Condensed Consolidated Interim Financial Statements

Unaudited

Nine months ended 30 September 2011

Íslandsbanki hf.
Kirkjusandur
155 Reykjavík
Reg. no. 491008-0160
Iceland

Contents

Endorsement and Statement by the Board of Directors and the CEO

The unaudited Condensed Consolidated Interim Financial Statements of Íslandsbanki hf. for the period 1 January to 30 September 2011 comprise the Condensed Interim Financial Statements of Íslandsbanki hf. and its subsidiaries, together referred to as "the Bank".

Accounting convention

The unaudited Condensed Consolidated Interim Financial Statements for the period 1 January to 30 September 2011 have been prepared on a going concern basis in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). The Financial Statements are presented in accordance with the International Accounting Standard (IAS) 34 Interim Financial Reporting.

The profit from the Bank's operations for the period 1 January to 30 September 2011 amounted to ISK 11,346 million, which corresponds to a 11.9% return on equity. Bank equity, according to the Consolidated Financial Position, amounted to ISK 132,076 million at 30 September 2011. The Bank's total capital ratio, calculated according to the Act on Financial Undertakings, was 28.8% and the Tier 1 ratio was 24.6%. Under Icelandic law the minimum capital requirement is 8.0%. However, as part of granting the Bank an operating licence as a financial undertaking, the Icelandic Financial Supervisory Authority (FME) requires the Bank to maintain a minimum Core Tier 1 ratio of 12% of risk weighted assets and a solvency ratio, allowing for subordinated Tier 2 debt, of 16%.The Bank's total assets amounted to ISK 679,088 million at the end of the period.

The Board of Directors and the CEO would like to draw attention to uncertainties relating to foreign currency loans. Uncertainties in relation to loan assets are discussed in detail under notes 2 and 36.

To the best of our knowledge, the Condensed Consolidated Interim Financial Statements provide a true and fair view of the Bank's operating profits and its financial position as at 30 September 2011.

The Board of Directors and the CEO of Íslandsbanki hf. hereby confirm the Bank's Condensed Consolidated Interim Financial Statements for the period 1 January to 30 September 2011 by means of their signatures.

Reykjavík, 29 November 2011

Board of Directors:

Chief Executive Officer:

Condensed Consolidated Statement of Comprehensive Income for the three and nine months ended 30 September 2011

	Notes	2011* 1.7-30.9	2010* 1.7-30.9	2011 1.1-30.9	2010 1.1-30.9
Interest income		12,568	12,930	40,123	47,053
Interest expense		(4,720)	(4,622)	(15,972)	(21,306)
Net interest income	6	7,848	8,308	24,151	25,747
Net valuation changes on loans and receivables	7	(576)	2,714	(831)	2,240
Provision for latent impairment losses	7,22	167	137	12	(473)
Net interest income after valuation changes on loans and receivables		7,439	11,159	23,332	27,514
Fee and commission income		1,786	2,937	6,188	8,084
Fee and commission expense		(433)	(1,035)	(1,822)	(2,850)
Net fee and commission income		1,353	1,902	4,366	5,234
Net financial income (expenses)	8-9	131	72	(337)	(362)
Net foreign exchange gain (loss)	10	72	(2,406)	408	(2,354)
Other net operating income	11	312	217	968	696
Operating income		9,307	10,944	28,737	30,728
Administrative expenses	12-13	(4,630)	(4,653)	(14,436)	(13,948)
Share of profit of associates		-	(50)	-	-
Profit before tax		4,677	6,241	14,301	16,780
Income tax	14	(1,030)	(1,544)	(3,097)	(3,891)
Bank tax		(165)	-	(509)	-
Profit for the period from continuing operations		3,482	4,697	10,695	12,889
(Loss) profit from discontinued operations, net of income tax		(198)	164	651	262
Profit for the period		3,284	4,861	11,346	13,151
Other comprehensive income					
Foreign currency translation differences for foreign operations		12	(4)	52	(11)
Other comprehensive income for the period		12	(4)	52	(11)
Total comprehensive income for the period		3,296	4,857	11,398	13,140
Attributable to:					
Equity holders of Íslandsbanki hf.		3,336	4,807	11,413	13,093
Non-controlling interests		(52)	54	(67)	58
Profit for the period		3,284	4,861	11,346	13,151
Basic earnings per share	15	0.33	0.48	1.14	1.31
Diluted earnings per share	15	0.33	0.48	1.14	1.31

* unaudited information

The notes on pages 7 to 39 are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK million

Condensed Consolidated Statement of Financial Position as at 30 September 2011

	Notes	30.9.2011	31.12.2010
Assets			
Cash and balances with Central Bank	5,16	57,077	30,799
Derivatives	5,17	932	70
Bonds and debt instruments	5	52,429	68,024
Shares and equity instruments	5	3,284	3,022
Loans to credit institutions	5,18-19	29,913	30,870
Loans to customers	5,20-21	495,588	515,161
Investments in associates	23	744	354
Property and equipment		5,608	5,419
Intangible assets		249	187
Deferred tax assets		200	283
Non-current assets and disposal groups held for sale	26	23,042	23,489
Other assets	27	10,022	5,544
Total Assets		679,088	683,222
Liabilities			
Financial liabilities	5	11,180	9,090
Derivatives	5,17	2,819	429
Deposits from Central Bank	5,28	19	26
Deposits from credit institutions	5,28	70,674	96,212
Deposits from customers	5,29,30	356,827	327,158
Debt issued and other borrowed funds	5,31	54,110	55,425
Subordinated loans	5	22,021	21,241
Current tax liabilities		9,524	9,024
Deferred tax liabilities		422	18
Non-current liabilities and disposal groups held for sale	26	6,170	16,442
Other liabilities	32	13,246	26,694
Total Liabilities		547,012	561,759
Equity			
Share capital	33	10,000	10,000
Share premium	33	55,000	55,000
Other reserves		2,550	2,498
Retained earnings		64,587	53,174
Total equity attributable to the equity holders of Íslandsbanki hf.		132,137	120,672
Non-controlling interests		(61)	791
Total Equity		132,076	121,463
Total Liabilities and Equity		679,088	683,222

The notes on pages 7 to 39 are an integral part of these Condensed Consolidated Interim Financial Statements

For the nine months ended 30 September 2011 4 Amounts are in ISK million

Condensed Consolidated Statement of Changes in Equity for the nine months ended 30 September 2011

	Attributable to equity holders of Íslandsbanki hf.					Non-controlling interests	Total equity
	Share capital	Share premium	Other reserves	Retained earnings	Total		
Equity at 1.1.2010	10,000	55,000	2,059	24,204	91,263	840	92,103
Translation differences for foreign operations			(11)		(11)		(11)
Contribution to statutory reserve			422	(422)	0		0
Net income recognised directly in equity	-	-	411	(422)	(11)	-	(11)
Profit for the period				13,093	13,093	58	13,151
Total comprehensive income for the period	-	-	411	12,671	13,082	58	13,140
Equity at 30.9.2010	10,000	55,000	2,470	36,875	104,346	898	105,243
Equity at 1.1.2011	10,000	55,000	2,498	53,174	120,672	791	121,463
Translation differences for foreign operations			52		52		52
Net income recognised directly in equity	-	-	52	-	52	-	52
Profit for the period				11,413	11,413	(67)	11,346
Total comprehensive income for the period	-	-	52	11,413	11,465	(67)	11,398
Change in non-controlling interests					-	(785)	(785)
Equity at 30.9.2011	10,000	55,000	2,550	64,587	132,137	(61)	132,076

The notes on pages 7 to 39 are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK million

Condensed Consolidated Statement of Cash Flows
for the nine months ended 30 September 2011

	Notes	2011 1.1-30.9	2010 1.1-30.9
Net cash provided by (used in) operating activities		32,742	(13,983)
Net cash (used in) by investing activities		(526)	(293)
Net cash (used in) by financing activities		(5,463)	-
Net increase (decrease) in cash and cash equivalents		26,753	(14,276)
Effects of exchange rate changes on cash and cash equivalents		13	(114)
Cash and cash equivalents at the beginning of the year		37,152	53,317
Cash and cash equivalents at the end of the period		63,918	38,927
Reconciliation of cash and cash equivalents:			
Cash on hand	16	2,011	1,943
Cash balances with Central Bank and certificates of deposit	16	49,019	18,527
Bank accounts	18	12,888	18,457
Total cash and cash equivalents		63,918	38,927

The notes on pages 7 to 39 are an integral part of these Condensed Consolidated Interim Financial Statements

For the nine months ended 30 September 2011 6 Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Condensed Consolidated Financial Statements

Accounting policies

General information

1. The reporting entity

Íslandsbanki hf. is a limited company incorporated and domiciled in Iceland. The Condensed Consolidated Interim Financial Statements for the nine months ended 30 September 2011 comprise Íslandsbanki hf. (the parent) and its subsidiaries (together referred to as "the Bank").

The Condensed Consolidated Interim Financial Statements were authorised for issue by the Board of Directors of Íslandsbanki hf. on 29 November 2011.

The Bank has changed its presentation of impairment and income from revised estimated future cash flow in the Condensed Consolidated Statement of Comprehensive Income and is now presenting individually and collectively assessed impairment and income from revised estimated future cash flow as a net figure under the line net valuation changes. Impairment, which is incurred but not yet indentified, is shown separately as latent impairment.

The Bank made a reclass transaction between interest income and income from revised estimated future cash flow at year end which affects the comparable information for 30 September 2010 whereas interest has been reduced by ISK 2.8bn and revised estimated future cash flow has been increased accordingly. This transaction had no effect on the net profit. Comparable information in notes 6 and 7 is affected by this change, as well as comparable information in the Condensed Consolidated Statement of Comprehensive Income.

The Bank has changed its presentation of profit for discontinued operations in the Condensed Consolidated Statement of Comprehensive Income and is now presenting it net of income tax. The comparable figures have been adjusted accordingly.

At 31 December 2010, bonds designated at fair value through profit and loss totalling 31,823m were categorised as being unlisted. The bonds were in fact listed in May 2010, although no transactions occurred with these bonds until April 2011.

Comparable information under Related party disclosures in note 25 has been changed, whereas balances with an associate of ISK 351m were wrongly presented for Members of the Board instead of for Associated companies.

Comparative information in note 34 for credit card commitments has been changed from ISK 25.4bn to ISK 17.9bn as part of the commitments were duplicated in the Consolidated Financial Statement 2010.

2. Basis of preparation

Statement of compliance

The unaudited Condensed Consolidated Interim Financial Statements for the nine months ended 30 September 2011 have been prepared on a going concern basis in accordance with the International Financial Reporting Standards (IFRS), as adopted by the European Union. The Interim Financial Statements are presented in accordance with the International Accounting Standard (IAS) 34 Interim Financial Reporting.

The Condensed Consolidated Interim Financial Statements do not include all the information required for annual financial statements and should be read in conjunction with the Consolidated Financial Statements of the Bank and the Risk Book for the year ended 31 December 2010, available at the Bank's website www.islandsbanki.is.

Accounting policies

The same accounting policies, presentation and methods of computation have been followed in these Condensed Consolidated Interim Financial Statements as were applied in the preparation of the Bank's Consolidated Financial Statements for the year ended 31 December 2010.

The Condensed Consolidated Interim Financial Statements are presented in Icelandic krona (ISK), which is the functional currency of the Bank, rounded to the nearest million.

Assumptions and uncertainties in relation to the Bank's loan assets

There were uncertainties in input parameters and assumptions used in valuation of the assets acquired from Glitnir at a deep discount. The Bank's management based their initial value estimates on expected five-year cumulative losses with conservative estimates for collateral values and a prudent risk premium, known facts, their knowledge of the customers and the market and on official macroeconomic forecasts from the Central Bank of Iceland, the IMF and the OECD.

2. Cont'd

Factors that can affect the recovery value of the loan portfolio include macroeconomic parameters such as the unemployment rate, inflation and wage growth, actions taken by the government to facilitate and ease debt service and legislation that lengthens the collection process or increases taxation and the extent of customer participation in flexible maturity and payment equalisation programmes.

At 30 September 2011 many of the uncertainties surrounding the valuation of the financial assets acquired at a deep discount and the economic environment were still present. The Bank's management is, however, confident that the Bank's capital base is robust enough to absorb reasonable variances in applied assumptions.

Critical assumptions used in the initial valuation are discussed in detail in the Consolidated Financial Statements 2009. Contingencies relating to the acquired loan assets are discussed under note 36.

Going concern

Supreme Court rulings on interest rates in the second half of 2010 and subsequent related legislative changes have reduced much of the inherent uncertainties surrounding foreign currency-linked loan contracts. The Bank conducted a thorough assessment of all of its corporate loan contract forms after a Supreme Court ruling on a corporate foreign exchange loan contract, to ascertain if any of them were affected by this ruling and subsequently recognised a provision for loans deemed to be at the highest risk. The Bank ascertains that financial effects of Supreme Court rulings and legislative changes are reflected in the consolidated financial statements. Contingencies are discussed under note 36.

The Bank is subject to a currency risk due to a mismatch in contractual currencies of its assets and liabilities. This imbalance has been offset to some extent by the Bank's treatment of loans with non-ISK contractual currency to borrowers with ISK-based income as ISK assets, whereby the Bank impairs any increase in loan balances due to depreciation of the ISK. To address the remaining imbalance, the Bank entered into a foreign exchange swap on 30 December 2010. Currency risk is discussed under note 46.

Most of the Bank's funding is in the form of on-demand deposits. The Bank is confident that this will change over the coming years as investors' risk aversion reduces and they start seeking higher yielding investment opportunities. In the future, the Bank will focus on extending the maturities of its deposit base and, at the same time, issue both unsecured and secured bonds. Access to funding in foreign currencies will be limited in the short to medium term.

As well as working closely with customers experiencing payment difficulties, in order to ensure maximum recovery of its assets, the Bank has strengthened its infrastructure and internal controls. The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Therefore, the financial statements continue to be prepared on a going concern basis.

Changes within the Bank

3. Acquisition of subsidiary

Following financial restructuring of Icelandair Group hf., where the Bank had a leading position, Miðengi ehf. acquired on 28 February 2011 71.1% shareholding in Bláfugl ehf., an aviation service company and 71.1% shareholding in IG Invest ehf., an aircraft brokerage and leasing company, through its 100% owned holding company, SPW ehf. Both entities qualify as being held for sale in accordance with IFRS 5 and have therefore been classified as non-current assets and disposal groups held for sale.

On 4 February 2011, the Bank acquired 62.9% shareholding in Bifreiðar og landbúnaðarvélar ehf., a car and farm vehicle dealership, and 62.9% shareholding in Ingvar Helgason ehf., a car dealership, through its 100% owned holding company, BLIH ehf. The acquisitions arose from foreclosures which were necessary to secure assets placed as collateral against loan assets. Both entities qualify as being held for sale in accordance with IFRS 5 and have therefore been classified as non-current assets and disposal groups held for sale. BLIH ehf. was sold on 17 November 2011.

On 12 January 2011, the Bank obtained control of Jarðboranir ehf., a geothermal drilling company, by exercising its option to acquire 100% of its shareholding. The option was part of restructuring of the previous owner, Atorka. The entity qualifies as being held for sale in accordance with IFRS 5 and has been classified as non-current asset and disposal group held for sale.

Acquisition of non-controlling interests

During the accounting period the Bank acquired an additional 45% shareholding in Kreditkort hf. The consideration was in the form of 15.71% shareholding in Borgun hf. The Bank recognised a decrease in non-controlling interest of 230m ISK.

Loss of control over subsidiary

During the accounting period the Bank disposed of 15.71% of its shareholding in Borgun hf. as consideration for 45% shareholding in Kreditkort. As a result of this transaction the Bank lost control over Borgun as the Bank's shareholding in Borgun reduced to 39.29% and the company has subsequently been classified as an associate of the Bank.

The Bank recognised a loss from disposal in the amount of ISK 58 million and included it in the statement of comprehensive income in the line item “Net financial expenses”. Comparative information in the comparative statement of comprehensive income and the comparative consolidated statement of financial position has not been restated.

The transaction did not result in any net cash inflow.

Discontinued operations

On 28 March 2011 the Bank sold its 100% shareholding in Steypustöðin hf. The entity was classified as non-current asset and disposal group held for sale. The results from the disposal are included under profit from discontinued operations, net of income tax.

On 30 June 2011 the Bank sold 90% of its shareholding in Eik Fasteignafélag ehf. This entity was classified as non-current asset and disposal group held for sale. The results from the disposal are included under profit from discontinued operations, net of income tax.

Quarterly statements

4. Operations by quarters:

	Q3* 2011	Q2* 2011	Q1* 2011	Q4* 2010	Q3* 2010
Net interest income	7,848	8,242	8,061	9,128	8,308
Net valuation changes on loans and receivables	(576)	409	(664)	12,267	2,714
Provision for latent impairment	167	16	(171)	(41)	137
Net fee and commission income	1,353	1,298	1,715	2,146	1,902
Net financial income (expenses)	131	(330)	(138)	(548)	72
Net foreign exchange gain (loss)	72	134	202	1,391	(2,406)
Other net operating income	312	297	359	490	217
Administrative expenses	(4,630)	(4,636)	(5,170)	(4,525)	(4,653)
Other income	-	-	-	-	(50)
Profit before tax	4,677	5,430	4,194	20,308	6,241
Income tax	(1,030)	(1,202)	(865)	(3,323)	(1,544)
Bank tax	(165)	(289)	(55)	(221)	-
Profit for the period from continuing operations	3,482	3,939	3,274	16,764	4,697
Profit from discontinued operation, net of income tax	(198)	537	312	(545)	164
Profit for the period	3,284	4,476	3,586	16,219	4,861

* The split between quarters is not audited.

Financial assets and liabilities

5. The following tables show the carrying value of financial assets and financial liabilities according to their IAS39 classification.

At 30 September 2011	Notes	Held for trading	Designated at fair value through P&L	Loans & receivables	Other amortised cost	Total carrying amount
Cash and balances with Central Bank	16	-	-	57,077	-	57,077
Loans and receivables						
Loans to credit institutions	18-19	-	-	29,913	-	29,913
Loans to customers	20-21	-	-	495,588	-	495,588
Loans and receivables		-	-	582,578	-	582,578
Bonds and debt instruments						
Listed		19,232	30,827	-	-	50,059
Unlisted		-	2,370	-	-	2,370
Bonds and debt instruments		19,232	33,197	-	-	52,429
Shares and equity instruments						
Listed		669	-	-	-	669
Unlisted		-	2,615	-	-	2,615
Shares and equity instruments		669	2,615	-	-	3,284
Derivatives	17	932	-	-	-	932
Total financial assets		20,833	35,812	582,578	-	639,223
Financial liabilities		11,180	-	-	-	11,180
Derivatives	17	2,819	-	-	-	2,819
Deposits from Central Bank	28	-	-	-	19	19
Deposits from credit institutions	28	-	-	-	70,674	70,674
Deposits from customers	29-30	-	-	-	356,827	356,827
Debt issued and other borrowed funds	31	-	-	-	54,110	54,110
Subordinated loans		-	-	-	22,021	22,021
Total financial liabilities		13,999	-	-	503,651	517,650

For the nine months ended 30 September 2011 11 Amounts are in ISK million

5. Cont'd

At 31 December 2010	Notes	Held for trading	Designated at fair value through P&L	Loans & receivables	Other amortised cost	Total carrying amount
Cash and balances with Central Bank	16	-	-	30,799	-	30,799
Loans and receivables						
Loans to credit institutions	18-19	-	-	30,870	-	30,870
Loans to customers	20-21	-	-	515,161	-	515,161
Loans and receivables		-	-	576,830	-	576,830
Bonds and debt instruments						
Listed		36,201	30,338	-	-	66,539
Unlisted		-	1,485	-	-	1,485
Bonds and debt instruments		36,201	31,823	-	-	68,024
Shares and equity instruments						
Listed		411	51	-	-	462
Unlisted		-	2,560	-	-	2,560
Shares and equity instruments		411	2,611	-	-	3,022
Derivatives	17	70	-	-	-	70
Total financial assets		36,682	34,434	576,830	-	647,946
Financial liabilities		9,090	-	-	-	9,090
Derivatives	17	429	-	-	-	429
Deposits from Central Bank	28	-	-	-	26	26
Deposits from credit institutions	28	-	-	-	96,212	96,212
Deposits from customers	29-30	-	-	-	327,158	327,158
Debt issued and other borrowed funds	31	-	-	-	55,425	55,425
Subordinated loans		-	-	-	21,241	21,241
Total financial liabilities		9,519	-	-	500,062	509,581

For the nine months ended 30 September 2011 12 Amounts are in ISK million

Net interest income

6. Net interest income is specified as follows:

	2011* 1.7.-30.9	2010* 1.7.-30.9	2011 1.1-30.9	2010 1.1-30.9
Interest income:				
Cash and balances with Central Bank	388	297	882	1,004
Loans and receivables	11,654	12,018	37,699	43,687
Financial assets held for trading	182	128	504	660
Financial assets designated at fair value through profit or loss	325	480	966	1,677
Other assets	19	7	72	25
Total interest income	12,568	12,930	40,123	47,053
Interest expense:				
Deposits from credit institutions and Central Bank	(303)	(819)	(1,400)	(3,437)
Deposits from customers	(2,749)	(3,223)	(8,706)	(13,109)
Borrowings	(1,273)	(101)	(4,489)	(3,264)
Subordinated loans	(312)	(261)	(895)	(795)
Financial liabilities held for trading	(110)	(83)	(288)	(335)
Other interest expense	27	(135)	(194)	(366)
Total interest expense	(4,720)	(4,622)	(15,972)	(21,306)
Net interest income	7,848	8,308	24,151	25,747

* unaudited information

Net valuation changes on loans and receivables

7. Net valuation changes on loans and receivables:

	2011* 1.7.-30.9	2010* 1.7.-30.9	2011 1.1-30.9	2010 1.1-30.9
Impairment charged to the comprehensive income:				
Specific impairment losses on financial assets	(2,013)	(710)	(12,507)	(27,474)
Reversal of impairment (impairment) of foreign exchange gain	325	4,917	(4,638)	10,410
Net specific impairment losses on financial assets	(1,688)	4,207	(17,145)	(17,064)
Provision for latent impairment losses	167	137	12	(472)
Total impairment charged to the comprehensive income (see note 22)	(1,521)	4,344	(17,133)	(17,536)
Net valuation changes:				
Income due to revised estimated future cash flow from loans	1,437	2,976	11,676	29,715
Net specific impairment losses on financial assets	(1,688)	4,207	(17,145)	(17,064)
Foreign exchange gain (loss) (see note 10)	(325)	(4,469)	4,638	(10,410)
Net valuation changes on loans and receivables	(576)	2,714	(831)	2,240

* unaudited information

Reversal of impairment (impairment) of foreign exchange gain from customers with foreign exchange loans and cash flow in ISK is offset against total foreign exchange gain (loss) as per note 10.

For the nine months ended 30 September 2011 13 Amounts are in ISK million

Net financial income (expenses)

8. Net financial income (expenses) are specified as follows:

	2011* 1.7.-30.9	2010* 1.7.-30.9	2011 1.1-30.9	2010 1.1-30.9
Net gain (loss) on financial instruments held for trading	32	(185)	(381)	(21)
Net gain (loss) on financial instruments designated at fair value through P&L	99	257	102	(341)
Net loss on loss of control over subsidiary	-	-	(58)	-
Net financial income (expenses)	131	72	(337)	(362)

9. Net gain (loss) on financial instruments designated at fair value through profit or loss is specified as follows:

Shares	99	257	102	(341)
Net gain (loss) on financial instruments designated at fair value through P&L	99	257	102	(341)

* unaudited information

Net foreign exchange gain (loss)

10. Net foreign exchange gain (loss) is specified as follows:

	2011* 1.7.-30.9	2010* 1.7.-30.9	2011 1.1-30.9	2010 1.1-30.9
Assets:				
Cash and balances with Central Bank	(22)	(39)	12	(114)
Financial assets held for trading	(313)	(1,704)	(1,167)	(2,588)
Loans to credit institutions	(18)	(1,395)	1,531	(4,638)
Loans to customers	(1,016)	(8,127)	8,526	(18,104)
Other assets	11	(60)	23	(113)
Total	(1,358)	(11,325)	8,925	(25,557)
Liabilities:				
Deposits from credit institutions	(23)	515	(159)	730
Deposits from customers	189	3,650	(2,883)	8,579
Subordinated loan	866	260	(780)	3,454
Other liabilities	73	25	(57)	30
Total	1,105	4,450	(3,879)	12,793
Unadjusted net foreign exchange gain (loss)	(253)	(6,875)	5,046	(12,764)
Foreign exchange reversal on loans to customers with ISK cash flow	325	4,469	(4,638)	10,410
Net foreign exchange gain (loss)	72	(2,406)	408	(2,354)

* unaudited information

Other net operating income

11. Other net operating income is specified as follows:

	2011* 1.7.-30.9	2010* 1.7.-30.9	2011 1.1-30.9	2010 1.1-30.9
Agency fees and service level agreement fees	89	80	240	272
Legal cost and fees	20	36	65	108
Rental income	97	3	232	60
Rental income on foreclosed mortgages	40	64	185	139
Other net operating income	66	34	246	117
Other net operating income	312	217	968	696

* unaudited information

For the nine months ended 30 September 2011 14 Amounts are in ISK million

Administrative expenses

12. Administrative expenses are specified as follows:	2011* 1.7.-30.9	2010* 1.7.-30.9	2011 1.1-30.9	2010 1.1-30.9
Salaries and related expenses	2,140	2,094	7,109	6,691
Other administrative expenses**	2,318	2,403	6,828	6,842
Depreciation and amortisation	172	156	499	415
Administrative expenses	4,630	4,653	14,436	13,948

* unaudited information

**Included in other administrative expenses for Q3 2011 is an insurance fund premium of ISK 684m for the Depositors and Investors Guarantee Fund (Q3 2010: ISK 876m).

Salaries and related expenses

13. Salaries and related expenses are specified as follows:	2011* 1.7.-30.9	2010* 1.7.-30.9	2011 1.1-30.9	2010 1.1-30.9
Salaries	1,739	1,710	5,753	5,394
Pension and similar expenses	232	228	774	720
Social security charges	166	149	537	486
Other	3	7	45	91
Salaries and related expenses	2,140	2,094	7,109	6,691

* unaudited information

Effective income tax rate

14. The corporate income tax rate in Iceland changed from 18% in 2010 to 20% from 1 January 2011. Taxes for the nine month period to 30 September 2011 are calculated at 20%. The effective income tax rate in the Bank's income statement is 21,7% for the nine months ended 30 September 2011. The difference is specified as follows:

	2011 1.1-30.9		2010 1.1-30.9	
Profit before tax	14,301		16,780	
Income tax calculated on the profit of the period	2,860	20.0%	3,020	18.0%
Effect of different tax rate in other countries	(10)	(0.1%)	-	0.0%
Taxable gain arising outside profit and loss	-	0.0%	388	2.3%
Non-deductable expenses	102	0.7%	-	0.0%
Income not subject to tax	(14)	(0.1%)	-	0.0%
Correction in accordance with ruling on prior years' taxable income	27	0.2%	345	2.1%
Other differences	132	0.9%	138	0.7%
Income tax according to the statement of comprehensive income	3,097	21.7%	3,891	23.2%

Earnings per share

15. Earnings per share are specified as follows:

	2011 1.1-30.9	2010 1.1-30.9
Net profit of the equity holders of the parent, according to the statement of comprehensive income	11,413	13,093
Average outstanding shares:		
Weighted average number of outstanding shares for the period, million	10,000	10,000
Average outstanding shares, million	10,000	10,000
Basic earnings per share	1.14	1.31
Diluted earnings per share	1.14	1.31

Amounts are in ISK million

Cash and balances with Central Bank

16. Specification of cash and balances with Central Bank:

	30.9.2011	31.12.2010
Cash on hand	2,011	1,833
Balances with Central Bank other than mandatory reserve deposits	5,883	16,352
Certificates of deposit	43,136	6,865
Included in cash and cash equivalents	51,030	25,050
Mandatory reserve deposits with Central Bank	6,047	5,749
Cash and balances with Central Bank	57,077	30,799

Mandatory reserve deposits are not available for use in the Bank's day-to-day operations.

Certificates of deposit (CDs) are short term instruments issued by the Central Bank at predetermined interest rates. CDs are issued solely to banks and other financial institutions and are not transferable except to other comparable institutions.

Derivative financial instruments

17. Derivatives held for trading:	Assets 30.9.2011	Notional values related to assets 30.9.2011	Liabilities 30.9.2011	Notional values related to liabilities 30.9.2011
Interest rate swap	71	9,850	28	4,000
Cross currency interest rate swaps	396	11,499	2,494	50,403
Equity options	-	-	-	-
Foreign exchange forwards	93	8,929	130	2,968
Foreign exchange swaps	313	6,760	74	2,115
Bond forwards	48	1,500	22	1,550
Bond options	11	300	71	25,300
Derivatives held for trading	932	38,838	2,819	86,336

Derivatives held for trading:	Assets 31.12.2010	Notional values related to assets 31.12.2010	Liabilities 31.12.2010	Notional values related to liabilities 31.12.2010
Interest rate swap	-	-	-	-
Cross currency interest rate swaps	-	-	312	48,217
Equity options	58	500	-	-
Foreign exchange forwards	12	3,453	44	8,859
Foreign exchange swaps	-	231	-	1,537
Bond forwards	-	-	-	-
Bond options	-	-	73	25,000
Derivatives held for trading	70	4,184	429	83,613

Amounts are in ISK million

Loans

18. Loans to credit institutions:

	30.9.2011	31.12.2010
Money market loans	16,772	17,788
Bank accounts	12,888	12,102
Repo loans	-	980
Other loans	253	-
Loans to credit institutions	29,913	30,870

19. Loans to credit institutions :

	30.9.2011			31.12.2010		
	Gross amount	Impairment allowance	Carrying amount	Gross amount	Impairment allowance	Carrying amount
Loans	30,476	(563)	29,913	31,456	(586)	30,870
Loans to credit institutions	30,476	(563)	29,913	31,456	(586)	30,870

20. Loans to customers:

	30.9.2011	31.12.2010
Loans and advances to customers at amortised cost	495,588	515,161
Loans to customers	495,588	515,161

Amounts are in ISK million

21. Loans to customers at amortised cost:

	Gross amount	Impairment allowance	30.9.2011 Carrying amount	Gross amount	Impairment allowance	31.12.2010 Carrying amount
Loans to customers						
Individuals	181,487	(10,696)	170,791	181,566	(8,853)	172,713
Commerce and Services	64,352	(6,753)	57,599	63,068	(11,922)	51,146
Construction	15,954	(4,706)	11,248	21,091	(4,003)	17,088
Energy	3,390	(68)	3,322	2,233	(111)	2,122
Financial institutions	3,408	(35)	3,373	4,257	(9)	4,248
Government secured customer loan	45,158	-	45,158	52,182	-	52,182
Industrials	33,513	(3,062)	30,451	23,670	(3,020)	20,650
Investment companies	31,771	(12,529)	19,242	55,495	(13,507)	41,988
Public sector and non-profit organisations	10,452	(299)	10,153	11,061	(496)	10,565
Real estate	98,986	(21,539)	77,447	92,456	(17,932)	74,524
Seafood	69,307	(2,503)	66,804	69,797	(1,862)	67,935
Loans to customers	557,778	(62,190)	495,588	576,876	(61,715)	515,161

The internal industry classification was changed in the first half of the year making the comparison to the credit risk notes in the 2010 annual accounts inappropriate. This change included a reclassification of some of the Bank's customers resulting in a shift between industries, for example a part of the exposure to Investment companies has moved to Commerce and Services and to Industrials.

22. Financial assets - impairments

The following table shows the movement in the provision for impairment losses for loans and receivables.

	Individually assessed	Collectively assessed	Latent	30.9.2011 Total	31.12.2010 Total
At 1 January	45,704	15,606	991	62,301	72,391
Disposal of subsidiaries	(171)	-	-	(171)	-
Amounts written-off	(8,591)	(706)	-	(9,297)	(25,840)
Recoveries of amounts previously written-off	366	-	-	366	402
Principal credit adjustment	(2,456)	(5,123)	-	(7,579)	(4,667)
Charged to the comprehensive income	15,706	1,439	(12)	17,133	20,015
At the end of the period*	50,558	11,216	979	62,753	62,301

*The provision for impairment losses at 30 September 2011 includes ISK 563 million relating to loans to credit institutions (2010: ISK 586 million).

	2011 1.1-30.9	2010 1.1-30.9
Impairment losses charged to the comprehensive income:		
Loans to customers	17,155	15,919
Loans to credit institutions	(22)	1,618
Impairment losses charged to the comprehensive income	17,133	17,537

For the nine months ended 30 September 2011 18 Amounts are in ISK million

Investment in associates

23. Changes in investments in associates:

	30.9.2011	31.12.2010
Investment in associates at the beginning of the period	354	827
Acquisition of shares in associates	-	54
Sales of shares in associates	-	(8)
Transfers	390	-
Revaluation	-	(519)
Investments in associates at the end of the period	744	354

Investment in subsidiaries

24. The parent's interest in its subsidiaries is as follows:

	Location	Ownership
Kreditkort hf.	Iceland	100%
Íslandssjóðir hf.	Iceland	100%
Miðengi ehf.	Iceland	100%
Eik Properties ehf.	Iceland	100%
Jarðboranir hf.	Iceland	100%
Island Fund S.A. (formerly Glitnir Asset Management)	Luxembourg	100%
Glacier Geothermal and Seafood Corporation	USA	100%
Glacier Securities LLC	USA	100%
Air Atlanta Properties Ltd.	UK	100%
19 other subsidiaries (SME)	Iceland	

Related party disclosures

25. Parent and ultimate controlling party

The Bank has determined that ISB Holding is the ultimate controlling party of the Bank with GLB Holding having significant influence. This is reflected in the related party transactions.

Entities which are controlled, jointly controlled or significantly influenced by the government (state-controlled entities) are not considered as being a related party if neither entity actually influenced the other and if the state did not actually influence either entity with regards to transactions between them. Transactions with state-controlled entities during the period were based on general business terms of the Bank.

Related party transactions

The Bank has a related party relationship with its subsidiaries, the Board of Directors of the parent company, the executive vice presidents of the Bank, close family members of individuals referred to herein and entities with significant influence as the largest shareholders of the Bank.

All loans to employees are provided on general business terms of the Bank. Included in assets are loans to key management.

Related parties have transacted with the Bank during the period as follows:

	30.9.2011	31.12.2010
CEO and Managing Directors (including companies owned by them)	(122)	(59)
Members of the Board (including companies owned by them)	(115)	(817)
Associated companies and other related parties	10,844	21,147
Total	10,607	20,271
Guarantees	161	55
Loan commitments, overdraft and credit card commitments	810	187

Impairment allowances of ISK 4.6bn were recognised in the period against balances outstanding with associated companies.

No share option programmes were operated during the reporting period 2011.

Amounts are in ISK million

Non-current assets and disposal groups held for sale

26. Specification of non-current assets and disposal groups held for sale:

	30.9.2011	31.12.2010
Repossessed collateral	8,093	7,435
Assets of disposal groups classified as held for sale	14,949	16,054
Total	23,042	23,489

Repossessed collateral:

Residential property	4,369	4,880
Vehicles	265	253
Equipment	82	160
Shares	3,267	2,067
Other assets	110	75
Total	8,093	7,435

Assets of disposal groups classified as held for sale:	30.9.2011	31.12.2010
Cash	1,408	5
Investment properties	179	15,086
Equipment	2,309	609
Receivables	3,227	98
Inventory	1,139	157
Intangible assets	1,122	-
Tax assets	330	-
Other assets	5,235	99
Total	14,949	16,054

Liabilities associated with assets classified as held for sale:	30.9.2011	31.12.2010
Payables	726	59
Deferred tax liabilities	385	-
Borrowings and other liabilities	4,229	16,383
Other liabilities	830	-
Total	6,170	16,442

Amounts are in ISK million

Other assets

27. Other assets are specified as follows:

	30.9.2011	31.12.2010
Receivables	120	1,532
Unsettled securities transactions	7,346	687
Prepaid expenses	291	303
Accruals	413	620
Inventory (real estate)	1,518	1,889
Other assets	334	513
Other assets	10,022	5,544

Inventory comprises real estate valued at the lower of cost and net realisable value.

Deposits from Central Bank and credit institutions

28. Deposits from Central Bank and credit institutions are specified as follows:

	30.9.2011	31.12.2010
Repurchase agreements with Central Bank	19	26
Deposits from credit institutions	70,674	96,212
Deposits from Central Bank and credit institutions	70,693	96,238

Deposits from customers

29. Deposits from customers are specified by type as follows:

	30.9.2011	31.12.2010
Demand deposits	219,125	214,597
Time deposits	137,702	112,561
Deposits from customers	356,827	327,158

30. Deposits from customers are specified by owners as follows:

	30.9.2011		31.12.2010	
	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	12,944	4%	4,065	1%
Municipalities	4,981	1%	4,927	2%
Other companies	206,369	58%	185,886	57%
Individuals	132,533	37%	132,280	40%
Deposits from customers	356,827	100%	327,158	100%

Debt issued and other borrowed funds

31. Specification of debt issued and other borrowed funds:

	30.9.2011	31.12.2010
Issued bonds	50,229	52,717
Loans from credit institutions	1	353
Other debt securities	3,880	2,355
Debt issued and other borrowed funds	54,110	55,425

Amounts are in ISK million

Other liabilities

32. Specification of other liabilities:

	30.9.2011	31.12.2010
Accruals	2,093	1,951
Liabilities to retailers for credit card provision	-	12,921
Provision for effects of court rulings	2,580	1,431
Guarantees	416	1,664
Chargeable gain tax	571	1,357
Unsettled securities transactions	3,995	1,386
Deferred income	215	345
Sundry liabilities	3,376	5,639
Other liabilities	13,246	26,694

Equity

33. Authorised share capital of the Bank is 10,000m ordinary shares of ISK 1 each. At 30.9.2011 paid up share capital totalled ISK 65,000m which is the total stated share capital of the Bank.

Total share capital

	30.9.2011	31.12.2010
Ordinary share capital	10,000	10,000
Share premium account	55,000	55,000
Total share capital	65,000	65,000

Off balance sheet items

Obligations

34. The Bank provides off balance sheet commitments. These items are specified as follows:

	30.9.2011	31.12.2010
Guarantees granted to customers	8,122	8,404
Committed undrawn lines of credit	15,432	13,453
Unused overdrafts	16,932	17,186
Credit card commitments	19,242	17,916
The Depositors and Investors Guarantee Fund – declaration of guarantee	3,724	3,689

An amendment to the legislation for the Depositors and Investors Guarantee Fund was passed in Parliament in May 2011. According to this amendment, the current basic fund premium is 0.3% of eligible deposits. In addition, the Bank pays a variable premium based on the total capital ratio, the deposit ratio and a Loan Portfolio Analysis (LPA) provided by the FME.

Balance of custody assets

35. Balance of custody assets:

	30.9.2011	31.12.2010
Custody assets	647,601	642,502

For the nine months ended 30 September 2011 22 Amounts are in ISK million

Contingencies

36. **Litigation threats**

Several former customers of Glitnir private banking services have threatened litigation against the Bank in order to claim compensation for alleged mistakes made by former employees of Glitnir. A few of those customers have already filed lawsuits against the Bank with the Reykjavík District Court. The Bank has not accepted liability and will challenge these lawsuits on the grounds that these claims relate to events that happened prior to the incorporation of the Bank and the assignment of related liabilities and assets and are therefore not the responsibility of the Bank in any way. The District Court has now ruled in favour of the Bank in one of these cases stating that the Bank cannot be held responsible for a mistake made by a former employee of Glitnir. This ruling was not appealed. The Bank estimates the total amount of compensation liabilities currently claimed by customers of Glitnir to be ISK 5.5bn.

Netting agreement

When certain assets and obligations were transferred from Glitnir to the Bank, the FME (Financial Supervisory Authority) ruled that customers would, upon liquidation of Glitnir, maintain their right to claim netting of assets and liabilities held by Glitnir prior to the Bank's acquisition. The Bank made an agreement with Glitnir that the latter will compensate the Bank for any losses incurred as a result of netting of assets and liabilities. The claims in question are priority claims on the liquidated assets of Glitnir and the netting exercise is therefore unlikely to affect either the net asset value or the earnings of the Bank.

Allocation of liens, guarantees and comparable rights

When certain assets and obligations were transferred from Glitnir to the Bank, the FME ruled that the Bank would take over all rights used to secure the performance of obligations of the debtors of Glitnir, including all liens, guarantees and other comparable rights connected to the claims of the Bank.

The Bank should, however, be accountable to Glitnir for specific collateral of its customers, as applicable, due to claims and derivatives which were not transferred to the Bank. The Bank has, in accordance with this decision, transferred to Glitnir certain collateralised obligations of customers. One customer filed a lawsuit against the Bank with the Reykjavík District Court challenging the Bank's decision to transfer the customer's money market deposit to Glitnir which the Bank, in good faith, identified as collateral for a foreign exchange future contract. The claim was for approximately ISK 450 million. The District Court ruled in favour of the Bank and the case has now been appealed to the Iceland Supreme Court. Any future allocation of collaterals will be made under an agreement with Glitnir, whereby Glitnir indemnifies the Bank against any future claims arising from the transfer of such rights.

Indexed loans and foreign currency loans

In order to address the uncertainty surrounding which foreign currency loans should be deemed to be illegally linked to foreign currency, the Parliament introduced in 2010 a new legislation proposing a change to the Interest Law 38/2001. The legislation was passed as Amendment to the Interest Law 151/2010, taking effect on 28 December 2010. Based on the context of this new law, the Bank treated all foreign currency dominated mortgages and car loans according to the method previously set forth in a September 2010 ruling of the Supreme Court concerning car loans/leasing contracts. All customers with foreign currency mortgages were presented with an offer of having their mortgage recalculated according to a similar formula, regardless of the validity of the contract in question. The definition of a mortgage in the new legislation refers to tax law. The recalculation had to be offered if the debtor was eligible for a refund in part of paid interest (interest subsidy) of the loan. The Bank decided to expand this definition to cover all residential loans to individuals, although the debtors were not obliged to accept the offer. The interest rate on car loans going forward will, according to the law, be replaced by non-indexed CPI-rate. The same goes for mortgages for the first five years, in addition to a choice of indexed CPI rate. At the end of the five year term, mortgages will revert back to market rates.

In April 2011, the District Court of Reykjavík ruled on a dispute regarding the nature of a financial leasing contract between the Bank and a customer. The court ruled that although the contract had the form of a lease, it was by nature a loan contract, thereby subject to the Interest Law 38/2001. The contract was denominated in foreign currency, and the court further ruled that the contract had an illegal foreign currency indexation, citing the precedent set by the Supreme Court in June 2010. In October 2011, the District Court ruling was confirmed by the Supreme Court. The ruling will affect, by precedent, approximately 4,100 similar contracts with a book value of approximately ISK 10.2bn. Each affected contract will be recalculated as a result of the ruling.

The ruling on financial leasing contracts does not appear to set new precedent affecting other loan contracts, as the dismissal of the disputed contract's currency indexation is based on the Supreme Court's ruling from June 2010. It should also be noted that although the currency indexation has been deemed illegal, the customer's debt obligation in ISK at the signing of the contract is still valid. It should also be noted that for contracts signed before 2004 – 2005, the effect of recalculation is minimal.

In 3 – 4 cases regarding disputed foreign currency denominated loan contracts, the District Courts have ruled in favour of the Bank, thereby confirming that the disputed loans were indeed legitimate foreign currency loans. These rulings are somewhat offset by the June 2011 Supreme Court's ruling on a case regarding a disputed loan contract between Landsbankinn and a customer (Landsbankinn vs. MótorMax). Although the case did not involve Íslandsbanki, the disputed contract in the case must be regarded as typical of many foreign currency corporate loans granted by Íslandsbanki. In the ruling, the Supreme Court set new precedent by deciding that the disputed contract contained an illegal foreign currency indexation. Following the June 2011 ruling, the Bank has evaluated all corporate contract forms and assessed which forms are affected by the ruling and which are, by the Bank's estimation, legal foreign currency loan contracts.

36. Cont'd

On 3 November 2011, the Supreme Court ruled on an appeal of a District Court's decision to dismiss a case involving a disputed foreign currency bond. The Supreme Court ruled that because the disputed bond was by its nature not affected by the Supreme Court's previous rulings (including the June 2010 and 2011 rulings) the District Court should hear the case and pass a ruling of its own. The Supreme Court specifically mentions in the ruling that the bond's principal is stated in foreign currencies, and reiterates that a correctly written foreign currency debt agreement is not prohibited by the Interest Law 38/2001.

Based on precedents already set, and assumptions made by inferences from the Supreme Court's latest ruling, the Bank will estimate the financial effect of remaining lawsuits. In its estimates, the Bank will take into account that customers have already been offered principal adjustment of foreign currency debt, and that a ruling has been made by the Supreme Court on replacement interest rates. The Bank has divided all foreign currency loans into four categories, depending on the risk of the loans being deemed illegal. The Bank holds provisions for the expected financial effect for the highest risk category. The work on processing each category is in its initial stages. Meanwhile, customers whose contracts are eligible for recalculation will have the option of fixed payments until the recalculations have been completed.

Final judgements for most types of Íslandsbanki's loan contracts are expected to emerge before the summer recess of the Supreme Court in July 2012.

Formal investigation by the EFTA Surveillance Authority regarding alleged government aid granted by the Icelandic government to investment funds and associated fund management companies connected to the three failed Icelandic banks Glitnir, Kaupthing and Landsbanki

At the height of the financial crisis in Iceland, in early October 2008, investment funds suspended redemption of unit certificates in order to protect the equality of unit certificate holders. The funds were subsequently wound-up and the unit certificate holders paid out the value of their unit shares. This was partly achieved by the banks buying the assets (mainly domestic bonds) held by the funds and adding the proceeds from that sale to assets already held in the form of deposits. The price paid for the assets was decided by the boards of the newly restored banks, based on internal valuations and valuations of external consultants (audit firms).

In this case, it is alleged that management companies of the investment funds and depositories of the three major Icelandic banks received unlawful government aid from the Icelandic authorities in October 2008. It is alleged that the government influenced the decisions of the new banks to purchase assets from the funds (managed by their subsidiaries) on favourable terms and, thus, enabling them to wind-up the funds and repay investors when there was no effective market for the assets.

The Icelandic government and the banks claim that the transactions were neither influenced by the government nor funded by its resources. Even if the banks were public undertakings, the acquisition was decided on independently by each bank and based on commercial motives. The assets acquired were valued in a professional manner, albeit in a period of uncertainty.

Formal investigation by the EFTA Surveillance Authority into government aid granted in the restoration of certain operations of Glitnir and the establishment and capitalisation of Íslandsbanki

The EFTA Surveillance Authority (Authority) decided to open formal investigations into the government aid granted in October 2008 and September 2009 to rescue domestic operations of the three main Icelandic banks: Glitnir, Kaupthing and Landsbanki, and to establish and capitalise new successor banks, now called Íslandsbanki, Arion and NBI (Landsbanki) respectively.

The measures to restore certain operations of the old Icelandic banks and to establish and capitalise new banks should have been notified prior to their implementation. The Icelandic authorities should also have submitted detailed restructuring plans outlining viable futures for the banks without a need for a government support.

The Authority has to assess whether the government aid granted to the banks adequately addresses each bank's situation without unduly distorting competition. In order to do so, it is imperative that detailed restructuring plans are submitted. As part of the investigation, the Authority will assess e.g. potential aid to the new banks in the form of a special liquidity facility. Also under scrutiny is the transfer of assets and deposit liabilities from Straumur to Íslandsbanki.

The Icelandic authorities and the Bank claim that the measures are compatible with the functioning of the EEA Agreement Article 61(3)(b), on the basis that they were necessary in order to remedy a serious disturbance in the Icelandic economy. The Icelandic authorities have stressed that the situation in Iceland in October 2008 was extreme and required immediate action in order to restore financial stability and confidence in the Icelandic economy.

The Bank has submitted a detailed restructuring plan to the Authority outlining viable futures for the Bank without a need for a government support.

Events after the end of the reporting period

37. **Acquisition of Byr hf.**

On 13 July 2011 the Bank announced its offer to acquire all of the shares of Byr hf. (Byr). The shares will be acquired from the Byr Savings Bank's winding-up committee and the Icelandic government. The acquisition has been approved by the Icelandic Parliament, the competition and regulatory authorities and the EFTA Surveillance Authority (ESA).

Byr is a newly incorporated financial institution built on the foundations of a savings bank which became insolvent in April 2010. Byr focuses mainly on retail banking. The Bank's intention is to merge Byr's operations fully with those of the parent. The Bank's CAD ratio after the merger is expected to remain well above the minimum requirements stipulated in the Act on Financial Undertakings. The transaction will be completed before year-end 2011.

Risk Management

The Bank is exposed to various risks through its use of financial instruments. Managing these risks is an integral part of the Bank's operations. More information about Risk Management at Íslandsbanki is available in the Risk Book 2010 at www.islandsbanki.is/riskbook.

Credit risk

Credit risk is defined as current or prospective risk to earnings and capital arising from an obligor's potential failure to meet the terms of any contract with the Bank or to otherwise fail to perform as agreed.

This risk comprises default risk, recovery risk, country risk, settlement risk and credit concentration risk.

Credit concentration risk is the significantly increased risk that is driven by common underlying factors, e.g. sector, economy, geographical location, type of financial instrument or due to connections or relations among counterparties. This includes large individual exposures to parties under common control and significant exposures to groups of counterparties whose likelihood of default is driven by common underlying factors.

Credit risk arises principally from the Bank's loans and advances to customers and other banks but also from balances with the Central Bank and off balance sheet items such as guarantees, loan commitments and derivatives.

The loan portfolio acquired from Glitnir is the largest part of the credit exposure of the Bank. Due to the extraordinary circumstances in the Icelandic economy and the fact that the loan portfolio was acquired at a deep discount, care must be taken when interpreting conventional measures of credit risk.

38. Maximum credit exposure

The Bank's credit risk exposure comprises both on balance sheet and off balance sheet items. Maximum exposure to credit risk for on balance sheet assets is the net carrying amount as reported in the statement of financial position. The maximum exposure for off-balance sheet items is the amount that the Bank might have to pay out against financial guarantees and loan commitments, less provisions the Bank has made because of these items.

The industry breakdown shows the Bank's credit exposure by industry classification. The breakdown follows an internal industry classification which is based on the Icelandic ISAT2008 that derives from the European NACE Rev. 2 classification standard.

The internal industry classification was changed in the first half of the year making the comparison to the credit risk notes in the Consolidated Financial Statement 2010 inappropriate. This change included a reclassification of some of the Bank's customers resulting in a shift between industries, for example a part of the exposure to Investment companies has been moved to Commerce and Services and to Industrials.

The Bank's credit exposure, before taking account of any collateral held or other credit enhancements, is as follows:

Credit risk exposure

38. **Maximum credit exposure**

Maximum credit exposure 30.9.2011

	Individuals	Central Governments	Commerce and Services	Construction	Energy	Financial institutions	Government secured customer loan	Industrials	Invest-ment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	57,077	-	-	-	-	-	-	-	-	-	-	57,077
Loans to credit institutions	-	-	-	-	-	29,913	-	-	-	-	-	-	29,913
Loans to customers:													
Overdrafts	8,243	-	4,608	1,906	2	953	-	2,716	454	1,554	794	1,130	22,360
Credit cards	11,910	-	691	80	1	11	6	168	25	118	30	32	13,072
Mortgages	109,777	-	-	-	-	-	-	-	-	-	-	-	109,777
Leases	11,248	-	8,685	2,319	16	25	-	3,811	281	709	1,998	410	29,502
Other loans	29,612	-	43,615	6,943	3,303	2,385	45,152	23,755	18,482	7,772	74,626	65,232	320,877
Bonds and debt instruments:		48,155				2,521			912		841		52,429
Derivatives	6	-	4	-	-	911	-	-	-	-	-	11	932
Balance sheet total	170,796	105,232	57,603	11,248	3,322	36,719	45,158	30,450	20,154	10,153	78,289	66,815	635,939
Financial guarantees	981	-	1,377	2,084	4	951	-	1,576	16	66	751	316	8,122
Loan commitments	-	-	1,254	-	8,789	5,000	-	-	-	-	389	-	15,432
Undrawn overdraft	7,249	-	3,625	756	202	1,657	-	1,787	48	738	430	440	16,932
Credit card commitments	16,988	-	1,215	205	2	26	12	271	70	334	56	63	19,242
Off balance sheet total	25,218	-	7,471	3,045	8,997	7,634	12	3,634	134	1,138	1,626	819	59,728
Total	196,014	105,232	65,074	14,293	12,319	44,353	45,170	34,084	20,288	11,291	79,915	67,634	695,667

Amounts are in ISK million

38. Cont'd

Maximum exposure 31.12.2010

	Individuals	Central Governments	Commerce and Services	Construction	Energy	Financial institutions	Government secured customer loan	Industrials	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	30,799	-	-	-	-	-	-	-	-	-	-	30,799
Loans to credit institutions	-	-	-	-	-	30,870	-	-	-	-	-	-	30,870
Loans to customers:													
Overdrafts	7,943	-	3,963	2,794	254	1,046	-	3,037	676	1,347	605	973	22,638
Credit cards	14,307	-	710	94	0	15	6	229	16	76	33	26	15,512
Mortgages	105,637	-	-	-	-	-	-	-	-	-	-	-	105,637
Leases	11,678	-	6,835	2,337	19	55	-	3,955	208	843	2,068	248	28,246
Other loans	33,148	-	39,380	11,864	1,849	3,132	52,176	13,734	41,223	8,118	71,817	66,687	343,128
Bonds and debt instruments:	-	64,087	-	-	324	2,129	-	-	659	-	825	-	68,024
Derivatives	-	-	-	58	-	12	-	-	-	-	-	-	70
Balance sheet total	172,713	94,886	50,888	17,147	2,446	37,259	52,182	20,955	42,782	10,384	75,348	67,934	644,924
Financial guarantees	920	-	1,308	2,499	-	-	-	2,266	82	22	700	607	8,404
Loan commitments	-	-	1,072	-	5,044	5,000	-	1,827	-	-	510	-	13,453
Undrawn overdraft	7,945	-	3,339	644	202	1,239	-	1,458	529	944	434	452	17,186
Credit card commitments	15,829	-	1,052	197	1	50	10	316	48	304	49	60	17,916
Off balance sheet total	24,694	-	6,771	3,340	5,247	6,289	10	5,867	659	1,270	1,693	1,119	56,959
Total	197,407	94,886	57,659	20,487	7,693	43,548	52,192	26,822	43,441	11,654	77,041	69,053	701,883

Amounts are in ISK million

39. Impaired loans to credit institutions and customers

Loans are classified as impaired loans if contractual cash payments are not expected to be fulfilled and if financial restructuring of the obligor is expected to lead to a loss on that particular loan. In most cases, loss is avoided because of the difference between the claim value and the carrying amount resulting from the deep discount of the acquired loan portfolio.

Loans are also classified as impaired if the Bank has made impairments to offset currency movements. For individuals and smaller companies this is the main reason for loans being classified as impaired. This impairment does not signal a loss from the deep discount.

The full carrying amount of all loans which give rise to individual impairment or collective impairment is included in impaired loans, even if parts are covered by collateral.

At 30 September 2011	Loans neither past due nor impaired	Past due loans but not impaired	Loans classified as impaired loans	Total carrying amount of loans
Loans to credit institutions	29,670	-	243	29,913
Loans to customers				
Individuals	130,122	24,491	16,178	170,791
Commerce and Services	41,501	4,069	12,030	57,600
Construction	3,509	2,237	5,502	11,248
Energy	2,643	1	678	3,322
Financial institutions	3,328	45	-	3,373
Government secured customer loan	45,158	-	-	45,158
Industrial	21,492	2,489	6,469	30,450
Investment companies	6,385	713	12,144	19,242
Public sector and non-profit organisations	6,547	181	3,424	10,152
Real estate	27,907	2,428	47,114	77,449
Seafood	60,474	1,178	5,151	66,803
Total	378,736	37,832	108,933	525,501

At 31 December 2010	Loans neither past due nor impaired	Past due loans but not impaired	Loans classified as impaired loans	Total carrying amount of loans
Loans to credit institutions	30,842	8	20	30,870
Loans to customers				
Individuals	123,086	21,194	28,433	172,713
Commerce and Services	25,075	3,442	22,369	50,886
Construction	8,326	2,680	6,082	17,088
Energy	1,003	15	1,104	2,122
Financial institutions	4,229	8	11	4,248
Government secured customer loan	52,182	-	-	52,182
Industrial	7,858	1,727	11,370	20,955
Investment companies	12,423	1,409	28,292	42,124
Public sector and non-profit organisations	6,255	1,549	2,579	10,383
Real estate	25,653	6,582	42,290	74,525
Seafood	56,003	951	10,981	67,935
Total	352,935	39,565	153,531	546,031

For the nine months ended 30 September 2011 28 Amounts are in ISK million

40. Past due but not impaired loans are loans where contractual interest or principal payments have passed due date without the obligor making full payment, but where specific impairment is not appropriate. These loans are expected to be restructured without any loss to the Bank. In some cases, loss is avoided because of the difference between the claim value and the carrying amount resulting from the deep discount of the acquired loan portfolio. In other cases, there is sufficient collateral or the assessment is that contractual payments will be fulfilled.

Amounts reported as past due refer to the total loan exposure and not only the payment or sum of payments that are past due. Past due but not impaired loans are as follows:

At 30 September 2011	Past due up to 30 days	Past due 31-60 days	Past due 61-90 days	Over 90 days	Total
Loans to credit institutions	-	-	-	-	-
Loans to customers					
Individuals	6,037	2,259	663	15,532	24,491
Commerce and Services	1,086	788	169	2,026	4,069
Construction	158	68	56	1,955	2,237
Energy	-	-	-	1	1
Financial institutions	19	-	-	26	45
Government secured customerloan	-	-	-	-	-
Industrial	478	511	69	1,431	2,489
Investment companies	34	1	8	670	713
Public sector ad non-profit organisations	70	79	2	30	181
Real estate	435	128	7	1,858	2,428
Seafood	168	215	73	722	1,178
Total	8,485	4,049	1,047	24,251	37,832

At 31 December 2010	Past due up to 30 days	Past due 31-60 days	Past due 61-90 days	Over 90 days	Total
Loans to credit institutions	8	-	-	-	8
Loans to customers					
Individuals	5,189	2,577	685	12,743	21,194
Commerce and Services	713	243	85	2,401	3,442
Construction	335	94	136	2,115	2,680
Energy	14	1	-	-	15
Financial institutions	1	-	1	6	8
Government secured customerloan	-	-	-	-	-
Industrial	383	153	192	999	1,727
Investment companies	56	553	8	792	1,409
Public sector ad non-profit organisations	1,355	103	72	19	1,549
Real estate	2,754	386	259	3,183	6,582
Seafood	44	227	20	660	951
Total	10,852	4,337	1,458	22,918	39,565

For the nine months ended 30 September 2011 29 Amounts are in ISK million

41. Large exposure disclosure

When the Bank's total exposure to a group of connected clients exceeds 10% of the Bank's capital base it is considered a large exposure. The exposure is evaluated net of credit risk mitigating effects eligible according to FME rules 216/2007.

When assessing the exposure, both on-balance sheet and off-balance sheet items from all types of financial instruments are included as defined by the FME rules. The Bank has an internal criteria that defines connections between clients. This criteria reflect the Bank's interpretation of Article (1)(a) in Law no. 161/2002 on Financial Undertakings, where groups of connected clients are defined.

The following table shows the Bank's large exposures as a percentage of the Bank's capital base, gross and net of eligible credit risk mitigating effects.

	30.9.2011		31.12.2010	
Client groups	Gross	Net	Gross	Net
Group 1	59%	0%	44%	0%
Group 2	30%	1%	37%	1%
Group 3	14%	14%	15%	15%

The Bank has one large exposure to a group of connected clients that amounts to 14% of the Bank's capital base which is below the aggregated 400% limit set by the law. No large exposure exceeds the maximum 25% set by the law.

For the nine months ended 30 September 2011 30 Amounts are in ISK million

Liquidity Risk

42. The Bank defines liquidity risk as the risk of not being able to fund its financial obligations or planned growth, or only being able to do so substantially above the prevailing market cost of funds.

Liquidity risk management

The Bank's main source of funding is customer deposits. The Bank's Treasury is responsible for the Bank's funding and long-term liquidity management. The Interbank desk is responsible for day-to-day liquidity management.

Risk management is responsible for measuring, monitoring and reporting on the Bank's liquidity position.

The Bank's liquidity risk policy assumes that the Bank has at all times sufficient liquidity to meet liabilities maturing over the next twelve months.

The tables below show the contractual payments of principal and interest for the Bank's financial liabilities. Thus, the total figures for each liability class are higher than the respective balance sheet amount.
For dated financial liabilities the amounts are grouped into maturity buckets according to contractual maturities of principal and estimated contractual payments of interest. For demand deposits or other non-dated liabilities, the figures are grouped according to the first possible required payment date.

Maturity analysis 30 September 2011

Financial Liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Short positions	11,180	-	-	-	-	-	11,180
Deposits from Central Bank	19	-	-	-	-	-	19
Deposits from credit institutions	55,244	6,257	9,416	59	-	-	70,976
Deposits from customers	247,144	55,020	22,977	19,953	6,895	-	351,989
Debt issued and other borrowed funds	-	2,775	6,785	30,445	22,389	-	62,394
Subordinated loans	-	312	998	6,686	29,118	-	37,114
Other financial liabilities	6,649	12,815	2,386	987	143	151	23,131
Total financial liabilities	320,236	77,179	42,562	58,130	58,545	151	556,803

Off balance sheet liabilities show the amount of contractual obligations that the Bank has taken towards customers, either by committing to lend out money in the future or as third party guarantees. The amounts shown reflect the maximum amount, not taking into account the Bank's ability to reduce overdraft or credit card limits before the current undrawn amount is fully utilised by the customer. These obligations all fall into the first time bucket since contractually, on a case by case basis, the Bank could be required to fulfil these obligations instantaneously.

Off balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial gurantees	8,122	-	-	-	-	-	8,122
Undraw loan commitments	15,432	-	-	-	-	-	15,432
Undrawn overdraft	16,932	-	-	-	-	-	16,932
Credit card commitments	19,242	-	-	-	-	-	19,242
Total	59,728	-	-	-	-	-	59,728
Total non-derivative financial liabilities and off balance sheet liabilities	379,964	77,179	42,562	58,130	58,545	151	616,531

The table below shows the contractual cash flow of the Bank's derivative liabilities, i.e. derivatives that have a negative carrying amount at the date of reporting. Derivatives with a positive carrying amount are detailed separately. For derivatives settled on a gross basis, the cash flow for both legs of the derivative is shown, since netting cannot be applied upon settlement.

For the nine months ended 30 September 2011 31 Amounts are in ISK million

42. Cont'd

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	4,842	1,889	56,790	25,000	-	88,521
Outflow	-	(4,953)	(2,368)	(61,832)	(25,069)	-	(94,222)
Total	-	(111)	(479)	(5,042)	(69)	-	(5,701)
Net settled derivatives	-	44	34	273	-	-	351
Total	-	(67)	(445)	(4,769)	(69)	-	(5,350)

Maturity classification of assets is based on contractual maturity. For loans that were acquired at a deep discount and have not yet been restructured, the contractual amount is scaled to reflect the carrying amount of the claim. For bonds and debt instruments in the banking book the maturity classification is based on contractual maturity dates while for bonds and debt instruments held for trading the maturity classification is based on the estimated liquidation time of the asset.

Financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Cash and balances with Central bank	13,942	43,135	-	-	-	-	57,077
Bonds and debt instruments	1,565	16,935	-	233	31,326	2,370	52,429
Shares and equity instruments	-	-	-	-	-	3,284	3,284
Loans to credit institutions	7,395	22,513	2	3	-	-	29,913
Loans to customers	-	37,550	38,954	164,142	254,942	-	495,588
Other financial assets	1,427	7,653	264	136	-	355	9,835
Total financial assets	24,329	127,786	39,220	164,514	286,268	6,009	648,126

Derivative financial assets							
Gross settled derivatives							
Inflow	-	9,295	3,112	9,270	-	-	21,677
Outflow	-	(8,892)	(2,949)	(8,943)	-	-	(20,784)
Total	-	403	163	327	-	-	893
Net settled derivatives	-	38	135	733	(7)	-	899
Total	-	441	298	1,060	(7)	-	1,792

The tables below show the comparative amounts for financial assets and liabilities at year-end 2010. In the Consolidated Financial Statements 2010, the signs were reversed for the inflow and outflow of derivative financial liabilities and credit card commitments were overestimated. This has been corrected in the tables below.

Maturity analysis 31 December 2010

Financial Liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Short positions	9,090	-	-	-	-	-	9,090
Deposits from Central Bank	26	-	-	-	-	-	26
Deposits from credit institutions	58,439	18,419	11,051	8,705	-	-	96,614
Deposits from customers	243,797	39,600	3,965	36,165	8,716	-	332,243
Debt issued and other borrowed funds	1,899	2,084	6,458	33,754	29,887	-	74,082
Subordinated loans	-	266	822	6,019	29,671	-	36,778
Other financial liabilities	15,712	6,687	9,237	527	507	1,011	33,681
Total financial liabilities	328,963	67,056	31,533	85,170	68,781	1,011	582,514

Amounts are in ISK million

42. Cont'd

Off balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial gurantees	8,404	-	-	-	-	-	8,404
Undraw loan commitments	13,453	-	-	-	-	-	13,453
Undrawn overdraft	17,186	-	-	-	-	-	17,186
Credit card commitments	17,916	-	-	-	-	-	17,916
Total	56,959	-	-	-	-	-	56,959
Total non-derivative financial liabilities and off balance sheet liabilities	385,922	67,056	31,533	85,170	68,781	1,011	639,473

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	10,811	1,267	57,837	25,000	-	94,915
Outflow	-	(10,797)	(1,403)	(60,757)	(25,113)	-	(98,070)
Total	-	14	(136)	(2,920)	(113)	-	(3,155)
Net settled derivatives	-	-	-	-	-	-	-
Total	-	14	(136)	(2,920)	(113)	-	(3,155)

Financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Cash and balances with Central bank	23,934	6,865	-	-	-	-	30,799
Bonds and debt instruments	4,492	30,378	1	4	31,111	2,038	68,024
Shares and equity instruments	-	-	-	-	-	3,022	3,022
Loans to credit institutions	7,027	23,501	-	-	342	-	30,870
Loans to customers	4,542	57,662	36,782	156,700	259,475	-	515,161
Other financial assets	-	1,235	766	30	513	548	3,092
Total financial assets	39,995	119,641	37,549	156,734	291,441	5,608	650,968

Derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	3,685	-	-	-	-	3,685
Outflow	-	(3,672)	-	-	-	-	(3,672)
Total	-	13	-	-	-	-	13
Net settled derivatives	-	-	-	-	-	-	-
Total	-	13	-	-	-	-	13

As a part of managing liquidity risk, the Bank holds a portfolio of liquid assets to meet unexpected outflow of funds or a temporary shortage in access to new funding. These assets are subject to strict criteria with respect to maximum liquidation time and price volatility. The table below shows the composition and amount of the Bank's liquidity back-up at the end of 2010 and end of 30 September 2011.

Composition and amount of liquidity back-up	30.9.2011	31.12.2010
Cash and balances with Central Bank	57,077	30,799
Domestic bonds eligible as collateral against borrowing at the Central Bank	55,611	54,881
Foreign government bonds	16,762	30,378
Short-term placements with credit institutions	28,883	28,332
Government liquidity facility	25,000	25,000
Composition and amount of liquidity back-up	183,333	169,390

For the nine months ended 30 September 2011 33 Amounts are in ISK million

Market risk

43. The Bank defines market risk as the current or prospective risk to earnings and capital arising from adverse movements in the level or volatility of prices of market instruments, such as those that arise from changes in interest rates, equity prices, commodity prices and foreign exchange rates.

Market risk management
The Bank's market risk appetite is determined by the Board of Directors. The Asset and Liability Committee (ALCO) decides on limits for portfolios and products in accordance with the market risk policy approved by the Board. Risk management is responsible for monitoring and reporting on the Bank's overall market risk positions and compliance to limits. The objective of market risk management is to manage and control market risk exposures within acceptable parameters.

The Bank separates exposures to market risk into trading book and banking book (non-trading portfolios). The Bank's primary sources of market risk in the trading portfolio are shares, debt instruments and foreign currency positions. All financial assets and liabilities in the trading portfolio are recognised at fair value and all resulting changes are immediately reflected in the income statement. Market risk in the banking book is mainly due to mismatches in interest rate terms and denomination currency of assets and liabilities. These mismatches are reported to management and are subject to regulatory and internal limits.

Interest rate risk

44. Interest rate risk in trading portfolios

The fixed income trading unit invests mainly in government bonds and bonds issued by the Housing Financing Fund (HFF), which are guaranteed by the Icelandic government. These positions can include short positions. Government bonds are either indexed to the Icelandic Consumer Price Index (CPI) or non-indexed, with duration up to 10 years. HFF bonds are CPI linked and have duration up to 13 years. All bond trading positions are subject to BPV limits, both intraday and end-of-day. In addition to BPV limits short and long positions in each instrument are subject to separate limits. Risk management monitors these limits and reports all breaches to ALCO.

Trading bonds and debt instruments, long positions		30.9.2011			31.12.2010	
	MV	Duration	BPV	MV	Duration	BPV
Indexed	2,075	5.63	(1.17)	2,124	9.01	(1.91)
Non-indexed	17,419	0.11	(0.19)	34,078	0.86	(2.92)
Total	19,494	0.70	(1.36)	36,202	1.33	(4.83)

Trading bonds and debt instruments, short positions		30.9.2011			31.12.2010	
	MV	Duration	BPV	MV	Duration	BPV
Indexed	185	9.07	0.17	1,129	4.74	0.54
Non-indexed	5,530	1.89	1.04	7,961	1.32	1.05
Total	5,715	2.12	1.21	9,090	1.75	1.59

Net position of trading bonds and debt instruments	13,779	0.11	(0.15)	27,112	1.20	(3.24)

Amounts are in ISK million

45. Interest rate risk in the non-trading portfolio

Interest rate risk in the non-trading portfolio arises from the Bank's core banking activities. The main source of this type of interest rate risk is the risk of loss from fluctuations in future cash flows or fair value of financial instruments as interest rates change over time, reflecting the fact that the Bank's assets and liabilities are of different maturities and are priced relative to different interest rates.

The Bank holds a government bond designated at fair value amounting to ISK 30.8 billion (2010: ISK 30.3 billion). The bond pays floating rates and carries relatively low interest rate risk.

The Bank uses traditional measures for assessing the sensitivity of the Bank's financial assets, financial liabilities and earnings to changes in the underlying interest rates. Standard scenarios include an adverse 100 basis point parallel shift in all yield curves.

Non-trading portfolio interest rate adjustment periods 30 September 2011

Assets	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Cash and balances with Central Bank	55,066	-	-	-	-	-	55,066
Bonds and debt instruments	32,643	1,307	-	-	-	-	33,950
Loans to credit institutions	29,721	192	-	-	-	-	29,913
Loans to customers	392,709	21,592	14,213	57,019	1,347	8,708	495,588
Other assets	1,091	-	-	-	-	-	1,091
Total assets	511,230	23,091	14,213	57,019	1,347	8,708	615,608
Off balance sheet items..	59,481	13,108	-	-	113	-	72,702
Liabilities							
Deposits from Central Bank	19	-	-	-	-	-	19
Deposits from credit institutions	61,270	9,404	-	-	-	-	70,674
Deposits from customers	351,342	2,321	86	1,446	1,632	-	356,827
Short positions	-	-	554	1,143	292	-	1,989
Debt issued and other borrowed funds	355	-	-	2,740	50,098	917	54,110
Subordinated loans	22,021	-	-	-	-	-	22,021
Total liabilities	435,007	11,725	640	5,329	52,022	917	505,640
Off balance sheet items	11,134	50,451	-	13,190	-	-	74,775
Net interest gap on 30 September 2011	124,570	(25,977)	13,573	38,500	(50,562)	7,791	107,895

For the nine months ended 30 September 2011 35 Amounts are in ISK million

45. Cont'd

Non-trading portfolio interest rate adjustment periods 31 December 2010

Assets	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
Cash and balances with Central Bank	28,966	-	-	-	-	-	28,966
Bonds and debt instruments	31,142	659	-	-	-	22	31,823
Loans to credit institutions	30,520	350	-	-	-	-	30,870
Loans to customers	389,089	37,855	9,481	60,557	2,572	15,607	515,161
Total assets	479,717	38,864	9,481	60,557	2,572	15,629	606,820
Off balance sheet items	47,903	-	-	-	-	-	47,903
Liabilities							
Deposits from Central Bank	26	-	-	-	-	-	26
Deposits from credit institutions	86,856	1,037	8,319	-	-	-	96,212
Deposits from customers	322,274	2,521	-	1,420	943	-	327,158
Debt issued and other borrowed funds	432	-	-	808	52,639	1,546	55,425
Subordinated loans	21,241	-	-	-	-	-	21,241
Total liabilities	430,829	3,558	8,319	2,228	53,582	1,546	500,062
Off balance sheet items	48,216	-	-	-	-	120	48,336
Net interest gap on 31 December 2010	48,576	35,306	1,162	58,329	(51,010)	13,963	106,327

Amounts are in ISK million

Currency risk

46. Currency risk is the risk that earnings or capital may be negatively affected from the fluctuations of foreign exchange rates, due to transactions in foreign currencies or due to mismatch in the currency composition of assets or liabilities.

The analysis of the Bank's foreign currency exposure presented below is based on the contractual currency of the underlying balance sheet items. Additionally, there are off balance sheet items that carry currency risk and are included in the total currency imbalance. The off balance sheet amounts below represent the notional amounts of derivatives and unsettled spot agreements. Most of the net non-adjusted currency imbalance is due to loans with a non-ISK contractual currency to customers with ISK income. As a part of the transfer of assets from Glitnir, the Bank determined that these loans have a recovery value that is limited in ISK terms. To reflect the ISK based recovery value of these loans the Bank has impaired fully the foreign exchange gains on these assets since the date of transfer. Should there be an appreciation of the ISK there will be a corresponding reversal of the impairment charge. This is in accordance with IFRS accounting standards. The Bank's regulators allow for an adjustment of the contractual currency imbalance to reflect the recovery of foreign currency denominated loans to customers with ISK income. The tables below summarise the Bank's exposure to currency risk at 30 September 2011 and 31 December 2010, based on contractual currencies, off balance sheet items along with the currency adjustment.

Currency analysis 30 September 2011

Assets	EUR	USD	GBP	CHF	JPY	Other	Total
Cash and balances with Central Bank......................	584	92	63	41	17	218	1,015
Bonds and debt instruments....................................	13,908	354	-	-	-	3,213	17,475
Shares and equity instruments.................................	-	32	-	-	-	5	37
Loans to credit institutions..	14,650	10,100	162	811	290	1,861	27,874
Loans to customers..	60,578	17,021	4,941	28,754	27,290	2,720	141,304
Investments in associates..	20	388	-	-	-	-	408
Total assets	89,740	27,987	5,166	29,606	27,597	8,017	188,113
Liabilities							
Deposits from credit institutions	2,870	1,151	302	-	-	37	4,360
Deposits from customers	17,657	18,084	4,762	761	617	7,164	49,045
Debt issued and other borrowed funds	51	2	-	187	217	302	759
Subordinated loans	22,021	-	-	-	-	-	22,021
Total liabilities	42,599	19,237	5,064	948	834	7,503	76,185
Non-adjusted foreign exchange on balance sheet imbalance	47,141	8,750	102	28,658	26,763	514	111,928
Adjustment of currency imbalance for FX/ISK loans	(16,879)	(3,390)	(688)	(17,693)	(16,480)	(946)	(56,076)
Adjusted imbalance	30,262	5,360	(586)	10,965	10,283	(432)	55,852
Off balance sheet items							
Off balance sheet assets	2,200	19,617	839	1,780	3,381	4,506	32,323
Off balance sheet liabilities	25,000	24,398	92	13,580	14,392	2,068	79,530
Net off balance sheet items	(22,800)	(4,781)	747	(11,800)	(11,011)	2,438	(47,207)
Net currency imbalance on 30 September 2011	7,462	579	161	(835)	(728)	2,006	8,645

Amounts are in ISK million

46. Cont'd

Currency analysis 31 December 2010

Assets	EUR	USD	GBP	CHF	JPY	Other	Total
Cash and balances with Central Bank	405	191	114	38	15	349	1,112
Bonds and debt instruments	15,018	10,695	3,473	-	-	1,953	31,139
Shares and equity instruments	12	51	-	-	-	-	63
Loans to credit institutions	16,620	6,403	1,173	30	200	2,589	27,015
Loans to customers	67,094	26,092	5,333	41,579	36,613	3,501	180,212
Investments in associates	218	-	-	-	-	-	218
Other assets	195	373	42	-	-	3	613
Total assets	99,562	43,805	10,135	41,647	36,828	8,395	240,371
Liabilities							
Deposits from credit institutions	7,701	6,920	5,412	-	11	590	20,634
Deposits from customers	15,791	13,165	2,732	465	1,202	4,935	38,290
Debt issued and other borrowed funds	134	-	-	-	-	32	166
Subordinated loans	21,241	-	-	-	-	-	21,241
Other liabilities	647	696	302	-	-	45	1,690
Total liabilities	45,514	20,781	8,446	465	1,213	5,602	82,021
Non-adjusted foreign exchange on balance sheet imbalance	54,048	23,024	1,689	41,182	35,615	2,793	158,350
Adjustment of currency imbalance for FX/ISK loans	(37,057)	(12,362)	(1,551)	(26,412)	(24,194)	(1,620)	(103,196)
Adjusted imbalance	16,991	10,662	138	14,770	11,421	1,173	55,155
Off balance sheet items							
Off balance sheet assets	3,877	5,995	1,151	1,258	2,578	156	15,015
Off balance sheet liabilities	24,945	22,015	1,280	6,967	13,514	688	69,409
Net off balance sheet items	(21,069)	(16,020)	(129)	(5,709)	(10,936)	(532)	(54,394)
Net currency imbalance on 31 December 2010	(4,078)	(5,358)	9	9,061	485	641	759

Inflation risk

47. The Bank is exposed to inflation risk since the value of CPI-indexed assets exceeds CPI-indexed liabilities. The value of these assets and liabilities changes according to changes in the CPI at any given time and all changes in the CPI index affect profit and loss. On 30 September 2011 the CPI gap amounted to ISK 16.5 billion (31 December 2010: ISK 25.1 billion). Thus, a 1% increase in the index would have a positive impact on the profit and loss account to the amount of ISK 165 million in profit and a 1% decrease would result in a corresponding loss, other risk factors held constant.

Amounts are in ISK million

Capital management

48. Icelandic capital adequacy rules are based on the EU capital requirements directives (CRD). The capital adequacy rules require an absolute minimum capital level of 8% of risk weighted assets.

As part of the conditions for granting the Bank an operating license as a financial undertaking, the Icelandic Financial Supervisory Authority (FME) requires the Bank to maintain a minimum Core Tier 1 ratio of 12% of risk weighted assets and a total capital ratio, allowing for subordinated Tier 2 debt, of 16%.

The Bank's regulatory capital calculations for credit risk and market risk are based on the standardised approach and the capital calculations for operational risk are based on the basic indicator approach. Market risk exposure for currency risk is based on the adjusted currency imbalance described in note 46.

The table below shows the capital base, risk weighted assets and capital ratios of the Bank at 30 September 2011 and 31 December 2010.

	30.9.2011	31.12.2010
Tier 1 capital		
Ordinary share capital	10,000	10,000
Share premium	55,000	55,000
Other reserves	2,550	2,498
Retained earnings	64,587	53,174
Non-controlling interests	(61)	791
Tax assets	(200)	(283)
Intangible assets	(249)	(187)
Total Tier 1 capital	131,627	120,993
Tier 2 capital		
Qualifying subordinated liabilities	22,021	21,241
Total regulatory capital	153,648	142,234
Risk weighted assets		
- due to credit risk	441,682	440,586
- due to market risk:	13,272	14,766
Market risk, trading book	2,597	4,583
Currency risk foreign exchange	10,675	10,183
- due to operational risk	79,079	79,079
Total risk weighted assets	534,033	534,431
Capital ratios		
Tier 1 ratio	24.6%	22.6%
Total capital ratio	28.8%	26.6%

In 2010, the Bank did an assessment of its internal capital adequacy (ICAAP) and submitted to the FME. Such an assessment is an integral part of the Bank's capital and risk management.

The FME reviewed the report as a part of the supervisory review process (SREP). The results from this review process were presented to the Bank during the quarter and show that the current capitalisation levels are well above of both internal and regulatory requirements.

For the nine months ended 30 September 2011 39 Amounts are in ISK million