

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

ISK 25,000,000,000

Debt Issuance Programme

Under this ISK 25,000,000,000 Debt Issuance Programme (the **Programme**), Arion Bank hf. (the **Issuer** or the **Bank**) may from time to time issue Debt Securities (the **Debt Securities**) denominated in any currency agreed between the Issuer and the relevant Dealer (as defined below). Bonds may be issued in bearer form (**Bearer Bonds**) or registered form (**Registered Bonds**). All Debt Securities may be issued in uncertificated and dematerialised book entry form registered in the Nasdaq CSD Iceland Ltd. (**NCS D Debt Securities** and the **NCS D** respectively). The maximum aggregate nominal amount of all Debt Securities from time to time outstanding under the Programme will not exceed ISK 25,000,000,000 (or its equivalent in other currencies calculated as described in the Programme Agreement described herein), subject to increase as described herein.

The Debt Securities 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 Base Prospectus to the relevant Dealer shall, in the case of an issue of Debt Securities being (or intended to be) subscribed by more than one Dealer, be to all Dealers agreeing to subscribe for such Debt Securities.

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

This Base Prospectus has been approved by the Financial Supervisory Authority Iceland (the **FME**), in its capacity as competent authority under the Act on Securities Transactions, as a base prospectus for the purposes of Article 5(4) of Directive 2003/71/EC (the "Prospectus Directive") and Article 45 of the Act on Securities Transactions No. 108/2007 for the purpose of giving information with regard to the issue of Debt Securities under the Programme during the period of twelve months from the date of its approval. An application will be submitted to Nasdaq Iceland hf. for Debt Securities issued under the Programme to be admitted to trading on Nasdaq Iceland Nasdaq Iceland Main Market, the regulated market of the Nasdaq Iceland. References in this Base Prospectus to Debt Securities being listed (and all related references) shall mean that such Debt Securities have been admitted to trading on the regulated market of the Nasdaq Iceland. The regulated market of the Nasdaq Iceland is a regulated market for the purposes of Directive 2004/39/EC (the "MiFID") which has been implemented in Iceland through the Act on Securities Transactions and Act on Stock Exchanges No. 110/2007. The Issuer may list the Debt Securities on additional regulated markets.

Notice of the aggregate nominal amount of Debt Securities, interest (if any) payable in respect of Debt Securities, the issue price of Debt Securities and certain other information which are applicable to each Tranche (as defined under "*Terms and Conditions of the Debt Securities*") of Debt Securities will be set out in a final terms document (the **Final Terms**) which will be filed with the FME. Copies of Final Terms in relation to Debt Securities to be listed on the Nasdaq Iceland hf. will also be published on the website of the Nasdaq Iceland hf. (www.nasdaqomxnordic.com) and on the Issuer's website: arionbanki.is.

The Programme provides that Debt Securities 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 Debt Securities.

The Debt Securities 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 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 Debt Securities*" for a description of the manner in which Debt

Securities will be issued. Registered Bonds are subject to certain restrictions on transfer, see "*Subscription and Sale and Selling Restrictions*".

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

Debt Securities issued under the Programme may be rated or unrated. Where a Series of Debt Securities 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 Standard & Poor's Credit Market Services Europe Limited (**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 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.

Arranger
Arion Bank hf.

The date of this Base Prospectus is 15.04.2019.

This Base Prospectus 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 Base Prospectus and the Final Terms for each Series of Debt Securities 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 Base Prospectus 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 Base Prospectus in connection with an offer of Debt Securities 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 and copies of the Final Terms relating to the Debt Securities which are admitted to trading on the regulated market of the Nasdaq Iceland hf. will be filed with the FME and also be published on the website of the Nasdaq Iceland hf., www.nasdaq.com and on the Issuer's website: arionbanki.is.

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

The Dealers have not independently verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Dealers as to the accuracy or completeness of the information contained or incorporated by reference in this Base Prospectus or any other information provided by the Issuer in connection with the Programme. No Dealer accepts any liability in relation to the information contained or incorporated by reference in this Base Prospectus or any other information provided by the 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 Base Prospectus or any other information supplied in connection with the Programme or the Debt Securities 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 Base Prospectus nor any other information supplied in connection with the Programme or any Debt Securities (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 Base Prospectus or any other information supplied in connection with the Programme or any Debt Securities should purchase any Debt Securities. Each investor contemplating purchasing any Debt Securities should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer. Neither this Base Prospectus nor any other information supplied in connection with the Programme or the issue of any Debt Securities 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 Debt Securities. Investors should review, *inter alia*, the documents deemed incorporated herein by reference when deciding whether or not to purchase any Debt Securities.

Neither the delivery of this Base Prospectus nor the offering, sale or delivery of any Debt Securities 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 Debt Securities of any information coming to their attention.

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

This Base Prospectus does not constitute an offer to sell or the solicitation of an offer to buy any Debt Securities in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Base Prospectus and the offer or sale of Debt Securities may be restricted by law in certain jurisdictions. The Issuer and the Dealers do not represent that this Base Prospectus may be lawfully distributed, or that any Debt Securities 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 Debt Securities or distribution of this document in any jurisdiction where action for that purpose is required. Accordingly, no Debt Securities may be offered or sold, directly or indirectly, and neither this Base Prospectus nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Base Prospectus or any Debt Securities may come must inform themselves about, and observe, any such restrictions on the distribution of this Base Prospectus and the offering and sale of Debt Securities. In particular, there are restrictions on the distribution of this Base Prospectus and the offer or sale of Debt Securities in the United States, the European Economic Area (including the United Kingdom and Iceland), Japan and Hong Kong, see "*Subscription and Sale and Selling Restrictions*".

This Base Prospectus has been prepared on the basis that subject to the existing currency restrictions in place at each time, any offer of Debt Securities in any Member State of the European Economic Area or contracting party to the Agreement of the European Economic Area (a **Member State**) which has implemented the Prospectus Directive (each, a **Relevant Member State**) must be made pursuant to an exemption under the Prospectus Directive, as implemented in that Relevant Member State, from the requirement to publish a prospectus for offers of Debt Securities. Accordingly any person making or intending to make an offer in that Relevant Member State of Debt Securities may only do so in circumstances in which no obligation arises for 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, in each case, in relation to such offer. Neither the Issuer nor any Dealer has authorised, nor do they authorise, the making of any offer of Debt Securities in circumstances in which an obligation arises for the Issuer or any Dealer to publish or supplement a prospectus for such offer.

In making an investment decision, investors must rely on their own examination of the Issuer and the terms of the Debt Securities being offered, including the merits and risks involved. The Debt Securities 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 Base Prospectus or confirmed the accuracy or determined the adequacy of the information contained in this Base Prospectus. Any representation to the contrary is unlawful.

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

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 Debt Securities*" or any other section of this Base Prospectus. In addition, all references in this document to "U.S. dollars", "U.S.\$"

and "\$" refer to United States dollars and references to "ISK", "krona" or "kronur" refer to Icelandic Krona. In addition, all references to "Sterling" and "£" refer to pounds sterling and references to "EUR", "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.

In connection with the issue of any Tranche of Debt Securities, the Dealer or Dealers (if any) named as the Stabilising Manager(s) (or persons acting on behalf of any Stabilising Manager(s)) in the applicable Final Terms may over-allot Debt Securities or effect transactions with a view to supporting the market price of the Debt Securities of the Series (as defined below) of which such Tranche forms part at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager(s) (or persons acting on behalf of a Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the relevant Tranche of Debt Securities is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the relevant Tranche of Debt Securities and 60 days after the date of the allotment of the relevant Tranche of Debt Securities. Any stabilisation action or over-allotment shall be conducted in accordance with all applicable laws and rules.

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OVERVIEW OF THE PROGRAMME

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

Words and expressions defined in "Form of the Debt Securities" and "Terms and Conditions of the Debt Securities" below shall have the same meanings in this overview. A glossary of certain defined terms is contained at the end of this Base Prospectus.

Description: ISK 25,000,000,000 Debt Issuance 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, corporate lending, investment banking and asset management, with total assets as at 31 December 2018 of ISK 1,164 billion and net profit of ISK 7.8 billion for the year ended 31 December 2018.

Arranger: Arion Bank hf.

Dealers: Arion Bank hf.

NCSA Agent: Arion Bank hf.

KEY FEATURES

Status of the Debt Securities: The Debt Securities may be issued on an unsubordinated (**Unsubordinated Bonds**) or a subordinated (**Subordinated Bonds**) basis, as described in Conditions 3.1 and 3.2, respectively, and as specified in the applicable Final Terms

References to **Bondholders** are to the Bondholders and the holders of any other securities issued by the Issuer.

Certain Restrictions: Each issue of Debt Securities 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.

Programme Size: Up to ISK 25,000,000,000 (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: The Debt Securities 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, 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.

2. FORM OF DEBT SECURITIES: The Debt Securities will be issued either (i) in bearer form, (ii) in registered form or (iii) in the case of NCSD Debt Securities, in uncertificated and dematerialised book entry form registered in the NCSD (Nasdaq CSD Iceland).

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

Terms of the Debt Securities: The terms of the Debt Securities will be set out in the Terms and Conditions of the Debt Securities, as completed by the applicable Final Terms.

Redenomination: Subject to any applicable legal or regulatory restrictions, the applicable Final Terms may provide that certain Debt Securities may be redenominated in euro. The relevant provisions applicable to such redenomination are contained in Condition 4 of the Terms and Conditions of the Debt Securities.

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: Debt Securities 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 Debt Securities may be issued: (a) Bonds which bear interest at a fixed rate and/or a floating rate; (b) Bonds which do not bear interest (c) Bills which do not bear interest; and (d) 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, Debt Securities 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 Debt Securities being issued and such terms will be specified in the applicable Final Terms.

Fixed Rate 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.

Fixed Reset Bonds:

The interest rate on Fixed Reset Bonds will reset on each Reset Date by reference to the relevant Reset Margin and Mid-Swap Rate.

Floating Rate Bonds:

Floating Rate Bonds will bear interest at a rate determined:

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 Bonds of the relevant Series); or

on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or

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 Bonds.

Inflation Linked Non-Amortising Bonds:

Inflation Linked Non-Amortising 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 Bonds will be redeemed by payment of one or more amounts adjusted for inflation in accordance with the provisions set out in Condition 7.4, constituting payments of principal in relation to such Inflation Linked Non-Amortising Bonds.

Inflation Linked Amortising Bonds:

Inflation Linked Amortising Bonds will bear interest which will be payable on such date or dates as may be agreed with the Issuer. Inflation Linked Amortising Bonds will be redeemed by payment of one or more amounts, adjusted for indexation in accordance with the provisions set out in Conditions 5.3 and 7.3, on such date or dates as may be agreed between the Issuer and the relevant Dealer.

Inflation Linked Zero Coupon Bonds: Inflation Linked Zero Coupon Bonds will be offered and sold at a discount to their nominal amount and will not bear interest. Inflation Linked Zero Coupon Bonds will be redeemed by payment of one or more amounts, adjusted for indexation in accordance with the provisions set out in Condition 7.4.

Inflation Linked Instalment Bonds: Inflation Linked Instalment Bonds may be issued on an instalment basis in which case such Bonds will be redeemed in the Instalment Amounts and on the Instalment Dates specified in the applicable Final Terms. Inflation Linked Bonds Instalment Bond will be redeemed by payment of one or more amounts, adjusted for indexation in accordance with the provisions set out in Condition 7.5

Other provisions in relation to Floating Rate Bonds, Inflation Linked Non-Amortising Bonds, Inflation Linked Amortising Bonds and Inflation Linked Instalment Bonds: Floating Rate Bonds may also have a maximum interest rate, a minimum interest rate or both or a maximum interest amount. Interest on Floating Rate 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 Amortising Bonds and Inflation Linked Non-Amortising Bonds may have variable interest amounts and principal amounts. Interest on Inflation Linked Amortising Bonds, Inflation Linked Non-Amortising Bonds and Inflation Linked Instalment 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 5.3 for Inflation Linked Amortising Bonds, Condition 5.4 for Inflation Linked Non-Amortising Bonds and Condition 5.5 for Inflation Linked Instalment Bonds.

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

Instalment Bonds: Instalment Bonds may be issued on an instalment basis in which case such Bonds will be redeemed in the Instalment Amounts and on the Instalment Dates specified in the applicable Final Terms.

Bills Bills will be offered and sold at a discount to their nominal amount and will not bear interest. Bills will have a maximum final maturity of 13 months when issued.

Redemption: The applicable Final Terms will indicate either that the relevant Bonds cannot be redeemed prior to their stated maturity (other than in specified instalments, if applicable, for taxation reasons or following an Event of Default, or in the case of Subordinated Bonds, upon the occurrence of a Capital Event) or that such Bonds will be redeemable at the option of the Issuer and/or the 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.

The applicable Final Terms may provide that Bonds are redeemable in two or more instalments of such amounts and on such dates as are indicated in the applicable Final Terms.

Benchmark Discontinuation:

In the case of Floating Rate 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 5.9.

Denomination of Debt Securities:

The Debt Securities will be issued in such denominations as may be agreed between the Issuer and the relevant Dealer save that the minimum denomination of each Debt Security 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 Debt Security admitted to trading on a regulated market within the European Economic Area or offered to the public in a Member State of the European Economic Area in circumstances which require the publication of a prospectus under the Prospectus Directive will be €100,000 (or, if the Debt Securities are denominated in a currency other than euro, the equivalent amount in such currency).

Taxation:

All payments in respect of the Debt Securities 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 8 of the Terms and Conditions of the Debt Securities, be required to pay additional amounts to cover the amounts so deducted.

- Use of Proceeds:** The net proceeds from each issue of Debt Securities will be applied by the Issuer for its general corporate purposes, which include making a profit. If, in respect of any particular issue of Debt Securities there is a particular identified use of proceeds, this will be stated in the applicable Final Terms.
- Rating:** The Debt Securities 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 Debt Securities 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 Debt Securities issued under the Programme will be cleared through Euroclear, Clearstream, Luxembourg or the NCSD, and/or any other clearing system as may be specified in the relevant Final Terms.
- Listing:** Debt Securities 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. Debt Securities 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 Debt Securities are to be listed and/or admitted to trading and, if so, on which stock exchanges and/or markets.
- Passporting:** Once a prospectus has been approved by the FME in Iceland, it may be passported into any member state of the European Economic Area and thereafter used to offer securities to the public and/or for an admission to trading in the relevant jurisdiction.
- Governing Law:** The Debt Securities and any non-contractual obligations arising out of or in connection with them, will be governed by, and construed in accordance with, Icelandic law.
- Selling Restrictions:** There are restrictions on the offer, sale and transfer of the Debt Securities in the United States, Japan, Hong Kong and the European Economic Area (including the United Kingdom, Norway, Denmark, Sweden, the Netherlands and Iceland) and such other restrictions as may be required in connection with the offering and sale of a particular Tranche of Debt Securities. 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 Debt Securities 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 Debt Securities issued under the Programme such as the fact that the Debt Securities may not be a suitable investment for all investors, certain risks relating to the structure of particular Series of Debt Securities and certain market risks.

RISK FACTORS

The following factors may affect the ability of the Bank to fulfil its obligations under Debt Securities 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 Debt Securities 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 Debt Securities issued under the Programme, but the inability of the Bank to pay interest, principal or other amounts on or in connection with any Debt Securities 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 Base Prospectus and reach their own views prior to making any investment decision.

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

The Issuer's business is materially affected by 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, 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 shown some signs of recovery since 2011, with gross domestic product (**GDP**) growth of 4.4 per cent. in 2013, 1.9 per cent. in 2014, 4.2 per cent. in 2015, 7.2 per cent. in 2016 and 3.6 per cent. in 2017. (source: *Statistics Iceland*). However, no assurance can be given that this recovery 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 Iceland's recent economic recovery include:

- *Fluctuations in the value of Icelandic Krona:* In 2018, Icelandic Krona depreciated by 11 per cent. against the U.S. dollar and depreciated by 6.7 per cent. against the euro (source: *Bloomberg*). 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.

Easing of the Capital Controls: In response to the financial crisis in 2008, the Parliament of Iceland (*Alþingi*) introduced capital controls in November 2008 with the view of stabilising the foreign exchange rate of Icelandic Krona (the "**Capital Controls**"). As of the date of this 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.

- *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.

- *Inflation:* While inflation currently remains within the Icelandic Central Bank's target rate of 2.5% per annum, the Icelandic Central Bank's current inflation outlook is that the rate of inflation could rise in excess of the target rate in 2019 and 2020 (*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*).
- *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 ongoing restructuring of the financial sector and winding down of Kaupthing, Glitnir and Landsbanki and 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 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 the above factors could adversely affect Iceland's economic recovery, 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 any Debt Securities.

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 the largest are tourism (*i.e.*, as a source of foreign income), seafood, aluminium and other industrial goods and services (including energy).

Key risks in these industry sectors include:

- *Tourism:* In the wake of the financial crisis in 2008, 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 24 per cent. in 2014, 30 per cent. in 2015, 40 per cent. in 2016 and 24 per cent. in 2017 and 5 per cent. in 2018 in each case as compared to the previous year (*source: Statistics Iceland, Isavia*). 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, 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 and processing of 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 can 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 Arion Bank estimates that between 8,000 and 10,000 extra houses will be needed before 2020. However, any destabilisation of the underlying factors which are driving this increased demand for real estate, such as a decline in tourism or 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 occurrence of any of the above factors 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 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 Debt Securities.

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 having 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 operations. . In February 2018, the Minister of Finance appointed a committee to prepare a white paper focusing on a full strategic review of the Icelandic financial system. The white paper was published in December 2018. The white paper will form part of parliamentary discussion, in its 2019 spring session

Although no such requirement has 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 Debt Securities.

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.

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 which could, for example, lead to the Bank deciding not to 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 a range of other typical financial institution market risks, including interest rate risk, equity price risk and inflation risk

As a financial institution, the Bank is exposed to various market risks, including interest rate risk, equity price risk and inflation risk. 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 proprietary trading 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 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. The Bank's proprietary trades are largely in Icelandic treasury notes and housing fund bonds and, to a limited extent, listed equity securities. The Bank has implemented a number of position limits and other controls designed to limit its trading book exposure, but no assurance can be given that these controls will be effective in all circumstances. The Bank is exposed to the risk that these controls do not prove to be effective in all circumstances and that the Bank could therefore experience material losses 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.

In relation to its balance sheet, the Bank's operations are subject to interest rate risk associated with mismatches between its interest-bearing assets and its interest-bearing liabilities. The principal mismatch 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 a period of changing 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 2018, the total amount of the Bank's CPI-linked assets was ISK 369,149 million and the total amount of its CPI-linked liabilities was ISK 268,605 million. 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 Debt Securities.

The Capital Controls restrict to some extent the manner in which the Bank conducts its business

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. The Capital Controls have been eased gradually over the past years but the following restrictions remain 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; and iii) in certain instances, foreign-denominated lending by residents to non-residents.

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. 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 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.

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% in Iceland, the Bank is subject to certain other taxes which are specific to Iceland which 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% on the total debt of the Bank, excluding tax liabilities, 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% tax levied on all remuneration paid to employees (**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.

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

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 Debt Securities.

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 have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations.

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 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 hold a combined market share of 60% of loans to households, 83% of loans to corporates and 98% of deposits from customers as of 31 December 2017. The small size of the Icelandic economy and the ongoing restructuring of 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 has declined from 42% as of 31 December 2009 to 2.6% as of 31 December 2018, 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. It is also unlikely that the Bank, Íslandsbanki or Landsbankinn will grow significantly through international operations in the near future. Iceland's economy could be 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 Debt Securities.

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, 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 digitalisations initiatives, which could result in less than expected customers satisfaction improvements and cost reductions and negatively impact revenues and operating results, respectively. In addition, the expansion of Valitor's operations and the intergration of Vörður tryggingar hf. (**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 expecations published by economic research institutions as well as in adjustments by market research specialist, sometimes giving rise to significant revisions to growth expecations for sppecific markets. As a result, many financial institutions, including the Bank, may find it difficult to accurately model and predict the prospects for their 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 implementaions. 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 advers effect on the Group's business, prospects, financial position and/or results of operations, and its ability to make payments in respect of the Debt Securities.

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

The Icelandic banking sector is dominated by Arion Bank, Íslandsbanki and Landsbankinn, the latter two being wholly owned by the Icelandic government, but also includes other commercial banks and savings banks, the Housing Financing Fund, a provider of financing for residential housing in Iceland, 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 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 recenetly introduced legislation in order to facilitate customers switching banks in an effort to promote competition, for example, by abolishing the stamp fee on collateral.

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'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 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, as the Capital Controls continue to be eased and there is sufficient credit demand, the Bank may potentially face competition from foreign banks seeking to establish operations in Iceland, in particular with respect to 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 Debt Securities.

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 regulations and from risks relating to the ability of Icelandic authorities to adopt, implement and administer applicable regulations and to supervise Icelandic Banks. In addition, certain of the Bank’s and its subsidiaries’ operations are contingent upon licences issued by financial authorities. The Bank and its subsidiaries are also subject to regulatory scrutiny from other supervisory bodies, such as the ICA and the Data Protection Authority. Compliance with the requirements of these licenses, 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.

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 to do so, for example with respect to capital requirements.

Leading up to the financial crisis in 2008, there was a significant difference in the resources of the FME and those of Icelandic banks, which may have negatively affected their supervision. Although these constraints have since been addressed, 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. Despite the increased FME resources and expanded regulatory framework, the possibility exist that employees of the Bank would, 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 Systems 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 of failure by the Bank to comply with corporate governance requirements and 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.

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 in certain of its business 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 Debt Securities.

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.

- *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 31 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;
- *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. A new party, EC-Clear ehf. 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 has submitted its statement of defence. 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 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. Decision about the next steps in the court proceedings is expected in April 2019. Further, in February 2018 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. The District Court 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. 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. The Bank has considered the allegations in this correspondence, and has conducted its own review of these allegations and 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.

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 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. 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.

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

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 is also exposed to customer claims in the Retail Banking and Corporate Banking divisions, including significant claims in relation to loans advanced by its predecessor, Kaupthing. See "*—Legal matters*".

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 Debt Securities.

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 adapt national law to conform to EEA rules, citizens may be unable to rely on them and the Icelandic courts barred from applying them, unless Icelandic legislation may be interpreted to conform with the relevant EEA rules. 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 mean that uniformity between EU law and the Icelandic legislation is not guaranteed. In such cases, Icelandic law will be deemed to prevail in the Icelandic courts. Such errors can cause confusion and debate as to what exact rules the Bank shall follow and can mean time consuming and resource demanding discourse with regulators.

Delays in the full implementation of European directives and regulations into Icelandic legislation may give rise to uncertainty as to the applicable requirements. Icelandic government authorities may seek to bridge delays in formal implementation into national law by seeking to apply in practice requirements equivalent to those under EEA rules. This gives rise to risk as the Bank may be unable to rely on the wording of statute or

draw guidance from legislative preparatory works. Complying with regulation that is in flux is liable to be demanding of the Bank's resources and exposes the Bank to a risk of non-compliance.

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 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.

In 2017, as a result of ongoing operating difficulties, the Bank foreclosed on collateral and took possession of the collateralised shares in Sameinað sílikon hf. ("**United Silicon**") and became the largest shareholder of the company, with an interest ownership of 66.58% and voting rights of 66.68%. The fair value calculation of the underlying assets of United Silicon resulted in a provision on loans of ISK 2,962 million recognised in net impairment as well as fair value loss of the unsecured bond of ISK 708 million recognised in net financial income of the consolidated statement of comprehensive income as of and for the year ended 31 December 2017. 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.

Any of the foregoing could have a material adverse effect on the Bank's business, prospects, financial position and/or results of operations.

Following the establishment of the Bank, a portfolio of assets and liabilities originated by Kaupthing was purchased by the Bank in 2008. These assets and liabilities initially resulted in significant foreign exchange, interest rate and liquidity mismatches within the Bank's asset portfolio, although these mismatches have now largely been addressed. In addition, the serious recession in Iceland in 2009 and 2010 resulted in a significant increase in problem loans and deteriorating asset quality. The valuation of assets that were purchased by the Bank from Kaupthing attempted to account for all realised and foreseen losses, and this has significantly reduced the credit risk that would otherwise have been present in the Bank's customer loan portfolio. However, 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.

In particular:

- as of 31 December 2018, 2.6% of the Bank's customer loan portfolio was classified as share of stage 3 loans, gross (Gross carrying value of stage 3 loans + gross carrying value of POCI loans in Risk class 4 or lower) / (Gross carrying value of loans to customers).
- the Bank has significant exposure to the real estate and construction and seafood industry sectors, with exposure amounting to 33.9% and 19.4%, respectively, of the Bank's total loans to customers as of 31 December 2018;
- the Bank's customer loan portfolio is also highly concentrated in Icelandic borrowers.

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.

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's 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 early 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, will be subject to unexpected implementation costs and delays, and no assurance can be given that such implementations could 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, 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 sensitive personal customer data (including, in certain instances, consumer names, addresses, credit and debit card numbers and bank account details) and 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 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 regulations 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 jurisdiction 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 fail to 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 Debt Securities.

The Bank may be unable to successfully maintain salary costs, and overrunning salary costs and relating 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 salary costs 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, 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. 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 Debt Securities.

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, as the Bank competes for talented people with both financial and non-financial services companies. In addition, the Bank may not have sufficient scale to offer employees rates of compensation comparable to its larger international competitors, 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 Debt Securities.

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 Credit Market Services Europe Limited ("**Standard & Poor's**").¹

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 Debt Securities.

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. ("**Stefnir**") given the volume of assets under management in any particular fund or portfolio and the consequent magnitude of any errors or misconduct.

The Bank has implemented controls designed to detect, monitor and mitigate operational risks. However, these controls cannot completely eliminate such risks as some can be difficult to detect, recommendations and suggestions of surveillance units of the Bank (such as the compliance and internal audit functions) could be ignored, misunderstood or misapplied, and mitigation could not be effective. Failures in internal controls could subject the Bank to regulatory scrutiny. 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 Debt Securities.

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

¹ Standard & Poor's is established in the European Union and is registered under Regulation (EC) No. 1060/2009 (as amended) (the "**CRA Regulation**"). As such, Standard & Poor's is included in the list of credit rating agencies published by the European Securities and Markets Authority on its website 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.

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 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:

1. poor customer service or IT failures or interruptions that impact customer services and accounts;
2. failure, or allegations of having failed, to maintain appropriate standards of customer privacy, customer service and record keeping and disclosure of confidential information ;
3. failure to appropriately address potential conflicts of interest and acting, or allegations of having acted, unethically in the conduct of its business;
4. breaching, or allegations of having breached, legal and regulatory requirements, including anti-money laundering and anti-terrorism financing requirements;
5. failure to properly identify legal, regulatory, compliance, reputational, credit, operational, liquidity and market risks inherent in the Bank's products and services;
6. third parties on whom the Bank relies for information, products and services failing to provide the required information, products and services;
7. the fact that the Bank is privately owned, while its principal competitors Íslandsbanki and Landsbankinn are government owned; and
8. 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, in particular 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 Debt Securities.

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 Debt Securities.

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 Nýherji hf. ("Nýherji"), and it is considering other opportunities for IT outsourcing and the 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 Debt Securities.

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 Debt Securities.

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 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 Debt Securities.

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

In 2013, the European Parliament and the European Council adopted a legislative package (“**CRD IV**”) for the implementation of the Basel III framework in the European Union, the implementation of which in Iceland has now 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 could also 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 registration with card schemes, the Bank, Valitor and their customers are subject to 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 Debt Securities.

The asset management operations of the Bank may fail to sustain or increase their level of assets under management

For the year ended 31 December 2018, the Bank generated ISK 4,164 million, or 9% 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, or to withdraw altogether from such open-ended 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. 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. In addition, the 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. The easing of the Capital Controls could also negatively impact the Bank and Stefmir as a result of increased competition from international asset management companies. 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. The Bank's historical performance is not an indicator of the level of its 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, market conditions and a lack of investment opportunities.

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

In addition, regulatory changes, in particular the adoption in Iceland of Directive (2014/65/EC) on Markets in Financial Instruments ("MiFID 2") 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 2 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 Debt Securities.

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 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. 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 Debt Securities.

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'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 Debt Securities.

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 its multicurrency EUR 2,000,000,000 medium term note programme (the "**EMTN Programme**") and covered bond facilities. For additional information on the Group's deposits, see "*Risk Management—Liquidity Risk*".

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

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

The Bank has recently sought to further diversify its funding profile through increased debt issuances and will continue to do so if its deposit base declines or fails to grow relative to any increases in its assets, as there will be a natural limit on the scope for growth in deposits in view of Iceland's relatively small economy and in view of competition for deposits with other banks and with pension funds. The Bank's loan-to-deposit ratio was 178.9 per cent. as of 31 December 2018 (135.7 per cent. excluding covered bonds), as compared to 165.5 per cent. 31 December 2017 (135.7 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.

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 funding 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 Debt Securities.

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

As a financial institution, the Bank is exposed to various market risks, including interest rate risk, equity price risk and inflation risk. 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 proprietary trading 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-bearing assets and its interest-bearing liabilities. The principal mismatch arises from the Bank's fixed interest liabilities as against its floating rate assets. The Bank also faces interest rate risk between its interest-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 a period of changing 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.

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 Debt Securities.

Legal and regulatory risks relating to the Debt Securities

Set out below is a brief description of certain legal and regulatory risks relating to Debt Securities

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 and investment firms considered to be at risk of failing. The implementation of the BRRD in Iceland and its impact on the Bank is currently unclear but the taking of any action under the BRRD following its implementation could materially affect the value of any Debt Securities

On 2 July 2014, Directive 2014/59/EU providing for the establishment of an EU-wide framework for the recovery and resolution of credit institutions and investment firms (the **Bank Recovery and Resolution Directive** or **BRRD**) entered into force. Iceland, Liechtenstein, Norway and Switzerland are members of the EFTA and Iceland, together with Liechtenstein and Norway (the **EEA EFTA States**) is also a party to the EEA Agreement by which the EEA EFTA States participate in the internal market of the European Union (the **EU**). On 27 November 2013, the EFTA Working Group on Financial Services stated that "it would appear that the proposal represented by the June 2012 draft of the BRRD may be deemed EEA relevant and thus likely to be incorporated into the EEA Agreement once adopted by the EU side." A committee has been established, charged with the task of preparing new legislation implementing the BRRD in Iceland. However, as at the date of this Prospectus, the proposed new legislation has not been put before the legislator. The BRRD is designed to provide authorities with a credible set of tools to intervene sufficiently early and quickly in an unsound or failing institution so as to ensure the continuity of the institution's critical financial and economic functions, while minimising the impact of an institution's failure on the economy and financial system.

The BRRD provides that it will be applied by Member States from 1 January 2015, except for the general bail-in tool (see below) which has applied from 1 January 2016.

The BRRD contains four resolution tools and powers which may be used alone or in combination where the relevant resolution authority considers that (a) an institution is failing or likely to fail, (b) there is no reasonable prospect that any alternative private sector measures would prevent the failure of such institution within a reasonable timeframe, and (c) a resolution action is in the public interest: (i) sale of business - which enables resolution authorities to direct the sale of the firm or the whole or part of its business on commercial terms; (ii) bridge institution - which enables resolution authorities to transfer all or part of the business of the firm to a "bridge institution" (an entity created for this purpose that is wholly or partially in public control), which may limit the capacity of the firm 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 institution (which write-down may result in the reduction of such claims to zero) and to convert certain unsecured debt claims (including Debt Securities) to equity (the **general bail-in tool**), which equity could also be subject to any future cancellation, transfer or dilution.

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

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

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

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

To the extent any resulting treatment of holders of Debt Securities pursuant to the exercise of the general bail-in tool is less favourable than would have been the case under such hierarchy in normal insolvency proceedings, a holder has a right to compensation under the BRRD based on an independent valuation of the firm. Any such compensation is unlikely to compensate that holder for the losses it has actually incurred and there is likely to be a considerable delay in the recovery of such compensation. Compensation payments (if any) are also likely to be made considerably later than when amounts may otherwise have been due under the Debt Securities.

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

The powers currently set out in the BRRD will, in certain circumstances, impact the rights of creditors. Once the BRRD is implemented in Iceland, holders of Debt Securities may be subject to the application of the general bail-in tool and, in the case of Subordinated Bonds, non-viability loss absorption, which may result in such holders losing some or all of their investment (in the case of Subordinated Bonds, see further “*There is a real risk that holders of Subordinated Bonds will lose some or all of their investment should the issuer become insolvent or subject to resolution and the maturity of Subordinated Bonds may only be accelerated in limited circumstances and, if accelerated, holders may only claim payment in the liquidation or insolvency of the Issuer*”). Such application could also involve modifications to or the disapplication of provisions in the conditions of the Debt Securities, including alteration of the principal amount or any interest payable on the Debt Securities, the maturity date or any other dates on which payments may be due, as well as the suspension of payments for a certain period. The exercise of any power under the BRRD or any suggestion of such exercise could, therefore, materially adversely affect the rights of Noteholders, the price or value of their investment in any Debt Securities and/or the ability of the Issuer to satisfy its obligations under any Debt Securities.

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.

Basel Capital Requirements Directive

Following the issue of proposals from the Basel Committee on Banking Supervision for reform of the 1988 Capital Accord, a framework has been developed by the Basel Committee on Banking Supervision which places enhanced emphasis on market discipline and sensitivity to risk. A comprehensive version of the text of the framework was published in June 2006 under the title "International Convergence of Capital Measurement and Capital Standards: A Revised Framework (Comprehensive Version)" (the **Framework**). The Framework is not self-implementing and, accordingly, the implementation measures and dates in participating countries are dependent on the relevant national implementation process in those countries.

In July 2009, the Basel Committee finalised certain revisions to the Framework, including changes intended to enhance certain securitisation requirements (e.g. increased risk weights for "resecuritisation" exposures). In addition, the European Parliament has approved certain amendments to the Capital Requirements Directive 2006/49/EC (the **CRD**) (including investment restrictions and put forward further securitisation related amendments to the European Parliament and the Council of Ministers for consideration (including increased capital charges for relevant trading book exposures and for resecuritisation exposures). As and when implemented, the Framework (and any relevant changes to it or to any relevant implementing measures) may affect the risk-weighting of the Debt Securities for investors who are subject to capital adequacy requirements that follow the Framework. Consequently, prospective investors of the Debt Securities should consult their own advisers as to the implications for them of the application of the Framework and any relevant implementing measures.

No gross-up

Under the Terms and Conditions of the Debt Securities, all payments 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 8 (*Taxation*)). If the withholding or deduction arises as a result of one of the circumstances described in paragraphs (a) to (f) of Condition 8, 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 7.2 (*Redemption for Tax Reasons*) to redeem the relevant Debt Securities early.

Paragraph (f) of Condition 8 deals with the Article 3 of the Income Tax Act no. 90/2003 (**ITA**) (as amended by Act no. 70/2009), which imposes withholding tax on payments of Icelandic sourced interest to a foreign bondholders at a rate of 10%, unless 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 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. The exception is subject to general registration of the programme with the Director of Revenue (*Ríkisskattstjóri*).

Existing currency restrictions – Icelandic rules on foreign exchange

In response to the financial crisis, the Parliament of Iceland passed Act No. 134/2008, amending the Foreign Exchange Act, which granted the Icelandic Central Bank powers to intervene in the currency-market with the view of stabilising the foreign exchange rate of the Icelandic Krona. Shortly thereafter, the Icelandic Central Bank introduced the Capital Controls by implementing Rules on Foreign Exchange which were later adopted as Act No. 127/2011, further amending the Foreign Exchange Act.

In April 2019 restrictions remain 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; and iii) cross-border movement with offshore króna assets falling under the Act on the Treatment of Króna-Denominated Assets Subject to Special Restrictions. Also, and there is still a reporting requirement to the Icelandic Central Bank of new investment three weeks after Icelandic Krona is bought for new inflow of foreign currency.

Early 2019, the Parliament passed Act No. 14/2019, amending the Foreign Exchange Act and the Central Bank subsequently amended the Rules on Treatment of Króna-Denominated Assets Subject to Special Restrictions where the possibility to liberalize assets is introduced and changes were also made to the Central Bank's rules on Special Reserve Requirements for New Foreign Currency Inflows where the special reserve ratio is changed from 20% to 0%.

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.

Liquidity

If the Issuer is wound up neither the Issuer nor its estate would be allowed to issue further Debt Securities. It would therefore not be possible for a winding up committee to raise finance in the market by the issuance of further Debt Securities following the winding up of the Issuer. 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 structure of a particular issue Debt Securities

A wide range of Debt Securities may be issued under the Programme. A number of these Debt Securities 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 Debt Securities at its option, this may limit the market value of the Debt Securities 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 Debt Securities is likely to limit their market value. During any period when the Issuer may elect to redeem Debt Securities, the market value of those Debt Securities 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 Debt Securities when its cost of borrowing is lower than the interest rate on the Debt Securities. 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 Debt Securities 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 Bonds and Inflation Linked Non-Amortising Bonds. In particular, an investor might receive less interest than expected or no interest in respect of such 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 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 Bonds with principal or interest payable in one or more currencies which may be different from the currency in which the Bonds are denominated. Potential investors should be aware that:

- (a) the market price of such 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 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 the Bonds. Accordingly, each potential investor should consult its own financial and legal advisers about the risk entailed by an investment in any Bonds linked to a Relevant Factor and the suitability of such Bonds in light of its particular circumstances.

Debt Securities 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

Debt Securities 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 Debt Securities will have more volatile market values than conventional Floating Rate Debt Securities

Inverse Floating Rate Debt Securities 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 Debt Securities 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 Debt Securities are more volatile because an increase in

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

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

Fixed/Floating Rate Debt Securities 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 Debt Securities 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 Debt Securities may be less favourable than then prevailing spreads on comparable Floating Rate Debt Securities tied to the same reference rate. In addition, the new floating rate at any time may be lower than the rates on other Debt Securities. 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 Debt Securities.

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

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

Debt Securities 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.

Changes or uncertainty in respect of LIBOR and/or EURIBOR may affect the value or payment of interest under the Debt Securities

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 including the EU Benchmark Regulation (Regulation (EU) 2016/1011) (the **Benchmark Regulation**).

The sustainability of LIBOR has been questioned by the UK Financial Conduct Authority as a result of the absence of relevant active underlying markets and possible disincentives (including possibly as a result of regulatory reforms) for market participants to continue contributing to such benchmarks. Additionally, in March 2017, the European Money Markets Institute (formerly Euribor-EBF) (the **EMMI**) published a position paper referring to certain proposed reforms to EURIBOR, which reforms aim to clarify the EURIBOR specification, to develop a transaction-based methodology for EURIBOR and to align the relevant methodology with the Benchmarks Regulation, the IOSCO Principles for Financial Benchmarks and other regulatory recommendations. The EMMI has since indicated that there has been a “change in market activity

as a result of the current regulatory requirements and a negative interest rate environment” and “under the current market conditions it will not be feasible to evolve the current EURIBOR methodology to a fully transaction-based methodology following a seamless transition path”. It is the current intention of the EMMI to develop a hybrid methodology for EURIBOR.

These reforms and other pressures may cause one or more interest rate benchmarks to disappear entirely, to perform differently than in the past (as a result of a change in methodology or otherwise), create disincentives for market participants to continue to administer or participate in certain benchmarks or have other consequences which cannot be predicted.

Based on the foregoing, prospective investors should in particular be aware that:

- a) any of these reforms or pressures described above or any other changes to a relevant interest rate benchmark (including LIBOR and EURIBOR) could affect the level of the published rate, including to cause it to be lower and/or more volatile than it would otherwise be; and
- b) if LIBOR or EURIBOR is discontinued or is otherwise unavailable then the rate of interest on the Floating Rate Debt Securities will be determined for a period by the fall-back provisions provided for under Condition 5.2 (*Interest*) of the Terms and Conditions of the Debt Securities, although such provisions, being dependent in part upon the provision by reference banks of offered quotations for the LIBOR rate/for leading banks in the London interbank market (in the case of LIBOR) or in the Euro-zone interbank market (in the case of EURIBOR), may not operate as intended (depending on market circumstances and the availability of rates information at the relevant time) and may in certain circumstances result in the effective application of a fixed rate based on the rate which applied in the previous period when LIBOR or EURIBOR was available.

Moreover, any of the above matters could affect the ability of the Issuer to meet its obligations under the Debt Securities and/or could have a material adverse effect on the value or liquidity of, and the amount payable under, the Debt Securities. Changes in the manner of administration of LIBOR, EURIBOR or any other relevant interest rate benchmark could result in adjustment to the Conditions, early redemption, discretionary valuation by the Calculation Agent, delisting or other consequences in relation to the Debt Securities. No assurance may be provided that relevant changes will not occur with respect to LIBOR, EURIBOR or any other relevant interest rate benchmark and/or that such benchmarks will continue to exist. Investors should consider these matters when making their investment decision with respect to the Debt Securities.

Risks related to Subordinated Bonds

There is a real risk that holders of Subordinated Bonds will lose some or all of their investment should the Issuer become insolvent or subject to resolution and the maturity of Subordinated Bonds may only be accelerated in limited circumstances and, if accelerated, holders may only claim payment in the liquidation or insolvency of the Issuer

The Issuer’s obligations under Subordinated Bonds issued by it will be unsecured and subordinated. In the event of the liquidation or insolvency of the Issuer, the rights of the Bondholders to payments on or in respect of the Subordinated Bonds shall rank:

- (i) *pari passu* without any preference among themselves;
- (ii) at least *pari passu* with payments to holders of any other Tier 2 Instruments and claims of any other subordinated creditors the claims of which rank, or are expressed to rank, *pari passu* with the Subordinated Bonds;
- (iii) in priority to payments to holders of any outstanding Additional Tier 1 Instruments and all classes of share capital of the Issuer in their capacity as such holders, and claims of any other

subordinated creditors the claims of which rank, or are expressed to rank, junior to the Subordinated Bonds; and

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

Although Subordinated Bonds may pay a higher rate of interest than comparable Notes which are not subordinated, there is a real risk that Bondholders will lose all or some of their investment should the Issuer become insolvent or subject to resolution under the BRRD as implemented in Iceland. In the case of any application of the general bail-in tool under the BRRD, the sequence of any resulting write-down or conversion of the Subordinated Bonds under Article 48 of the BRRD provides for the write-down or conversion of Subordinated Bonds prior to Unsubordinated Bonds, which write-down or conversion shall be implemented in accordance with the hierarchy of claims in normal insolvency proceedings.

Bondholders may only accelerate the maturity of their Subordinated Bonds in limited circumstances and, if accelerated, may claim payment only in the liquidation of the Issuer, see Condition 14.2 of the Bonds.

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

In addition to the application of the general bail-in tool to Subordinated Bonds (see “*The Council of the European Union has adopted the BRRD which provides for a range of actions to be taken in relation to credit institutions and investment firms considered to be at risk of failing. The implementation of the BRRD in Iceland and its impact on the Bank is currently unclear but the taking of any action under the BRRD following its implementation could materially affect the value of any Debt Securities*”), the BRRD and the terms of the Subordinated Bonds contemplate that Subordinated Bonds may be subject to non-viability loss absorption. As a result, resolution authorities may require the permanent write-down of capital instruments such as Subordinated Bonds (which write-down may be in full) or the conversion of them into equity capital at the point of non-viability and before any other resolution action is taken. Prior to the implementation of the BRRD in Iceland, such non-viability loss absorption is provided for in Condition 8 of the Bonds.

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

For the purposes of the application of any non-viability loss absorption measure, the point of non-viability under the BRRD is the point at which the relevant authority determines that the institution meets the conditions for resolution or will no longer be viable unless the relevant capital instruments (such as the Subordinated Bonds) are written down or converted into equity or extraordinary public support is to be provided and without such support the appropriate authority determines that the institution would no longer be viable. This is further reflected in the definition of “Non-Viability Event” under Condition 8.

The occurrence of a Non-Viability Event or the application of the general bail-in tool or any non-viability loss absorption measure pursuant to any Applicable Statutory Loss Absorption Regime (including the BRRD) or Condition 8 of the Subordinated Bonds may result in Bondholders losing some or all of their investment. The exercise of any such power or any suggestion of such exercise could, therefore, materially adversely affect the rights of Bondholders, the price or value of Subordinated Bonds issued under the Programme and/or the ability of the Issuer to satisfy its obligations under Subordinated Bonds.

Risks related to Debt Securities generally

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

The Debt Securities may not be a suitable investment for all investors

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

- (h) have sufficient knowledge and experience to make a meaningful evaluation of the Debt Securities, the merits and risks of investing in the Debt Securities and the information contained or incorporated by reference in this Base Prospectus or any applicable supplement;
- (i) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Debt Securities and the impact the Debt Securities will have on its overall investment portfolio;
- (j) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Debt Securities, including Debt Securities 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;
- (k) understand thoroughly the terms of the Debt Securities and be familiar with the behaviour of any relevant indices and financial markets; and
- (l) 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 Debt Securities 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 Debt Securities which are complex financial instruments unless it has the expertise (either alone or with a financial adviser) to evaluate how the Debt Securities will perform under changing conditions, the resulting effects on the value of the Debt Securities and the impact this investment will have on the potential investor's overall investment portfolio.

The Debt Securities are obligations of the Issuer only

The Debt Securities will constitute obligations of the Issuer only. An investment in the Debt Securities involves a reliance on the creditworthiness of the Issuer. The Debt Securities are not guaranteed by any other person. In addition, an investment in the Debt Securities involves the risk that subsequent changes in the actual or perceived creditworthiness of the Issuer may adversely affect the market value of the relevant Debt Securities.

Debt Securities issued under the Programme

Debt Securities issued under the Programme (save in respect of the first issue of Debt Securities) will either be fungible with an existing Series of Debt Securities or have different terms to an existing Series of Debt Securities (in which case they will constitute a new Series).

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

The conditions of the Debt Securities are governed by Icelandic law in effect as at the date of this Base Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to Icelandic

law or administrative practice after the date of this Base Prospectus and any such change could materially adversely impact the value of any Debt Securities affected by it.

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

In relation to any issue of Debt Securities 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 Debt Securities may be traded in amounts 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 at the relevant time may not receive a definitive Debt Securities in respect of such holding (should definitive Debt Securities be printed) and, in order to receive a definitive Debt Securities, would need to purchase a principal amount of Debt Securities such that its holding amounts to a Specified Denomination.

If such Debt Securities in definitive form are issued, holders should be aware that definitive Debt Securities 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

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

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

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 Debt Securities may never be established or may be illiquid and this would adversely affect the value at which an investor could sell his Debt Securities

Debt Securities 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 Debt Securities 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 Debt Securities 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 Debt Securities 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 Debt Securities.

The Debt Securities 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 Debt Securities

Generally weak global credit market conditions could contribute to a lack of liquidity in the secondary market for instruments similar to the 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 Debt Securities. While some measures have been taken by governments, there can be no assurance that the market for securities similar to the Debt Securities will recover at the same time or to the same degree as such other recovering global credit market sectors.

If an investor holds Debt Securities 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 Debt Securities could result in an investor not receiving payments on those Debt Securities

The Issuer will pay principal and interest on the Debt Securities in the Specified Currency. Subject to currency restrictions in place at each time, if Debt Securities 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 Debt Securities, (2) the Investor's Currency-equivalent value of the principal payable on the Debt Securities and (3) the Investor's Currency-equivalent market value of the Debt Securities.

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

In addition, a holder of Fixed Reset Bonds is also exposed to the risk of fluctuating interest rate levels and uncertain interest income.

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 Debt Securities.

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

One or more independent credit rating agencies may assign credit ratings to the Debt Securities. 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 Debt Securities. 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 Debt Securities.

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

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

ISSUER'S STATEMENT

CEO of Arion Bank hf. (in its capacity as Issuer), ID-number 581008-0150, registered office being Borgartun 19, 105 Reykjavik, Iceland, hereby declares that, the Issuer (the **Responsible Person**) accepts responsibility for the information contained in this Base Prospectus and the Final Terms for each Series of Debt Securities 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 Base Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

Reykjavik, Iceland, 15 April 2019

On behalf of the Issuer

Höskuldur H. Ólafsson, ID-number 090259-5479
CEO of the Issuer



ISSUE OF DEBT SECURITIES FROM THE PROGRAMME

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

This Base Prospectus and any supplement to the Base Prospectus will only be valid for listing Debt Securities on the Nasdaq Iceland hf. or further stock exchanges during the period of 12 months from the date of this Base Prospectus in an aggregate nominal amount which, when added to the aggregate nominal amount then outstanding of all Debt Securities previously or simultaneously issued under the Programme, does not exceed ISK 25,000,000,000 or its equivalent in other currencies. For the purpose of calculating the ISK equivalent of the aggregate nominal amount of Debt Securities issued under the Programme from time to time:

- (a) the ISK equivalent Debt Securities denominated in another Specified Currency (as specified in the applicable Final Terms in relation to the relevant Debt Securities, described under "*Form of the Debt Securities*", below) shall be determined, at the discretion of the Issuer, either as of the date on which agreement is reached for the issue of Debt Securities or on the preceding day on which commercial banks and foreign exchange markets are open for general business in Iceland, in each case on the basis of the spot rate for the sale of the ISK against the purchase of such Specified Currency in the Reykjavik foreign exchange market quoted by any bank selected by the Issuer on the relevant day of calculation;
- (b) subject to any existing legal or regulatory restrictions in Iceland, the ISK equivalent of Inflation Linked Bonds and Inflation Linked Non-Amortising Bonds (each as specified in the applicable Final Terms in relation to the relevant Bonds, described under "*Form of the Debt Securities*", below) shall be calculated in the manner specified above by reference to the original nominal amount on issue of such Debt Securities; and
- (c) the ISK equivalent of Zero Coupon Bonds and Bills (as specified in the applicable Final Terms in relation to the relevant Debt Securities, described under "*Form of the Debt Securities*", below) and other Debt Securities 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 Base Prospectus and have been filed with the FME shall be incorporated by reference in, and form part of, this Base Prospectus:

- (a) the auditors' reports and audited consolidated annual financial statements of the Issuer for the year ended 31 December 2018 and for the financial year ended 31 December 2017 including the information set out at the following pages in particular:

	Consolidated Financial Statements for the year 2018	Consolidated Financial Statements for the year 2017
Consolidated Statement of Financial Position	Page 13	Page 13
Significant Accounting Policies	Page 77	Pages 77
Consolidated Statement of Cash Flows	Page 15	Page 15
Consolidated Statement of Comprehensive Income	Page 12	Page 12
Consolidated Statement of Changes in Equity.....	Page 14	Page 14
Notes	Pages 17 to 90	Pages 17 to 95
Independent Auditor's Report	Page 8	Page 9

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; and

- (b) the terms and conditions of the Debt Securities set out on pages 52 to 113 (inclusive) of this Base Prospectus and prepared by the Issuer in connection with the Programme.

Following the publication of this Base Prospectus, a supplement to the Base Prospectus may be prepared by the Issuer and approved by the FME in accordance with Article 16 of the Prospectus Directive, cf. Article 46 of the Act on Securities Transactions No. 108/2007. Statements contained in any such supplement (or contained in any document incorporated by reference therein) shall, to the extent applicable, be deemed to modify or supersede statements contained in this Base Prospectus or in a document which is incorporated by

reference in this Base Prospectus. Any statement so modified or superseded shall not, except as so modified or superseded, constitute a part of this Base Prospectus.

Copies of documents incorporated by reference in this Base Prospectus can be obtained from the Nasdaq Iceland hf. website at www.nasdaqomxnordic.com and from the registered office of the Issuer. Any documents themselves incorporated by reference in the documents incorporated by reference in this Base Prospectus shall not form part of this Base Prospectus. In each case, where only certain sections of a document referred to (in items (a) and (b to (c) above) are incorporated by reference in this Base Prospectus, the parts of the document which are not incorporated by reference are either not relevant to prospective investors in the Debt Securities or elsewhere in this Base Prospectus.

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

FORM OF THE DEBT SECURITIES

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

Bearer Bonds

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

- (c) if the Global 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
- (d) if the Global 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 Bonds will be issued outside the United States in reliance on Regulation S under the Securities Act (**Regulation S**).

Debt Securities 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 Bonds issued in respect of any Tranche are in NGCB form, the applicable Final Terms will also indicate whether such Global Bonds are intended to be held in a manner which would allow Eurosystem eligibility. Any indication that the Global Bonds are to be so held does not necessarily mean that the 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 Debt Security is represented by a Temporary Global Bond, payments of principal, interest (if any) and any other amount payable in respect of the Bonds due prior to the Exchange Date (as defined below) will be made (against presentation of the Temporary Global Bond if the Temporary Global 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 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 Bond is issued, interests in such Temporary Global Bond will be exchangeable (free of charge) upon a request as described therein either for (a) interests in a Permanent Global Bond of the same Series or (b) for definitive 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 Debt Securities, 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 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 Bond for an interest in a Permanent Global Bond or for definitive Debt Securities is improperly withheld or refused.

Payments of principal, interest (if any) or any other amounts on a Permanent Global Bond will be made through Euroclear and/or Clearstream, Luxembourg (against presentation or surrender (as the case may be) of the Permanent Global Bond if the Permanent Global 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 Bond will be exchangeable (free of charge), in whole but not in part, for definitive Debt Securities 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 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 Debt Securities represented by the Permanent Global Bond in definitive form. The Issuer will promptly give notice to Debt holders in accordance with Condition 13 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg 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 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 Bonds which have an original maturity of more than 1 year and on all receipts and interest coupons relating to such Bonds:

"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 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 Bonds, receipts or interest coupons.

Bonds which are represented by a Bearer Global 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 Bonds

The Registered 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 Bonds or Registered Global Bonds). Prior to expiry of the distribution compliance period (as defined in Regulation S) applicable to each Tranche of Bonds, beneficial interests in a Regulation S Global 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 Bonds*) and may not be held otherwise than through Euroclear or Clearstream, Luxembourg and such Regulation S Global Bonds will bear a legend regarding such restrictions on transfer.

Registered Global 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 Bonds will be entitled or required, as the case may be, under the circumstances described below, to receive physical delivery of definitive Bonds in fully registered form.

Payments of principal, interest and any other amount in respect of the Registered Global Bonds will, in the absence of provision to the contrary, be made to the person shown on the Registered Bond Register (as defined in Condition 6.6 (*Payments - Payments in respect of Registered Bonds*)) as the registered holder of the Registered Global 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 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 Bonds in definitive form will, in the absence of provision to the contrary, be made to the persons shown on the Registered Bond Register on the relevant Record Date (as defined in Condition 6.6 (*Payments - Payments in respect of Registered Bonds*)) immediately preceding the due date for payment in the manner provided in that Condition.

Interests in a Registered Global Bonds will be exchangeable (free of charge), in whole but not in part, for definitive Registered 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 Debt Securities 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 Debt Securities represented by the Registered Global Debt Security in definitive form. The Issuer will promptly give notice to Debt holders in accordance with Condition 13 (*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 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 Bonds may, subject to compliance with all applicable restrictions, be transferred to a person who wishes to hold such interest in another Registered Global Bonds. No beneficial owner of an interest in a Registered Global 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 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*".

NCSD Debt Securities

Each Tranche of NCSD Debt Securities will be issued in uncertificated book entry form cleared through the NCSD. On the issue of such NCSD Debt Securities, the Issuer (if it is not the NCSD Agent) will send a copy

of the applicable Final Terms to the NCSD Agent. On delivery of the applicable Final Terms by the NCSD Agent to the NCSD and notification to the NCSD of the subscribers and their NCSD account details by the relevant Dealer, the NCSD Agent acting on behalf of the Issuer will credit each subscribing account holder with the NCSD with a nominal amount of NCSD Debt Securities equal to the nominal amount thereof for which it has subscribed and paid.

Settlement of sale and purchase transactions in respect of NCSD Debt Securities in the NCSD will take place in accordance with the market practice at the time of the transaction.

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

General

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

For so long as any of the Debt Securities (other than a NCSD Debt Securities) is represented by a Global 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 Debt Securities (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the nominal amount of such Debt Securities 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 Debt Securities for all purposes other than with respect to the payment of principal or interest on such nominal amount of such Debt Securities, for which purpose the bearer of the relevant Global Bond shall be treated by the Issuer and its agents as the holder of such nominal amount of such Bonds in accordance with and subject to the terms of the relevant Global Bond and the expressions **Bondholders** and **holder of Bonds** and related expressions shall be construed accordingly.

Any reference herein to Euroclear and/or Clearstream, Luxembourg and/or the NCSD 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 Debt Securities may be issued in a form not contemplated by the Terms and Conditions of the Debt Securities herein, in which event a new Base Prospectus or a supplement to the Base Prospectus, if appropriate, will be made available which will describe the effect of the agreement reached in relation to such Debt Security.

APPLICABLE FINAL TERMS

[Date]

ARION BANK HF

Issue of [Aggregate Nominal Amount of Tranche] [Title of Debt Securities] under the ISK 25,000,000,000 Debt Issuance Programme

PART A – CONTRACTUAL TERMS

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions set forth in the Base Prospectus dated 15 April 2019 which constitutes 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 Debt Securities described herein for the purposes of Article 5.4 of the Prospectus Directive, cf. Paragraph 6 og Article 45 of the Act on Securities Transactions No. 108/2007, and must be read in conjunction with the Base Prospectus. Full information on the Issuer and the offer of the Debt Securities is only available on the basis of the combination of these Final Terms and the Base Prospectus. The Base Prospectus and the Final Terms are available for viewing at Borgartún 19, 105 Reykjavík, Iceland and on the Nasdaq Iceland hf. website at www.nasdaqomxnordic.com, on the Issuer's website: arionbanki.is and from the registered office of the Issuer.

1. 1. Series Number: []
 - (a) Tranche Number: []
 - (b) Series which Debt Securities will be consolidated and form a single Series with: [●]/[Not Applicable]
 - (c) Date on which the Debt Securities 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: []/ €[100,000] and integral multiples of [€1,000] in excess thereof up to and including €199,000. No Debt Securities 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. Interest Basis: [[]% Fixed Rate]
[Fixed Reset]
[[LIBOR/EURIBOR/REIBOR] +/- []% Floating Rate]
[Zero Coupon]
[See paragraphs [18/19/20/21/22] below]
9. Redemption/Payment Basis: Subject to any purchase or cancellation or early redemption[, the Debt Securities will be redeemed on the Maturity Date at [100] per cent. of their nominal amount./Inflation linked redemption in accordance with item 18 below, and Conditions 5.3 and 7.3/ Inflation linked redemption in accordance with Condition 7.4]
10. Change of Interest Basis: [In accordance with paragraphs [19 or 20] below]/[Not applicable]
11. Put/Call Options: [Investor Put]
[Issuer Call]
[Not Applicable]
12. [Date of [Board] approval for issuance of Debt Securities obtained:] [[●] [and ●], respectively]
13. Method of distribution: [Syndicated/Non-syndicated]
14. Name and address of the Calculation Agent []
15. Status of Debt Securities [Unsubordinated/Subordinated]

PROVISIONS RELATING TO INFLATION LINKED AMORTISING BONDS

16. [Inflation Linked Amortising Bond] [Applicable /Not Applicable]
Provisions
- (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 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 INFLATION LINKED ZERO COUPON BONDS

17. [Inflation Linked Zero Coupon Bond] [Applicable /Not Applicable]
Provisions
- (a) Accrual Yield: []% per annum
 - (b) Reference Price: []
 - (c) Base Index: [●], being the value of the CPI on [●]
 - (d) Day Count Fraction in relation to Early Redemption Amounts and late payment: [Conditions 7.8 apply/ 30/360 or Actual/Actual (ICMA) r]

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

PROVISIONS RELATING TO INFLATION LINKED INSTALMENT BONDS

18. [Inflation Linked Instalment Bond] [Applicable /Not Applicable]
Provisions
- (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) Instalment Payments Date(s): [The [] day in each month]/[] in each year] up to and including the Final Maturity Date
- (e) Total number of instalment payments on the relevant Bonds: []
- (f) Base Index: [●], being the value of the CPI on [●]
- (g) Day Count Fraction: [30/360 or Actual/360 or Actual/Actual (ICMA)]

PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE

- 19. Fixed Rate 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 as applicable]
 - (c) Fixed Coupon Amount[(s)]: [] per Calculation Amount
(Applicable to Debt Securities in definitive form.)
 - (d) Broken Amount(s): [] per Calculation Amount, payable on the Interest Payment Date falling [in/on] []/[Not Applicable]
(Applicable to Debt Securities in definitive form.)
 - (e) Day Count Fraction: [30/360 or Actual/Actual (ICMA)]
 - (f) Determination Date(s): [] in each year]/[Not Applicable]
- 20. Fixed Reset Provisions: [Applicable/Not Applicable]
 - (a) Initial Interest Rate: [] per cent. per annum [payable [annually/semi-annually/quarterly] in arrear on each Interest Payment Date]
 - (b) Interest Payment Date(s): [[] in each year up to and including the Maturity Date]
 - (c) Fixed Coupon Amount to (but [[] per Calculation Amount/Not Applicable] excluding) the First Reset Date:
(Applicable to Debt Securities in definitive form.)
 - (d) Broken Amount(s): [[] per Calculation Amount payable on the Interest Payment Date falling [in/on] []][Not Applicable]
(Applicable to Debt Securities in definitive form.)
 - (e) Day Count Fraction: [30/360 or Actual/Actual (ICMA)]
 - (f) Determination Date(s): [[] in each year][Not Applicable]
 - (g) Reset Date: []

- (h) Subsequent Reset Date(s): [] [and []]
- (i) Reset Margin: [+/-] [●] per cent. per annum
- (j) Relevant Screen Page: []
- (k) Floating Leg Reference Rate: []
- (l) Floating Leg Screen Page: []
- (m) Initial Mid-Swap Rate: [] per cent. per annum (quoted on a [n annual/semi-annual basis])
21. Floating Rate 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/REIBOR]
- Interest Determination Date(s): []
- Relevant Screen Page: []
- (g) ISDA Determination: [Applicable/ Not Applicable]
- Floating Rate Option: []
- Designated Maturity: []
- Reset Date: []
- (h) Margin(s): [+/-] [] % per annum

- (i) Minimum Rate of Interest: []% per annum
- (j) Maximum Rate of Interest: []% per annum
[Actual/Actual (ISDA)]
- (k) Day Count Fraction: Actual/365 (Fixed)
Actual/365 (Sterling)
Actual/360
30/360
30E/360
30E/360 (ISDA)]
22. Zero Coupon Bond Provisions [Applicable/Not Applicable]
- (a) Accrual Yield: []% per annum
- (b) Reference Price: []
- (c) Day Count Fraction in relation to Early Redemption Amounts and late payment: [Conditions 7.8 apply/ 30/360 or Actual/Actual (ICMA) r]
- (Consider applicable day count fraction if not U.S. dollar denominated)*
23. Bills Provisions [Applicable/Not Applicable]
- (a) Accrual Yield: []% per annum
- (b) Reference Price: []
- (c) Day Count Fraction in relation to Early Redemption Amounts and late payment: [Conditions 7.8 apply/ 30/360 or Actual/Actual (ICMA) r]
- (Consider applicable day count fraction if not U.S. dollar denominated)*
24. Inflation Linked Non-Amortising 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

25. Issuer Call [Applicable/Not Applicable]

- (a) Optional Redemption Date(s): []
- (b) Optional Redemption Amount of [] per Debt Security of [] Specified each Debt Security: 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): []
26. Investor Put: [Applicable/Not Applicable] (*N.B. Investor Put only applicable to Unsubordinated Bonds*)
- (a) Optional Redemption Date(s): [●]
- (b) Optional Redemption Amount: [●] per Calculation Amount
- (c) Notice period (if other than as set out in the Conditions):
27. Final Redemption Amount of each Debt Security [[] per Debt Security of [] Specified Denomination/ [●] for the Inflation Linked Debt Securities/Not Applicable]/ In accordance with Condition 7.4 per Debt Security of [] Specified Denomination]
28. Early Redemption Amount of each Debt Security payable on redemption for taxation reasons, upon the occurrence of a Capital Event or on an event of default: [] per Calculation Amount
29. [Relevant Percentage:] As at the Issue Date, [] per cent.

GENERAL PROVISIONS APPLICABLE TO THE DEBT SECURITIES

30. Form of Bonds: [Bearer Bonds]
- [Temporary Global Bond exchangeable for a Permanent Global Bond which is exchangeable for definitive Bonds [on 60 days' notice given at any time/only upon an Exchange Event.]]
- [Temporary Global Bond exchangeable for definitive Bonds on and after the Exchange Date.]
- [Permanent Global Bond which is exchangeable for definitive 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 Bonds" section of the Base Prospectus and the 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 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 Bonds which is to be represented on issue by a Temporary Global Bond exchangeable for Definitive Bonds.)

[Registered Bonds

[Regulation S Global Note (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]]

[NCSD Debt Securities

NCSD Debt Securities issued in uncertificated and dematerialised book entry form. See further item [7] of Part B below.]

31. New Global Bond: [Yes] [No]
- (If NCSD Debt Securities, insert "No")*
32. Additional Financial Centre(s): [●]/[Not Applicable]
33. Talons for future Coupons or Receipts to be attached to definitive Debt Securities in bearer form (and dates on which such Talons mature): [Yes, as the Debt Securities 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.]
34. Details relating to Instalment Bonds; amount of each instalment, date on which each payment is to be made: [Applicable/Not Applicable]
- [For Instalment Bonds:]*
- Instalment Amount = [●]
- Instalment Date(s) = [●]]
35. Redenomination: [Redenomination not applicable/ The provisions of Condition 4 apply]

DISTRIBUTION

36. (a) If syndicated, names of Managers: [Not Applicable/give names]
- (If the Debt Securities 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 Debt Securities are derivative securities to which Annex XII of the Prospectus Directive Regulation applies.)*
- (c) Stabilising Manager(s) (if any): [Not Applicable/give name]
37. If non-syndicated, name of Dealer: [Name]
38. U.S. Selling Restrictions: [Reg. S Category 1/2/3; TEFRA D/TEFRA C/TEFRA not applicable]

PART B – OTHER INFORMATION

1. LISTING AND ADMISSION TO TRADING

[Application has been made by the Issuer (or on its behalf) for the Debt Securities to be admitted to trading on [*specify relevant regulated market (for example the Bourse de Luxembourg, the London Stock Exchange's regulated market or the Regulated Market of the Nasdaq Iceland hf.)*] and, if relevant, listing on an official list (for example, the Official List of the Nasdaq Iceland hf.)] with effect from [].]

[Application is expected to be made by the Issuer (or on its behalf) for the Debt Securities to be admitted to trading on [*specify relevant regulated market (for example the Bourse de Luxembourg, the London Stock Exchange's regulated market or the Regulated Market of the Irish Stock Exchange)*] and, if relevant, listing on an official list (for example, the Official List of the Nasdaq Iceland hf.)] with effect from [].] [Not Applicable.]

Estimate of total expenses related to admission to trading: [●]

2. RATINGS

Ratings:

The Debt Securities to be issued have [not] been rated:

[S & P: []]

[Moody's: []]

[Fitch: []]

[[Other]: []]

[The Debt Securities 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 Debt Securities 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 Debt Securities 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 []
- (ii) Estimated net proceeds: []
- (iii) Estimated total expenses: []

5. YIELD (FIXED RATE BONDS AND FIXED RESET BONDS ONLY)

Indication of yield: []

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

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

The Debt Securities 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 Debt Securities are derivative securities to which Annex XII of the Prospectus Directive Regulation applies.)

7. OPERATIONAL INFORMATION

- (i) ISIN Code: []
- (ii) Common Code: []
- (iii) Any clearing system(s) other than Euroclear Bank S.A./N.V. and Clearstream Banking, société anonyme (together with the address of each such clearing system) and the relevant identification number(s): [Not Applicable/ Nasdaq CSD Iceland Ltd., Iceland. The Issuer shall be entitled to obtain certain information from the register maintained by the NCSD for the purpose of performing its obligations under the issue of NCSD Debt Securities. The NCSD Agent shall be entitled to obtain such information as is required to perform its duties under the Terms and Conditions of the Debt Securities and rules and regulations of, and applicable to, the NCSD.]
- (iv) Delivery: Delivery [against/free of] payment

- (v) Names and addresses of additional Paying Agent(s) (if any) or, in the case of NCSD Debt Securities, the NCSD Agent: []
- (vi) Deemed delivery of clearing system notices for the purposes of Condition 13 (*Notices*): Any notice delivered to Debt Security holders 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 NCSD.
- (vii) Intended to be held in a manner which would allow Eurosystem eligibility: [Yes. [Note that the designation "yes" simply means that the Debt Securities 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 Bonds which are to be held under the NSS*] and does not necessarily mean that the Debt Securities 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 Debt Securities are capable of meeting them the Debt Securities may then be deposited with one of the ICSDs as common safekeeper. Note that this does not necessarily mean that the Debt Securities 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 DEBT SECURITIES

The following are the Terms and Conditions of the Debt Securities. Where applicable, the Terms and Conditions will be incorporated by reference into each Global Bond (as defined below) and each Definitive Debt Security, 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 Debt Security 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 Bond and definitive Bond. Reference should be made to "Form of the Debt Securities" for a description of the content of Final Terms which will specify which of such terms are to apply in relation to the relevant Debt Securities.

The Debt Securities are bonds issued by Arion Bank hf. (the **Issuer**) and will be issued in compliance with any applicable legal or regulatory restrictions including the rules on foreign exchange issued by the Central Bank of Iceland, and any reference to currencies other than ISK, and to Inflation Linked Bonds and related expressions shall be construed as taking effect subject to such restrictions being lifted.

This Debt Security is one of a Series (as defined below) of Debt Securities issued by the Issuer.

References herein to the Debt Securities shall be references to the Debt Securities of this Series and shall mean:

- (a) in relation to any Debt Securities represented by a global Bond (a **Global 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 Bond; and
- (c) any definitive Bonds in bearer form (**Bearer Bonds**) issued in exchange for a Global Bond in bearer form; and
- (d) any definitive Bonds in registered form (**Registered Bonds**) (whether or not issued in exchange for a Global Bond in registered form); and
- (e) any Debt Securities issued in uncertificated book entry form cleared through the Nasdaq CSD Iceland (the **NCSD Debt Securities** and the **NCSD**, respectively). NCSD Debt Securities are in dematerialised form. Any references in these Terms and Conditions (the **Conditions**) to Receipts, Coupons and Talons shall not apply to NCSD Debt Securities and no global or definitive Debt Securities will be issued in respect of NCSD Debt Securities.

The Bonds (other than the NCSD Debt Securities), the Receipts (as defined below) and the Coupons (as defined below) have the benefit of an Agency Agreement, (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 fiscal agent (the **Fiscal Agent**) and transfer agent (the **Transfer Agent**, which expression shall include any additional or successor transfer agents), and Arion Bank 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 NCSD Bonds, Arion Bank hf. will act as the NCSD system account manager (the **NCSD Agent**, which expression shall include any additional agent appointed by the Issuer from time to time in relation to the NCSD Debt Securities). The Fiscal Agent, the Registrar, the other Paying Agents, the NCSD Agent and the other Transfer Agents are together referred to as the **Agents**.

Interest bearing definitive 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 Bonds repayable in instalments have receipts (**Receipts**) for the payment of the instalments of principal (other

than the final instalment) attached on issue. Global Bonds do not have Receipts, Coupons or Talons attached on issue.

The Final Terms for this Debt Security (or the relevant provisions thereof), as set out in Part A of the Final Terms which are (except in the case of NCSD Debt Securities) attached to or endorsed on this Bond, complete the Conditions for the purposes of this 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 NCSD Debt Securities) attached to or endorsed on this Debt Securities and (in the case of the NCSD Debt Securities) which are deposited with the NCSD and the NCSD Agent.

Any reference to **Bondholders** or **holders** in relation to any Debt Securities shall mean (in the case of Bearer Bonds) the holders of the Bonds, (in the case of Registered Bonds) the persons in whose name the Bonds are registered and (in the case of NCSD Debt Securities) the persons who are for the time being shown in the records of the NCSD as the holders of the Debt Securities, and shall, in relation to any Debt Securities represented by a Global Bond and any NCSD Debt Securities, 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 Debt Securities which are identical in all respects (including as to listing and admission to trading) and **Series** means a Tranche of Debt Securities together with any further Tranche or Tranches of Debt Securities which are (a) expressed to be consolidated and form a single series and (b) identical in all respects (including as to listing and admission to trading) except for their respective Issue Dates, (unless this is a Zero Coupon Bond) Interest Commencement Dates and/or Issue Prices.

The Bondholders (except in the case of NCSD Debt Securities), the Receiptholders and the Couponholders are entitled to the benefit of the Deed of Covenant (the **Deed of Covenant**) made by the Issuer.

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 on the Issuer's website: arionbanki.is and of the Fiscal Agent and on the Nasdaq Iceland hf. website (www.nasdaqomxnordic.com) and copies may be obtained from those offices save that, if this Debt Securities 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 Bondholder holding one or more unlisted Debt Securities of that Series and such Bondholder must produce evidence satisfactory to the Issuer and (except in the case of NCSD Debt Securities) the relevant Paying Agent as to its holding of such Debt Securities and identity. The 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 Debt Securities are in bearer form (**Bearer Bonds**) or registered form (**Registered Bonds**) or, in the case of NCS D Debt Securities, uncertificated book entry form, as specified in the applicable Final Terms, and, in the case of definitive Debt Securities, in the Specified Currency and the Specified Denomination(s) and (other than NCS D Debt Securities) serially numbered. Debt Securities of one Specified Denomination may not be exchanged for Debt Securities of another Specified Denomination and Bearer Bonds may not be exchanged for Registered Bonds and *vice versa*. Neither Bearer Bonds nor Registered Bonds may be exchanged for NCS D Debt Securities and *vice versa*.

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

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

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

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

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

For so long as any of the Debt Securities is represented by a Global 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 Debt Securities is an NCS D Debt Securities each person (other than Euroclear, Clearstream, Luxembourg or the NCS D) who is for the time being shown in the records of Euroclear or of Clearstream, Luxembourg or the NCS D, as the case may be, as the holder of a particular nominal amount of such Debt Securities (in which regard any certificate or other document issued by Euroclear, Clearstream, Luxembourg or the NCS D, as the case may be, as to the nominal amount of such Debt Securities 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 Debt Securities for all purposes other than (in the case only of Debt Securities not being NCS D Debt Securities) with respect to the payment of principal or interest on such nominal amount of such Debt Securities, for which purpose, in the case of Bonds represented by a bearer Global Bond, the bearer of the relevant Global Bond, or, in the case of Bonds represented by Registered Global Bonds, the registered holder shall be treated by the Issuer and any Agent as the holder of such nominal amount of such Bonds in accordance with and subject to the terms of the relevant Global Bond and the expressions **Bondholder** and **holder of Bonds** and related expressions shall be construed accordingly. Bonds which are represented by a Global 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.

References to the NCSD, 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 BONDS

2.1 Transfers of interests in Registered Global Bonds

Transfers of beneficial interests in Registered Global 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 Bond will, subject to compliance with all applicable legal and regulatory restrictions, be transferable for Bonds in definitive form or for a beneficial interest in another Registered Global 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 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 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 Bond for registration of the transfer of the Registered Bond (or the relevant part of the Registered 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 Bond in definitive form of a like aggregate nominal amount to the Registered Bond (or the relevant part of the Registered Bond) transferred. In the case of the transfer of part only of a Registered Bond in definitive form, a new Registered Bond in definitive form in respect of the balance of the Registered 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 Debt Securities under Condition 7, the Issuer shall not be required to register the transfer of any Registered Bond, or part of a Registered Bond, called for partial redemption.

2.4 Costs of registration

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 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 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 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 Bonds generally

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

2.7 Definitions

In these Conditions, 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 Debt Securities, 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);

Regulation S means Regulation S under the Securities Act;

Regulation S Global Bond means a Registered Global Bond representing 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 DEBT SECURITIES

3.1 Status – Unsubordinated Bonds

This Condition 3.1 is applicable in relation to Debt Securities specified in the applicable Final Terms as being Unsubordinated Bonds. The Debt Securities constitute direct, unconditional, unsubordinated and unsecured obligations of the Issuer and rank pari passu among themselves and with all other obligations of the Issuer that have been provided the same priority (save for certain obligations required to be preferred by law) (other than subordinated obligations, if any), from time to time outstanding and will rank pari passu with the claims of all other unsubordinated creditors of the Issuer

(other than those preferred by law) in all other respects. The costs of bankruptcy administration will rank ahead of claims for payments of the Bonds.

3.2 Status – Subordinated Bonds

This Condition 3.2 is applicable in relation to Debt Securities specified in the applicable Final Terms as being Subordinated Bonds. In such case, the Debt Securities constitute unsecured, subordinated obligations of the Issuer.

In the event of the insolvency of the Issuer, the rights of the Bondholders to payments on or in respect of the Debt Securities shall rank:

- (v) *pari passu* without any preference among themselves;
- (vi) at least *pari passu* with payments to holders of any other Tier 2 Instruments and claims of any other subordinated creditors the claims of which rank, or are expressed to rank, *pari passu* with the Debt Securities;
- (vii) in priority to payments to holders of any Additional Tier 1 Instruments and all classes of share capital of the Issuer in their capacity as such holders, and claims of any other subordinated creditors the claims of which rank, or are expressed to rank, junior to the Debt Securities; and
- (viii) junior in right of payment to the payment of any present or future claims of (a) depositors of the Issuer, (b) other unsubordinated creditors of the Issuer and (c) claims of any other subordinated creditors the claims of which rank, or are expressed to rank, in priority to the Debt Securities.

In these Terms and Conditions:

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

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

Applicable Banking Regulations means at any time the laws, regulations, requirements, guidelines and policies relating to capital adequacy or resolution then in effect in Iceland and applicable to the Issuer, including, without limitation to the generality of the foregoing, those regulations, requirements, guidelines and policies relating to capital adequacy or resolution of the FME or the Relevant Resolution Authority (as defined in Condition 8), respectively, in each case to the extent then in effect in Iceland (whether or not such requirements, guidelines or policies have the force of law and whether or not they are applied generally or specifically to the Issuer);

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

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

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

3.3 No Holder of a Subordinated Bond who shall in the event of the liquidation or insolvency of the Issuer be indebted to it shall be entitled to exercise any right of set-off or counterclaim against money owed by the Issuer in respect of that Subordinated Bond.

4. REDENOMINATION

4.1 Redenomination

Where redenomination is specified in the applicable Final Terms as being applicable, the Issuer may, without the consent of the Bondholders, the Receiptholders and the Couponholders, on giving prior notice to the Fiscal Agent, Euroclear and Clearstream, Luxembourg (in the case of Bonds other than NCSD Debt Securities) or to the NCSD Agent and the NCSD (in the case of NCSD Debt Securities) and at least 30 days' prior notice to the Bondholders in accordance with Condition 13, elect that, with effect from the Redenomination Date specified in the notice, the Debt Securities with a Specified Currency other than euro shall be redenominated in euro.

The election will have effect as follows:

- (a) the Debt Securities and the Receipts shall be deemed to be redenominated in euro in the denomination of euro 0.01 with a nominal amount for each Debt Securities and Receipt equal to the nominal amount of that Debt Securities 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 Bonds other than NCSD Debt Securities, 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 Bondholders, the stock exchange (if any) on which the 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 Debt Securities will be calculated by reference to the aggregate nominal amount of Debt Securities 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 Debt Securities 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 Debt Securities in the denomination of euro 100,000 and/or such higher amounts as the Fiscal Agent (in the case of Bonds other than NCSD Debt Securities) or the Issuer (in the case of NCSD Debt Securities) may determine and notify to the Bondholders and any remaining amounts less than euro 100,000 shall be redeemed by the Issuer and paid to the Bondholders in euro in accordance with Condition 6 (*Payments*); and (ii) in the case of Debt Securities which are not Relevant Debt Securities, 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 Bonds other than NCSD Debt Securities) or the Issuer (in the case of NCSD Debt Securities) shall determine and notify to the Bondholders;
- (d) if issued prior to the Redenomination Date, all unmatured Coupons denominated in the Specified Currency (whether or not attached to the Debt Securities) will become void with effect from the date on which the Issuer gives notice (the **Exchange Notice**) that replacement euro-denominated Debt Securities, 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 Debt Securities and Receipts so issued will

also become void on that date although those Debt Securities and Receipts will continue to constitute valid exchange obligations of the Issuer. New euro-denominated Debt Securities, Receipts and Coupons will be issued in exchange for Debt Securities, Receipts and Coupons denominated in the Specified Currency in such manner as the Fiscal Agent (in the case of Bonds other than NCSD Debt Securities) or the Issuer (in the case of NCSD Debt Securities) may specify and as shall be notified to the 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 Debt Securities;

- (e) after the Redenomination Date, all payments in respect of the Debt Securities, 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 Debt Securities 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 Debt Securities are Fixed Rate Bonds or Fixed Reset 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 Debt Securities represented by a Global Bond or NCSD Debt Securities, by applying the Rate of Interest to the aggregate outstanding nominal amount of the Debt Securities; and
 - (ii) in the case of definitive Debt Securities, 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 Bond in definitive form is a multiple of the Calculation Amount, the amount of interest payable in respect of such Fixed Rate 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 Debt Securities are Floating Rate Bonds, or Fixed Reset 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 Bonds (other than NCSD Debt Securities), and as may be specified in the notice, to conform it to conventions then applicable to instruments denominated in euro.

4.2 Definitions

In these 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 rounding's 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 Debt Securities) any date for payment of interest under the Debt Securities or (in the case of Zero Coupon Bonds) any date, in each case specified by the Issuer in the notice given to the Bondholders pursuant to paragraph 4.1 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 Debt Securities means all Debt Securities 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.

5. INTEREST

5.1 Interest on Fixed Rate Bonds

Each Fixed Rate 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 arrears on the Interest Payment Date(s) in each year up to (and including) the Maturity Date or, any earlier Interest Payment Date on which the 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 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 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 Bonds which are represented by a Global Bond or Fixed Rate Bonds which are NCS Debt Securities, the aggregate outstanding nominal amount of the Fixed Rate Bonds; or
- (b) in the case of Fixed Rate 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 Bond in definitive form is a multiple of the Calculation Amount, the amount of interest payable in respect of such Fixed Rate 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 5.1:

- (i) if "**Actual/Actual (ICMA)**" is specified in the applicable Final Terms:
 - (A) in the case of Debt Securities 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 Debt Securities 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.

5.2 Interest on Fixed Reset Bonds

- (a) The applicable Final Terms contains provisions applicable to the determination of the resetting of the Rate of Interest for Fixed Reset Bonds and must be read in conjunction with this Condition 5.2 for full information on the manner in which interest is calculated on Fixed Reset Bonds. In particular, the applicable Final Terms will specify the Interest Commencement Date, the Reset Date, any Subsequent Reset Date(s), the Reset Margin, the Specified Currency, the Relevant Screen Page, the Floating Leg Reference Rate, the Floating Leg Screen Page and the Initial Mid-Swap Rate.

- (b) If the Debt Securities are specified in the applicable Final Terms as being Fixed Reset Bonds, the Debt Securities shall bear interest:
- (i) from (and including) the Interest Commencement Date to (but excluding) the Reset Date at the rate per annum equal to the Initial Interest Rate; and
 - (ii) from (and including) the Reset Date to (but excluding) either (a) the Maturity Date or (b) if applicable, the first Subsequent Reset Date and each successive period from (and including) any Subsequent Reset Date to (but excluding) the next succeeding Subsequent Reset Date (if any) (each period in (a) and (b) being a **Reset Period**), in each case at the rate per annum equal to the relevant Reset Rate,

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

The provisions of this Condition 5.2 shall apply, as applicable, in respect of any determination by the NCSD Agent of the Rate of Interest for a Reset Period in accordance with this Condition 5.2 as if the Fixed Reset Bonds were Floating Rate Bonds. The Rate of Interest for each Reset Period shall otherwise be determined by the NCSD Agent on the relevant Reset Determination Date in accordance with the provisions of this Condition 5.2. Once the Rate of Interest is determined for a Reset Period, the provisions of Condition 5.1 shall apply to Fixed Reset Bonds, as applicable, as if the Fixed Reset Bonds were Fixed Rate Bonds.

In these Conditions:

Mid-Swap Rate means, in relation to the Reset Date or relevant Subsequent Reset Date, as the case may be, and the Reset Period commencing on the Reset Date or that Subsequent Reset Date, the rate for the Reset Date or that Subsequent Reset Date of, in the case of semi-annual or annual Interest Payment Dates, the semi-annual or annual swap rate, respectively (with such semi-annual swap rate to be converted to a quarterly rate in accordance with market convention, in the case of quarterly Interest Payment Dates) for swap transactions in the Specified Currency maturing on the last day of such Reset Period, expressed as a percentage, which appears on the Relevant Screen Page as of approximately 11.00 a.m. in the principal financial centre of the Specified Currency on such Reset Determination Date. If such rate does not appear on the Relevant Screen Page, the Mid-Swap Rate for the Reset Date or relevant Subsequent Reset Date, as the case may be, will be the Reset Reference Bank Rate for the Reset Period;

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

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

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

Reset Period Mid-Swap Rate Quotations means the bid and offered rates for the semi-annual or annual, as applicable, fixed leg (calculated on the day count basis customary for fixed rate payments in the Specified Currency), of a fixed-for-floating interest rate swap transaction in the Specified

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

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

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

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

5.3 Interest on Floating Rate Bonds

(a) Interest Payment Dates

Each Floating Rate Bond bears interest from (and including) the Interest Commencement Date and such interest will be payable in arrears 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 5.2(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 Bonds will be determined in the manner specified in the applicable Final Terms.

(i) ISDA Determination for Floating Rate 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 NCSA 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 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**), or on the Reykjavík Inter Bank Offering Rate (**REIBOR**), 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 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, or Reykjavík time, in the case of REIBOR) 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, or Reykjavík time, in the case of REIBOR), 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, or Reykjavík time, in the case of REIBOR) 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, or Reykjavík time, in the case of REIBOR) 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) or the Reykjavík Inter Bank Offering Rate (if the Reference Rate is REIBOR) 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, or Reykjavík time, in the case of REIBOR) 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), or the Reykjavík Inter Bank Offering Rate (if the Reference Rate is REIBOR) 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 Bonds which are NCSD Debt Securities:

- 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), or the Reykjavík Inter Bank Offering Rate (if the Reference Rate is REIBOR) 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), or the Reykjavík Inter Bank Offering Rate (if the Reference Rate is REIBOR) 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 Bonds is specified in the applicable Final Terms as being other than LIBOR, EURIBOR or REIBOR, the Rate of Interest in respect of such Debt Securities will be determined as provided in the applicable Final Terms.

In this Condition 5.3:

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 and in the case of a determination of REIBOR, the principal Reykjavik office of four major banks in the Icelandic inter-bank market, in each case selected by the Agent; and

Specified Time means 11.00 a.m. (London time, in the case of LIBOR, or Brussels time, in the case of EURIBOR, or Reykjavik time, in the case of REIBOR).

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

- (i) in the case of Floating Rate Bonds which are represented by a Global Bond or a NCSD Debt Securities, the aggregate outstanding nominal amount of the Debt Securities; or
- (ii) in the case of Floating Rate 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 Bond in definitive form is a multiple of the Calculation Amount, the Interest Amount payable in respect of such Debt Securities 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 5.2:

- (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:

Y_1 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 Bonds are ISD Debt Securities, 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 Bonds are for the time being listed (by no later than the first day of each Interest Period (or, where the relevant Floating Rate Bonds are not NCSD Debt Securities 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 13 as soon as possible after their determination but in no event later than the fourth London Business Day thereafter. Each Interest Amount and Interest Payment Date so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without prior notice in the event of an extension or shortening of the Interest Period. Any such amendment will be promptly notified to each stock exchange on which the relevant Floating Rate Bonds are for the time being listed and to the Bondholders in accordance with Condition 13. For the purposes of this paragraph, the expression **London Business Day** means a day (other than a Saturday or a Sunday) on which banks and foreign exchange markets are open for general business in London.

(g) Certificates to be final

All certificates, communications, opinions, determinations, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition 5.2, 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 NCSD Agent (in the case of NCSD Debt Securities) and all Bondholders, Receiptholders and Couponholders and (in the absence of wilful default or bad faith) no liability to the Issuer, the 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.

5.4 Interest on Inflation Linked Amortising Bonds

Each Inflation Linked Amortising Bond bears interest from (and including) the Interest Commencement Date at the rate per annum equal to the Rate of Interest payable in arrears 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 5.2 (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 5.2 (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.

5.5 Interest on Inflation Linked Non-Amortising Bonds

Each Inflation Linked Non-Amortising 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 6.1(b) (*Payments in respect of Inflation Linked Amortising Bonds*)) below. Interest will be payable in arrears 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 in respect of any period by applying the Rate of Interest multiplied by the Index Ratio (as defined in Condition 6.1(b) (*Payments in respect of Inflation Linked Amortising Bonds*)) to:

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

and, in each case, multiplying such sum by the applicable Day Count Fraction (as defined in Condition 5.1), 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 Bond in definitive form is a multiple of the Calculation Amount, the amount of interest payable in respect of such Inflation Linked Non-Amortising 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.

5.6 Interest on Inflation Linked Instalment Bonds:

Each Inflation Linked Instalment 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 6.2 (*Payments in respect of Inflation Linked Instalment Bonds*)) below. Interest will be payable in arrears 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 5.2 (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 5.2 (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.

5.7 Accrual of interest

Each Debt Security (or in the case of the redemption of part only of a Debt Securities, that part only of such Debt Securities) 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 Debt Securities have been paid; and
- (b) five days after the date on which the full amount of the moneys payable in respect of such Bond has been received by the Fiscal Agent or the NCSD Agent or the Registrar, as the case may be, and notice to that effect has been given to the Bondholders in accordance with Condition 13.

5.8 Interest on any Write-Down of Subordinated Bonds

In the case of any Write-Down (as defined in Condition 8) of Subordinated Bonds, interest will be paid on the Subordinated Bonds:

- (a) if the Subordinated Bonds are Written-Down in full, on the date of the Write-Down (the **Write-Down Date**) and in respect of: (i) the period from (and including) the Interest Payment Date immediately preceding the Write-Down Date (or, if none, the Issue Date) to (but excluding) the Write-Down Date and (ii) the Prevailing Principal Amount(s) of the outstanding Notes during that period; and
- (b) if the Notes are not Written-Down in full, on the Interest Payment Date immediately following such Write-Down (the **Partial Write-Down Interest Payment Date**) and calculated as the sum of the amount of interest payable in respect of:
 - (i) the period from (and including) the Interest Payment Date immediately preceding the Write-Down Date (or, if none, the Issue Date) to (but excluding) the Write-Down Date; and
 - (ii) the period from (and including) the Write-Down Date to (but excluding) the Partial Write-Down Interest Payment Date,

and, in each case, the Prevailing Principal Amount(s) of the outstanding Notes during those respective periods.

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

5.9 Benchmark Discontinuation

Notwithstanding the provisions in 5.3, as the case may be, above, if the Bank determines that a Benchmark Event has occurred in relation to an Original Reference Rate when any Rate of Interest (or any component part thereof) remains to be determined by reference to that Original Reference Rate, then the following provisions of this Condition 5.9 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 15, the Bondholders of such Successor Rate and that Successor Rate shall (subject to adjustment as provided in Condition 5.9(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 Bonds (subject to the further operation of this Condition 5.9).

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 15, the Bondholders of such Alternative Rate and that Alternative Rate shall (subject to adjustment as provided in Condition 5.9(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 Bonds (subject to the further operation of this Condition 5.9).

(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 15, the 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 15, the 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 15, the 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 5.9 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 Bondholders in accordance with Condition 15, without any requirement for the consent or approval of Bondholders, agree to the necessary modifications to these Conditions and/or the Agency Agreement to give effect to such Benchmark Amendments with effect from the date specified in such notice.

[In connection with any such modifications in accordance with this Condition 5.9(c), the Bank shall comply with the rules of any stock exchange on which the Bonds are for the time being listed or admitted to trading.]

Any Benchmark Amendments determined under this Condition 5.9(c) shall be notified promptly by the Bank to the Fiscal Agent and, in accordance with Condition [15,] the 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 5.9, 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 5.9 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 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 5.9 or otherwise in connection with the 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 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 Bonds (acting in such capacity), shall have any relationship of agency or trust with the Bondholders.

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

Without prejudice to the obligations of the Bank under this Condition 5.9, the Original Reference Rate and the fallback provisions provided for in the conditions, 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 5.9.

(f) **Definitions**

In this Condition 5.9:

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 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 5.9 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 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 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 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. PAYMENTS

6.1 Payments in respect of Inflation Linked Amortising Bonds

If this is an Inflation Linked Amortising Bond, the Issuer shall, on each relevant Interest Payment Date, make a combined payment of principal due under Condition 7.3, interest due under Condition 5.3 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 Bonds;

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

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

d = The Specified Denomination of the relevant Bonds;

n = [*Insert total number of annuity payments on the relevant 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 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.

6.2 Payments in respect of Inflation Linked Instalment Bonds

If this is an Inflation Linked Instalment Bond, the Issuer shall, on each relevant Interest Payment Date, make a combined payment of principal due under Condition 6.2, interest due under Condition 5.5 and any indexation amount (together, the **Instalment Payment Amount**) as calculated by the Calculation Agent in accordance with the following formula.

$$P_t = (PR + PAO_{t-1} \times R) \times IR$$

where

$$PAO_t = (PAO_{t-1} - PR)$$

- P_t = The indexed total payment on the relevant Interest Payment Date;
- PAO_t = The non-indexed Principal Amount Outstanding on the relevant Interest Payment Date;
- PAO_{t-1} = The non-indexed Principal Amount Outstanding on the preceding Interest Payment Date;
- PR = The Principal Repayment;
- R = The Rate of Interest applicable to the relevant Bonds multiplied with the appropriate Day Count Fraction;
- IR = The Index Ratio as determined in accordance with condition 5.2 subparagraph (b)

6.3 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 any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 8 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 Conditions 9 (Taxations)) any law implementing an intergovernmental approach thereto (**FATCA**).

6.4 Presentation of definitive Debt Securities, Receipts and Coupons

Payments of principal in respect of definitive Bearer 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 Debt Securities, and payments of interest in respect of definitive Debt Securities 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 Bonds, other than the final instalment, will (subject as provided below) be made in the manner provided in paragraph 6.1 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 6.1 above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Debt Security in accordance with the preceding paragraph. Each Receipt must be presented for payment of the relevant instalment together with the definitive Bearer Bond to which it appertains. Receipts presented without the definitive Bearer Bond to which they appertain do not constitute valid obligations of the Issuer. Upon the date on which any definitive Bearer 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 Bonds and Inflation Linked Bonds in definitive bearer form (other than Long Maturity 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 8) in respect of such principal (whether or not such Coupon would otherwise have become void under Condition 9) 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 Bond or Inflation Linked 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 Bond, Fixed Reset Bond or Long Maturity 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 Bond** is a Fixed Rate Bond (other than a Fixed Rate Bond which on issue had a Talon attached) or an Inflation Linked Non-Amortising Bond whose nominal amount on issue is less than the aggregate interest payable thereon provided that such Bond shall cease to be a Long Maturity 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 Bond.

If the due date for redemption of any definitive Bearer Bond is not an Interest Payment Date, interest (if any) accrued in respect of such Bearer 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 Bond.

6.5 Payments in respect of Bearer Global Bonds

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

6.6 Payments in respect of Registered Bonds

Payments of principal (other than instalments of principal prior to the final instalment) in respect of each Registered 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 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 Bond appearing in the register of holders of the Registered Bonds maintained by the Registrar (the **Registered 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 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 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 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 Bond appearing in the

Registered 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 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 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 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 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 Bond.

Holders of Registered Bonds will not be entitled to any interest or other payment for any delay in receiving any amount due in respect of any Registered 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 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 Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

6.7 General provisions applicable to payments

The holder of a Global Bond shall be the only person entitled to receive payments in respect of Bonds represented by such Global Bond and the Issuer will be discharged by payment to, or to the order of, the holder of such Global 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 Bonds represented by such Global 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 Bond.

Notwithstanding the foregoing provisions of this Condition, if any amount of principal and/or interest in respect of Bonds is payable in U.S. dollars, such U.S. dollar payments of principal and/or interest in respect of such 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 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.

6.8 Payments in respect of NCSD Debt Securities

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

6.9 Payment Day

If the date for payment of any amount in respect of any Debt Security, 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 9) 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 Debt Securities 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.

6.10 Interpretation of principal and interest

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

- (a) any additional amounts which may be payable with respect to principal under Condition 8;
- (b) the Final Redemption Amount of the Debt Securities;
- (c) the Early Redemption Amount of the Debt Securities;
- (d) the Optional Redemption Amount(s) (if any) of the Debt Securities;
- (e) in relation to Debt Securities redeemable in instalments, the Instalment Amounts;
- (f) in relation to Zero Coupon Bonds, the Amortised Face Amount (as defined in Condition 7.8); and
- (g) any premium and any other amounts (other than interest) which may be payable by the Issuer under or in respect of the Debt Securities.

Any reference in the Conditions to interest in respect of the Debt Securities shall be deemed to include, as applicable, any additional amounts which may be payable with respect to interest under Condition 8.

7. REDEMPTION AND PURCHASE

7.1 Redemption at maturity

Unless previously redeemed or purchased and cancelled as specified below, each Debt Security 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.

7.2 Redemption for tax reasons

(a) The Debt Securities may, subject to Condition 7.2(b) and 7.8 below, be redeemed at the option of the Issuer in whole, but not in part, at any time (if this Debt Security is neither a Floating Rate Bond, an Inflation Linked Bond nor an Inflation Linked Non-Amortising Bond) or on any Interest Payment Date (if this Debt Security is either a Floating Rate Bond, an Inflation Linked Bond or an Inflation Linked Non-Amortising Bond), on giving not less than 30 nor more than 60 days' notice to the AgentFiscal or the NCSA Agent, as applicable, and, in accordance with Condition 13, the Bondholders (which notice shall be irrevocable), if:

- (i) (A) on the occasion of the next payment due under the Debt Securities, the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 8 or (B) in the case of Subordinated Bonds only, the Issuer would not be entitled to claim a deduction in computing its taxation liabilities in any Tax Jurisdiction (as defined in Condition 9, in respect of any payment of interest to be made on the Debt Securities on the occasion of the next payment due under the Debt Securities or the value of such deduction to the Issuer would be materially reduced, in each case as a result of any change in, or amendment to, the laws or regulations of such Tax Jurisdiction, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after (A) (in the case of Unsubordinated Bonds) the date on which agreement is reached to issue the first Tranche of the BondsUnsubordinated ; or (B) (in the case of Subordinated Bonds) the Issue Date; 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 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 or the NCSA Agent, as applicable, (i) 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 (ii) 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 or, as the case may be, will not be entitled to claim such deduction or the amount of such deduction would be reduced as a result of such change or amendment.
- (c) Each Debt Security redeemed pursuant to this Condition 7.2 will be redeemed at the Early Redemption Amount, together, if appropriate, with interest accrued to (but excluding) the date of redemption.

7.3 Calculation of principal payments in respect of Inflation Linked Amortising Bonds

Unless previously redeemed or purchased and cancelled, each Inflation Linked Bond will, subject to Condition 6.1 (*Payments in respect of Inflation Linked Amortising Bonds*), be redeemed in one or more amounts constituting payments of principal in relation to such Inflation Linked 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 Bonds;

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

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

d = The Specified Denomination of the relevant Bonds;

n = [*Insert total number of [annuity] payments on the relevant 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.

7.4 Calculation of principal payments in respect of Inflation Linked Non-Amortising Bonds and Inflation Linked Zero Coupon Bonds

Unless previously redeemed or purchased and cancelled, each Inflation Linked Non-Amortising Bond and Inflation Linked Zero Coupon Bond will be redeemed in one or more amounts constituting payments of principal in relation to such Inflation Linked Non-Amortising 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 Bond;

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

IR = the Index Ratio as set out in Condition 6.1(b), above.

7.5 Calculation of principal payments in respect of Inflation Linked Instalment Bonds

Unless previously redeemed or purchased and cancelled, each Inflation Linked Instalment Bond will, subject to Condition 6.2 (Payments in respect of Inflation Linked Instalment Bonds), be redeemed in one or more amounts constituting payments of principal in relation to such Inflation Linked Instalment Bond, in the relevant Specified Currency on the relevant Interest Payment Dates, calculated in accordance with the following formula:

$$PRI = PR \times IR$$

Where

$$PR = \frac{d}{n}$$

- d = The Specified Denomination of the relevant Inflation Linked Instalment Bonds;
- n = Number of principal repayment dates;
- PR = The Principal Repayment;
- IR = The Index Ratio as determined in accordance with condition 5.2 subparagraph (b);
- PRI = The indexed principal repayment

7.6 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 Bondholders in accordance with Condition 13; 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 Bonds) the Registrar;

(which notices shall be irrevocable and shall specify the date fixed for redemption), redeem all or some only of the 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 Bonds, the Bonds to be redeemed (**Redeemed Bonds**) will be selected individually by lot, in the case of Redeemed Bonds represented by definitive 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 Bonds represented by a Global Bond, and in accordance with the rules of the NCSD in the case of the NCSD 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 Bonds represented by definitive Bonds, a list of the serial numbers of such Redeemed

Bonds will be published in accordance with Condition 13 not less than 15 days prior to the date fixed for redemption. No exchange of the relevant Global 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 7.3 and notice to that effect shall be given by the Issuer to the Bondholders in accordance with Condition 13 at least five days prior to the Selection Date.

7.7 Redemption at the option of the Bondholders (Investor Put)

If the Debt Securities are Unsubordinated Bonds and Investor Put is specified in the applicable Final Terms, upon the holder of any Bond giving to the Issuer in accordance with Condition 13 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 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 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 Bond the holder of this Bond must, if this 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 Bonds) or the Registrar (in the case of Registered 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 Bonds, the nominal amount thereof to be redeemed and, if less than the full nominal amount of the Registered Bonds so surrendered is to be redeemed, an address to which a new Registered Bond in respect of the balance of such Registered Bonds is to be sent subject to and in accordance with the provisions of Condition 2. If this Bond is in definitive bearer form, the Put Notice must be accompanied by this Bond or evidence satisfactory to the Paying Agent concerned that this Bond will, following delivery of the Put Notice, be held to its order or under its control.

If the Bond is represented by a Global Bond or is in definitive form and held through Euroclear or Clearstream, Luxembourg, to exercise the right to require redemption of this Bond the holder of this 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 depository 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 Bond is represented by a Global Bond, at the same time present or procure the presentation of the relevant Global Bond to the Agent for notation accordingly.

If the Bond is an NCSD Bond, to exercise the right to require redemption of this Bond the holder of this Bond must, within the notice period, give notice to the NCSD Agent of such exercise in accordance with the standard procedures of the NCSD 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 NCSD Bonds, the NCSD given by a holder of any Bond pursuant to this paragraph shall be irrevocable.

7.8 Early Redemption Amounts

For the purpose of Condition 7.2 above, Condition 7.13 below, and Condition 14 below each Debt Security will be redeemed at the Early Redemption Amount. The Early Redemption Amount is calculated as follows:

- (a) in the case of a Debt Security with a Final Redemption Amount equal to the Issue Price, at the Final Redemption Amount thereof;
- (b) in the case of a Debt Security (other than a Zero Coupon Bond but including an Instalment Bond) with a Final Redemption Amount which is or may be less or greater than the Issue Price or which is payable in a Specified Currency other than that in which the Bond is denominated, at the amount specified in, the applicable Final Terms or, if no such amount or manner is so specified in the applicable Final Terms, at its nominal amount; or
- (c) in the case of a Zero Coupon Bond, 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 Debt Securities to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Debt Security 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.

7.9 Instalments

Instalment 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 Bond will be redeemed at the Early Redemption Amount.

7.10 Purchases

Subject, in the case of Subordinated Bonds, to the provisions of Condition 7.14, the Issuer or any subsidiary of the Issuer may at any time purchase Debt Securities (provided that, in the case of definitive Debt Securities, all unmaturing Receipts, Coupons and Talons appertaining thereto are purchased therewith) at any price in the open market or otherwise. Such Debt Securities may be held, reissued, resold or, at the option of the Issuer, surrendered to any Paying Agent and/or the Registrar for cancellation.

7.11 Cancellation

All Debt Securities which are redeemed or surrendered for cancellation pursuant to this Condition 7 will forthwith be cancelled (together with all unmaturing Receipts, Coupons and Talons attached thereto or surrendered therewith at the time of redemption). All Debt Securities 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.

7.12 Late payment on Zero Coupon Bonds

If the amount payable in respect of any Zero Coupon Bond upon redemption of such Zero Coupon Bond pursuant to Condition 7.1, 7.2, 7.3 or 7.7 above is improperly withheld or refused, the amount due and repayable in respect of such Zero Coupon Bond shall be the amount calculated as provided in Condition 7.8(c) above as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon 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 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 Bonds has been received by the Fiscal Agent or the Registrar and notice to that effect has been given to the Bondholders in accordance with Condition 13.

7.13 Redemption upon a Capital Event - Subordinated Bonds

If the Debt Securities are Subordinated Bonds, then upon the occurrence of a Capital Event, the Issuer may, at its option, having given not less than 30 days' nor more than 60 days' notice to the Fiscal Agent or the NCSD Agent, as applicable, the Registrar (in the case of Registered Bonds) and the Bondholders in accordance with Condition 13 (which notice shall be irrevocable and shall specify the date fixed for such redemption), at any time (if this Debt Security is neither a Floating Rate Bond, an Inflation Linked Bond nor an Inflation Linked Non-Amortising Bond) or on any Interest Payment Date (if this Debt Security is either a Floating Rate Bond, an Inflation Linked Bond or an Inflation Linked Non-Amortising Bond) redeem all (but not some only) of the Subordinated Bonds then outstanding at the Early Redemption Amount specified in the applicable Final Terms, together, if appropriate, with interest accrued to (but excluding) the date of redemption.

Prior to the publication of any notice of redemption pursuant to this Condition, the Issuer shall deliver to the Fiscal Agent or the NCSD Agent, as applicable, 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.

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

7.14 FME approval

Any redemption or purchase of Subordinated Bonds pursuant to Conditions 7.2, 7.6, 7.10 and 7.13 is subject to the prior approval of the FME (if, and to the extent then required, by the FME).

8. POINT OF NON-VIABILITY LOSS ABSORPTION

- 8.1** This Condition 8 applies only to Subordinated Bonds and prior to the date on which any Applicable Statutory Loss Absorption Regime becomes effective in respect of the Debt Securities.

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

- (a) promptly notify Bondholders thereof in accordance with Condition 15 (a **Non-Viability Event Notice**); and
- (b) irrevocably and mandatorily (and without any requirement for the consent or approval of Bondholders) write-down the Prevailing Principal Amount of the Subordinated Bonds in full or to the extent required in order for the Issuer no longer to be considered Non-Viable by the Relevant Resolution Authority and in order that such Non-Viability Event is no longer continuing, whichever is lower (a **Write-Down** and **Written-Down** shall be construed accordingly), which Non-Viability Write-Down shall take place as directed by the Relevant Resolution Authority in accordance with the priority of claims under normal insolvency proceedings and may be effected before any public provision of capital to the Issuer or any other equivalent measure of extraordinary financial support without which, in the determination of the Relevant Resolution Authority, the Issuer would be Non-Viable.

With effect on and from the date on which an Applicable Statutory Loss Absorption Regime becomes effective in respect of the Debt Securities, the foregoing provisions of this Condition 8 will lapse and cease to have any effect (and without any requirement for the consent or approval of Bondholders or any notice to be given to Bondholders), except to the extent such provisions are required by the Applicable Statutory Loss Absorption Regime. If a Non-Viability Event occurs on or after such date, the Relevant Resolution Authority (or the Issuer following instructions from the Relevant Resolution Authority) may (without any requirement for the consent or approval of Bondholders or any notice to be given to Bondholders) take such action in respect of the Debt Securities as is required or permitted by such Applicable Statutory Loss Absorption Regime.

Bondholders shall have no claim against the Issuer in respect of any Prevailing Principal Amount of the Subordinated Bonds that is Written-Down in accordance with the provisions of this Condition 8 or otherwise pursuant to any Applicable Statutory Loss Absorption Regime.

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

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

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

- (a) the Relevant Resolution Authority determines that the Issuer is or will be Non-Viable without a Non-Viability Write-Down;
- (b) the Relevant Resolution Authority decides to inject capital into the Issuer or provide any other equivalent extraordinary measure of financial support without which, the Issuer would become Non-Viable; or
- (c) any other event or circumstance specified in Applicable Banking Regulations or any Applicable Statutory Loss Absorption Regime that leads to a determination by the Relevant Resolution Authority that the Issuer is Non-Viable;

Non-Viable means the insolvency of the Issuer or if the Issuer is, unable to pay a material part of its debts as they fall due or unable to carry on its business or is subject to restructuring or resolution under Act on Financial undertaking, No. 161/2002 and Act on Bankruptcy, etc. No. 21/1991 or any other

event or circumstance specified as such in Applicable Banking Regulations or any Applicable Statutory Loss Absorption Regime;

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

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

9. TAXATION

All payments of principal and interest in respect of the Debt Securities, 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 Debt Securities, 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 Debt Securities, 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 Debt Securities, 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 Debt Security, Receipt or Coupon by reason of his having some connection with a Tax Jurisdiction other than the mere holding of such Debt Security, 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 6.9); 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; or

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 NCS D Debt Securities, the NCS D 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 Bondholders in accordance with Condition 13.

10. PRESCRIPTION

The Debt Securities (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 8) 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 6.4) or any Talon which would be void pursuant to Condition 6.4.

11. REPLACEMENT OF BONDS, RECEIPTS, COUPONS AND TALONS

Should any Debt Security, 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 Bonds, Receipts or Coupons) or the Registrar (in the case of Registered 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 Debt Securities, 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, a Registrar and an NCS D Agent; and
- (b) so long as the Debt Securities 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 Bonds) and a Transfer Agent (in the case of Registered 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); and
- (c) [RESERVED]
- (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.

In addition, the Issuer shall forthwith appoint a Paying Agent having a specified office in New York City in the circumstances described in Condition 6.7. 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 Bondholders in accordance with Condition 13.

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 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 Debt Security to which it appertains) a further Talon, subject to the provisions of Condition 10.

14. EVENTS OF DEFAULT

14.1 Events of Default – Unsubordinated Bonds

This Condition 14.1 is applicable in relation to Debt Securities specified in the applicable Final Terms as being Unsubordinated Bonds. If any one or more of the following events (each an Event of Default) shall occur with respect to the Debt Securities:

- (a) if default is made in the payment of any principal or interest due in respect of the Debt Securities or any of them and the default continues for a period of five days in the case of principal and ten days in the case of interest; or
- (b) if the Issuer fails to perform or observe any of its other obligations under the Conditions and (except in any case where the failure is incapable of remedy when no such continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 30 days next following the service by a Bondholder on the Issuer of notice requiring the same to be remedied; or
- (c) if (i) any Financial Indebtedness (as defined below) of the Issuer becomes due and repayable prematurely by reason of an event of default (however described); (ii) the Issuer fails to make any payment in respect of any Financial Indebtedness on the due date for payment as extended by any originally applicable grace period; (iii) any security given by the Issuer for any Financial Indebtedness becomes enforceable; or (iv) default is made by the Issuer in making any payment due under any guarantee and/or indemnity given by it in relation to any Financial Indebtedness of any other person, provided that the aggregate nominal amount of any such Financial Indebtedness of the Issuer in the case of (i), (ii) and/or (iii) above, and/or amount of Financial Indebtedness in relation to which such guarantee and/or indemnity of the Issuer has been given in the case of (iv) above, is at least € 25,000,000 (or its equivalent in any other currency); or
- (d) if any order is made by any competent court or resolution passed for the winding up or dissolution of the Issuer, save for the purpose of reorganisation on terms previously approved by an Extraordinary Resolution; or
- (e) if the Issuer ceases or threatens to cease to carry on the whole or a substantial part of its business, save in each case for the purposes of reorganisation on terms previously approved by an Extraordinary Resolution, or the Issuer stops or threatens to stop payment of, or is unable to, or admits inability to, pay, its debts (or any class of its debts) as they fall due, or is deemed unable to pay its debts pursuant to or for the purposes of any applicable law, or is adjudicated or found bankrupt or insolvent; or

- (f) if (i) proceedings are initiated against the Issuer under any applicable liquidation, insolvency, composition, reorganisation or other similar laws, or an application is made (or documents filed with a court) for the appointment of an administrative or other receiver, manager, administrator or other similar official, or an administrative or other receiver, manager, administrator or other similar official is appointed, in relation to the Issuer or, as the case may be, in relation to the whole or a substantial part of the undertaking or assets of any of them, or an encumbrancer takes possession of the whole or a substantial part of the undertaking or assets of any of them, or a distress, execution, attachment, sequestration or other process is levied, enforced upon, sued out or put in force against the whole or a substantial part of the undertaking or assets of any of them and (ii) in any case (other than the appointment of an administrator) the same is not discharged or stayed within 14 days; or
- (g) if the Issuer initiates or consents to judicial proceedings relating to itself under any applicable liquidation, insolvency, composition, reorganisation or other similar laws or makes a conveyance or assignment for the benefit of, or enters into any composition or other arrangement with, its creditors generally (or any class of its creditors) or any meeting is convened to consider a proposal for an arrangement or composition with its creditors generally (or any class of its creditors);

then any holder of a Debt Security may, by written notice to the Issuer, effective upon the date of receipt thereof by the Issuer, declare any Debt Security held by it to be forthwith due and payable whereupon the same shall become forthwith due and payable at its Early Redemption Amount (as defined in Condition 7.8), together with accrued interest (if any) to the date of repayment, without presentment, demand, protest or other notice of any kind.

For the purposes of these Conditions:

Financial Indebtedness means any indebtedness for or in respect of:

- (i) moneys borrowed;
- (ii) any amount raised by acceptance under any acceptance credit facility or any dematerialised equivalent;
- (iii) any amount raised pursuant to any note purchase facility or the issue of any debenture, bond, note or loan stock or other similar instrument (with the exception of any loan stock issued by the Issuer which is cash collateralised);
- (iv) the amount of any liability in respect of any lease or hire purchase contract which would, in accordance with IFRS, be treated as a finance or capital lease;
- (v) receivables sold or discounted (otherwise than on a non-recourse basis);
- (vi) any amount raised under any other transaction (including any forward sale or purchase agreement) having the commercial or economic effect of a borrowing and which, for the avoidance of doubt, includes any transaction that is required to be classified and accounted for as borrowings, for financial reporting purposes in accordance with IFRS;
- (vii) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price (and, when calculating the value of any derivative transaction, only the marked to market value shall be taken into account);
- (viii) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, standby or documentary letter of credit or any other instrument issued by a bank or financial institution.

IFRS means International Financial Reporting Standards.

14.2 Events of Default – Subordinated Bonds

- (a) This Condition 14.2 is applicable in relation to Debt Securities specified in the applicable Final Terms as being Subordinated Bonds. If:
- (i) default is made in the payment of any principal or interest due in respect of the Subordinated Bonds or any of them and the default continues for a period of five days in the case of principal and ten days in the case of interest; or
 - (ii) an order is made or an effective resolution is passed for the liquidation or winding up or dissolution of the Issuer (except for the purposes of a merger, reconstruction or amalgamation under which the continuing entity effectively assumes the entire obligations of the Issuer under the Subordinated Bonds) or the Issuer is otherwise declared insolvent or put into liquidation, in each case by a court or agency or supervisory authority in Iceland having jurisdiction in respect of the same Act on Financial undertaking, No. 161/2002 and Act on Bankruptcy, etc. No. 21/1991,

any holder of a Subordinated Bond may:

- (A) (in the case of (i) above) institute proceedings for the Issuer to be declared insolvent or its winding-up or liquidation, in each case in Iceland and not elsewhere, and prove or claim in the liquidation of the Issuer; and/or
- (B) (in the case of (ii) above), prove or claim in the liquidation of the Issuer, whether in Iceland or elsewhere and instituted by the Issuer itself or by a third party,

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

- (b) In any of the events or circumstances described in Condition 14.2(a)(ii) above, the holder of any Subordinated Bond may, by notice to the Issuer, declare such Subordinated Bond to be due and payable, and such Subordinated Bond shall accordingly become due and payable at its principal amount together with accrued interest to the date of payment but subject to such Bondholder only being able to claim payment in respect of the Subordinated Bond in the liquidation of the Issuer.
- (c) The holder of any Subordinated Bond may at its discretion institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Issuer under the Subordinated Bonds (other than, without prejudice to Conditions 14.2(a) or 14.2(b) above, any obligation for the payment of any principal or interest in respect of the Subordinated Bonds) provided that the Issuer shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it, except with the prior approval of the FME.
- (d) No remedy against the Issuer, other than as provided in Conditions 14.2(a), 14.2(b) above and 14.2(c) above shall be available to the Bondholders, whether for the recovery of amounts owing in respect of the Subordinated Bonds or in respect of any breach by the Issuer of any of its obligations or undertakings under the Subordinated Bonds.

15. NOTICES

- (a) *Bonds other than NCSD Debt Securities*

All notices regarding the Bearer Bonds will be deemed to be validly given if published (a) in a leading Icelandic language daily newspaper of general circulation in Reykjavík and (b) if and for so long as the Bearer Bonds are admitted to trading on the regulated market of the Nasdaq Iceland hf. and listed on the Official List of the Nasdaq Iceland hf., and/or the Nasdaq Iceland hf. website (www.nasdaqomxnordic.com). 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 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 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 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 Bonds are admitted to trading on the regulated market of the Nasdaq Iceland hf. and listed on the Official List of the Nasdaq Iceland hf., and/or the Nasdaq Iceland hf. website (www.nasdaqomxnordic.com), 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 Bonds are issued, there may, so long as any Global Bonds representing the Debt Securities 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 Debt Securities and, in addition, for so long as any Debt Securities 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 Nasdaq Iceland hf. website (www.nasdaqomxnordic.com). Any such notice shall be deemed to have been given to the holders of the Debt Securities on the third day after the day on which the said notice was given to Euroclear and/or Clearstream, Luxembourg.

(b) *NCS D Debt Securities*

All notices regarding the NCS D Debt Securities 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 NCS D Debt Securities 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 Bonds are NCS D Debt Securities, the Issuer can additionally at its own discretion obtain information from the NCS D on the Bondholders in order to send notices to each Bondholder directly.

(c) *Notices given by Bondholders*

Notices to be given by any Bondholder shall be in writing and given by lodging the same, together (in the case of any Debt Security in definitive form) with the relative Debt Security or Debt Securities, with the Fiscal Agent (in the case of Bearer Bonds) or the Registrar (in the case of Registered Bonds). Whilst any of the Debt Securities are represented by a Global Bond, such notice may be given by any holder of a 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.

16. MEETINGS OF BONDHOLDERS, MODIFICATION AND WAIVER

(a) *Bonds other than NCSD Debt Securities*

The Agency Agreement contains provisions for convening meetings of the Bondholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of the Debt Securities, 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 Bondholders holding not less than 5% in nominal amount of the 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 Debt Securities for the time being outstanding, or at any adjourned meeting one or more persons being or representing Bondholders whatever the nominal amount of the Bonds so held or represented, except that at any meeting the business of which includes the modification of certain provisions of the Debt Securities, the Receipts or the Coupons (including modifying the date of maturity of the Debt Securities 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 Debt Securities or altering the currency of payment of the Debt Securities, 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 Debt Securities 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 Debt Securities for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Bondholders shall be binding on all the 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 Bondholders, Receiptholders or Couponholders, to:

- (a) any modification (except as mentioned above) of the Debt Securities, the Receipts, the Coupons or Agency Agreement which is not prejudicial to the interests of the Bondholders; or
- (b) any modification of the Debt Securities, 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 Bondholders, the Receiptholders and the Couponholders and any such modification shall be notified to the Bondholders in accordance with Condition 13 as soon as practicable thereafter.

In relation to modifications made pursuant Condition 14(a) and (b) , the Issuer shall consider the interest of the 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 Bondholder and (ii) entitled to assume without further enquiry that the conditions set out in this Condition have been satisfied.

(b) *NCSD Debt Securities*

The Issuer may, in its capacity as NCSD Agent, convene meetings of the holders of NCSD Debt Securities to consider any matter affecting their interests, including sanctioning by a majority of votes a modification of the NCSD Debt Securities. Such a meeting may be convened by the Issuer or by the holders of not less than 10 per cent. of the Voting NCSD Debt Securities. For the purpose of this Condition, Voting NCSD Debt Securities means the aggregate nominal amount of the total number of NCSD Debt Securities not redeemed or otherwise deregistered in the NCSD, less the NCSD Debt Securities 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 NCS D Debt Securities or at any adjourned meeting one or more persons being or representing holders of Voting NCS D Debt Securities whatever the nominal amount of the NCS D Debt Securities so held or represented, except that at any meeting the business of which includes the modification of certain provisions of the NCS D Debt Securities (including modifying the date of maturity of the NCS D Debt Securities 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 NCS D Debt Securities or altering the currency of payment of the NCS D Debt Securities), the quorum shall be one or more persons holding or representing not less than two-thirds in aggregate nominal amount of the Voting NCS D Debt Securities 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 NCS D Debt Securities. A resolution passed at any meeting of the holders of NCS D Debt Securities 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 NCS D Debt Securities of more than one Series, (i) a resolution which affects the NCS D Debt Securities of only one Series shall be deemed to have been duly passed if passed at a separate meeting of the holders of the NCS D Debt Securities of that Series; (ii) a resolution which affects the NCS D Debt Securities of more than one Series but does not give rise to a conflict of interest between the holders of NCS D Debt Securities 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 NCS D Debt Securities of all the Series so affected; and (iii) a resolution which affects the NCS D Debt Securities of more than one Series and gives or may give rise to a conflict of interest between the holders of the NCS D Debt Securities of one Series or group of Series so affected and the holders of the NCS D Debt Securities 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 NCS D Debt Securities of each Series or group of Series so affected.

The Issuer, in its capacity as NCS D Agent, may in certain circumstances, without the consent of the holders of the NCS D Debt Securities, 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 NCS D Debt Securities. The Issuer shall consider the interest of the holders of NCS D Debt Securities while making such decisions.

17. FURTHER ISSUES

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

18. GOVERNING LAW AND SUBMISSION TO JURISDICTION

18.1 Governing law

The Agency Agreement, the Deed of Covenant, the Debt Securities, 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, Icelandic law.

18.2 Submission to jurisdiction

The Issuer irrevocably agrees, for the benefit of the Bondholders, the Receiptholders and the Couponholders, that the courts of Iceland are to have jurisdiction to settle any disputes which may arise out of or in connection with the Bonds (other than the NCS D Debt Securities), the Receipts and/or the Coupons (including a dispute relating to any non-contractual obligations arising out of or in

connection with the Bonds, the Receipts and/or the Coupons) and accordingly submits to the exclusive jurisdiction of the Icelandic courts. Legal action taken in respect of Debt Securities 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 Iceland on the grounds that they are an inconvenient or inappropriate forum. The 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 Bonds, the Receipts and the Coupons (including any Proceeding relating to any non-contractual obligations arising out of or in connection with the 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 acts as a Process Agent, unless he appoints another person as its agent for service of process in Iceland 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 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 Icelandic 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:

Records of Euroclear, Clearstream, Luxembourg and the NCSD means the records that each of Euroclear, Clearstream, Luxembourg and the NCSD holds for its customers which reflect the amount of such customer's interest in the Debt Securities;

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

USE OF PROCEEDS

The net proceeds from each issue of Bonds will be applied by the Issuer for general funding purposes, which include making a profit and/or hedging certain risks. If, in respect of any particular issue there is a particular identified use of proceeds, this will be stated in the applicable Final Terms.

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 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 has strategically acquired 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. 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, the Bank seeks to meet those needs whatever they may be. While the Bank will always consider 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 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 shareholders.

In the year ended 31 December 2018, the Bank's net interest income was ISK 29.3 billion (compared to ISK 28.9 billion in 2017), its operating income was ISK 45.5 billion (compared to ISK 46.8 billion in 2017) and its net earnings were ISK 7.7 billion (compared to ISK 14.4 billion in 2017). As at 31 December 2018, the Bank's total assets were ISK 1,164 billion.

Arion Bank was assigned ratings from Standard and Poor's BBB+; outlook stable. Standard and Poor's have been registered in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies.

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 Icelandic government. The inheritance 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 clean and newly valued balance sheet, reflecting a loan portfolio acquired 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.

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 (the **Kaupthing Covered Note Programme**). As a part of this acquisition, the Bank was substituted for, and has assumed all liabilities and obligations (past, present and future, other than Kaupthing's liabilities and obligations relating to withholding tax payments) of, Kaupthing in respect of each of the four series of Kaupthing Covered Notes. The Covered Note series have all been prepaid but one. The outstanding Kaupthing Covered Note series is inflation-linked with a final maturity 2048, and has a face value of approximately ISK 78.3 billion as of 31 December 2017.

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 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*”.

SHAREHOLDERS OF THE ISSUER

The Bank’s listing on Nasdaq Iceland and Nasdaq Stockholm took place on 15 June following an initial public offering of 28.7% of shares in the Bank, placed mostly with investors in Iceland, the United States, the United Kingdom, Scandinavia and Continental Europe. It was the first listing of an Icelandic bank on the main market in Iceland since 2008. During the year and prior to the IPO, Icelandic State Financial Investments (ISFI) sold its shareholding and the Bank is now fully privately owned. The IPO had a big impact on the shareholder base. At the end of the year, Kaupskil ehf. was the largest shareholder with a 32.67% shareholding and was at the time the only shareholder with more than a 10% share. At year-end the Bank had more than 6,000 shareholders.

At Arion Bank’s annual general meeting on 20 March 2019 it was approved to cancel 186,000,000 of the Bank’s own shares, thereby reducing issued share capital in the Bank from ISK 2,000,000,000, to ISK 1,814,000,000 nominal value. The cancellation of the Bank’s own shares, which is expected to become effective on or around the date of issuance of this Base Prospectus will not affect current voting rights of shareholders as voting rights are not attached to a company’s own shares under Icelandic law. Following the cancellation of the 186,000,000 shares the Bank holds 0.01% of issued shares.

In the beginning of April 2019 Kaupskil sold 290.7 million of its shares in the Bank in two separate sales, but remains the largest shareholder of the Bank. Kaupskil sold 90.7 million shares to two entities managed by Taconic Capital Advisors LP, a current shareholder of the Bank. Around the same time Kaupskil sold 200 million shares to a number of investors. Following the cancellation of the Bank’s own shares at the Bank’s annual general meeting on 20 March 2019 Kaupskil will hold 19.998% of the Bank’s shares. Following these changes two shareholders hold more than 10% share in the Bank. In the following table is a list of shareholders holding more than 1% share:

Largest shareholders 15 April 2019	Capital prior to cancellation of Bank's own shares	Capital following cancellation of Bank's own shares
Kaupskil ehf. (subsidiary of Kaupthing hf.)	18.14%	19.998%
Taconic Capital (through TCA New Sidecar s.á.r.l.)	14.53%	16.03%
Arion banki hf.	9.31%	0.01%
Och-Ziff Capital management	6.58%	7.25%
Attestor Capital Llp	6.55%	7.22%
Stoðir hf	4.22%	4.65%
Lansdowne funds	3.52%	3.88%
Goldman Sachs funds	3.46%	3.81%
Eaton Vance funds	3.35%	3.69%
Íslandsbanki hf.	2.57%	2.83%
Gildi pension fund	2.52%	2.78%
Artemis Fund Managers Limited	1.69%	1.86%
Miton Asset Management funds	1.64%	1.81%
Lífeyrissjóður starfsmanna ríkisins	1.10%	1.21%
MainFirst Bank AG	0.99%	1.09%
Deutsche Asset & Wealth Management	0.96%	1.06%

Kaupthing's share in the Issuer is held through its wholly owned subsidiary Kaupskil ehf. (**Kaupskil**), a private limited liability company, ID no. 580609-0150, Borgartún 26, Reykjavík.

According to a decision by the Financial Supervisory Authority from 22 September 2017 the total voting rights of Kaupthing ehf, through Kaupskil ehf, and Taconic Capital Advisors LP and related parties, through TCA New Sidecar S.á.r.l, are restricted to 33% of total voting rights in the Bank. Following the two sales in April 2019 by Kaupskil of 290.7 million shares in the Bank and the cancellation of 186,000,000 the Bank's own shares at the Bank's Annual General Meeting on 20 March 2019, the combined shareholding of these shareholders in April 2019 is 36% of issued share capital. The aforementioned decision by the Financial Supervisory Authority however restricts the total voting rights of these shareholders to 33% of total voting rights in the Bank. More than half of shares are owned by Icelandic shareholders, while other holdings come mostly from the United Kingdom, the United States, Germany and Sweden. It should be noted, however, that the largest shareholder is the Icelandic holding company Kaupthing ehf, through its subsidiary Kaupskil ehf, which is almost solely owned by international investors.

STRATEGY

Arion 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 Arion 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.

Build long-term business relationships

Arion 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. Arion 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, Arion Bank is increasingly investing in its IT division to improve its customers' experience and satisfaction when using the Bank's digital products and services. Arion Bank has also decentralised certain smaller credit decisions to move credit authority closer to its customers, 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 Arion Bank's credit committees, which will continue to assess larger credit cases.

Increase operational efficiency

Arion 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% (the ratio was 56.1% for the year ended 31 December 2017). The lean banking initiative aims to implement effective processes to help meet customers' needs by eliminating waste, instability and inflexibility in Arion Bank's infrastructure with the overall goal of improving customers' experiences. In addition, Arion Bank plans to increasingly pursue its digitalisation initiatives in several areas, particularly mortgage loans, credit cards and digital customer onboarding as well as increased automation to reduce manual work and improve efficiency. These initiatives are expected to enhance customer satisfaction and experience, ultimately increasing the value of Arion Bank's brand, and to have bottom-line effect by reducing salary expenses. Arion Bank has also announced cost cutting and plans to implement operational improvements and streamline its operations through outsourcing of non-core functions to reduce overhead and administrative costs. Arion Bank also expects to benefit from commercial, financial and operational synergies from the acquisition of the universal insurance company Vörður.

Strengthen the core business

Arion Bank expects its core business 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. Arion Bank also expects to harness this growth to help bolster its leading position across businesses and increase its share in lending to SMEs as well as in leasing and insurance businesses. Arion 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 Arion Bank's core business development. Arion Bank also expects its cost of risk to decrease in the future through a focus on collateralisation and closer relationships with its customers, allowing

Arion Bank to encourage improved lending practices and early intervention should customers face financial difficulties.

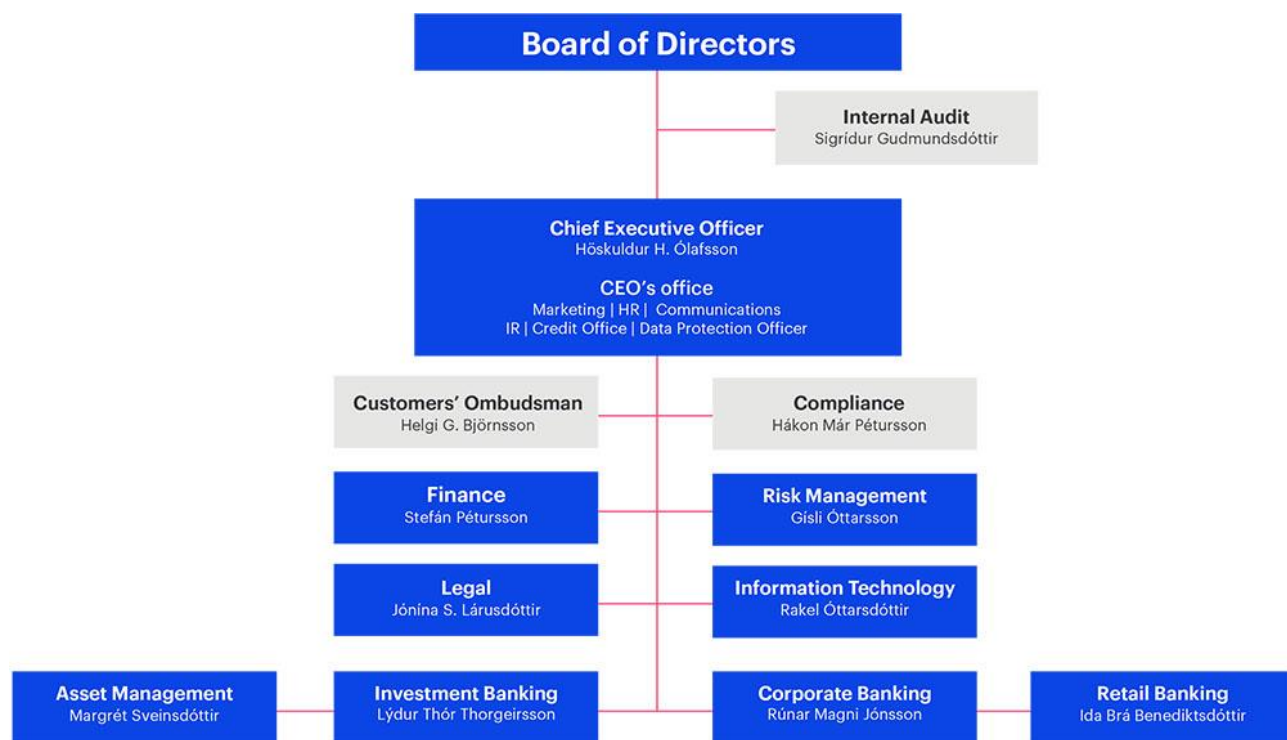
Pursue value creation opportunities

Arion 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 Arion Bank’s divisions, in particular between the Retail Banking division and Vörður, for example through the use of Arion Bank’s branch network to sell Vörður’s products as a registered insurance intermediary. Arion 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 Arion 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 will tie into Arion Bank’s overall strategies by enabling Arion Bank to remain balanced and diverse and to meet the changing needs of its customers. Arion Bank has also developed a number of specific strategic priorities and focus areas for each of its divisions.

BUSINESS

The chart below illustrates the Bank's principal operating and support functions as at the date of this Base Prospectus.



The Bank has six main reporting segments:

Corporate Banking provides customised lending solutions, including term loans, revolving credit facilities and guarantees, to large corporate customers across all industry sectors with an emphasis on top 100 companies in Iceland. The Corporate Banking division derives the majority of its income from the provision of loans to corporate customers.

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 2018, the Retail Banking division operated out of 20 branches across Iceland.

Asset Management, (which includes Stefnir, an independently operating financial company wholly owned by Arion Bank) provides a full range of asset management products and services to institutional investors, such as pension funds and insurance companies, and high net worth individuals.

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.

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, which include proprietary trading and market making in domestic securities and currencies. The subsidiaries are Eignabjarg ehf., Eignarhaldsfélagið Landey ehf., Valitor holding hf., Vördur tryggingar hf. and other smaller entities.

The tables below show operating income and earnings before tax for each segment for each of the period as at year ended 31 December 2018 and year ended 31 December 2017 and the total assets of each reporting segment at, 31 December 2018 and 31 December 2017.

At 31 December 2018

	Corporate Banking	Retail Banking	Asset Manage- ment	Investment Banking	Treasury	Other Divisions and Sub- sidiaries	Head- Quarters and Eliminatio n	Total
<i>(ISK million)</i>								
Operating income.....	6,306	23,341	4,164	2,168	4,709	4,739	744	46,171
Earnings before tax	(1,565)	9,157	1,642	590	2,149	2,656	(1,647)	12,982
Total assets.....	289,076	594,154	71,244	16,302	486,982	91,852	(385,283)	1,164,327

At 31 December 2017

	Corporate Banking	Retail Banking	Asset Manage- ment	Investment Banking	Treasury	Other Divisions and Sub- sidiaries	Head- Quarters and Eliminatio n	Total
<i>(ISK million)</i>								
Operating income.....	8,543	21,151	4,677	1,467	6,216	5,736	(927)	46,863
Earnings before tax	3,297	11,504	2,338	(57)	4,377	3,071	(3,420)	21,110
Total assets.....	274,917	527,652	75,564	16,165	483,794	89,936	(320,274)	1,147,754

Corporate Banking Division

The Bank's Corporate Banking division provides a range of financial services and products to its corporate clients. The prime focus of the division is to maintain long-term relationships with its clients and to deliver tailored solutions and personalised services.

The Corporate Banking division provides services to corporate clients, from medium-sized businesses to large corporations. Corporate Banking comprises a team of account managers specialising in industries, such as services, manufacturing and real estate, and/or lending, such as project finance and structured finance. The account managers are each responsible for specific clients, thus ensuring personal services and a clear overview of each client's financial requirements. Each account manager also relies on the assistance of staff in a range of support functions, including trade finance and guarantees, legal and documentation, portfolio management and corporate services.

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

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

Retail Banking Division

The Retail Banking division provides a range of banking services to individual as well as SMEs. Retail Banking serves its customers through its branch network and other points of contact such as online banking, a call centre and automatic telling machines (ATMs). As at 31 December 2018, the Bank had 20 branches throughout Iceland and over 100,000 retail customers. The branches provide a comprehensive range of financial services, including advice on deposits and loans, payment cards, pension savings, insurance, securities and funds, with a focus on tailored solutions and personalised services to meet customer needs.

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

The Retail Banking division strives to provide better customer service at lower costs. In accordance with the lean banking principles which guide the operations of Arion Bank, the Retail Banking division has continuously optimised its branch network since 2008 in order to respond rapidly to changes in customers' needs. The optimisation process has included reducing opening hours and the total size of the branch network by either relocating to smaller branches or renting out part of the excess space at existing branches as well as closing or merging certain branches, such as the Holmavík branch and the Reykjavík branches. Other initiatives included opening the only branch at the Keflavík international airport, merging two existing branches to open a flagship branch in the Borgartún financial area and opening a new digital branch concept for the Kringlan mall branch. The new digital branch has been successful and is piloting new projects such as remote advisors, new ATM technology and events management to attract new customers. The Retail Banking division continues to pursue additional opportunities to further optimise its existing branch network, including through combination with Vörður's insurance networks and strategic location choices for its branches

The Retail Banking division has trained and certified financial consultants within its branches in order to improve the level of service to its customers. The financial consultants are knowledgeable in a wide range of fields, including banking services, pensions and insurance and other financial instruments

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% 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 the digital solutions has been positive: most credit assessments are performed digitally, the majority of mortgage applications are digital and payment plans and other functions are set up almost entirely by using the app.

The Retail Banking division focuses on diversifying its product and services offering, including through cooperation with other divisions of Arion Bank and revamping its existing loyalty schemes to give its customers more choices. As part of this strategy, the Retail Banking division intends to leverage the relationship of the Corporate Banking division with construction companies to offer mortgage loans. The Retail

Banking division also anticipates taking advantage of the Bank's acquisition of Vörður, the fourth largest universal insurance company in Iceland based on insurance premiums (*source: FME*), to further integrate the Bank's banking and insurance businesses and to diversify its product and services offering, such as the use of the branch network to sell Vörður's insurance products. Finally, the enlargement of the vehicle and equipment financing and leasing unit has expanded the choices available to the Retail Banking division's customers, and the Retail Banking division intends to pursue further opportunities in vehicle and equipment financing..

Asset Management Division

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

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

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

The Bank's subsidiary, Stefmir Asset Management Company (**Stefmir**), is also part of the Asset management division. Stefmir hf. is Iceland's largest fund management company with assets of around ISK 350 billion under active management. Stefmir caters for both retail and professional clients with the aim of managing its clients' assets as best serves their interests. The company was founded in 1996 and its employees possess on average over 10 years' experience in the financial market. Stefmir has 20 specialists in four teams managing a diverse collection of mutual, investment and institutional investment funds. The company also manages assets of several limited partnerships that have been established around private equity investments in well-known Icelandic companies. Stefmir is wholly-owned by the Bank.

By the end of 2018, the Bank had consolidated assets under management of ISK 971 billion.

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

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

Investment Banking Division

The Investment Banking division is divided into three units, Corporate Finance, Capital Markets and Research.

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.

In recent years the IPO market in Iceland has been relatively active and since 2011 Arion Bank's Corporate Finance subdivision has been involved in 8 out of 13 IPOs on the Main Market of NASDAQ Iceland. During 2009 and 2010, the Corporate Finance subdivision was involved in a limited number of public offerings and delistings of shares from NASDAQ Iceland as well as the sale of shares in companies which had been acquired by Arion Bank in settlement of debts owed. Since 2010, the Corporate Finance subdivision has introduced a number of strategic initiatives in order to become a leading player in building up the equity and bond markets in Iceland. Accordingly, the Corporate Finance subdivision has managed the majority of initial public offerings in Iceland since 2011 and arranged the listing on NASDAQ Iceland of structured covered bonds issued by institutional investor funds managed by Stefnir. The Corporate Finance subdivision has advised on and managed various bond issues by large issuers, such as Reitir fasteignafélag, the largest real estate company in Iceland, and Orkuveita Reykjavíkur, one of Iceland's largest energy providers. The Corporate Finance subdivision has been active in mergers and acquisitions, including a number of high-profile sell-side and buy-side M&A transactions and financial restructurings and managed the acquisitions of Vörður and the Danish group AltaPay A/S. In 2017, the Corporate Finance subdivision advised on two of the largest M&A transactions announced in Iceland, i.e. the acquisition by N1 of Festi and the purchase by Reginn of FAST-1 subsidiaries..

Capital Markets Unit

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.

The securities brokerage services include domestic and foreign brokerage of equity, fixed income, swaps and forwards as well as related derivative products. The foreign exchange services include spot, forwards, money market, options and swaps. The equity and fixed income desks provide services primarily to pension funds, asset management companies and professional investors, and the foreign exchange desk provides services primarily to corporate customers in spot, forward, swap and option products, with Arion Bank being the only Icelandic bank to provide oil hedging products.

In the equity market, the Capital Markets subdivision focuses on the domestic Icelandic market and has also provided services to its local clients in foreign markets, particularly the United States and Nordic equity markets. Several companies have listed their shares on NASDAQ Iceland since 2011, and Arion Bank had the largest market share in equity brokerage on NASDAQ Iceland amounting to 24.3% as of 31 December 2017 (*source: NASDAQ Iceland*).

In the fixed income market, the principal instruments traded are government bonds. While issuance of new Icelandic government bonds has slowed, additional investment options, such as asset-backed bonds and corporate bonds, have been introduced. Arion Bank had the fourth largest market share in fixed income brokerage on NASDAQ Iceland amounting to 14.9% as of 31 December 2018 (*source: NASDAQ Iceland*).

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. The number

of publications by the Research subdivision was 217 in 2015, 187 in 2016 and 192 in 2017. 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..

Other Divisions and Subsidiaries

Other divisions

The Bank has five support divisions:

- ***Corporate Development & Marketing***: This division assists the Bank in implementing organisational changes, entering new markets, introducing new products, acquiring or divesting assets or divisions and establishing strategic partnerships. The division also develops the Bank's marketing strategy and is responsible for brand management, coordinating marketing initiatives, marketing and tactical plans for products and services and market research, such as statistical analysis, focus groups, interviews and surveys. Finally, the division is responsible for developing the Bank's internet banking solutions, websites, online communication and electronic distribution channels.
- ***Finance***: The Finance division includes funding and treasury (which together form the Treasury reporting segment) as well as accounting and analysis. The accounting unit is responsible for the Bank's financial reporting, both internally and to external stakeholders, including the FME and the Central Bank. The analysis unit is responsible for short-term and long-term budgeting and for benchmarking the Bank with comparable financial institutions, both local and international. The funding unit is responsible for the Bank's long-term funding in both the domestic and international markets and the treasury unit is responsible for the Bank's liquidity, currency and interest rate management, the internal pricing of interest rates and currency, liaison with other financial institutions, proprietary trading and market making in domestic securities and currencies.
- ***Risk Management***: For a description of the activities of the Risk Management division, see "*Risk Management*".
- ***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.
- ***Operations***: The Operations division comprises information technology (IT), human resources, back office and property management units.
- ***Subsidiaries***

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

Stefnir

Stefnir is Iceland's largest fund management company. Stefnir is an independently operating financial company owned by Arion Bank. Stefnir manages a broad range of mutual funds, investment funds and institutional investor funds.

Valitor Holding hf. (Valitor)

Valitor is a leading payment services company in Iceland. It is a group member of Visa Europe and a licensee of MasterCard and provides card acquiring services to merchants and card issuing services to Icelandic and international banks, savings banks and cardholders. After the Bank acquired a 38 per cent. holding in Valitor from Landsbanki in December 2014, Arion Bank owns 98.8 per cent. of Valitor.

Vörður tryggingar hf

Vörður tryggingar is the fourth largest insurance company in Iceland and provides both non-life and life insurance services. On 1 January 2017 Vörður tryggingar acquired the Bank's 100% shareholding in Okkar líftrygginar hf.

Asset Holding Companies

The Bank operates two holding companies, whose main purpose is to manage the assets the Bank has acquired through collateral enforcement. The goal is to preserve or increase the value of these assets before they are sold. The three principal asset holding companies are:

Eignabjarg ehf. (Eignabjarg)

Eignabjarg is a wholly-owned subsidiary of the Bank and is responsible for managing and selling shareholdings in companies which the Bank has acquired through debt restructurings or other enforcement procedures. Its function is 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. Eignabjarg aims to limit its holding period to as short a time as possible, without compromising its goal of maximising recovery through the divestment of assets. In 2015 a wholly-owned subsidiary with the same name and purpose was liquidated under a different name.

Eignarhaldsfélagið Landey ehf. (Landey)

Landey is a wholly-owned subsidiary of the Bank and is a property development company which manages properties that currently do not generate any revenue but which may do so in the future. Such assets include unfinished housing developments, building lots and the rights attached to them. The company's objective is to maintain and increase the value of its properties through professional development, design and construction in collaboration with the planning authorities until a satisfactory price can be obtained.

LOAN PORTFOLIO

The table below sets out details of the Bank's loans and receivables to customers as at 31 December 2018 and 31 December 2017 classified by type of loan.

As at 31 December 2018					
Individuals		Corporates		Total	
Gross carrying amount	Book value	Gross Carrying amount	Book Value	Gross Carrying amount	Book value

Overdrafts	14,536	13,616	19,200	18,267	33,736	31,883
Credit cards.....	12,958	12,706	1,348	1,305	14,306	14,011
Loans to customers at fair value	-	-	4,812	4,812	4,812	4,812
Mortgage loans	343,119	342,469	23,417	23,351	366,536	365,820
Other loans.....	33,560	31,692	390,767	385,608	424,327	417,300
Loans and receivables to customers.....	404,173	400,483	439,544	433,343	843,717	833,826

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

The total book value of pledged loans that were pledged against amounts borrowed was ISK 203 billion at the end of the year 2018 (31.12.2017: ISK 183 billion). Pledged loans comprises mortgage loans to individuals.

The table below sets out details of the book value of the Bank's loans and receivables to customers as at year ended 31 December 2018 and 31 December 2017 classified by customer sector.

	31 December 2018	31 December 2017
Individuals	48.0%	47.7%
Real estate activities and construction.....	17.6%	16.7%
Fishing industry	10.1%	10.3%
Information and communication technology.....	2.5%	4.1%
Wholesale and retail trade	7.9%	7.5%
Financial and insurance activities.....	4.5%	4.5%
Industry, energy and manufacturing.....	4.2%	3.8%
Transportation.....	1.4%	2.2%

Services.....	2.0%	2.4%
Public sector	0.8%	1.0%
Agriculture and forestry.....	0.9%	0.9%
Total	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 31 December 2018 and 31 December 2017 classified by type of loan.

	<u>31 December 2018</u>	<u>31 December 2017</u>
	<i>(ISK million)</i>	
Bank accounts.....	38,038	51,303
Money market loans	17,101	32,309
Other loans	1,183	2,997
Loans and receivables to credit institutions	56,322	86,609

The table below shows the credit quality of the Bank's loans to customers, as at 31 December 2018 and 31 December 2017.

Credit quality by rating class : Loans to customers

	<u>As at 31 December 2018</u>				
	<u>Stage 1</u>	<u>Stage 2</u>	<u>Stage 3</u>	<u>POCI</u>	<u>Total</u>
	<i>(ISK million)</i>				
Risk class 1 (Grades A+ to BBB-)	370,832	78	-	-	370,910
Risk class 2 (Grades BB+ to BB-)	265,361	18,521	-	41	283,923
Risk class 3 (Grades B+ to B-)	107,897	24,582	-	87	132,566
Risk class 4 (Grades CCC+ to CCC-)	15,287	11,318	-	48	26,653
Risk class 5 (DD)	-	-	18,175	3,640	21,815
Unrated	1,977	1,061	-	-	3,038
Gross carrying amount	761,354	55,560	18,175	3,816	838,905
Loss allowance	(1,415)	(931)	(6,301)	(1,244)	(9,891)
Book Value	759,939	54,629	11,874	2,572	829,014

Impairment loss allowance for loans to customers

	As at 31 December 2018				
	Stage 1	Stage 2	Stage 3	POCI	Total
	<i>(ISK million)</i>				
ECL balance at 31.12.2017	3,189	-	10,294	-	13,483
Net effect of assets and disposal groups held for sale	(175)	-	-	-	(175)
Net remeasurement due to adoption of IFRS 9	<u>(1,502)</u>	<u>572</u>	<u>(363)</u>	<u>363</u>	<u>(930)</u>
Opening balance at 1.1.2018	1,512	572	9,931	363	12,378
Transfer of financial assets	-	-	18,175	3,640	21,815
Transfer to stage 1 (12-month ECL)	1,159	(603)	(556)	-	-
Transfer to stage 2 (lifetime ECL)	(269)	465	(196)	-	-
Transfer to stage 3 (credit impaired financial assets)	(166)	(268)	434	-	-
Net remeasurement of loss allowance	(1,147)	866	2,410	50	2,179
New financial assets, originated or purchased	515	61	713	5,065	6,354
Derecognitions and maturities	(180)	(136)	(2,902)	(41)	(3,259)
Write-offs	(20)	(42)	(3,607)	(4,384)	(8,053)
Foreign exchange	11	16	74	191	292
Impairment loss allowance for loans to customers	1,415	931	6,301	1,244	9,891

	As at 31 December 2017			
	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

FUNDING AND LIQUIDITY

Funding

The Bank is predominantly funded with domestic deposits. Its total deposit base at 31 December 2018 was ISK 466.0 billion, or 48.3 per cent. of its total liabilities. The Bank's other funding at 31 December 2018 comprised bonds, other debt and equity.

The Bank's funding profile changed significantly in 2012-2017. In January 2012, the Bank acquired a mortgage portfolio from Kaupthing and was substituted as issuer under four series of Kaupthing Bonds. In February 2012, the Bank issued its first series of bonds. The bonds, which mature in 2034, are denominated in Icelandic krónur and the total issue amounted to ISK 2.5 billion. The Bank issued a total of ISK 5 billion in bonds in 2012. In May 2012, the Bank became the first Icelandic bank to issue non-indexed bonds and further such bonds were issued in January 2013.

On 11 January 2016, the Bank issued the Resettable Notes (see "*Description of the Bank – Kaupthing*").

In April 2016 Arion Bank issued bonds for a total of €300 million. It was the Bank's second issue in euros to a diverse group of investors. Offers were received from approximately 70 investors for more than € 500 million. The bonds are 3-year instruments and bear a fixed 2.5% coupon and were sold at terms equivalent to 2.70% margin over interbank rates.

In December 2016 Arion Bank issued 5-year bonds for a total of € 300 million. Offers were received from approximately 50 investors for more than € 400 million. The instruments bear a fixed 1.625% coupon and

were sold at terms equivalent to 1.65% margin over interbank rates. At the beginning of 2017 the issue was tapped for a further € 200 million at terms equivalent to 1.55% margin over interbank rates, bringing the total issue to € 500 million.

In June 2017, Arion Bank issued new three-year senior unsecured bonds for a total of EUR 300 million (ISK 35 billion) in a transaction which was oversubscribed twofold. The bonds were sold at rates corresponding to a 0.88% margin over interbank rates.

In March 2018 Arion Bank issued 5-year bonds in the amount of €300 million. The issue was oversubscribed, attracting offers for €375 million from more than 40 investors. The instruments bear a fixed 1.0% coupon and were sold at terms equivalent to 0.65% margin over interbank rates.

Arion Bank concluded its inaugural Tier 2 issuance in 2018, issuing floating rate notes in the amount of SEK 500 million. The bonds are eligible as Tier 2 capital under the Icelandic Financial Undertakings Act No. 161/2002. The bonds are pre payable on behalf of the issuer in November 2023 with final maturity in November 2028. The bonds were priced at a spread of STIBOR +310. The Tier 2 bond issue strengthens the Bank's own funds and is a milestone towards reaching a more optimal capital structure.

The Bank has also completed smaller private placements in NOK, SEK and other currencies.

Liquidity

In general, financial institutions are exposed to liquidity risk due to the uncertainty over the stability of deposits and the fact that a large proportion of their liabilities are short-term relative to the contractual maturity of their assets. New liquidity and funding requirements were introduced as part of the Basel III Accord to strengthen financial institution's liquidity. On 31 March 2017, new liquidity rules No. 266/2017 took effect. The rules are issued by the Central Bank of Iceland and effectively adopt the liquidity rules of the EU Capital Requirements Regulation (CRR), replacing the previous LCR rules No. 1031/2014. The Bank is required to maintain a 100% minimum LCR ratio for the total balance sheet as well as for its aggregated position in foreign currencies.

One of Arion Bank's key objectives is to maintain strong liquidity. 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. The Bank intends to continue diversifying its funding profile by issuing bonds in the domestic and international bond market when conditions permit.

At the end of 2018 the Bank's liquidity coverage ratio was 164% and the ratio for foreign currencies was 439%. Risk Management analyses the Bank's liquidity risk and the behaviour of its deposit base and reports its findings to ALCO (The Asset and Liability Committee).

RISK MANAGEMENT

Overview

The Bank seeks to manage its risks through a process of on-going risk identification, measurement and monitoring, using limits and other controls. This process of risk management and the ability to evaluate, manage and price the risk encountered is critical to the Bank's continuing profitability and its ability to ensure that the Bank's exposure to risk remains within acceptable levels.

The Board is ultimately responsible for the Bank's risk management framework and ensuring that satisfactory risk policies and governance for controlling the Bank's risk exposure are in place. The Board defines the overall risk appetite of the Bank which is translated into exposure limits and targets that are monitored by the

Bank's Risk Management division, which reports its findings regularly to the CEO and the Board. Risk is measured, monitored and reported according to internal policies, principles and processes that are reviewed and approved by the Board at least annually. The Board is also responsible for the Bank's internal capital adequacy assessment process (**ICAAP**) and internal liquidity adequacy assessment process (**ILAAP**). The Board 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, sustaining an effective risk management framework, processes and control as well as maintaining a high level of risk awareness among the Bank's employees.

The Bank operates the following committees to manage risk:

- Board Risk Committee (the **BRIC**). This committee is responsible for supervising the Bank's risk management framework, risk appetite and ICAAP/ILAAP. The BRIC regularly reviews reports on the Bank's risk exposures.
- Asset and Liability Committee (the **ALCO**). This committee is chaired by the CEO and is responsible for managing any asset and liability mismatches, liquidity risk, market risk, interest rate risk and capital management.
- Underwriting and Investment Committee (the **UIC**). This committee decides on underwriting and principal investments.
- Data Committee (the **DC**). This committee is responsible for ensuring that data is managed properly.
- Security Committee (the **SC**). This committee is responsible for security matters, both information security and physical security.
- Credit Committees. The Bank operates four credit committees: The Board Credit Committee (BCC) which decides on all major credit risk exposures, the Arion Credit Committee (ACC) which operates within limits specified as a fraction of the Bank's capital, and the Corporate Credit Committee (CCC) and Retail Branch Committees (RBC) which operate within tighter credit granting limits. In addition the Bank operates five Collateral Valuation Committees, which set guidelines on collateral assessment and valuation, and two Debt Cancellation Committees which deals with applications to reach composition with debtors.

The Bank's internal audit division conducts independent reviews of the Bank's operations, risk management framework, processes, policies and measurements. Internal audits examine both the adequacy and completeness of the Bank's control environment and processes as well as the Bank's compliance with its procedures, internal rules and external regulations. Results of internal audits are discussed with the Bank's management and reported to the BRIC. The Bank's Risk Management division is headed by the Chief Risk Officer. It is independent and centralised and reports directly to the CEO. The division is divided into three units: Credit Control, which monitors weak and impaired credit exposures on a customer-by-customer basis and loan portfolio credit risk; 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 Operational Risk which is a part of the Bank's second line of defence and monitors risks associated with the daily operation of the Bank. The Bank's Data Officer is part of the Risk Management division.

The Bank is exposed to four major areas of risk: credit risk, market risk, liquidity risk and operational risk. In addition, the Bank manages its capital position with the focus on optimising the capital structure in the medium term and maintaining the Group's capitalisation comfortably above the regulatory minimum, including capital buffer and the 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 clients, 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 loan portfolio. Therefore managing and analysing the loan portfolio is of utmost importance. Credit risk management entails diversification of risk, well informed lending decisions, good oversight of the portfolio performance, and a clear identification of any sign of weaknesses to conduct a timely recovery. To ensure well informed lending decisions, Credit Office monitors credit risk before a credit decision is made and participates in credit committee meetings at ACC and CCC level, both with an advisor who follows through with the comments as described above, and with a voting member. Various controls ensure that a loan is only disbursed following a thorough review of all documents and the registration of all relevant information regarding the loan and collaterals into the Bank's IT systems.

During the repayment phase, Risk Management monitors the credit portfolio. The Credit Control department aggregates the portfolio monthly, based on consistent criteria, to analyze the outstanding risk, the collateral level, as well as the portfolio quality. Credit Control analyzes loans that have been classified at risk and maintains an independent and centralized 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

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. Note 41 to the Bank's Consolidated Financial Statements as at 31 December 2017 shows the Bank's maximum exposure to credit risk by type of financial instrument and industry sector classification. As at year ended 31 December 2018 and 31 December 2017, the Bank's total on and off balance sheet credit risk exposure totalled ISK 1,170,644 million and ISK 1,226,324 million respectively.

Underwriting and Credit Approval Process

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

The BCC, which acts on the behalf of the Board 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.

CollateralThe 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 places great emphasis on 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 sector stability and outlook, and quantitative factors, such as their equity and liquidity ratios. The rating model for SMEs and individuals are purely quantitative models.

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 centralized 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.

Individual Assessment

Financial assets 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. 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 impaired 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.

Collective Provision for Performing Loans

Collective provisioning is applied to all credit that has been not specifically impaired. Loans that are over 90 days in default but have been determined not to require provisions for impairment are also exempt from the collective provisions. Collective provisions are based on estimates of one-year expected loss, the borrower's probability of default (PD), loss given default (LGD) and exposure at default (EAD). Both the probability of default and loss given default are based on the Bank's internal models.

Counterparty Credit Risks

The Bank offers financial derivatives instruments to professional investors. The table below shows derivative trading products that are currently offered by the Bank to its customers classified according to the primary risk factors 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 customer's the 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 per cent. of the Group's eligible capital. The legal maximum for individual large exposures is 25 per cent. of the Group's eligible capital, net of eligible collateral. The Group had no large exposures at 31 December 2018.

Market Risk

Market risk is the current or prospective risk that changes in financial market prices and rates will cause fluctuations in the value and cash flows of financial instruments. The risk arises from imbalances in the Bank's balance sheet as well as in market making activities and position taking in bonds, equities, currencies, derivatives and other commitments which are marked to market.

The Bank monitors market risk and separates its exposures for its trading book (which represents positions held with trading intent, and associated hedging positions) and banking book. Market risk in the trading book arises from market-making activities and non-strategic derivatives positions arising from the Bank's customers' investments and risk management needs. Market risk in the banking book arises from various mismatches in assets and liabilities, principally in relation to currencies, maturities and interest rates. Market risk in the trading and banking books is managed separately by the Treasury division and Market Making.

The Bank's overall market risk allowance is set by the Board of Directors in the Bank's risk appetite, and the CEO, or through the appropriate framework set up by the CEO, determines the limit framework for each trading desk and sets individual limits. The ALCO is responsible for managing the Bank's overall market risk. The Risk Management division is responsible for measuring and monitoring market risk exposure and reporting the exposure, usage and limit breaches.

The Bank's strategy towards market risk is to seek to limit the risk exposure due to imbalances in the Bank's balance sheet (referred to as its **banking book**) but to 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.

Interest Rate Risk

Interest rate risk arises from the possibility that changes in market rates adversely affect net interest earnings and fair value of interest-bearing instruments on the Bank's balance sheet. The Bank's operations are subject to interest rate risk due to mismatches in the fixing of interest rates between assets and liabilities, resulting in a repricing risk for the Bank. The Bank also faces interest basis risk between interest-bearing assets and interest-bearing liabilities due to different types of floating-rate indices in different currencies.

The Bank's interest rate risk for foreign currencies is limited as foreign denominated assets predominantly have short interest fixing periods (i.e., the period during which interest is payable at a fixed rate), and the Bank hedges its foreign denominated fixed rate borrowings. For domestic rates, longer interest fixing periods are more common, and this especially applies to indexed mortgages issued between 2004 and 2006. The profile of the interest fixing periods of indexed mortgages is however largely matched by that of the Bank's structured covered bond issues, which serves as a hedge against repricing risk. The Bank has been able to manage relatively small interest gaps for interest fixing periods.

In the past few years domestic rates, nominal and real, have fallen. Due to favourable refinancing spreads, prepayments and/or refinancing of loans have been considerable. Prepayment risk is mitigated by prepayment fees and the Bank's own prepayment options on its borrowings. The Bank's prepayment of structured covered bonds is a reaction to mortgage prepayments and mortgage refinancing.

For additional information on the Bank's interest rate risk, see the note titled "Market risk" in the Annual Financial Statements.

Indexation Risk

A significant part of the Bank's balance sheet is linked to the Icelandic CPI. Index-linked loans and borrowings are typically annuities, where the principal and monthly payments change in the same proportion as the CPI. The Bank is exposed to indexation risk as indexed assets exceed indexed liabilities. As of 31 December 2017, the total amount of the Bank's CPI-linked assets was ISK 363,791 million and the total amount of its CPI-linked liabilities was ISK 230,851 million. See the note titled "Market risk" in the Annual Financial Statements.

Currency Risk

Currency risk is the risk of loss due to adverse movements in foreign exchange rates. The Bank is exposed to currency risk through a currency mismatch between assets and liabilities. ISK denominated deposits are primary source of funding for the Bank, whereas a substantial part of the Bank's assets consist of foreign currency denominated loans to customers. Net exposures per currency are monitored centrally in the Bank

The table below indicates the currencies to which the Bank had significant exposure at 31 December 2017. The analysis calculates the effect of a 10 per cent. movement of the currency rate against the ISK (with +10% in the table denoting a depreciation of the ISK) on the Bank's income statement as a result of the change in fair value of currency sensitive non-trading monetary assets and liabilities. A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase.

The table assumes that all other variables remain constant.

	As at 31 December 2018	
	-10%.	+10%
	<i>(ISK million)</i>	
EUR	(263)	263
USD	(55)	55
GBP	(23)	23
DKK	56	(56)
NOK	(18)	18
Other	(53)	53

	As at 31 December 2017	
	-10%.	+10%
	<i>(ISK million)</i>	
EUR	239	(239)
USD	(75)	75
GBP	(277)	277
DKK	232	(232)
NOK	(36)	36
Other	(101)	101

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 the past 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.

Liquidity and Funding Risk

Liquidity risk is defined as the risk that the Group, though solvent, either does not have sufficient financial resources available to meet its liabilities when they 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 Arion 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 maturity of its loans exceeds the maturity of its deposits, of which 77% is on-demand or with less than 30 days term.

As of 31 December 2009, over 90 per cent. of the Bank's deposits were on demand, as compared to 76.9 per cent. as of 31 December 2011, 59.7 per cent. as of 31 December 2012, 52.2 per cent. as of 31 December 2013, 58.0 per cent. as at 31 December 2014, 57.3 per cent. as of 31 December 2015, 70 per cent. as at 31. December 2016, and 71.8% as of 31 December 2017.

LCR deposit categorization

As per the LCR methodology, the Group's deposit base is split into different categories depending on customer type. A second categorization 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 categorization, with the associated expected stressed outflow weights as at year ended 31 December 2018 and 31 December 2017. The table contains deposits at the Bank and at banking subsidiaries. Thus, amounts due to Central Bank and amounts due to credit institutions at non-banking subsidiaries are excluded.

	As at 31 December 2018					
	Deposits maturing within 30 days					
	Less stable	Weight (%)	Stable	Weight (%)	Term deposits*	Total deposits
	<i>(ISK million)</i>					
Individuals	126,196	11%	51,232	5%	69,000	246,428
SME	48,961	11%	4,836	5%	5,417	59,214
Corporations	48,033	40%	852	20%	7,605	19,119
Sovereigns, central banks and PSE ²	14,052	40%	-	-	5,067	19,119
Pension funds	45,671	100%	-	-	10,038	55,709
Domestic financial entities	22,494	100%	-	-	12,630	35,124
Foreign financial entities	3,187	100%	-	-	-	3,187

² Public Sector Entity

Total	308,594	56,920	109,757	475,271
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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

* Term deposits in this context refer to deposits with maturities greater than 30 days. No outflow assumed from term deposits.

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%. The purpose of the requirements with respect to the foreign exchange ratio is to prevent domestic financial institutions from accumulating short-term need for market funding in foreign currency, as the Icelandic Central Bank is not a lender of last resort in foreign currency.

The table below sets forth the Group’s total NSFR as of the dates indicated based on sub-consolidated figures for Arion Bank and ABMIIF.

	As of 31 December	
	2018	2017
ISK.....	111%	115%
Foreign exchange ⁽¹⁾	155%	181%
Total NSFR	120%	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.

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 interaction 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 subdivision is responsible for developing and maintaining tools for identifying, measuring, monitoring and reporting the Bank's operational risk. The division 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 uses the Basel II standardised approach to the calculation of capital requirements for operational risk.

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 ADEQUACY

The Bank's capital ratios are calculated in accordance with Act No. 161/2002 on Financial Undertakings and Regulation No. 233/2017 on prudential requirements. Iceland has adopted the EU 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 standardized 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 situation as stipulated in CRR is the Bank's accounting consolidation without Vördur tryggingar hf. (Vördur). As the full accounting consolidation has been applied in prior statements, figures for earlier dates are restated to reflect the defined consolidated situation. The capital position and solvency requirements of Vördur should be viewed independently from capital adequacy for the Bank's consolidated situation. 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 to its risk profile. The FME supervises the Bank, reviews the Bank's ICAAP and sets capital requirements for the Bank's consolidated situation as a whole following the SREP. Stress tests constitute an important part of the ICAAP, because they demonstrate how the Bank's capital could be affected by sharp macroeconomic changes, downturns in the Bank's core businesses or other major events.

Capital requirements according to Pillar 1 are based on the sum of risk weighted assets (**RWA**) for credit risk, credit valuation adjustment, market risk and operational risk, computed using formulas from CRD IV and the CRR. 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 RWA 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, and are measured by means of a hierarchy of risk weightings classified according to the nature of each asset and counterparty, taking into account eligible collateral or guarantees. Trading book RWA are determined by taking into account market related risks such as foreign exchange, interest rate risk, and equity position risks. Operational risk also gives rise to risk-weighted assets, measured on the basis the Bank's average operating income over three years.

To measure the Pillar 2 capital requirement the Bank uses internal economic capital models. Capital add-ons under Pillar 2 are based on risks that are underestimated or not covered in Pillar 1, including credit risk, market position risk, concentration risk, interest rate risk in the banking book, 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 arises due 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	15.05.2019	1.2.2020
Capital conservation buffer	2.50%	2.50%	2.50%
Capital buffer for systemically important institutions ...	2.00%	2.00%	2.00%
Systemic risk buffer ⁽¹⁾	3.00%	3.00%	3.00%
Countercyclical risk buffer ⁽¹⁾	1.25%	1.75%	2.0%
Combined capital buffer requirement.....	8.75%	9.25%	9.50%⁽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 credit risk RWA. 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%; however, the FME is authorised to apply a higher countercyclical risk buffer on the basis of a recommendation from the Financial Stability Council.

(2) Because the institution specific systemic risk buffer and the countercyclical risk buffer are determined as described above, the Bank had the effective combined capital buffer requirement of 8.40% based on the Bank's risk profile as of 31 December 2017.

The Bank's Pillar 2R capital add-on, which is the result of ICAAP / SREP, may be comprised of 56.25% CET1³ capital, 18.75% AT1 capital and 25.00% Tier 2 capital. With the current capital structure of the Bank, the Pillar 2R requirement is solely met with CET1 capital.

The table below sets forth the total regulatory capital requirement, as applied to the Bank on the basis of its consolidated situation, as a percentage of risk-weighted assets as of 31 December 2018.

Total regulatory capital requirement as a percentage of risk-weighted assets

Pillar 1 capital requirement	8.0%
Pillar 2R capital requirement ⁽¹⁾	2.9%
Combined buffer requirement ⁽²⁾	8.5%
Total regulatory capital requirement	19.4%
Available capital	22.0%

(1) SREP result based on the Group's financial position as of 31 December 2017. The Pillar 2 requirement is 3.7% of risk-weighted assets based on accounting consolidation. Based on the Group's consolidation situation under CRR, which excludes Vörður, the requirement is 3.4%.

(2) With the possible recognition by the FME of systemic risk buffers and countercyclical buffers applied in other countries, those requirements will apply to the corresponding foreign exposures, resulting in a higher combined buffer requirement.

The table below sets forth the CET1 regulatory capital requirement, as applied to the Bank, as a percentage of risk-weighted assets as of 31 December 2018.

CET1 regulatory capital requirement as a percentage of risk-weighted assets

Pillar 1 CET1 requirement	4.5%
Pillar 2R CET1 requirement ⁽¹⁾	1.6%
Combined buffer requirement	8.5%
Total CET1 regulatory capital requirement	14.6%
Available CET1 capital	21.2%

(1) SREP result based on the Group's financial position as of 31 December 2017. The Pillar 2 requirement is 2.9% of risk-weighted assets based on accounting consolidation. Based on the Group's consolidation situation under CRR, which excludes Vörður.

Stress Testing

The Bank's stress testing framework is aligned with the relevant FME guidelines, which in turn are based on the Guidelines on Stress Testing of the European Banking Authority. Stress testing at the Bank focuses on sensitivity and scenario analyses. The sensitivity analysis measures the potential impact of a specific single risk factor or simple multi-risk factors affecting capital or liquidity. In turn, scenario analysis measures the Bank's resilience to a given scenario, which comprises a set of risk factors that are aligned in an internally consistent way, presuppose the simultaneous occurrence of forward-looking events covering a range of risks and business areas and aims at revealing the nature of linked risks across the Bank and across time, system-wide interactions and feedback effects.

The stress tests serve as an important management tool for the Bank and are incorporated into the review of the Bank's risk appetite and the Bank's limits framework, and raise risk awareness and improve general understanding of the Bank's operations. The Board of Directors and Board Risk Committee consider the results for strategic, capital and contingency planning.

The Bank's business plan is stress tested annually with at least two adverse economic scenarios. One of the two stressed scenarios carried out on the business plan is provided by the Central Bank in collaboration with the FME. The Bank's Economic Research department contributes stressed projections that are used in the Bank's internal stress test on the Bank's business plan. The design of the bank-wide internal stress test is

³ Common equity tier 1

challenged and reviewed by the Executive Committee and the Board Risk Committee. The impact is estimated on the Bank's earnings and own funds as well as for the Bank's capital and liquidity ratios and other risk appetite metrics.

In addition to the internal bank-wide stress test and the Central Bank stress test, the Bank performs both focused ad hoc stress tests and regular planned stress tests. The focused stress tests are used to estimate losses for example due to changes in regulations.

The table below sets forth the stress tests which the Bank regularly performs.

Stress Test	Frequency	Description
Icelandic Central Bank and FME stress tests	Annually	Stressed scenarios provided by the Icelandic Central Bank in collaboration with the FME
Internal stress tests on the Bank's business plan.....	Annually	Risks and stressed scenarios designed on the basis of input from each division, stressed macro-economic projections provided by the Research subdivision
ICAAP / ILAAP	Annually	Interest rate risk, value-at-risk on trading book, credit risk stress tests
Focused stress tests	Daily / Monthly	Liquidity and market risk, risk appetite for indirect equity positions

COMPLIANCE

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

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

The Bank's compliance officer coordinates the Bank's compliance activities.

The compliance officer works independently and reports directly to the CEO in accordance with both FME and internal audit requirements. The compliance officer has monthly meetings with the CEO at which the compliance officer presents a report on activities during the past month and refers certain matters to the CEO. The compliance officer also meets the chief risk officer and the internal auditor on a monthly basis.

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

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

INVESTMENTS

The Bank has a small portfolio of debt and equity investments. These instruments are classified either as trading assets (being assets which are held by the Bank with a view to generating profit from short-term changes in price) or as assets held at fair value through profit and loss.

The table below shows the classification of the Bank's investment portfolio at year end 31 December 2018 and 31 December 2017.

	As at 31 December 2018			
	Trading	Fair value through OCI	Mandatorily at fair value thr. P/L	Total
	<i>(ISK million)</i>			
Listed bonds and debt instruments	-	51,329	17,274	68,603
Unlisted bonds and debt instruments	-	2,459	389	2,848
Total bonds and debt instruments	-	53,788	17,663	71,451
Listed shares and equity instruments	-	-	7,270	7,270
Unlisted shares and equity instruments	-	-	9,867	9,867
Bond funds with variable income	-	-	3,128	3,128
Total shares and equity instruments	-	-	20,265	20,265

	As at 31 December 2017			
	Trading	Designated at fair value	Available to sale	Total
	<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
Bond funds with variable income	1,782	15,651		17,433

Total shares and equity instruments	4,762	31,428	36,190
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COMPETITION

The Bank currently faces competition from the two other large commercial banks in Iceland, although this competition is currently limited as all three banks are focused on restructuring their loan portfolios and improving their asset and liability matching. As Iceland's economy recovers and demand for new lending and other banking products increases, the Bank expects to face increased competition from both the other large Icelandic banks and smaller specialised institutions as well as, potentially, foreign banks seeking to establish operations in Iceland. The Bank expects to compete on the basis of a number of factors, including transaction execution, its products and services, its ability to innovate, reputation and price.

The Bank also believes that it has a leading investment banking franchise in Iceland although there is currently little activity in this area in Iceland.

INFORMATION TECHNOLOGY

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

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

Control of information security is an essential tool to achieve this objective. The Bank's Information Security Policy forms the basis of the measures used by the Bank to ensure the security of data, data systems and communication systems. Through the implementation of this policy, the Bank aims to prevent the inappropriate use of information, to safeguard the secure and uninterrupted transfer of electronic data and communications, and to integrate a risk management process into the work processes and daily tasks of all employees.

Legal security and the secrecy of information on customers are required to be observed at all times when IT is used. The Bank operates two data centres in an active mode to ensure continuous system uptime and to minimise downtime in disaster scenarios.

LITIGATION

Litigation is a common occurrence in the banking industry due to the nature of the business undertaken. Due to the current economic climate in Iceland, the chances of litigation against the Bank have increased. The Bank has formal controls and policies for managing legal claims. Once professional advice has been obtained and the amount of any possible loss has been reasonably estimated, the Bank takes appropriate steps to mitigate any adverse effects which the claims may have on its financial standing.

Contingent liabilities

Investigation and legal proceedings regarding alleged breaches of competition law

With a writ issued in June 2013, Kortþjónustan ehf. claimed damages from Arion Bank hf., Íslandsbanki hf., Landsbankinn hf., Borgun hf. and the Bank's subsidiary Valitor hf. to the amount of ISK 1.2 billion plus

interest, due to damage Kortabjónustan hf. contends the five parties caused the company due to violations of the Competition Act. The case was dismissed on procedural grounds rather than the merits by the District Court of Reykjavík in March 2017 and confirmed by the Supreme Court in 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 of 2 March 2018. It is unclear whether Kortathjonustan will appeal the ruling to a higher court. If the defendants would be ordered to pay damages, they would be jointly responsible for the payment of damages. The Bank has not made any provision

Legal proceedings regarding damages

The former chairman of the Board of BM Vallá hf., together with Lindarflöt ehf., have filed two cases against the Bank claiming damages in the amount of more than ISK 4 billion plus interest. The plaintiffs claim that the Bank caused them, as shareholders of BM Vallá hf. and Fasteignafélagið Ártún ehf., damage by not allowing the companies to be financially restructured and thereby forcing the companies into bankruptcy. The Bank believes it likely that it will be acquitted of the plaintiffs' claims in both cases and has not therefore made any provision.

In January 2015, Datacell ehf. and Sunshine Press Productions ehf. jointly filed suit against Valitor hf. for compensatory damages relating to Valitor hf.'s cessation of Datacell's vendor agreement. The Icelandic Supreme Court ruled on 24 April 2013 in case no. 612/2012 that Valitor hf. did not have a premise to rescind the agreement. The plaintiffs had court appointed appraisers evaluate their alleged losses. The appraisers returned their report in March 2016. Valitor disagreed with the assessment stated in the report and filed a motion and the reassessment has been completed, but not filed with the District Court. Valitor has requested a new assessment, which will examine particular aspects not yet assessed. The District Court of Reykjanes has not ruled on this motion. When the Bank acquired a 39.22% 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. The Group has not made any provision in this case..

Other legal matters

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 has transferred these assets to the Bank. During the moratorium period, three unsecured creditors of United Silicon sent the Bank a letter in which they asked for the cooperation of creditors in order to solve issues related to United Silicon, but they also submitted observations on the Bank's lien on the assets of United Silicon and reserved the right to lodge claims against the Bank if these liens are invalid. The Bank has examined these criticisms and has rejected them all, but in the contract between the Bank and the estate on the transfer of the pledged assets to the Bank, it is agreed that if the Bank's collateral should be found invalid, the Bank will refund to the estate the amount of the invalidated lien.

Mortgage documents

Courts cases are being prosecuted against the Bank in which it is demanded that the mortgaging of part of a property be invalidated on the basis that the signature of the mortgagor on the mortgage documents was not correct. Recently the district court, in respect of a case which did not involve the Bank, invalidated a mortgage under similar circumstances to these. It is the Bank's view that the overall legal situation remains inconclusive. The Bank is awaiting further rulings from the Supreme Court of Iceland to assess the possible impact of a negative outcome on the Bank's loan portfolio. The Bank has not recorded any provision.

The uncertainty regarding the book value of foreign currency loans

Some uncertainty over the legality of FX loans has continued in 2016 and the Group constantly monitors judgements involving itself and others to refine its provisions on foreign currency loans. Although there is much more clarity in the matters of FX loans there still remains some uncertainty regarding foreign currency linked loans in certain respects, such as regarding the recalculation of particular loans and compensations on account of enforcement actions that have been made on the basis of currency-linked loans. Nevertheless, the Group considers its portfolio of foreign currency linked loans to be fully provisioned for the most likely outcome.

Legal matters concluded

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. 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, Kaupthing, the Bank's associates, the Board of the Bank, the key management personnel of the Bank and close family members of the directors and key management personnel.

ISFI and related entities are defined as related parties and balances and transactions with these entities are included in the table in Note 39 to the Financial Statements for the year 2016 under Shareholders with significant influence over the Group.

No unusual transactions took place with related parties during 2016, 2015, 2014, 2013 or 2012. Transactions with related parties have been conducted on an arm's length basis. There have been no guarantees provided or received for related party receivables or payables during 2016, 2015, 2014, 2013 or 2012.

See note 39 to the Financial Statements for further information in relation to the Bank's related party transactions.

MANAGEMENT AND EMPLOYEES

MANAGEMENT

Shareholders' meetings

The Bank's shareholders in general meetings are the supreme authority in the affairs of the Bank, within the limits established by the articles of association and statutory law. The Bank's annual general meeting is required to be held before the end of April each year.

Board of Directors

The Board is the supreme authority between shareholders' meetings, as further stipulated by law, regulations, and the Articles of Association.

The Board appoints the CEO. The Board also manages the Bank's affairs and ensures that its organisation and activities are at all-time maintained in good order. The Board and the CEO undertake the administration of the Bank.

The Board is responsible for ensuring that the Bank's book-keeping and the handling of its funds is sufficiently supervised. The Board represents the Bank and may grant directors, the CEO or others authority to sign for the Bank.

The Board bears the principal responsibility for the Bank's daily operations and is required to regularly discuss the manner in which it discharges its duties, its substantive areas of focus and the main goals of its work.

The Board also bears the principal responsibility for the development and long-term success of the Bank. To that effect, individual directors must exercise their duties with due diligence and care, and with good faith in the best interests of the Bank and its shareholders. The Board confirms and bears the principal responsibility for the Bank's strategy.

The Board and the CEO are required to inform the FME without delay of any issues they become aware of that could affect the ongoing operation of the Bank.

The Board, which must be of a size and composition that makes it possible for the Board to discharge its duties efficiently and with integrity, currently comprises seven members. All the members are nominated by Kaupskil except one.

The Bank's Board comprises the following members:

Brynjólfur Bjarnason, Chairman

Brynjólfur was born in 1946. He was first elected as a Director at a shareholders' meeting on 20 November 2014. He is not a shareholder of Arion Bank and is an independent Director. Brynjólfur is Chairman of the Board, Chairman of the Board Audit Committee and Board Credit Committee and a member of the Board Credit 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.

He 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 and been chairman of several.

Herdís Dröfn Fjelsted, Director

Herdís was born in 1971. She was first elected as a Director at Arion Bank's Annual General Meeting on 15 March 2018. She is not a shareholder of Arion Bank and is an independent candidate. Herdís is Vice Chairman of the Board, a member of the Board Audit Committee and Chairman of the Board Risk Committee and the Board Remuneration Committee.

Herdís graduated with a BSc in Business Administration with emphasize on International Marketing from the Technical University of Iceland in 2004 and a Master's degree in corporate finance from Reykjavik University in 2011. Herdís is also a certified stockbroker.

Today Herdís is the CEO of The Icelandic Enterprise Investment Fund (Framtakssjóður Íslands - FSÍ). Herdís previously worked as a senior investment analyst at Thule Investments from 2004 to 2010. Herdís has served on numerous boards of directors, e.g. as the chairman of VÍS hf. from 2015 to 2017, vice-chairman of Promens from 2011 to 2015 and as a board member of Invent Farma from 2013-2014, Medicopack A/S from 2014 to 2016, Icelandair Group from 2011 to 2014 and Copeinca AS from 2013 to 2014. Today Herdís is the chairman of the board of Icelandic Group and a board member at The Icelandic-Canadian Chamber of Commerce.

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, the Board Credit Committee and the Board Remuneration Committee. Benedikt gained a CSc in mechanical and industrial engineering from the University of Iceland in 1998.

Benedikt works as a senior consultant for Kaupthing ehf. He previously worked as a senior advisor for Iceland's Ministry of Finance and Economic Affairs, as managing director of Investment Banking at MP Bank 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 on the board of Genís hf., EC Hugbúnadur ehf. and EC Software Sweden and an alternate board member of Brekkuás ehf.

Liv Fiksdahl

Liv was born in 1965. She was first elected as Directors at Arion Bank's Annual General Meeting on 20 March 2019. She is not a shareholder in Arion Bank and is an independent Director.

Liv graduated in Finance and Management from Trondheim Business School (today NTNU) in 1986. In 2018, Liv completed programs at Stanford University in Big Data, strategic decisions and analysis, and the Innovative Technology ILeader. She has also completed a Advanced Management Program for executives in management, innovation and technology at Massachusetts Institute of Technology.

Liv is a Vice President (associated) within Financial Services at Capgemini Invent, Norway. Liv has longstanding experience at DNB where she has served various senior roles over the years. She has been part of the Executive Management Team for 10 years, and the most recent role was being the Group EVP, CIO/COO, for IT & Operations. Liv has a broad experience from DNB, and have had different positions across the value-chain within the bank. Before DNB she had Key Account roles for the corporate clients within

Danske Bank/Fokus Bank, and Svenska Handelsbanken. Liv has served on numerous boards, including BankAxept, Sparebankforeningen, Doorstep, Finans Norge and Trondheim Kommune Bystyret.

Liv is currently a board member of Scandinavian Airlines SAS AB, Posten Norge AS and Nille AS.

Renier Lemmens

Renier was born in 1964. He was first elected as a Director at Arion Bank's Annual General Meeting on 20 March 2019. He is not a shareholder in Arion Bank and is an independent Director.

Renier has an MBA from INSEAD and an MSc in Computer Science from Delft University of Technology.

Renier is currently Professor of Fintech and Innovation at the London Institute of Banking and Finance and the chairman of the board of TransferGo and Divido. Renier previously worked as CEO of Viadeo SA, was partner at Ramphastos Investments, CEO EMEA at PayPal, CEO of Amodo Consumer Finance, COO of International Retail & Commercial Banking at Barclays Bank, consumer finance officer at GE Capital and a partner at McKinsey & Company. Renier has also served on numerous boards, including Revolut, Zenith Bank Ltd., Novum Bank Ltd. as chairman, Antenna Company Ltd., Robin Mobile BV, VoiceTrust BV, Krefima NV as chairman, Arenda BV as chairman, ZA Life Assurance NV, First Caribbean International Bank and chairman and CEO of Budapest Bank.

Steinunn Kristín Thórdardóttir, Director

Steinunn was born in 1972. She was first elected as a Director at a shareholders' meeting on 30th November 2017. She is not a shareholder of Arion Bank and is an independent Director. Steinunn is a member of the Board Credit Committee and the Board Risk Committee.

Steinunn has a Master degree in international management from Thunderbird, Arizona and a BA in international business and politics from University of South Carolina.

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.

Board of Directors Alternates

In the event that a Director resigns or is unable to attend a meeting of the Board, an alternate director attends such meeting. The Board's alternate directors are:

- Ólafur Örn Svansson, Attorney at Law. Olafur is a member of the Board Remuneration Committee

- Sigurbjörg Ásta Jónsdóttir, Lawyer
- Pröstur Ríkharðsson, Attorney at Law

Other Members of the Board of Directors

The Board of Directors has appointed Heimir Thorsteinsson as an external member of the Board Audit Committee to bring in a greater level of expertise.

Senior Management

The Bank's senior management team comprises the following members:

Höskuldur H. Ólafsson, CEO

Höskuldur graduated with a degree in business administration from the University of Iceland in 1987. He joined the Bank in June 2010 from Valitor hf. - 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.

On 12 April 2019 it was announced that Höskuldur had resigned as CEO of Arion Bank and that he and the Board of Directors had reached an agreement whereby he would serve as CEO until the end of April 2019. At the date of this Base Prospectus Höskuldur's successor had not been hired.

Ida Brá Benediktsdóttir, Managing Director of Retail Banking

Ida Brá was born in 1976. Ida Brá was appointed managing director of Retail Banking in July 2017. Ida Brá has worked for Arion Bank and its predecessor since 1999 when she joined the research department. She has held various positions within the Bank including Head of a department within treasury, head of Private banking and Head of Corporate Communications. Ida Brá was managing director of Investment Banking from 2016 to 2017. Ida Brá served on the board of numerous companies, including Ólafsfjörður savings bank, AFL – savings bank, Landfestar and HB Grandi hf. Ida Brá graduated with a degree in business administration from the University of Iceland in 1999 and has a Master's in finance from the Erasmus Graduate School of Business in Rotterdam. She is also a certified stockbroker.

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.

Lýður Thór Thorgeirsson, Managing Director of Investment Banking

Lýður was born in 1976. He was appointed managing director of Investment Banking in October 2017. From 2010 to 2017 he worked for GAMMA Capital Management hf, first as a fund manager and from 2013 as managing director of Alternative Investments. Lýður worked for Kaupthing from 2009 to 2010, where he managed international corporate loans and equity positions. Prior to that he was at Arion Bank and its predecessor in the Corporate Finance division from 2007. Between 2000 and 2005 Lýður worked for Íslandsbanki in Leverage Finance and Risk Management. Lýður has an MBA from MIT Sloan School of Management and a B.Sc. in electrical and computer engineering from the University of Iceland. He holds a stockbroker certification.

Jónína S. Lárusdóttir, Managing Director of Legal Division

Jónína graduated from the faculty of law at the University of Iceland in 1996 and qualified as a district court attorney the following year. In 2000, Jónína completed a master's degree from the London School of Economics and Political Science, including European competition law. In 1996, Jónína started working for the A&P law firm, but moved to the Ministry of Commerce in 2000 where she was a specialist in the financial markets department. She was appointed director of the general office of the Ministry of Industry and Commerce in 2004. In 2007, she became permanent secretary of the Ministry of Commerce, now the Ministry of Economic Affairs, where she worked until late 2010 when she took over the post of managing director of the Bank's Legal Division. Jónína has served on and chaired numerous committees and has worked as a lecturer in several institutions, including the faculty of law of the University of Iceland. She was chairman of the Depositors' and Investors' Guarantee Fund in 2003 and 2004.

Margrét Sveinsdóttir, Managing Director of Asset Management

Margrét graduated with an MBA from Babson College in Massachusetts in 1990. She has a degree in business administration from the University of Iceland and is a certified stockbroker. Margrét has been managing director of Asset Management at the Bank since February 2009. She has more than 20 years' experience in the financial sector, having worked in credit analysis, customer relationship management and asset management. She started her career in the corporate banking division of the Industrial Bank of Iceland in 1985. Margrét then moved on to Íslandsbanki Securities Ltd, later the asset management division of Glitnir, where she was head of securities brokerage and advisory. In 2007, she became head of financial institutions client relations at Glitnir. Margrét has served on a number of boards of directors, including: The Depositors' and Investors' Guarantee Fund on behalf of SFF, Okkar Life Insurance and several funds in Luxembourg. She has also contributed to several books and magazines on asset management services, investments and financial planning.

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 is also a certified stockbroker.

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. 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 Landfestar hf.

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.

Hákon Már Pétursson, Compliance Officer

Hákon was born in 1981. He was appointed Compliance Officer of Arion Bank in April 2011. From 2009 to 2011 Hákon worked for Kvasir Legal as a specialist in financial services and financial restructuring. Between 2006 and 2009 Hákon worked as a specialist in the securities market division at the Financial Supervisory Authority of Iceland (FME). During this time he was the FME's representative on various expert groups, including the Takeover Directive expert group and the MiFID expert group at the Committee of European Securities Regulators (CESR). He was also a guest lecturer at the University of Reykjavík and Reykjavík University. He graduated from the faculty of law at the University of Iceland in 2007. He is also a certified stockbroker and holds an international advanced certificate in anti-money laundering.

Sigríður Guðmundsdóttir, Chief Audit Executive

Sigríður has a cand. oecon degree from the University of Iceland and a Master's degree in accounting and Finance from the London School of Economics and Political Science. She is a certified internal auditor (CIA). Sigríður worked as Marel's internal auditor from 2010 to 2018. 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.

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

The role of the Ombudsman is to ensure fairness and objectivity when dealing with recovery cases, prevent discrimination between customers and to ensure that the process for handling cases is transparent and documented. In the case of companies, the Ombudsman must also ensure that competition perspectives are taken into account, viable companies are entered into the restructuring process and rules on financial restructuring are adhered to.

In order to achieve these objectives, the Ombudsman takes part in the formation of procedures and solutions for customers as appropriate. In addition, the Ombudsman reviews specific cases upon request from customers, the Bank's employees or at his own initiative. Such a review can take place both while cases are being processed and after they are closed. The Ombudsman has access to information and data on specific issues. The Ombudsman submits information about the outcome of cases to clients, employees and the Board as appropriate.

Internal Audit

The Internal Auditor is appointed by the Board and reports directly to the Board. The Board sets the Internal Auditor a charter which lays out the responsibilities associated with the position and the scope of work. Internal Audit is required to provide independent and objective assurance and consulting services designed to add value and improve the Bank's operations. The scope of the audit is the Bank, its subsidiaries and pension funds serviced by the Bank.

The internal audit is governed by the audit charter, an FME directive on the internal audit function in financial institutions and international standards on internal auditing. All internal audit work is completed by issuing an audit report with deadlines for the implementation of audit findings. Implementations are followed up by Internal Audit every quarter.

Employees

DURING 2018, THE AVERAGE NUMBER OF FTES AT THE GROUP WAS 904 (COMPARED TO 949 DURING 2017). 794 OF THESE POSITIONS WERE AT ARION BANK, COMPARED WITH 844 AT THE END OF 2017

FINANCIAL MARKETS IN ICELAND

General

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

The establishment of the new banks

After the government took control of Kaupthing Bank hf., Glitnir Bank hf. and Landsbanki Íslands hf. in October 2008, certain assets and liabilities were transferred from the banks into new entities, which have now become the Issuer, Íslandsbanki hf. and Landsbankinn hf. Following an agreement between the Icelandic government and the Kaupthing Resolution Committee in July 2009, the Kaupthing Resolution Committee announced that it intended to exercise its option to purchase 87% of the Issuer's equity, and subsequent capital injection took place on 8 January 2010. A similar agreement was reached between the government and Íslandsbanki hf., and the Glitnir Resolution Committee, through ISB Holding, held 95% of the shares in Íslandsbanki and the Ministry of Finance held the remaining 5%. In January 2016 the Glitnir Resolution Committee agreed to deliver the 95% stake to the Ministry of Finance as part of a stability contribution, effective on 11 March 2016. Landsbankinn hf. and Íslandsbanki remain fully state-owned.

Development of ownership in the Bank

The Bank's ownership underwent a change in March 2017 when Kaupskil reduced its holding by almost 30%. Four new shareholders came on board: three international investment funds and Goldman Sachs. At the end of 2017 Kaupthing ehf., through its subsidiary Kaupskil ehf., held 57.41% of the shares in Arion Bank hf. Kaupskil ehf. also controlled the 9.99% shareholding of Taconic Capital Advisors UK LLP through TCA New Sidecar III S.A.R.L. and 6.58% shareholding of Sculptor Investments S.A.R.L., an affiliated entity of Och-Ziff Capital Management Group. The remaining shareholding was held by the Icelandic State Financial Investments which held 13.00% on behalf of the Icelandic government, Attestor Capital LLP through Trinity Investment Designated Activity Company held 10.44% and Goldman Sachs International through ELQ Investors II Ltd. held 2.57%.

In February 2018, Kaupskil exercised a call option to purchase the shares held by ISFI and purchased the entirety of ISFI's stake, 13.0% of the issued share capital of Arion Bank. Arion Bank bought back 9.5% of those shares.

Arion Bank was listed on Nasdaq Iceland and Nasdaq Stockholm on 15 June 2018, when 28.7% of issued shares were acquired by a diverse group of investors from Iceland, Scandinavia, the United Kingdom, continental Europe and the United States. It was the first IPO by an Icelandic bank in Iceland since 2008 and represented a very important step for Arion Bank. The Bank welcomes the new shareholders. At the end of 2018, Kaupskil ehf. was the largest shareholder with a holding of 32.67%. The Bank has more than 6,000 shareholders.

At Arion Bank's annual general meeting on 20 March 2019 it was approved to cancel 186,000,000 of the Bank's own shares, reducing issued share capital in the Bank from ISK 2,000,000,000, to ISK 1,814,000,000 nominal value. It is expected that the cancellation will become effective in April 2019.

In the beginning of April 2019 Kaupskil sold 290.7 million of its shares in the Bank in two separate sales, but remains the largest shareholder of the Bank. Kaupskil sold 90.7 million of its shares in the beginning of April 2019 to two entities managed by Taconic Capital Advisors LP, a current shareholder of the Bank. Around the same time Kaupskil sold 200 million of its shares to a number of investors. Following these sales and the cancellation of the Bank's own shares at the Bank's annual general meeting on 20 March 2019, two shareholders hold more than 10% of issued shares in the Bank, Kaupskil with 19.998% of issued shares and Taconic Capital Advisors with 16% of issued shares.

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 agreement on the European Economic Area (EEA), 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 Bank hf., Glitnir Bank hf. and Landsbanki Íslands hf.), 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 2007.⁴

Other relevant institutions

A new Housing Financing Fund (www.ils.is) was established at the beginning of 1999. The new fund is based on legislation approved by the Parliament in June 1998, which is aimed at rationalising the existing state housing fund system. The Regional Development Institute will remain a state-owned institution. 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 prior to 2008 its market share shrunk significantly. However, after the collapse of the banking system, the importance of the Housing Financing Fund has greatly grown.

Furthermore, 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. It is also worth noting that 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.

The Financial Supervisory Authority, the Central Bank of Iceland and the Icelandic Stock Exchange

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

The Central Bank (www.sedlabanki.is) is responsible for implementing monetary policy consistent with the goal of maintaining price stability. The activities of the Central Bank are primarily governed by Act No.

⁴ <http://sedlabanki.is/lisalib/getfile.aspx?itemid=848>

36/2001, on The Central Bank of Iceland. The Central Bank imposes a reserve requirement on all the commercial banks and savings banks. The purpose of this limitation is to ensure that credit institutions have sufficient margin on the reserve requirement account to meet fluctuations in their liquidity positions. Foreign exchange transactions have been subject to capital controls since the banking system collapsed in 2008. The Central Bank oversees surveillance of the Rules on foreign exchange.

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.

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 NCSD (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 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 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 Bonds Represented by Registered Global Bonds

Transfers of any interests in Bonds represented by a Registered Bond within Euroclear and Clearstream, Luxembourg will be affected 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 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 Bonds have been deposited.

On or after the Issue Date for any Series, transfers of 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 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 Bonds represented by Registered Global Bonds or for maintaining, supervising or reviewing any records relating to such beneficial interests.

TAXATION

General

Prospective purchasers of 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 Bonds, including, but not limited to, the consequences of receipt of payments under the 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 Bonds. They may not apply to certain classes of persons, such as dealers. Prospective holders of the 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 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

There are no taxes payable under the laws of Iceland or any authority of, or in, Iceland in respect of the amounts payable on the Bonds paid to a holder who is not a tax resident of Iceland. Article 3 (8) of the ITA specifically states that even though any interest received from Iceland (outbound payments), such as e.g. the interests payable according to bonds, received by any person or entity residing outside of Iceland is taxable income in Iceland, interest income payable pursuant to certain financial instruments issued by financial institutions such as the Issuer, is specifically exempted. This exemption includes bonds registered with a securities depository within the EEA or OECD such as those issued under this programme. The exception is subject to general registration of the programme with the Director of Revenue (Ríkisskattstjóri).

There are no estate or inheritance taxes, succession duties, gift taxes or capital gains taxes imposed on the holder of the Bonds by Iceland or any authority of, or in, Iceland in respect of the Bonds if, at the time of the death of the holder or the transfer of the Bonds, such holder or transferor and transferee are not tax residents of Iceland.

In instances other than those specifically stated herein as being applicable, the provisions of Condition 8 will apply and the Issuer will be required to pay additional amounts as provided in Condition 8, but may be entitled to redeem the relevant Bonds pursuant to Condition 7.2.

(b) Icelandic Tax Residents

Beneficial owners of the 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.

In April 2013 the Icelandic Parliament adopted an amendment to Article 3 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. The exception is subject to general registration of the programme with the Director of Revenue (Ríkisskattstjóri). Subject to this general registration and according to the binding opinion of the Icelandic Director of Revenue (*Ríkisskattstjóri*)

No 2/2006, the Issuer, paying agent or any relevant securities depository, will not be held responsible to withhold tax on income related to bonds that have been registered as exempted with the Director of Revenue. This exemption of the withholding obligation does not affect the final tax obligations of the relevant bondholder.

EU Savings Directive

Under EC Council Directive 2003/48/EC (the **Directive**) on the taxation of savings income, Member States are required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in the case of Switzerland).

The European Commission has proposed certain amendments to the Directive, which may, if implemented, amend or broaden the scope of the requirements described above.

U.S. Foreign Account Tax Compliance Act

Sections 1471 through 1474 of the U.S. Internal Revenue Code (**FATCA**) impose 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 will be phased in beginning 1 January 2014 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 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 on or after the **grandfathering date**, which is the later of (a) 1 January 2014 and (b) 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 on or after the grandfathering date and (ii) any Bonds characterized as equity or which do not have a fixed term for U.S. federal tax purposes, whenever issued. If Bonds are issued before the grandfathering date, and additional Bonds of the same series are issued on or after that date, the additional Bonds may not be treated as grandfathered, which may have negative consequences for the existing 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 a Model 1 IGA jurisdiction would 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 (unless it has agreed to do so under the U.S. "qualified intermediary," "withholding foreign partnership," or "withholding foreign trust" regimes). The Model 2 IGA leaves open the possibility that a Reporting FI might in the future be required to withhold as a Participating FFI on foreign passthru payments and payments that it makes to Recalcitrant Holders. 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.

If the Issuer becomes a Participating FFI under FATCA, the Issuer and financial institutions through which payments on the Bonds are made may be required to withhold FATCA Withholding if (i) any FFI through or to which payment on such 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.

If an amount in respect of FATCA Withholding were to be deducted or withheld from interest, principal or other payments made in respect of the Bonds, neither the Issuer nor any paying agent nor any other person would, pursuant to the conditions of the Bonds, be required to pay additional amounts as a result of the deduction or withholding. As a result, investors may receive less interest or principal than expected.

Whilst the Bonds are in global form and held within the clearing systems, it is expected that FATCA will not affect the amount of any payments made under, or in respect of, the Bonds by the Issuer, any paying agent and the Common Depository or the Common Safekeeper, given that each of the entities in the payment chain beginning with the Issuer and ending with 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 Bonds. The documentation expressly contemplates the possibility that the 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 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 Bonds.

TO ENSURE COMPLIANCE WITH IRS CIRCULAR 230, EACH TAXPAYER IS HEREBY NOTIFIED THAT: (A) ANY TAX DISCUSSION HEREIN IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED BY THE TAXPAYER FOR THE PURPOSE OF AVOIDING U.S. FEDERAL INCOME TAX PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER; (B) ANY SUCH TAX DISCUSSION WAS WRITTEN TO SUPPORT THE PROMOTION OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) THE TAXPAYER SHOULD SEEK ADVICE BASED ON THE TAXPAYER'S PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

SUBSCRIPTION AND SALE AND SELLING RESTRICTIONS

In order to facilitate the offering of any Tranche of the 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 Bonds during and after the offering of the Tranche. Specifically such persons may over-allot or create a short position in the Bonds for their own account by selling more Bonds than have been sold to them by the Issuer. Such persons may also elect to cover any such short position by purchasing Bonds in the open market. In addition, such persons may stabilise or maintain the price of the Bonds by bidding for or purchasing 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 Bonds are reclaimed if 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 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 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 Stabilising Manager(s) named in the applicable Final Terms (or persons acting on behalf of any Stabilising Manager(s)) and only for a limited period following the Issue Date of the relevant Tranche of Bonds.

Selling Restrictions

United States

The 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 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 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 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 Bonds (a) as part of their distribution at any time or (Uniteb) 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 Bonds on a syndicated basis, the relevant lead manager, of all Bonds of the Tranche of which such Regulation S 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 Bonds during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Regulation S 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 Bonds, an offer or sale of such 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.

Public Offer Selling Restriction under the Prospectus Directive

In relation to each Member State of the European Economic Area 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 Bonds which are the subject of the offering contemplated by this Base Prospectus as completed by the final terms in relation thereto to the public in that Relevant Member State, except that it may, with effect from and including the Relevant Implementation Date, make an offer of such 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 or, if the relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive, 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 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 Bonds to the public** in relation to any 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 Bonds to be offered so as to enable an investor to decide to purchase or subscribe the 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 (and amendments thereto, including the 2010 PD Amending Directive), and includes any relevant implementing measure in the Relevant Member State and the expression **2010 PD Amending Directive** means Directive 2010/73/EU.

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 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 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 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 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 Bonds in, from or otherwise involving the United Kingdom.

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 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 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 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 and each further Dealer appointed under the Programme will be required to represent and agree that:

(a) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any of the Bonds (except for Bonds which are a "structured product" as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong) other than (i) to persons whose ordinary business is to buy or sell shares or debentures (whether as principal or agent); or (ii) to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance; or (iii) in other circumstances which do not result in the document being a "prospectus" as defined in the Companies Ordinance (Cap. 32) of Hong Kong or which do not constitute an offer to the public within the meaning of that Ordinance; and

(b) it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the 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 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 Securities and Futures Ordinance and any rules made under that Ordinance.

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 Bonds or possesses or distributes this Base Prospectus and will obtain any consent, approval or permission, required by it for the purchase, offer, sale or delivery by it of 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 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, the issue of Bonds and continued update and issue of Bonds under the Programme were duly authorised by a resolution of the Board of Directors of the Issuer dated 20 March 2019.

Listing, Approval and Admission to Trading

This document has been approved by the FME as a base prospectus. Application will also be made to the Nasdaq Iceland hf. for Bonds issued under the Programme to be admitted to trading on the regulated market of the Nasdaq Iceland hf. and to be listed on the Main Market of the Nasdaq Iceland hf. The regulated market of the Nasdaq Iceland hf. is a regulated market for the purposes of the Markets in Financial Instruments Directive (Directive 2004/39/EC).

Documents available

For the period of 12 months following the date of this Base Prospectus, copies of the following documents will, when published, be available for inspection from the registered office of the Issuer:

- (a) the articles of association (with an Icelandic translation thereof) of the Issuer;
- (b) the audited financial statements of the Issuer in respect of the financial years ended 31 December 2018 and 2017 (with an Icelandic translation thereof). 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 Icelandic 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 Bonds, the Bonds in definitive form, the Receipts, the Coupons and the Talons;
- (e) a copy of this Base Prospectus;
- (f) any future Base Prospectus, prospectuses, information memoranda and supplements, and any Final Terms (save that a Final Terms relating to a Bond which 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 will only be available for inspection by a holder of such Bond and such holder must produce evidence satisfactory to the Issuer and the Paying Agent as to its holding of Bonds and identity) to this Base Prospectus and any other documents incorporated herein or therein by reference; and
- (g) in the case of each issue of Bonds admitted to trading on the regulated market of the Nasdaq Iceland hf. subscribed pursuant to a subscription agreement, the subscription agreement (or equivalent document).

In addition, copies of this Base Prospectus, each Final Terms relating to Bonds which are admitted to trading on the regulated market of the Nasdaq Iceland hf. and each document incorporated by reference are available on the Nasdaq Iceland hf. website at www.nasdaqomxnordic.com and on the Issuer's website: arionbanki.is.

Investors should consult the Issuer should they require a copy of the 2006 ISDA Definitions.

Clearing systems

The Bonds have been accepted for clearance through Euroclear, Clearstream, Luxembourg and the NCSD (which are the entities in charge of keeping the records). The appropriate Common Code and ISIN for each Tranche of Bonds allocated by Euroclear and Clearstream, Luxembourg or the NCSD will be specified in the applicable Final Terms. If the 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 and the address of Clearstream, Luxembourg is Clearstream Banking, 42 Avenue JF Kennedy, L-1855 Luxembourg. The address of NCSD is Nasdaq CSD Iceland, Laugavegur 182, 105 Reykjavik.

Conditions for determining price

The price and amount of 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 31 December 2018 and there has been no material adverse change in the financial position or prospects of the Issuer since 31 December 2018.

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

The auditors of the Issuer are Deloitte ehf., members of The Institute of State Authorised Public Accountants in Iceland, who have audited the Issuer's accounts, without qualification, in accordance with International Standards on Auditing for each of the two financial years ended on 31 December 2018 and 31 December 2017. The auditors of the Issuer have no material interest in the Issuer.

Post-issuance information

The Issuer does not intend to provide any post-issuance information in relation to any assets underlying any 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.

THE ISSUER

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AUDITORS

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