency Swap Agreements

The Issuer will enter into Indexed Currency Swaps from time to time with Indexed Currency Swap Providers by executing ISDA Master Agreements (including schedules, a credit support annex and confirmations) (each such agreement, an **Indexed Currency Swap Agreement** and each of the transactions thereunder, an **Indexed Currency Swap** in order to hedge currency and inflation risks arising between (a) Covered Bonds issued in currencies other than ISK and (b) assets forming part of the Cover Pool but denominated in ISK and indexed linked, subject always to the matching requirements as referred to in "*Overview of the Icelandic Legislation Regarding Covered Bonds- Matching Rules*" above.

Ratings downgrade

Under each of the Indexed Currency Swap Agreements, in the event that the relevant rating(s) of an Indexed Currency Swap Provider are downgraded by a rating agency below the rating(s) specified in the relevant Indexed Currency Swap Agreement (in accordance with the requirements of the rating agencies) for such Indexed Currency Swap Provider, the relevant Indexed Currency Swap Provider will, in accordance with the relevant Indexed Currency Swap Agreement, be required to take certain remedial measures which may include providing additional collateral for its obligations under the relevant Indexed Currency Swap, arranging for its obligations under the relevant Indexed Currency Swap to be transferred to an entity with rating(s) required by the relevant rating agency as specified in the relevant Indexed Currency Swap Agreement (in accordance with the requirements of the relevant rating agency), procuring another entity with rating(s) required by the relevant rating agency as specified in the relevant Indexed Currency Swap Agreement (in accordance with the requirements of the relevant rating agency) to become a co-obligor or guarantor, as applicable, in respect of its obligations under the relevant Indexed Currency Swap or taking some other action as it may agree with the relevant rating agency.

Termination events

The Indexed Currency Swap Agreements will or may be terminated under certain circumstances, including the following:

- at the option of each Indexed Currency Swap Provider, if the Issuer is in breach of representations contained in the relevant Indexed Currency Swap Agreement to register the relevant Indexed Currency Swap Agreement and each Indexed Currency Swap thereunder in the Cover Pool register;
- at the option of one party to the relevant Indexed Currency Swap Agreement, if there is a failure by the other party to pay any amounts due under that Indexed Currency Swap Agreement and any applicable grace period has expired;
- at the option of the Issuer, upon the occurrence of an insolvency of the relevant Indexed Currency Swap Provider or its guarantor, or the merger of the relevant Indexed Currency Swap Provider without an assumption of its obligations under the relevant Indexed Currency Swap Agreement, or if a material misrepresentation is made by the relevant Currency Swap Provider under the relevant Indexed Currency Swap Agreement, or if the relevant Indexed Currency Swap Provider defaults under an over-the-counter derivatives transaction under another agreement between the Issuer and such Indexed Currency Swap Provider or if a breach of a provision of the relevant Indexed Currency Swap Agreement by the Indexed Currency Swap Provider is not remedied within the applicable grace period;
- if a change in law results in the obligations of one party becoming illegal or if a *force majeure* event occurs;
- at the option of the relevant Indexed Currency Swap Provider, if withholding taxes are imposed on payments made by the Issuer or by the relevant Indexed Currency Swap Provider under the relevant Indexed Currency Swap due to a change in law;
- if the relevant Indexed Currency Swap Provider or its guarantor, as applicable, is downgraded and fails to comply with the requirements of the ratings downgrade provisions contained in the relevant Indexed Currency Swap Agreement and described above under "*Ratings downgrade*";
- at the option of the relevant Indexed Currency Swap Provider, upon the redemption, prepayment or purchase of the Covered Bonds in whole or in part.

Upon the occurrence of a swap early termination event, the Issuer or the relevant Indexed Currency Swap Provider may be liable to make a termination payment to the other. The amount of any termination payment will be based on a good faith determination of total losses and costs (or gains) as to entering into a swap with terms and conditions that would have the effect of preserving the economic equivalent of the respective full payment obligations of the parties (which may be determined following consideration of quotations sought from leading dealers, relevant market data and information from internal sources), and will include any unpaid amounts that became due and payable prior to termination. Any such termination payment could be substantial and may affect the funds available to pay amounts due to the Covered Bondholders.

Covered Bondholders will not receive extra amounts (over and above interest and principal payable on the Covered Bonds) as a result of the Issuer receiving a termination payment from a Indexed Currency Swap Provider.

Transfer

Each Indexed Currency Swap Provider may, subject to certain conditions specified in the relevant Indexed Currency Swap Agreement, including the satisfaction of certain requirements of the rating agencies, transfer its obligations under any Indexed Currency Swap to another entity.

Taxation

Either party may be obliged to gross up payments made by it to the other party if withholding taxes are imposed on payments made under a Swap. However, if due to a change in law, either the Issuer or the Swap Provider is required to gross up a payment under a Swap or to receive a payment under a Swap from which an amount has been deducted or withheld, either the Issuer or the relevant Swap Provider, as the case may be, may terminate the relevant Swap.

The Indexed Currency Swap Agreements will be governed by English law.

Eligibility Criteria for Swap Providers

The Issuer will only enter into Swaps with entities which are "qualified counterparties" for the purposes of the Icelandic Covered Bond Act (such Swaps, the **Eligible Swaps**).

BOOK-ENTRY CLEARANCE SYSTEMS

*The information set out below is subject to any change in or reinterpretation of the rules, regulations and procedures of Euroclear or Clearstream, Luxembourg or the ISD (together, the **Clearing Systems**) currently in effect. Investors wishing to use the facilities of any of the Clearing Systems are advised to confirm the continued applicability of the rules, regulations and procedures of the relevant Clearing System. None of the Issuer nor any other party to the Agency Agreement will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Covered Bonds held through the facilities of any Clearing System or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.*

In light of the existing withholding tax regime in Iceland, the clearing of the Covered Bonds through Euroclear or Clearstream, Luxembourg will be subject to confirmation that the relevant registration requirements with the Icelandic authorities have been completed.

Book-entry Systems

Euroclear and Clearstream, Luxembourg

Euroclear and Clearstream, Luxembourg each holds securities for its customers and facilitates the clearance and settlement of securities transactions by electronic book-entry transfer between their respective account holders. Euroclear and Clearstream, Luxembourg provide various services including safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depository and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective participants may settle trades with each other.

Euroclear and Clearstream, Luxembourg customers are world-wide financial institutions, including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions that clear through or maintain a custodial relationship with an account holder of either system.

Transfers of Covered Bonds Represented by Registered Global Covered Bonds

Transfers of any interests in Covered Bonds represented by a Registered Covered Bond within Euroclear and Clearstream, Luxembourg will be effected in accordance with the customary rules and operating procedures of the relevant clearing system.

Subject to compliance with the transfer restrictions applicable to the Registered Covered Bonds described under "*Subscription and Sale and Selling Restrictions*", and directly or indirectly through Clearstream, Luxembourg or Euroclear accountholders, will be effected by the relevant clearing system in accordance with its rules and through action taken by the Registrar, the Fiscal Agent and any custodian (**Custodian**) with whom the relevant Registered Global Covered Bonds have been deposited.

On or after the Issue Date for any Series, transfers of Covered Bonds of such Series between accountholders in Clearstream, Luxembourg and Euroclear will generally have a settlement date three business days after the trade date (T+3). The customary arrangements for delivery versus payment will apply to such transfers.

Clearstream, Luxembourg and Euroclear have each published rules and operating procedures designed to facilitate transfers of beneficial interests in Registered Global Covered Bonds among participants and accountholders of Clearstream, Luxembourg and Euroclear. However, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued or changed at any

time. None of the Issuer, the Agents or any Dealer will be responsible for any performance by Clearstream, Luxembourg or Euroclear or their respective direct or indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations and none of them will have any liability for any aspect of the records relating to or payments made on account of beneficial interests in the Covered Bonds represented by Registered Global Covered Bonds or for maintaining, supervising or reviewing any records relating to such beneficial interests.

TAXATION

General

Prospective purchasers of Covered Bonds are advised to consult their tax advisers as to the consequences, under the tax laws of the countries of their respective citizenship, residence or domicile, of a purchase of Covered Bonds, including, but not limited to, the consequences of receipt of payments under the Covered Bonds and their disposal or redemption.

Iceland

The comments below are of general nature based on the understanding of the Issuer of current law and practice in Iceland. They should not be construed as providing specific advice as to Icelandic taxation and are subject to changes as to the applicable rules in the future. They relate only to the position of persons who are the absolute beneficial owners of the Covered Bonds. They may not apply to certain classes of persons, such as dealers. Prospective holders of the Covered Bonds who are in any doubt as to their personal tax position or who may be subject to tax in any other jurisdiction should consult their professional advisers.

In light of the existing withholding tax regime in Iceland, the clearing of the Covered Bonds through Euroclear or Clearstream, Luxembourg will be subject to confirmation that the relevant registration requirements with the Icelandic authorities have been completed.

(a) 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 Covered Bonds, by any person or entity residing outside of Iceland is taxable income in Iceland. According to Article 70 (8) of the ITA, the current tax rate on taxable income under Article 3(8) is (a) 12 per cent. for individuals (only applicable to interest income exceeding the annual amount of ISK 150,000.00); and (b) 12 per cent. for legal entities.

From the general rule of Article 3(8) of the ITA, there are certain exemptions listed in the provision, e.g. if an applicable double taxation treaty states otherwise. Also, according to Article 3(8), cf. Article 3(3) of Regulation no. 630/2013, the Bank is not required by Icelandic law to deduct or withhold tax from interest payments on notes or bonds that are issued by a financial institution, in its own name, registered with a securities depository in 1) a member state of the OECD, 2) a member state of the European Economic Area (**EEA**), 3) a member state of The European Free Trade Association (**EFTA**), or 4) the Faroe Islands, and 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. Accordingly, the Bank will, based on this confirmation, register any Bonds issued under the Programme with the RSK and request that the RSK provide a certificate confirming that the relevant Bonds 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).

There are no estate or inheritance taxes, succession duties, gift taxes or capital gains taxes imposed on the holder of the Covered Bonds by Iceland or any authority of, or in, Iceland in respect of the Covered Bonds if, at the time of the death of the holder or the transfer of the Covered Bonds, such holder or transferor and transferee are not tax residents of Iceland.

Capital gains on the sale of the Bonds 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 Bonds should not be subject to Income tax in Iceland, provided a tax exemption is in place.

In instances other than those specifically stated herein as being applicable, the provisions of Condition 9 will apply and the Issuer will be required to pay additional amounts as provided in Condition 9, but may be entitled to redeem the relevant Covered Bonds pursuant to Condition 8.2.

(b) Icelandic Tax Residents

Beneficial owners of the Covered Bonds 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 rate depends on their tax status. Any capital gains upon sale of Covered Bonds are subject to the same tax as interest income of Icelandic residents.

Subject to certain exemptions (which apply, inter alia, to most banks and pension funds), the Bank is required to withhold a 22 per cent. tax on the interest paid to the owners of Covered Bonds 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.

The proposed financial transactions tax (FTT)

On 14 February 2013, the European Commission published a proposal (the **Commission's Proposal**) for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (each, other than Estonia, a **participating Member State**). However, Estonia has since ceased to participate.

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

Under the Commission's Proposal, the FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in the Covered Bonds where at least one party is a financial institution and at least one party is established in a participating Member State. A financial institution 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 Covered Bonds are advised to seek their own professional advice in relation to the FTT and its potential impact on the Covered Bonds.

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 Covered Bonds 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 Covered Bonds

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 Covered Bonds, nor on accrued but unpaid interest in respect of the Covered Bonds, nor is any Luxembourg withholding tax payable upon redemption or repurchase of the Covered Bonds held by non-resident holders of Covered Bonds.

(ii) Resident holders of Covered Bonds

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 Covered Bonds, nor on accrued but unpaid interest in respect of Covered Bonds, nor is any Luxembourg withholding tax payable upon redemption or repurchase of Covered Bonds held by Luxembourg resident holders of Covered Bonds.

Under the Relibi Law payments of interest or similar income made or ascribed by a paying agent established in Luxembourg to an individual beneficial owner who is a resident of Luxembourg will be subject to a withholding tax of 20 per cent. Such withholding tax will be in full discharge of income tax if the beneficial owner is an individual acting in the course of the management of his/her private wealth. Responsibility for the withholding of the tax will be assumed by the Luxembourg paying agent. Payments of interest under the Covered Bonds coming within the scope of the Law will be subject to a withholding tax at a rate of 20 per cent.

U.S. Foreign Account Tax Compliance Act

FATCA imposes a new reporting regime and potentially a 30% withholding tax with respect to certain payments to (i) any non-U.S. financial institution (a "foreign financial institution", or **FFI** (as defined by FATCA)) that does not become a **Participating FFI** by entering into an agreement with the U.S. Internal

Revenue Service (**IRS**) to provide the IRS with certain information in respect of its account holders and investors or is not otherwise exempt from or in deemed compliance with FATCA and (ii) any investor (unless otherwise exempt from FATCA) that does not provide information sufficient to determine whether the investor is a U.S. person or should otherwise be treated as holding a "United States account" of the Issuer (a "Recalcitrant Holder"). The Issuer is classified as an FFI.

The new withholding regime is currently in effect for payments from sources within the United States and will apply to **foreign passthru payments** (a term not yet defined) no earlier than 1 January 2017. This withholding would potentially apply to payments in respect of (i) any Covered Bonds characterized as debt (or which are not otherwise characterized as equity and have a fixed term) for U.S. federal tax purposes that are issued after the **grandfathering date**, which is the date that is six months after the date on which final U.S. Treasury regulations defining the term foreign passthru payment are filed with the Federal Register, or which are materially modified after the grandfathering date and (ii) any Covered Bonds characterized as equity or which do not have a fixed term for U.S. federal tax purposes, whenever issued. If Covered Bonds are issued on or before the grandfathering date, and additional Covered Bonds of the same series are issued on or after that date, the additional Covered Bonds may not be treated as grandfathered, which may have negative consequences for the existing Covered Bonds, including a negative impact on market price.

The United States and a number of other jurisdictions have announced their intention to negotiate intergovernmental agreements to facilitate the implementation of FATCA (each, an **IGA**). Pursuant to FATCA and the "Model 1" and "Model 2" IGAs released by the United States, an FFI in an IGA signatory country could be treated as a **Reporting FI** not subject to withholding under FATCA on any payments it receives. Further, an FFI in an IGA jurisdiction would generally not be required to withhold under FATCA or an IGA (or any law implementing an IGA) (any such withholding being **FATCA Withholding**) from payments it makes. Under each Model IGA, a Reporting FI would still be required to report certain information in respect of its account holders and investors to its home government or to the IRS. The United States and Iceland have entered into an agreement (the **US-Iceland IGA**) based largely on the Model 1 IGA.

If the Issuer is treated as a Reporting FI pursuant to the US-Iceland IGA it does not anticipate that it will be obliged to deduct any FATCA Withholding on payments it makes. There can be no assurance, however, that the Issuer will be treated as a Reporting FI, or that it would in the future not be required to deduct FATCA Withholding from payments it makes. The Issuer and financial institutions through which payments on the Covered Bonds are made may be required to withhold FATCA Withholding if (i) any FFI through or to which payment on such Covered Bonds is made is not a Participating FFI, a Reporting FI, or otherwise exempt from or in deemed compliance with FATCA or (ii) an investor is a Recalcitrant Holder.

Whilst the Covered Bonds are in global form and held within the ICSD, it is expected that FATCA will not affect the amount of any payments made under, or in respect of, the Covered Bonds by the Issuer, any paying agent and the Common Depositary or the Common Safekeeper, given that each of the entities in the payment chain between the Issuer and the clearing systems is a major financial institution whose business is dependent on compliance with FATCA and that any alternative approach introduced under an IGA will be unlikely to affect the Covered Bonds. The documentation expressly contemplates the possibility that the Covered Bonds may go into definitive form and therefore that they may be taken out of the clearing systems. If this were to happen, then a non-FATCA compliant holder could be subject to FATCA Withholding. However, definitive covered bonds will only be printed in remote circumstances.

FATCA is particularly complex and its application is uncertain at this time. The above description is based in part on regulations, official guidance and model IGAs, all of which are subject to change or may be implemented in a materially different form. Prospective investors should consult their tax advisers on how these rules may apply to the Issuer and to payments they may receive in connection with the Covered Bonds.

SUBSCRIPTION AND SALE AND SELLING RESTRICTIONS

The Dealers have, in a programme agreement dated 10 February 2012, as amended and restated on 8 January 2019 (the **Programme Agreement**), agreed with the Issuer a basis upon which they or any of them may from time to time agree to purchase Covered Bonds. Any such agreement will extend to those matters stated under "*Form of the Covered Bonds*" and "*Terms and Conditions of the Covered Bonds*". In the Programme Agreement, the Issuer 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 Covered Bonds under the Programme and to indemnify the Dealers against certain liabilities incurred by them in connection therewith.

In order to facilitate the offering of any Tranche of the Covered Bonds, certain persons participating in the offering of the Tranche may engage in transactions that stabilise, maintain or otherwise affect the market price of the relevant Covered Bonds during and after the offering of the Tranche. Specifically such persons may over-allot or create a short position in the Covered Bonds for their own account by selling more Covered Bonds than have been sold to them by the Issuer. Such persons may also elect to cover any such short position by purchasing Covered Bonds in the open market. In addition, such persons may stabilise or maintain the price of the Covered Bonds by bidding for or purchasing Covered Bonds in the open market and may impose penalty bids, under which selling concessions allowed to syndicate members or other broker-dealers participating in the offering of the Covered Bonds are reclaimed if Covered Bonds previously distributed in the offering are repurchased in connection with stabilisation transactions or otherwise. The effect of these transactions may be to stabilise or maintain the market price of the Covered Bonds at a level above that which might otherwise prevail in the open market. The imposition of a penalty bid may also affect the price of the Covered Bonds to the extent that it discourages resales thereof. No representation is made as to the magnitude or effect of any such stabilising or other transactions. Such transactions, if commenced, may be discontinued at any time. Under U.K. laws and regulations stabilising activities may only be carried on by the Stabilisation Manager(s) named in the applicable Final Terms (or persons acting on behalf of any Stabilisation Manager(s)) and only for a limited period following the Issue Date of the relevant Tranche of Covered Bonds.

Selling Restrictions

United States

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

In connection with any Covered Bonds which are offered or sold outside the United States in reliance on an exemption from the registration requirements of the Securities Act provided under Regulation S (**Regulation S Covered Bonds**), 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 such Regulation S Covered Bonds (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 Covered Bonds on a syndicated basis, the relevant lead manager, of all Covered Bonds of the Tranche of which such Regulation S Covered Bonds 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 Regulation S Covered Bonds during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Regulation S Covered Bonds 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 Covered Bonds, an offer or sale of such Covered Bonds within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with an available exemption from registration under the Securities Act.

Prohibition of Sales to EEA Retail Investors

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that it has not offered, sold or otherwise made available and will not offer, sell or otherwise make available any Covered Bonds which are the subject of the offering contemplated by this Base Prospectus as completed by the relevant Final Terms in relation thereto to any retail investor in the EEA. For the purposes of this provision:

- (a) the expression “**retail investor**” means a person who is one (or more) of the following:
 - (i) a retail client as defined in point (11) of Article 4(1) of MiFID II; or
 - (ii) a customer within the meaning of IMD, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or
 - (iii) not a qualified investor as defined in the Prospectus Directive; and
- (b) the expression an “**offer**” includes the communication in any form and by any means of sufficient information on the terms of the offer and the Covered Bonds to be offered so as to enable an investor to decide to purchase or subscribe the Covered Bonds.

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 Covered Bonds which are the subject of the offering contemplated by this Offering Circular as completed by the final terms in relation thereto to the public in that Relevant Member State, except that it may, with effect from and including the Relevant Implementation Date, make an offer of such Covered Bonds to the public in that Relevant Member State:

- (a) at any time to any legal entity which is a qualified investor as defined in the Prospectus Directive and, where relevant, is registered with the Financial Supervisory Authority of Norway as a professional investor;
- (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 Issuer 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 Covered Bonds referred to in (a) to (c) above shall require the Issuer or any Dealer to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression **an offer of Covered Bonds to the public** in relation to any Covered Bonds in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Covered Bonds to be offered so as to enable an investor to decide to purchase or subscribe the Covered Bonds, 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 Covered Bonds 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 Covered Bonds 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 Covered Bonds would otherwise constitute a contravention of Section 19 of the Financial Services and Markets Act 2000 (**FSMA**) by the Issuer;
- (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 Covered Bonds in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer; 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 such Covered Bonds in, from or otherwise involving the United Kingdom.

Republic of Italy

The offering of the Covered Bonds has not been registered pursuant to Italian securities legislation and, accordingly, no Covered Bonds may be offered, sold or delivered, nor may copies of the Prospectus or of any other document relating to the Covered Bonds be distributed in the Republic of Italy, except:

- (a) to qualified investors (*investitori qualificati*), as defined pursuant to Article 100 of Legislative Decree No. 58 of 24 February 1998, as amended (the **Financial Services Act**) and Article 34-ter, first paragraph, letter (b) of CONSOB (the Italian Securities Exchange Commission) Regulation No. 11971 of 14 May 1999, as amended from time to time (**Regulation No. 11971**); or
- (b) in other circumstances which are exempted from the rules on public offerings pursuant to Article 100 of the Financial Services Act and Article 34-ter of Regulation No. 11971.

Furthermore, each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that any offer, sale or delivery of the Covered Bonds or distribution of copies of the Prospectus or any other document relating to the Covered Bonds in the Republic of Italy under (a) or (b) above must be:

- (i) made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act, CONSOB Regulation No. 16190 of 29 October 2007 (as amended from time to

time) and Legislative Decree No. 385 of 1 September 1993, as amended (the **Italian Banking Act**); and

- (ii) in compliance with Article 129 of the Italian Banking Act, as amended and the implementing guidelines of the Bank of Italy (as amended from time to time) pursuant to which the Bank of Italy may request information on the issue or the offer of securities in the Republic of Italy; or
- (iii) in compliance with any other applicable laws and regulations or requirement imposed by CONSOB or other Italian authority.

Iceland

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 Covered Bonds to the public in Iceland, except in compliance with the Icelandic Act on Securities Transactions (No.108/2007), as amended, and any applicable laws or regulations of Iceland.

Japan

The Covered Bonds have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (Act No. 25 of 1948, as amended; the **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 Covered Bonds, 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 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 Covered Bonds (except for Covered Bonds which are a "structured product" as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong) (the **SFO**) other than (i) to persons whose ordinary business is to buy or sell shares or debentures (whether as principal or agent); or (ii) to "professional investors" as defined in the SFO and any rules made under the SFO; or (iii) in other circumstances which do not result in the document being a "prospectus" as defined in the Companies Ordinance (Cap. 32) of Hong Kong the **C(WUMPO)** or which do not constitute an offer to the public within the meaning of that the **C(WUMPO)**; 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 Covered Bonds, 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 Covered Bonds which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" as defined in the SFO and any rules made under the SFO.

General

Each Dealer has represented and agreed and each further Dealer appointed under the Programme will be required to represent and 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 Covered Bonds or possesses or distributes this Offering Circular and will obtain any consent, approval or permission, required by it for the purchase, offer, sale or delivery by it of Covered Bonds 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 Issuer nor any of the other Dealers shall have any responsibility therefor.

None of the Issuer and the Dealers represents that Covered Bonds 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.

With regard to each Tranche, the relevant Dealer will be required to comply with such other restrictions as the Issuer and the relevant Dealer shall agree and as shall be set out in the applicable Final Terms.

GENERAL INFORMATION

Authorisation

The establishment of the Programme and the issue of Covered Bonds were duly authorised by a resolution of the Board of Directors of the Issuer dated 2 March 2011, 11 October 2011 and 27 July 2013¹¹. Board approval for continued update and issuances of Covered Bonds under the Programme and to approve the increase of the size of the Programme from €1,000,000,000 to €1,500,000,000 was obtained on 6 December 2017.

Listing, Approval and Admission to Trading

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 Covered Bonds issued under the Programme to be admitted to trading on the regulated market of the Luxembourg Stock Exchange and to be listed on the Official List of the Luxembourg Stock Exchange. The regulated market of the Luxembourg Stock Exchange is a regulated market for the purposes of MiFID II.

Documents available

For the period of 12 months following the date of this Offering Circular, copies of the following documents will, when published, be available for inspection from the registered office of the Issuer and from the specified office of the Paying Agent for the time being in Luxembourg:

- (a) the articles of association (with an English translation thereof) of the Issuer;
- (b) the 2017 Consolidated Financial Statements and the 2016 Consolidated Financial Statements (with an English translation thereof) in each case together with the audit reports prepared in connection therewith. The Issuer currently prepares audited consolidated accounts on an annual basis. The Issuer does not currently prepare non-consolidated accounts;
- (c) the most recently published audited annual financial statements of the Issuer and the most recently published unaudited interim financial statements of the Issuer (with an English translation thereof) in each case together with any audit or review reports prepared in connection therewith. The Issuer currently prepares unaudited consolidated interim accounts on a quarterly basis;
- (d) the Agency Agreement, the Deed of Covenant and the forms of the Global Covered Bonds, the Covered Bonds in definitive form, the Receipts, the Coupons and the Talons;
- (e) relevant Cover Pool Swap Agreements, Currency Swap Agreements, Indexed Currency Swap Agreements and Interest Rate Swap Agreements, if any;
- (f) a copy of this Offering Circular;
- (g) the terms and conditions of the Covered Bonds set out on pages 70 to 102 (inclusive) of the Prospectus dated 9 February 2012 and prepared by the Issuer in connection with the Programme;
- (h) the terms and conditions of the Covered Bonds set out on pages 64 to 100 (inclusive) of the Prospectus dated 23 August 2013 and prepared by the Issuer in connection with the Programme;
- (i) the terms and conditions of the Covered Bonds set out on pages 65 to 101 (inclusive) of the Prospectus dated 5 December 2014 and prepared by the Issuer in connection with the Programme;

¹¹ Arion to update/confirm

- (j) the terms and conditions of the Covered Bonds set out on pages 68 to 104 (inclusive) of the Prospectus dated 18 December 2015 and prepared by the Issuer in connection with the Programme;
- (k) the terms and conditions of the Covered Bonds set out on pages 73 to 108 (inclusive) of the Prospectus dated 23 December 2016 and prepared by the Issuer in connection with the Programme;
- (l) the terms and conditions of the Covered Bonds set out on pages 84 to 119 (inclusive) of the Prospectus dated 5 January 2018 and prepared by the Issuer in connection with the Programme;
- (m) any future offering circulars, prospectuses, information memoranda and supplements, and any Final Terms (save that a Final Terms relating to a Covered Bond which is neither admitted to trading on a regulated market in the EEA nor offered in the EEA in circumstances where a prospectus is required to be published under the Prospectus Directive will only be available for inspection by a holder of such Covered Bond and such holder must produce evidence satisfactory to the Issuer and the Paying Agent as to its holding of Covered Bonds and identity) to this Offering Circular and any other documents incorporated herein or therein by reference; and
- (n) in the case of each issue of Covered Bonds admitted to trading on the regulated market of the Luxembourg Stock Exchange subscribed pursuant to a subscription agreement, the subscription agreement (or equivalent document).

In addition, copies of this Offering Circular, each Final Terms relating to Covered Bonds which are admitted to trading on the regulated market of the Luxembourg Stock Exchange and each document incorporated by reference are available on the Luxembourg Stock Exchange's website at www.bourse.lu.

Investors should consult the Issuer should they require a copy of the 2006 ISDA Definitions.

Clearing systems

The Covered Bonds have been accepted for clearance through Euroclear, Clearstream, Luxembourg and the ISD (which are the entities in charge of keeping the records). The appropriate Common Code and ISIN for each Tranche of Covered Bonds allocated by Euroclear and Clearstream, Luxembourg or the ISD will be specified in the applicable Final Terms. If the Covered Bonds 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. The address of ISD is Icelandic Securities Depository, Laugavegur 182, 105 Reykjavik.

Conditions for determining price

The price and amount of Covered Bonds to be issued under the Programme will be determined by the Issuer and the relevant Dealer at the time of issue in accordance with prevailing market conditions.

Significant change or material adverse change

There has been no significant change in the financial or trading position of the Issuer since 30 September 2018 and there has been no material adverse change in the financial position or prospects of the Issuer since 31 December 2017.

Litigation

Neither the Issuer nor any of its subsidiaries is or has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer 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 Issuer or the Issuer and its subsidiaries, taken as a whole.

Auditors

On 19 March 2015 Deloitte ehf., members of The Institute of State Authorised Public Accountants in Iceland, were appointed auditors of the Issuer. Deloitte ehf. has audited the Annual Financial Statements, without qualification, in accordance with International Standards on Auditing.

Deloitte ehf. does not have a material interest in the Bank.

Post-issuance information

The Issuer does not intend to provide any post-issuance information in relation to any assets underlying any Covered Bonds constituting derivative securities.

Dealers transacting with the Issuer

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 services to, the Issuer and its affiliates in the ordinary course of business.

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