

**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 OMX Iceland hf. for Debt Securities issued under the Programme to be admitted to trading on NASDAQ OMX Iceland Main Market, the regulated market of the NASDAQ OMX 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 OMX Iceland. The regulated market of the NASDAQ OMX 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 OMX Iceland hf. will also be published on the website of the NASDAQ OMX Iceland hf. ([www.nasdaqomxnordic.com](http://www.nasdaqomxnordic.com)) and on the Issuer's website: [arionbanki.is](http://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 and/or Debt Securities not admitted to trading on any market.

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 8.04.2016.**

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 (as defined below) and copies of the Final Terms relating to the Debt Securities which are admitted to trading on the regulated market of the NASDAQ OMX Iceland hf. will be filed with the FME and also be published on the website of the NASDAQ OMX Iceland hf., [www.nasdaq.com](http://www.nasdaq.com) and on the Issuer's website: [arionbanki.is](http://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*" below). 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.

**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

**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 2015 of ISK 1,011 billion and net profit of ISK 49.7 billion for the year ended 31 December 2015.

**Arranger:** Arion Bank hf.

**Dealers:** Arion Bank hf.

**NCSD Agent:** Arion Bank hf.

### KEY FEATURES

**Status of the Debt Securities:** The Debt Securities constitute direct, unconditional and unsubordinated 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 obligation 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 those preferred by law) in all other respects. The cost of bankruptcy administration will rank ahead of claims for payments of the Debt Securities.

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.

<b>Programme Size:</b>	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.
<b>Distribution:</b>	The Debt Securities may be distributed by way of private or public placement and in each case on a syndicated or non-syndicated basis.
<b>Currencies:</b>	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.
<b>2. FORM OF DEBT SECURITIES:</b>	<p>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) .</p> <p>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.</p>
<b>Terms of the Debt Securities:</b>	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.
<b>Redenomination:</b>	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.
<b>Maturities:</b>	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.
<b>Issue Price:</b>	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.
<b>Interest:</b>	The following types of Debt Securities may be issued: (a) Bonds which bear interest at a fixed rate 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.

**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, or for taxation reasons) 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.

**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 Bank's business is materially affected by Iceland's economy which was in recession throughout 2009 and 2010 and, although GDP growth has returned in 2011-2015, Iceland's economy remains vulnerable to a range of internal risks and external shocks***

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

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

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

Although Iceland's economy showed some signs of recovery since 2011 with GDP growth of 1.6 per cent. in 2012, 3.9 per cent in 2013, 1.9 per cent in 2014 and 4.0 per cent in 2015, it is too early to predict whether or not there will be a sustained and stable recovery because of the difficulties in resolving the problems arising out of the financial crisis and sustaining the economic recovery process.

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

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

- *Removal of capital controls:* As a result of the financial crisis in 2008, the Icelandic Central Bank (the Central Bank) introduced capital controls in November 2008 which are now in the process of being gradually relaxed in accordance with the capital controls liberalisation strategy established in March 2011. In June 2015 the government announced a plan towards removal of the capital controls. The plan is threefold; firstly the failed banks' estates will need to fulfil certain stability conditions, either by making a voluntary contribution (after completing their winding up proceedings by reaching composition agreements with their respective creditors, which are ultimately confirmed by the Reykjavik District Court, no later than 15 March 2016) or paying a 39% tax on all assets, secondly offshore ISK holder will be offered to exit via a product-mix auction held by the Central Bank and ultimately controls will be lifted on the domestic market when conditions allow, commencing in steps after the fulfilment of the stability conditions. If the capital control regime is terminated too quickly, or in a manner which fails to protect the Icelandic economy from the negative impact of its removal, there will be negative consequences for the government's fiscal position, the stability and recovery of Iceland's financial sector, and the Icelandic economy as a whole.
- *Lack of foreign direct investment:* Even if gradual liberalisation of the capital control regime is successful, there can be no assurance that additional foreign direct investment in Iceland will materialise when capital controls are removed. Should there be insufficient foreign direct investment in Iceland following removal of the capital controls, Iceland's fiscal and balance of payments deficits could worsen.

Iceland's economy remains vulnerable to external factors, including conditions in Europe and other international economic and political developments, many of which are outside the control of the government. In particular, instability or deterioration of the international financial markets and the European sovereign debt crisis could have a material adverse effect on the recovery of Iceland's economy. Although the financial sector in Iceland is subject to capital controls and is mostly funded by domestic deposits, a global recession is likely to affect demand for, and the price of, Iceland's most important exports (being fish products and aluminium) and adversely impact its receipts from tourism (which is also an important element of its economy).

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

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

Following the collapse of Glitnir, Landsbanki and Kaupthing, the Financial Supervisory Authority Iceland (the **FME**) transferred certain of their assets and liabilities (including the domestic deposits) into three new banks, Arion, Landsbankinn and Islandsbanki (the **New Banks**), that were established in October 2008. The Icelandic banking sector is dominated by the New Banks but also includes other commercial banks and savings banks. The New Banks currently have limited access to the international financial markets and have so far engaged in only limited new lending, primarily domestic lending in króna. The vast majority of the New Banks' funding comes from deposits by customers and it may be difficult for these banks to diversify their funding in the near

future. Since October 2008, the government has maintained a policy that deposits in banks domiciled in Iceland are guaranteed by the State. The government's guarantee of domestic deposits has never been enacted into law by Parliament, and the government may withdraw the guarantee at any time, which may adversely affect the availability of deposits and therefore have a negative impact on the business and assets of Icelandic banks. Moreover, as current capital controls are lifted, funding of Icelandic banks could be adversely affected by the withdrawal of deposits by customers who are currently unable to do so due to such capital controls. The government has stated its intention to manage the exchange controls with a view to mitigating the risk of capital flight from such customers. However, there is no guarantee that the central bank will be able to halt capital flight as controls are lifted. In addition, the ability of the central bank to manage the controls may be affected by the need for foreign investment to spur economic growth. If the capital control regime is terminated too quickly, or in a manner which fails to protect the Icelandic financial sector from the negative impact of its removal, Icelandic banks would suffer a material adverse effect.

Further, the growth of foreign currency transactions by Icelandic banks is expected to be limited by continued capital controls, which may continue to be in place for some time as there is no set date for their removal. Even though a large amount of Icelandic banks' assets are denominated in foreign currencies, the banks do not have access to foreign funding or exchange rate hedging to the same degree as before and may continue to experience difficulty in protecting the value of their portfolios.

Uncertainty about the quality of the loan assets held by the New Banks and the continued high levels of non-performing loans on their balance sheets is a major risk to the success of Icelandic banks. However, levels of non-performing loans on the balance sheet of Arion Bank have declined from 52% as at 30 June 2010 to 2.5% as at 31 December 2015. Iceland's New Banks are capitalised with pre-crisis domestic loans extended by the failed banks, many of which are being restructured and many of which may be unrecoverable. During the period from 2003 through 2007, the old banks maintained liberal lending policies, and Icelandic households and businesses took on a large amount of debt, of which a large proportion was denominated in, or indexed to the value of, a foreign currency. Prior to October 2008, Iceland's banks lent extensively in foreign currency. As a result, a large portion of the assets of the New Banks consist of foreign currency loans to businesses and individuals in Iceland that were made before the financial crisis. As a result of the pre-crisis lending practices of the banks, these borrowers were highly indebted before the crisis, and the subsequent collapse of the króna raised their foreign loan balances sharply. In many cases, these borrowers lack sources of foreign currency income or assets to service their borrowings. The depreciation of the króna and the resulting changes in operating conditions have caused these borrowers financial and operating difficulties. Many borrowers have negotiated deferred payments or have had their loans frozen temporarily, many others are in need of balance sheet restructuring and defaults have escalated. In the current economic climate, it is exceptionally difficult to determine both borrowers' actual capacity to pay and the value of loan collateral. As a result, loan recovery is unusually uncertain, in terms of both the amount recoverable and whether loans will be repaid on time. Uncertainty about the quality of the loan book also reflects legal risk regarding loans linked to foreign currencies, especially with respect to commercial loans indexed to a foreign currency, and various adverse Supreme Court judgments in relation to such loans have resulted in significant impairments being taken by Icelandic banks. As a result, loan recovery is unusually uncertain, in terms of both the amount recoverable and whether loans will be repaid on time. Determination of loan values and write-off needs will depend on general economic developments and on the operating and financial condition of the particular borrowers.

Levels of non-performing loans, the fair value of loan assets 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 Icelandic Supreme Court affecting the value of foreign exchange indexed loans. Worldwide financial and economic developments, and particularly financial and economic developments in the United Kingdom and the European countries that constitute Iceland's main trading partner countries, will also have an effect. If the assets of one or more of the New Banks turn out to be inadequate to sustain the banks' capital adequacy ratios, capital contributions from the State will likely be necessary to restore

their financial condition. Any such rescue could be costly for the State and would represent a major setback for the growth and international acceptance of the new Icelandic banking system.

Iceland's savings banks, which represent a smaller share of the banking system than the commercial banks, have also experienced distress. The total assets of the savings bank system amounted to ISK 43 billion as of 30 June 2015 compared to ISK 627 billion as of 31 December 2007. The biggest factor in this decline was the collapse of Reykjavik Savings Bank (**SPRON**), the largest of the savings banks, which was taken over by the FME in March 2009. SPRON's deposits were subsequently transferred to the Bank, and a bond was issued to the Bank to back up those deposits, secured by the estate of SPRON and by a State indemnity. Overall, the savings banks have taken substantial write-offs due to falling securities prices and anticipated loan losses.

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

In addition the Icelandic Government has since autumn 2008 backed deposits in domestic commercial and savings banks, on the basis of an announcement from the Prime Minister's Office of 6 October 2008 stating that deposits in domestic commercial and savings banks and their branches in Iceland will be fully covered. This announcement has since been repeated by subsequent Governments and the European Free Trade Association Surveillance Authority has not objected to the guarantee under the European Economic Area (**EEA**) State Aid rules to date. It is assumed that the blanket guarantee will be gradually lifted when the banking market both domestic and foreign has stabilised. However, a sudden lifting of the guarantee, with or without regulatory intervention, could have an impact on deposit holders and the outflow of deposits held by Arion.

The estates of Glitnir, Landsbanki and Kaupthing have reached formal composition agreement with its respective creditors at creditors' meeting held on 20, 23 and 24 November 2015 (the **Creditors' Meeting**). There was a high acceptance rate at all the meetings, with Kaupthing creditors voting 100% in favour and Glitnir and Landsbanki having close to the same rate of acceptance. The estates have also received provisional approval from the Central Bank that exemptions will be provided from the currency restrictions to allow payments to creditors in accordance with these agreements. In very simple terms, the payments were made by combinations of foreign currency (not ISK) payments, and the issuance of shares and bond instruments. It should also be noted that all the agreements were approved by Icelandic courts. These composition agreements include payments from Glitnir, Landsbanki and Kaupthing to the Icelandic Authorities (Central Bank and/or special vehicle held by the Ministry of Finance) in the form of so-called Stability Contribution. This contribution is intended to assist in maintaining stability in the Icelandic economy following the assumed negative impact of the composition agreements on the balance of payments and economic recovery program for Iceland. The payments of the Stability Contribution varies between the estates, the largest payment is made by Glitnir (including its shares in Íslandsbanki), but lower payments are from Kaupthing and Landsbanki. Post composition, Kaupthing will still hold 87% of the shares in Arion Bank through its wholly owned subsidiary Kaupskil ehf. (**Kaupskil**). However, there is a profit sharing scheme under the Stability Contribution, whereby part of the proceeds from a future sale of Arion Bank will form part of the contribution from Kaupthing.



The occurrence of any the factors described above could seriously undermine Iceland's economy and confidence in the banking system in Iceland and could have a material adverse effect on the Bank's business and its ability to make payments in respect of the Debt Securities.

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

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

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

In accordance with applicable Icelandic regulations, a large exposure is defined as an exposure to a group of financially related borrowers which exceeds 10 per cent. of a bank's capital base net of eligible collateral. The legal maximum for individual large exposures is 25 per cent. of a bank's risk capital and the sum of all large exposures cannot exceed 400 per cent. of a bank's risk capital. The loans which were transferred from Kaupthing to the Bank include loans which have led to high counterparty concentration for the Bank. In particular, as at 31 December 2015, the Bank had one large exposure (as defined by Icelandic regulation). Should any of the customers to which the Bank has a large exposure default, this would have a material adverse effect on the Bank's business and its ability to make payments in respect of the Debt Securities.

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

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

The Bank has developed a number of solutions to assist customers that are experiencing payment difficulties. The recovery strategy is based on identifying clusters of similar customers, such as small to medium sized enterprises (**SMEs**) and individuals, and implementing standardised solutions for those customers. In the case of larger companies, the solutions are tailored to the circumstances of each company. Although significant progress has been made restructuring the debts of the Bank's largest corporate customers, considerable work remains in relation to restructuring the debts of SMEs and individuals, especially in the case of customers with foreign currency loans that have been the subject of court cases. The goal of the corporate restructuring process is to create companies with a healthy capital structure, no covenant breaches, satisfactory operating results and motivated management teams and owners although no assurance can be given as to the extent to which this can be achieved or that the Bank will not be forced to put a significant number of corporate customers into liquidation, thereby experiencing material losses.

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

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

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

The EFTA Court has delivered two Advisory Opinions (Cases E-25/13 on 28 August 2014 and 27/13 on 24 November 2014) on whether provisions in a mortgage loan stating that it is inflation-linked are in compliance with provisions of Directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit ("the Consumer Credit Directive") and of Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts ("the Unfair Terms Directive"). The Bank is not a party to the cases. The EFTA Court found i.e. that an assumed 0% rate of inflation indicated in a loan agreement, at a time when the actual rate of inflation was considerably higher, did not correctly represent the charges resulting from the price indexation and thus the total cost of credit. The Court also held that a failure by a credit institution to provide the consumer with full information regarding the total cost of credit and annual percentage rate of charge specified in the Consumer Credit Directive may also qualify as an unfair business-to-consumer commercial practice under Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market. The Court found that it is for the national court to assess the legal consequences and the remedies.

On 6 February 2015 the District Court of Reykjavík delivered two Judgements based on these Advisory Opinions (Cases E-4521/2013 and Y-12/2012). The District Court found that although the provisions in the mortgage loans were not in compliance with EEA Law, this should not lead to such provisions being deemed illegal. The Court also decided that although the credit institution had not provided the consumer with full information regarding the total cost of credit and annual percentage rate of charge specified in the Consumer Credit Directive, that should not lead to the provisions in the mortgage loan being deemed illegal. These Cases will be appealed to the Supreme Court of Iceland.

There are more Cases Pending before the District Court of Reykjavík on whether provisions in a mortgage loan stating that it is inflation-linked are in compliance with provisions of the Consumer Credit Directive and the Unfair Terms Directive. Should any District Court or the Supreme Court of Iceland pass a judgement on the illegality of such provisions, it would have a materially negative impact on the Bank's loan portfolio, financial condition and results of operations.

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

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

The Bank's total deposit base was ISK 469 billion at 31 December 2015. The Bank's other funding at 31 December 2015 was in the form of long-term senior and subordinated debt (ISK 256.1 billion and ISK 10.3 billion, respectively, at 31 December 2015) and equity (ISK 192.8 billion at 31 December 2015). As at 31 December 2015, around 57 per cent. of the Bank's deposits were on demand, 20.3 per cent. had a maturity of up to three months, 19.2 per cent. had a maturity of between three and 12 months, 2.9 per cent. had a maturity of between one and five years and 0.4 per cent. had a maturity of more than five years.

The Bank's strategy is to seek to increase the maturity profile of its liabilities and to strengthen the Bank's liquidity reserve. The Bank has made significant process in converting its on demand deposits to term deposits. At 31 December 2009, over 90 per cent. of the Bank's deposits were on demand compared to 57 per cent. at 31 December 2015. However, no assurance can be given that the Bank will continue to be successful in converting its deposits or will otherwise be able to increase the maturity profile of its funding. The Bank's non-deposit funding principally comprises bond issues, senior unsecured bonds denominated in Euros and Norwegian Krone (NOK) and covered bond issuance (including covered bonds previously issued by Kaupthing and acquired by the Bank in January 2012), a limited number of other loans (including two subordinated loans from the Icelandic state and a loan from the Central Bank) and equity funding.

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

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

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

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

Currently, the legitimacy of certain types of loans remains unclear. By a series of judgments in 2011, the Icelandic Supreme Court has held that certain types of foreign currency-linked loans and lease agreements with SMEs were in fact loans in Icelandic krona and indexed to a foreign currency exchange rate. As a result, these loans were held to be in breach of applicable Icelandic legislation relating to interest and price indexation.

Following these judgments, the Bank recalculated approximately 2,000 retail and corporate foreign currency indexed ISK loans into ISK denominated loans.

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

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

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

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

The Bank's exposure to market risk arises from imbalances in the Bank's balance sheet as well as in market making activities and position taking in certain securities traded by it. The Bank's strategy towards market risk is to seek to limit the risk exposure that arises as a result of imbalances in the Bank's balance sheet but to accept limited market risk in its trading book. The market risk in the trading book arises from proprietary trading activities whereas market risk in the banking book arises from mismatches in assets and liabilities principally in relation to currencies, maturities and interest rates. The Bank principally trades Icelandic treasury notes and housing fund bonds and, to a limited extent, listed equity securities. The Bank has implemented a number of position limits and other controls designed to limit its trading book exposure but no assurance can be given that these controls will be effective in all circumstances. The Bank is exposed to the risk that these controls do not prove to be effective in all circumstances and that the Bank could therefore experience material losses on its trading book. In addition, to the extent that these securities are marked to market, the Bank could experience significant fluctuations in its consolidated income statement as a result of movements in the market value of these securities.

In relation to its balance sheet, the Bank's operations are subject to interest rate risk associated with mismatches between its interest bearing assets and its interest bearing liabilities. The principal mismatch is the large maturity gap resulting from the fact that the Bank has significant on demand liabilities. The Bank also faces interest rate risk between its interest bearing assets and interest bearing liabilities due to different floating rate calculations in different currencies. The Bank's own account equity price risk principally arises as a result of the fact that, through the loan restructuring process, it has acquired significant shareholdings in troubled companies. The Bank is exposed to inflation risk when there is a mismatch between its inflation-linked assets and liabilities. As at 31 December 2015, the total amount of the Bank's inflation-linked assets was ISK 311.6 billion and the total amount of its inflation-linked liabilities was ISK 216.6 billion. The Bank also has significant maturity mismatches in its inflation-linked assets and liabilities. Whilst the Bank has implemented a range of risk management procedures designed to control these risks, no assurance can be given that these controls will be effective in all circumstances. The Bank is exposed to the risk that these controls do not prove to be effective in all circumstances and that the Bank could therefore experience material losses.

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

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

The operational risks that the Bank faces include the possibility of inadequate or failed internal or external processes or systems, human error, regulatory breaches, employee misconduct or external events such as fraud. The Bank's business inherently generates operational risks. The business is dependent on processing numerous complex transactions. The recording and processing of these transactions are potentially exposed to the risk of human and technological errors or a breakdown in internal controls relating to the due authorisation of transactions. Given the volume of transactions processed by the Bank, errors may be repeated or compounded before they are discovered and rectified, and there can be no assurance that risk assessments made in advance will adequately estimate the costs of these errors.

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

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

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

The Bank's losses thus could be significantly greater than its risk management measures would indicate. In addition, the Bank's quantified modelling does not take all risks into account. The Bank's more qualitative approach to managing risks takes into account a broader set of risks, but is less precise than quantified modelling and could prove insufficient. Unanticipated or incorrectly quantified risk exposures could have a material adverse effect on the Bank's business and its ability to make payments in respect of the Debt Securities.

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

The Bank currently faces competition from the two other large commercial banks in Iceland, Landsbankinn and Islandsbanki. As Iceland's economy recovers and demand for new lending and other banking products increases, the Bank expects to face increased competition from both the other large Icelandic banks and smaller specialised institutions as well as, potentially, foreign banks seeking to establish operations in Iceland.

The Bank expects to compete on the basis of a number of factors, including transaction execution, its products and services, its ability to innovate, reputation and price. If the Bank is unable to compete effectively in the future in any market in which it has a significant presence, this could adversely affect its business.

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

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

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

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

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

Violations of rules and regulations, whether intentional or unintentional, may lead to the withdrawal of some of these licences or to liability claims. Any breach of these or other regulations may adversely affect the Bank's reputation or financial condition. In addition, existing laws and regulations could be amended, the manner in which laws and regulations are enforced or interpreted could change and new laws or regulations could be adopted, which could adversely affect the way the Bank operates its business and its market reputation.

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

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

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

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

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

Should any of the cases described above be determined adversely to the Bank, this could have a material adverse effect on its results of operations and financial condition, and therefore impact its ability to make payments in respect of the Debt Securities.

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

- The ICA has opened a formal investigation into the alleged abuse of an alleged collective dominant position by the three major banks in Iceland, including the Bank. The investigation was initiated by separate complaints from BYR hf., MP banki hf. and an insurance company in 2010. The complaints from BYR hf. and MP banki hf. concern the terms of the banks' mortgage arrangements, which, according to the complaint, deter individuals from moving their business to other banks and thereby restrict competition. The insurance company's complaint concerns the banks' alleged tying of banking services and insurances.

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

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

The Bank's results of operations could be harmed by changes in tax laws and tax treaties or the interpretation thereof, changes in corporate tax rates and the refusal of tax authorities to issue or extend advanced tax rulings. The unavailability of tax rulings could diminish the range of structured transactions the Bank can enter into with its clients.

In December 2010, the Icelandic Parliament passed a new law (Act no. 155/2010) under which certain types of financial institution, including the Bank, are required to pay an annual levy calculated at 0.041 per cent. of the carrying amount of their liabilities as determined for tax purposes, with effect from the year ending 31 December 2010. In December 2013 the Icelandic Parliament passed a new law (Act no. 139/2013) and raised the tax up to 0,376 per cent. of the carrying amount of the liabilities in order to finance a government plan on household debt relief.

In June 2009, the Icelandic Parliament adopted an amendment to the income tax law as a result of which payments of Icelandic sourced interest by an Icelandic debtor (such as the Bank) to a foreign creditor (including holders of Bonds who are not Icelandic) is taxable in Iceland and can be subject to withholding tax at the rate of 10 per cent., unless the foreign creditor can demonstrate and get approval from the Icelandic Inland Revenue to the effect that a relevant double taxation treaty applies, in which case the provisions of the double tax treaty will apply. In March 2013, a further amendment was passed. As a result of this amendment, bonds issued by certain financial institutions (including the Bank) and energy companies are exempted from withholding tax. Subject to certain other requirements, the exemption applies to bonds that are registered with a clearing system (such as the Nasdaq CSD Iceland, Euroclear and Clearstream, Luxembourg) within a member state of the Organisation for Economic Co-operation and Development (the **OECD**), the EEA, a founding member state of European Free Trade Association or the Faroe Islands.

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

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

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

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

The Bank's future success depends, in part, on its ability to attract, retain and motivate qualified and experienced banking and management personnel. Competition for personnel with relevant expertise is significant, due to the relatively small number of available qualified individuals. The geographical location of employment may also make it less attractive to a large portion of potential applicants.

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

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

The Bank maintains customary insurance policies for its operations, including insurance for its liquid assets, money transport and directors' and officers' liability, as well as insurance against computer crimes and for employee dishonesty and mistakes. Due to the nature of the Bank's operations and the nature of the risks that it faces, there can be no assurance that the coverage that the Bank maintains is adequate to cover the losses for which it believes it is insured.

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

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

Management has identified certain accounting policies in the notes to its financial statements as being critical because they require management's judgment to ascertain the valuations of assets, liabilities, commitments and contingencies. See note 2 in the 2015 Consolidated Financial Statements for year ended 31 December 2015.

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

**Legal and regulatory risks relating to the Debt Securities**

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

On 28 November 2008, the Icelandic Parliament passed Act no. 134/2008 (the **Amending Act**), on Amendments to the Act on Foreign Exchange no 87/1992, as amended, (the **Foreign Exchange Act**) granting the Icelandic Central Bank powers to intervene in the currency-market with the view of stabilizing the foreign exchange rate of the Icelandic króna. For this purpose, the Central Bank issued new Rules on Foreign Exchange, no 1082, of 28 November 2008 (the **Foreign Exchange Rules**) which were subject to review every six months. With the adoption of Act no 127/2011 in 2011, amending the Foreign Exchange Act, the rules were codified. The Act has since been amended three times, once in March 2012 and twice in March 2013. The general regime on currency restrictions is set out in Article 13 of the Act.

The Foreign Exchange Rules effectively prohibited the outflow of foreign currency from Iceland unless it was a payment for goods or services. Therefore all financial transactions leading to currency outflow were prohibited unless explicitly allowed for in the future. More specifically the Foreign Exchange Rules included provisions prohibiting certain transactions including lending and borrowing between resident and non-resident parties as well as currency-derivatives of any kind, the acquisition by domestic parties of financial instruments nominated in foreign currency etc. Furthermore the Rules made it compulsory for Icelanders and Icelandic companies to “repatriate” all their foreign currency back into the country. The basic principles remain the same, following the codification of the Foreign Exchange Rules subject to certain minor amendments.

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

In addition to the general exemptions, the Foreign Exchange Act provides for specific exemptions from the restrictions of the legislation, subject to the Central Bank’s approval. Such exemptions have to be applied for to the Central Bank where the process can take an estimated 6-8 weeks.

The amendments in March 2012, with act no 17/2012, imposed further restrictions on the outflow of foreign currency. This entailed two amendments to the capital controls regime, inter alia, in response to a perceived increase in circumvention of the currency controls. Before these amendments, an investor could change principal payment, amortization and the indexation share of a CPI indexed annuity bond into foreign currency and transfer out of the economy. The legislation removed the previous exemption provided for the principal payment, amortization and indexation share of bond payments which are now subject to the general capital controls regime. Furthermore, the wide exemptions for payments of the winding-up committees of the failed Icelandic banks to their creditors were removed and are now subject to the Central Bank’s approval.

Two additional amendments were made to the Foreign Exchange Act in March 2013. Firstly on 9 March, act no 16/2013 was adopted, implementing changes to the currency control regime, including the removal of the expiration date from the Act, making them continuous. Moreover the amendments imposed limits on the exemptions which the Central Bank can apply and may now be subject to prior consultation with the relevant ministry. This primarily relates to financial institutions or legal entities under the control of the FME through winding up proceedings or legal entities with a balance sheet exceeding ISK 400bn and where the transaction has substantial effect on the debt position of the economy and regards ownership of a commercial bank. Secondly on 26 March 2013 further amendments were adopted with act no. 35/2013, primarily relating to general exemptions and enhanced authorisations for the Central Bank. The amendments enhanced the Central Bank’s surveillance on foreign exchange, including in relation to payments of interest, indexation, dividends and contractual maturities. This includes authorisation to collect information, which may extend to any relevant third party and to impose fines.

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

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

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

The currency controls constitute protective measures under Article 44 of the EEA Agreement and have as such been notified to the EFTA Standing Committee under the procedures provided for in Protocol 18 of that agreement in conjunction with Protocol 2 to the Surveillance and Court Agreement. Following a referral by the District Court of Reykjavík, the EFTA Court issued a reasoned opinion on 14 December 2011, whereby the Court ruled that it had competence under the EEA Agreement and the Surveillance and Court Agreement to review the rules on currency restrictions inter alia in light of the general principle of proportionality. The Court further declared that at the time in question the rules in question were proportionate. Thus the rules on currency restrictions may at any time be subject to the scrutiny of the EEA Institutions.

In light of this prospective investors must consider the risk of changes to the law and the impact on their investments.

### ***Abnormal pricing as a consequence of capital control***

The currency controls set out above have now become continuous. Domestic parties, primarily investors, are therefore prohibited from transferring their funds and investing outside of the Icelandic market. Consequently they are confined to and must focus their investments on Iceland, which entails various risks, including a risk for abnormal pricing and financial bubbles occurring within several sectors of the Icelandic market. This applies both to investments in shares of listed and un-listed companies, investment funds, various other financial instruments, real-estate (primarily commercial) and may have a negative impact on the Bank.

### ***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.

***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.

### **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:

- (a) 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;

- (b) 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;
- (c) 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;
- (d) understand thoroughly the terms of the Debt Securities and be familiar with the behaviour of any relevant indices and financial markets; and
- (e) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for legislative, economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

Some 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).

#### ***Withholding under the EU Savings Directive***

Under EC Council Directive 2003/48/EC 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 or to certain limited types of entities established 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.

If a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment, neither the Issuer nor any Paying Agent (as defined in the Conditions of the Debt Securities) nor any other person would be obliged to pay

additional amounts with respect to any Debt Securities as a result of the imposition of such withholding tax. The Issuer is required to maintain a Paying Agent in a Member State that is not obliged to withhold or deduct tax pursuant to the Directive.

***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 NCSD 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 NCSD 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 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 involves the risk that if market interest rates subsequently increase above the rate paid on the Fixed Rate Bonds, this will adversely affect the value of the Fixed Rate Bonds. Investments in Floating Rate Bonds will involve a risk of interest rate changes.

***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 advisors 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, 8 April 2016

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 OMX 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 2015 and for the financial year ended 31 December 2014 including the information set out at the following pages in particular:

	Consolidated Financial Statements for the year 2015	Consolidated Financial Statements for the year 2014
Consolidated Statement of Financial Position .....	Page 9	Page 8
Significant Accounting Policies .....	Pages 69 to 78	Pages 66 to 76
Consolidated Statement of Cash Flows .....	Page 11	Page 11
Consolidated Statement of Comprehensive Income .....	Page 8	Page 8
Consolidated Statement of Changes in Equity..... ....	Page 10	Page 10
Notes .....	Pages 13 to 69	Pages 13 to 61
Independent Auditor's Report .....	Page 7	Page 7

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 87 (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 OMX Iceland hf. website at [www.nasdaqomxnordic.com](http://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:

- (a) 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
- (b) 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 depositary 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 depositary 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 8 April 2016 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 OMX Iceland hf. website at [www.nasdaqomxnordic.com](http://www.nasdaqomxnordic.com), on the Issuer's website: arionbanki.is. and from the registered office of the Issuer.

1.
  - (a) Series Number: [ ]
  - (b) Tranche Number: [ ]
  - (c) Series which Debt Securities will be consolidated and form a single Series with: [●]/[Not Applicable]
  - (d) 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]  
[[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 [   ]

#### **PROVISIONS RELATING TO INFLATION LINKED AMORTISING BONDS**

15. [Inflation Linked 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) 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

16. [Inflation Linked Zero Coupon Bond Provisions] [Applicable /Not Applicable]

- (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

17. [Inflation Linked Instalment Bond Provisions] [Applicable /Not Applicable]

- (a) Rate(s) of Interest: [ ] per cent. per annum [payable [annually/semi-annually/quarterly/other (specify)] in arrear]
- (b) Interest Payment Date(s): [The [ ] day in each month]/[ ] in each year] up to and including the Final Maturity Date
- (c) Number of Interest payments in a year: [ ]
- (d) 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**

18. 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 Bonds in definitive form.)

(d) Broken Amount(s): [ ] per Calculation Amount, payable on the Interest Payment Date falling [in/on] [ ]/[Not Applicable]  
(Applicable to Bonds in definitive form.)

(e) Day Count Fraction: [30/360 or Actual/Actual (ICMA)]

(f) Determination Date(s): [ ] in each year / [Not Applicable]

19. 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)]
20. 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)*
21. 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)*
22. 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

23. Issuer Call [Applicable/Not Applicable]
- (a) Optional Redemption Date(s): [ ]
- (b) Optional Redemption Amount of each Debt Security: [ ] per Debt Security of [ ] Specified Denomination
- (c) If redeemable in part:
- (i) Minimum Redemption Amount: [ ]
- (ii) Maximum Redemption Amount: [ ]
- (d) Notice period (if other than as set out in the Conditions): [ ]
24. Investor Put: [Applicable/Not Applicable]
- (a) Optional Redemption Date(s): [●]
- (b) Optional Redemption Amount: [●] per Calculation Amount
- (c) Notice period (if other than as set out in the Conditions):
25. 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]
26. Early Redemption Amount of each Debt Security payable on redemption for taxation reasons: [ ]/[As set out in Condition 7.8(b)]
27. [Relevant Percentage:] As at the Issue Date, [ ] per cent.

## GENERAL PROVISIONS APPLICABLE TO THE DEBT SECURITIES

28. 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 depositary 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.]

29. New Global Bond:

[Yes] [No]

*(If NCSD Debt Securities, insert "No")*

30. Additional Financial Centre(s):

[●]/[Not Applicable]

31. 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. ]



32. 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) = [●]]
33. Redenomination: [Redenomination not applicable/ The provisions of Condition 4 apply]

## DISTRIBUTION

34. (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]
35. If non-syndicated, name of Dealer: [Name]
36. 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 OMX Iceland hf.) and, if relevant, listing on an official list (for example, the Official List of the NASDAQ OMX 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 OMX 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 DEBT SECURITIES 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 Any notice delivered to Debt Security holders  
notices for the purposes of through the clearing systems will be deemed to have  
Condition 13 (*Notices*): 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 [Yes. [Note that the designation "yes" simply means  
which would allow Eurosystem that the Debt Securities are intended upon issue to be  
eligibility: 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**.

Interests 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](http://arionbanki.is) and of the Fiscal Agent and on the NASDAQ OMX Iceland hf. website ([www.nasdaqomxnordic.com](http://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 NCSD 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 NCSD 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 NCSD Debt Securities and *vice versa*.

This Debt Security may be a Fixed Rate Bond, a Floating Rate Bond, a 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 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 the 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 NCSD Debt Securities will pass by registration in the registers between the direct or indirect accountholders at the NCSD in accordance with the rules and procedures of the NCSD. 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 NCSD 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 NCSD Debt Securities each person (other than Euroclear, Clearstream, Luxembourg or the NCSD) who is for the time being shown in the records of Euroclear or of Clearstream, Luxembourg or the NCSD, 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 NCSD, 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 NCSD 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 this Condition, the following expressions shall have the following meanings:

**Distribution Compliance Period** means the period that ends 40 days after the completion of the distribution of each Tranche of 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);

**Reference Banks** means, in the case of a determination of LIBOR, the principal London office of four major banks in the London inter-bank market and, in the case of a determination of EURIBOR, the principal Euro-zone office of four major banks in the Euro-zone inter-bank market, in each case selected by the Agent;

**Regulation S** means Regulation S under the Securities Act;

**Regulation S Global 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**

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 cost of bankruptcy administration will rank ahead of claims for payments of the Bonds.

## **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 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, 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 the Conditions, the following expressions have the following meanings:

**Established Rate** means the rate for the conversion of the Specified Currency (including compliance with rules relating to 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 NCSD 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 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 NCSD 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 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.

(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<sub>1</sub>** is the year, expressed as a number, in which the first day of the Interest Period falls;

**Y<sub>2</sub>** is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

**M<sub>1</sub>** is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

**M<sub>2</sub>** is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

**D<sub>1</sub>** is the first calendar day, expressed as a number, of the Interest Period, unless such number is 31, in which case D<sub>1</sub> will be 30; and

**D<sub>2</sub>** is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless such number would be 31 and **D<sub>1</sub>** is greater than 29, in which case **D<sub>2</sub>** 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:

**Y<sub>1</sub>** is the year, expressed as a number, in which the first day of the Interest Period falls;

**Y<sub>2</sub>** is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

**M<sub>1</sub>** is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

**M<sub>2</sub>** is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

**D<sub>1</sub>** is the first calendar day, expressed as a number, of the Interest Period, unless such number would be 31, in which case **D<sub>1</sub>** will be 30; and

**D<sub>2</sub>** is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless such number would be 31, in which case **D<sub>2</sub>** 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:

**Y<sub>1</sub>** is the year, expressed as a number, in which the first day of the Interest Period falls;

**Y<sub>2</sub>** is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

**M<sub>1</sub>** is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

**M<sub>2</sub>** is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

**D<sub>1</sub>** is the first calendar day, expressed as a number, of the Interest Period, unless (i) that day is the last day of February or (ii) such number would be 31, in which case **D<sub>1</sub>** will be 30; and

**D<sub>2</sub>** is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless (i) that day is the last day of February but not the Maturity Date or (ii) such number would be 31, in which case D<sub>2</sub> 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.

### 5.3 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.

#### 5.4 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.

#### 5.5 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.

#### 5.6 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.

## 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;

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

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 <sub>t</sub>	=	The non-indexed Principal Amount Outstanding on the relevant Interest Payment Date;
PAO <sub>t-1</sub>	=	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.

### 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, 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 Bonds may, subject to Condition 7.2(b) below, be redeemed at the option of the Issuer in whole, but not in part, at any time (if this Bond 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 Bond 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 Agent and, in accordance with Condition 13, the Bondholders (which notice shall be irrevocable), if:
  - (i) on the occasion of the next payment due under the Bonds, the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 8 as a result of any change in, or amendment to, the laws or regulations of the Republic of Iceland (**Iceland**) or any political subdivision of, or any authority in, or of, Iceland having power to tax, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the date on which agreement is reached to issue the first Tranche of the Bonds; and

- (ii) such obligation cannot be avoided by the Issuer taking reasonable measures available to it,

provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be obliged to pay such additional amounts were a payment in respect of the Bonds then due.

- (b) Prior to the publication of any notice of redemption pursuant to this Condition, the Issuer shall deliver to the Fiscal Agent a certificate signed by two Directors of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred, and an opinion of independent legal advisers of recognised standing to the effect that the Issuer has or will become obliged to pay such additional amounts as a result of such change or amendment.
- (c) Each Bond redeemed pursuant to this Condition 7.2 will be redeemed at the Early Redemption Amount.

### 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;

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

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 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 sub-clause 7.2 above (*Redemption for Tax Reasons*), each Bond will be redeemed at the Early Redemption Amount. The Early Redemption Amount is calculated as follows:

- (a) in the case of a Bond with a Final Redemption Amount equal to the Issue Price, at the Final Redemption Amount thereof;
- (b) in the case of a Bond (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 Bonds to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Bond becomes due and repayable and the denominator of which is 360,

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

## 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**

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 unmatured 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 paragraph 7.10 above will forthwith be cancelled (together with all unmatured 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 paragraph 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 paragraph 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.

### **8. TAXATION**

All payments of principal and interest in respect of the Debt Securities, Receipts and Coupons by 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 (i) by or on behalf of any Tax Jurisdiction or (ii) 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 and any regulations or agreements thereunder or official interpretations thereof, unless such withholding or deduction is required by law (including pursuant to an agreement described in Section 1471(b) of the Code or otherwise imposed pursuant to Sections 1471 through 1474 of the Code and any regulations or agreements thereunder or any official interpretations thereof). 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) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (e) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Debt Security, Receipt or Coupon to another Paying Agent in a Member State of the European Union;
- (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
- (g) where such withholding or deduction is required by reason of the failure by any person other than the Issuer or an Agent to claim or perfect an exemption from any withholding or deduction (including, for the avoidance of doubt, as a result of any payment being made through an intermediary other than an Agent that is subject to withholding or deductions pursuant to Sections 1471 through 1474 of the Code and any regulations or agreements thereunder or official interpretations thereof).

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 NCSD Debt Securities, the NCSD 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.

## 9. 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 four 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.

## **10. 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.

## **11. 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 NCSD 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) there will at all times be a Paying Agent in a Member State of the European Union that will not be obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; and
- (d) there will at all times be a Paying Agent in a jurisdiction within Europe, other than the jurisdiction in which the Issuer is incorporated.

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, a Participating FFI, 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.

## **12. EXCHANGE OF TALONS**

On and after the Interest Payment Date on which the final Coupon comprised in any Coupon sheet matures, the Talon (if any) forming part of such Coupon sheet may be surrendered at the specified office of the 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.

### 13. EVENTS OF DEFAULT

If any one or more of the following events (each an Event of Default) shall occur with respect to any 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. 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 OMX Iceland hf. and listed on the Official List of the NASDAQ OMX Iceland hf., and/or the NASDAQ OMX Iceland hf. website ([www.nasdaqomxnordic.com](http://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 OMX Iceland hf. and listed on the Official List of the NASDAQ OMX Iceland hf., and/or the NASDAQ OMX Iceland hf. website ([www.nasdaqomxnordic.com](http://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 OMX Iceland hf. website ([www.nasdaqomxnordic.com](http://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) NCSD Debt Securities*

All notices regarding the NCSD 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 NCSD 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 NCSD Debt Securities, the Issuer can additionally at its own discretion obtain information from the NCSD 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.

## **15. 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 NCSD Debt Securities or at any adjourned meeting one or more persons being or representing holders of Voting NCSD Debt Securities whatever the nominal amount of the NCSD Debt Securities so held or represented, except that at any meeting the business of which includes the modification of certain provisions of the NCSD Debt Securities (including modifying the date of maturity of the NCSD 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 NCSD Debt Securities or altering the currency of payment of the NCSD 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 NCSD 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 NCSD Debt Securities. A resolution passed at any meeting of the holders of NCSD 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 NCSD Debt Securities of more than one Series, (i) a resolution which affects the NCSD 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 NCSD Debt Securities of that Series; (ii) a resolution which affects the NCSD Debt Securities of more than one Series but does not give rise to a conflict of interest between the holders of NCSD 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 NCSD Debt Securities of all the Series so affected; and (iii) a resolution which affects the NCSD Debt Securities of more than one Series and gives or may give rise to a conflict of interest between the holders of the NCSD Debt Securities of one Series or group of Series so affected and the holders of the NCSD 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 NCSD Debt Securities of each Series or group of Series so affected.

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

## **16. 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.

## **17. GOVERNING LAW AND SUBMISSION TO JURISDICTION**

### **17.1 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.

### **17.2 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 NCSD 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.

### **17.3 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.

#### **17.4 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.

#### **17.5 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.

### **18. 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

Arion Bank hf. is the entity to which certain assets and liabilities of Kaupthing Bank hf. (**Kaupthing**) were transferred following the assumption of control of Kaupthing by the Icelandic government towards the end of 2008. The Bank was established on 18 October 2008 and is incorporated in Reykjavik and domiciled in Iceland. It is a public limited company established under Act No 2/1995 regarding Public Limited Companies, under the laws of the Republic of Iceland with ID number 581008-0150 in the Icelandic Register of Enterprises. The Bank was initially named New Kaupthing banki hf. and, on 21 November 2009, its name was changed to Arion banki hf.

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

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

Since 2011, the Bank made significant progress in loan restructuring and has completed the majority of this work, although it expects that some personal and corporate borrowers will continue to require assistance for some time. In 2015, the Bank continued its progress in the sale of companies acquired as a result of collateral enforcement procedures and has now sold most of these companies.

In the year ended 31 December 2015, the Bank's net interest income was ISK 26.9 billion (compared to ISK 24.2 billion in 2014), its operating income was ISK 86.6 billion (compared to ISK 53.9 billion in 2014) and its net earnings were ISK 49.7 billion (compared to ISK 28.6 billion in 2014). As at 31 December 2015, the Bank's total assets were ISK 1,011 billion.

Arion Bank was assigned ratings from Standard and Poor's BBB-; outlook positive.

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

### HISTORY

The Bank was established at the end of 2008 as the vehicle to receive the transfer of certain assets and liabilities of Kaupthing following the Icelandic government assuming control over it towards the end of 2008. Kaupthing was the product of a merger in May 2003 of two of Iceland's then leading banks, Kaupthing Bank hf. and Bunadarbanki Islands hf. (**Bunadarbanki**). Bunadarbanki was established in 1929 by a law passed by the Icelandic parliament, the Althingi. At the beginning of 1998, Bunadarbanki became a limited liability company and was privatised in stages up to the beginning of 2003. Kaupthing hf. was established in Reykjavik in 1982, coinciding with the launch of the free capital market in Iceland. Kaupthing hf. later became an investment bank before its merger with Bunadarbanki in 2003.

In July 2009, the Icelandic government and the resolution committee of Kaupthing (the **Kaupthing Resolution Committee**) reached agreement on the valuation of the assets transferred to the Bank through the issue of a compensation instrument by the Bank to Kaupthing. In addition, the agreement identified certain ring-fenced assets in respect of which the creditors were accorded a share in certain future increases of value through an escrow and contingent rights agreement (the **ECVRA**) and the creditors (through the Kaupthing Resolution

Committee) were also granted an option to purchase up to 87 per cent. of the Bank's equity, see "*—Related Party Transactions*".

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

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

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

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

In January 2012, the Bank acquired the mortgage portfolio managed in a special fund (the Fund) owned by the estate of Kaupthing. The Fund had guaranteed the bonds issued from 2006 to 2008 by Kaupthing to finance its mortgage loans (the Kaupthing Bonds) under the structured bond programme established by Kaupthing on 30 March 2006 (the Kaupthing Bond Programme). As a part of this acquisition, the Bank was substituted for, and has assumed all liabilities and obligations (past, present and future, other than Kaupthing's liabilities and obligations relating to withholding tax payments) of, Kaupthing in respect of each of the six series of outstanding Kaupthing Bonds. The Kaupthing Bonds are inflation linked with final maturities between 2033 and 2048, and have an aggregate face value of approximately ISK 92.5 billion.

The Bank paid an agreed cash consideration to the Kaupthing Resolution Committee in connection with the acquisition. 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.

## **CURRENT WINDING UP PROCEEDINGS FOR KAUPTHING**

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

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

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

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

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

The Kaupthing Resolution Committee was dissolved on 1 January 2012 and the Winding-up Committee has assumed all responsibility for managing the Kaupthing estate since that date.

Since the claims against Kaupthing exceed its assets, the Winding-up Committee has reached formal composition agreements with its respective creditors at a creditors' meeting held on 24 November 2015 where Kaupthing creditors voted 100% in favour of adopting the relevant composition agreements. The estate of Kaupthing has also received provisional approval from the Central Bank of Iceland that exemptions will be provided from the Foreign Exchange Act.

More information about Kaupthing, its current status and potential closing of the winding-up proceedings can be found on [www.kaupthing.com](http://www.kaupthing.com).

## **SHAREHOLDER OF THE ISSUER**

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. The Kaupthing Winding-up Committee appoints one member of Kaupskil's board but the other two must be independent. Further, under a special representation agreement between Kaupskil and Kaupthing dated 20 April 2010, Kaupthing has agreed to respect the independence of the board of directors of Kaupskil and Kaupthing's duty to promote sound and solid financial operations of the Issuer free of external intervention. The board of directors of Kaupskil is required to report to the FME on the implementation of this policy on a quarterly basis. In order to facilitate supervision, Kaupskil is required to transfer the ownership of all financial and insurance subsidiaries to a single parent company if the FME considers such a transfer necessary.

Various restrictions have been placed on Kaupthing by the FME, including with regard to the sale of shares of the Issuer until September 2012. Kaupthing is required to notify the FME in advance of a proposed transfer of ownership of shares in the Issuer or Kaupskil. Upon receipt of such a notification, the FME will carry out a new eligibility assessment of the prospective owners if the change of ownership affects the board of directors of the Issuer. Further conditions relate to the financial strength of Kaupskil, the ownership of the Issuer, supervisory interest and the owners' objectives. The FME set out the details of its approval and conditions in a press release dated 18 January 2010 (<http://www.fme.is/utgefid-efni/frettir-og-tilkynningar/frettir/nr/602>)

## **STRATEGY**

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

- positioning the Bank as a universal bank in Iceland, providing a wide range of services and focusing on tailored and personalised solutions for its customers, with special emphasis being placed on the Bank's ability to meet the financial needs of those customers, both retail and corporate, which require comprehensive and diverse financial services; and
- improving the Bank's competitiveness by focusing on its product offering, quality of service, efficiency and profitability in its operations. In particular, the Bank reduced its branch network from 39 branches at the end of 2008 to 25 branches at 31 December 2014 and has also sought to reduce back office costs and streamline its organisational structure.

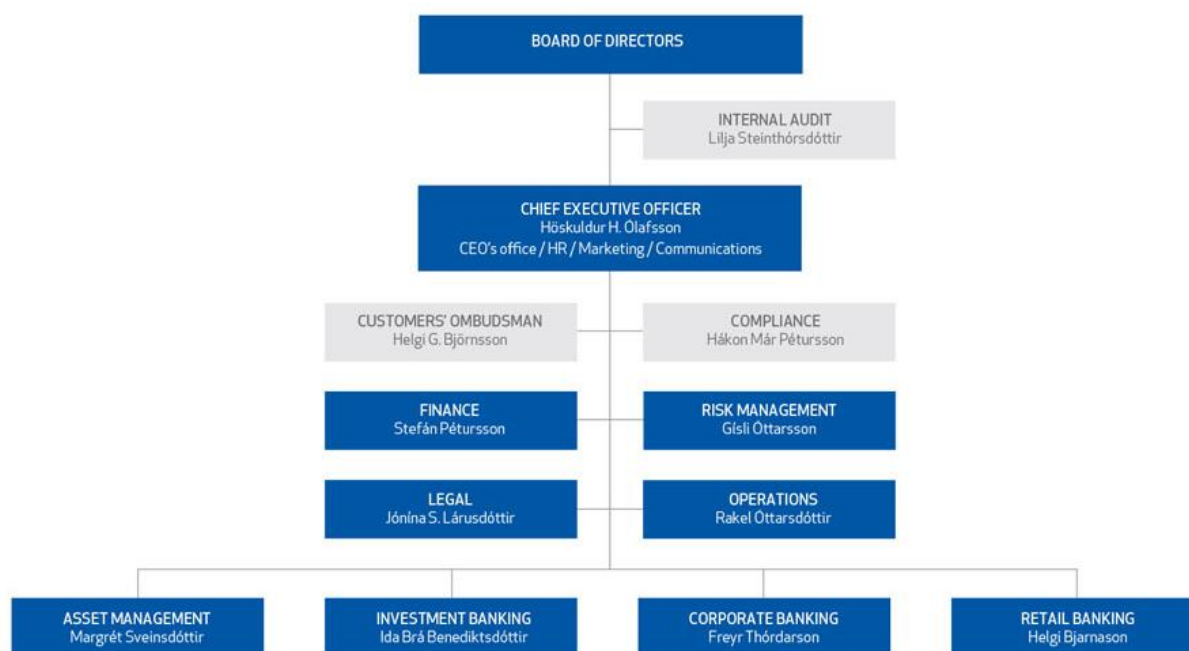
- in relation to business customers, emphasising the Bank's focus on developing long-term business relationships through continuous dialogue with customers so as to fully understand their needs and continuous product development which the Bank believes is fundamental to successful business relationships. The Bank aims to innovate and develop products and services which respond to the changing needs of its customers and to put its customers' interests first in all transactions.

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

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

## BUSINESS

The chart below illustrates the Bank's principal operating and support functions as at 29 Februar 2016.



The Bank has six main reporting segments:

**Corporate Banking** provides services to the Bank's larger corporate clients. Its role is to provide comprehensive financial services and tailored services to meet the needs of each company. Corporate Banking offers diverse solutions relating to loans and other services required by companies. The division is also responsible for the financial restructuring of companies which need it.

**Retail Banking**, the Bank, through its retail branch network, Arion Bank Mortgages Institutional Investor Fund and AFL Sparisjodur provide a comprehensive range of services, including advice on deposits and loans,

savings, payment cards, pension savings, insurance, securities and funds. To maximise operational efficiency the branch network is divided into seven clusters, with the smaller branches capitalising on the strength of larger units within each cluster.

**Asset Management**, which comprises Institutional Asset Management, Private Banking and Investment Services. Asset Management is the fund distributor for Stefnir, an independently operating financial company owned by the Bank. Asset Management offers pension savings, other regular savings, investments and asset management services. It also offers funds from other leading fund management companies.

**Investment Banking**, which comprises Corporate Advisory, Capital Markets and Research. Corporate Advisory advises clients on securities offerings and the admission of securities for trading on regulated securities markets and also provides M&A advisory services. Capital Markets handles securities brokerage and foreign exchange trading for the Bank's clients. Research publishes regular analyses of listed securities, the major business sectors, markets and the Icelandic economy and also produces economic forecasts. Investment Banking's clients are private individuals, companies and institutions.

**Treasury**, which is organisationally included within the Finance division, is responsible for the Bank's liquidity management as well as currency and interest rate management. Treasury also deals with the internal pricing of interest rates and currency exchange rates and liaises 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., Okkar líftryggingar hf., Valitor holding hf. and other smaller entities.

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

	At 31 December 2015							
	Corporate Banking	Retail Banking	Asset Manage- ment	Investment Banking	Treasury	Other Divisions and Sub- sidiaries	Head- Quarters and Eliminatio n	Total
(ISK million)								
Operating income.....	7,012	16,346	4,882	36,434	6,758	7,646	7,477	86,555
Earnings before tax .....	3,391	8,077	3,431	38,312	6,513	777	(8,047)	52,454
Total assets.....	236,621	448,547	5,884	62,904	179,375	50,166	27,546	1,011,043

**Year ended/as at 31 December 2014**

	<b>Corporate Banking</b>	<b>Retail Banking</b>	<b>Asset Manage- ment</b>	<b>Investment Banking</b>	<b>Treasury</b>	<b>Other Divisions and Sub- sidiaries</b>	<b>Head- Quarters and Elimination</b>	<b>Total</b>
<i>(ISK million)</i>								
Operating income.....	9,481	15,277	4,144	7,640	4,454	12,086	908	<b>53,990</b>
Earnings before tax .....	12,303	8,193	2,735	6,421	4,481	6,815	(11,865)	<b>29,083</b>
Total assets.....	231,575	416,912	5,230	33,730	160,210	65,459	20,620	<b>933,736</b>

### **Corporate Banking Division**

The Bank's Corporate Banking division provides a range of financial services and products to its corporate clients. The prime focus of the division is to maintain long-term relationships with its clients and to deliver tailored solutions and personalised services. The division had 27 full time equivalent employees (**FTEs**) at 31 December 2015.

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

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

The Corporate Banking loan portfolio principally comprises large corporate customers many of which had become over-leveraged following the 2008 financial crisis and the sharp depreciation of the Icelandic 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.

In 2011, the Bank started to offer factoring, or asset-based lending, which is used by SMEs, both importers and exporters. In particular, the Bank uses factoring in connection with trade finance, where inventory financing is linked with the financing of receivables which suits the needs of exporters, such as fishing companies.

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

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



transferred into separate holding companies under the control of the Bank. The restructuring process is now overseen by the Bank's legal department.

## **Retail Banking Division**

The Retail Banking division provides a range of banking services to individual as well as SMEs. Retail Banking serves its customers through its branch network and other points of contact such as online banking, a call centre and automatic telling machines (ATMs). As at 31 December 2015, the Bank had 23 branches throughout Iceland and over 100,000 retail customers. The branches provide a comprehensive range of financial services, including advice on deposits and loans, payment cards, pension savings, insurance, securities and funds, with a focus on tailored solutions and personalised services to meet customer needs. Retail Banking had 348 FTEs at 31 December 2015.

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

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

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

In the period up to 2012, the Bank's key focus was to work with its customers to restructure their debts. However, during 2012 the Bank noted clear signs that demand for traditional financial services was increasing and accordingly switched its focus to providing such services. In August 2012, the Bank launched a new application which enables its customers to keep track of their finances with a single click and without having to log in. Use of the application has steadily increased and, during the first three months of 2013, 15 per cent. of log-ins to Arion Online Bank were through the application.

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

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

## **Asset Management Division**

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

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

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

The Bank's subsidiary, 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 403 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 and had 23 FTEs at 31 December 2015.

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

During 2012, the Bank's subsidiary, Verdis, was merged into the Bank. Verdis provided custody and fund administration services which are now provided under the 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. The Investment Banking division had 32 FTEs at 31 December 2015.

#### ***Corporate Finance***

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

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

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

During 2012, Corporate Finance managed the sale of the Group's shares in Hagar hf., B.M. Valla ehf., Penninn a Islandi ehf., Boyfood Oy in Finland and Fram Foods AB in Sweden. Corporate Finance also advised the Bakkavor Group on its financial restructuring and arranged the listing of asset-backed bonds issued by institutional investor funds run by Stefmir hf. on NASDAQ OMX Iceland. The main projects completed by Corporate Finance in 2013 were the listing of VÍS hf. and the sale of Klakki ehf.'s stake in VÍS. During the year Corporate Finance also prepared the prospectus for N1 hf. and arranged the listing of the company's shares on the Main Market of NASDAQ OMX Iceland. The department also prepared the prospectus for the

bond offering by Skipti hf. and the subsequent listing of the bonds on the Main Market of NASDAQ OMX Iceland. Corporate Finance furthermore arranged the sale of Fram Foods Ísland hf. which was owned by Arion Bank's subsidiary Eignabjarg ehf. During the first half of the year it advised the sellers on the sale of a 30% stake in Sena ehf. At the end of the year SF IV slhf., which is managed by Arion Bank's subsidiary Stefnir hf., acquired Skeljungur hf. and Magn P/F in the Faroe Islands, with Corporate Finance advising the buyers in these deals. The department has also been involved in merger talks between the Bank's subsidiary Landfestar ehf. and Eik Fasteignafélag hf. In addition it arranged the listing on NASDAQ OMX Iceland of covered bonds issued by institutional investor funds managed by Stefnir.

In 2014, corporate finance arranged the refinancing of Reitir fasteignafélag hf. (Reitir), the largest commercial real estate company in Iceland and the Sale and listing of HB Grandi hf., a fishing company, on NASDAQ OMX Iceland. In 2015 it arranged the listing of real estate companies Reitir and Eik, and Siminn the largest telecommunication company in Iceland on NASDAQ OMX Iceland.

### ***Capital Markets Unit***

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

FX and Fixed Income Sales offers domestic and foreign brokerage of currency, fixed income and derivatives for institutional investors, corporate clients and smaller domestic financial institutions. Equity Sales is responsible for the brokerage of domestic and foreign equities for institutional investors and corporate clients. Trading on the FX market is significantly restricted in Iceland by the capital controls established in 2008. In the fixed income market, the principal instruments traded are government bonds.

On the equities side, the Bank focuses on the United States and Nordic equity markets. The Bank also remains active in the domestic equity market although the market is currently limited.

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

Trading on the foreign exchange market remains minimal, although the Central Bank held a number of currency auctions in 2014 as part of the process of lifting the capital controls. The main aim of Capital Markets is to provide its growing client base with good services and access to expert knowledge. The focus in the medium term is expected to shift towards product development as investors seek more opportunities to invest and distribute risk.

### ***Research***

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

### **Other Divisions and Subsidiaries**

#### ***Other divisions***

The Bank has five support divisions:

- **Corporate Development & Marketing:** This division assists the Bank in implementing organisational changes, entering new markets, introducing new products, acquiring or divesting assets or divisions and establishing strategic partnerships. The division also develops the Bank's marketing strategy and is responsible for brand management, coordinating marketing initiatives, marketing and tactical plans for products and services and market research, such as statistical analysis, focus groups, interviews and surveys. Finally, the division is responsible for developing the Bank's internet banking solutions, websites, online communication and electronic distribution channels. This division had 29 FTEs at 31 December 2015.
- **Finance:** The Finance division includes funding and treasury (which together form the Treasury reporting segment) as well as accounting and analysis. The accounting unit is responsible for the Bank's financial reporting, both internally and to external stakeholders, including the FME and the Central Bank. The analysis unit is responsible for short-term and long-term budgeting and for benchmarking the Bank with comparable financial institutions, both local and international. The funding unit is responsible for the Bank's long-term funding in both the domestic and international markets and the treasury unit is responsible for the Bank's liquidity, currency and interest rate management, the internal pricing of interest rates and currency, liaison with other financial institutions, proprietary trading and market making in domestic securities and currencies. The Finance division had 50 FTEs at 31 December 2015.
- **Risk Management:** For a description of the activities of the Risk Management division, see "*Risk Management*". The Risk Management division had 27 FTEs at 31 December 2015
- **Legal:** The Legal division handles collection, appropriated assets and legal representation on behalf of the Bank as well as a range of other legal services for the Bank's other divisions. As at 31 December 2012, the legal division was working on 4,050 collection cases, compared with 5,363 at 31 December 2011. The legal division had 42 FTEs at 31 December 2015.
- **Operations:** The Operations division comprises information technology (IT), human resources, back office and property management units. The Operations division had 260 FTEs at 31 December 2015.
- **Subsidiaries**

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

*Okkar líftryggingar hf. (Okkar Life Insurance)*

Okkar Life Insurance was founded in 1966 and acquired by Kaupthing in 2005. Okkar Life Insurance provides a range of insurance policies against illness, disability and death. Okkar Life Insurance has sales and distribution partnerships with the Bank and KB ráðgjöf, which also sells pension products on behalf of the Bank. Okkar is wholly-owned by the Bank.

*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.

## *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.

Since 2011, Eignabjarg completed a significant number of disposals from its asset portfolio:

- Hagar hf. was listed on the main market of NASDAQ OMX Iceland in December 2011. In February 2012, Eignabjarg sold a 13.3 per cent. share in Hagar in a private placement. By the end of 2012, Eignabjarg had sold its entire stake in Hagar.
- All share capital in Sigurplast ehf. was sold in April 2012 to the company Hilmar D. Ólafsson ehf.
- B.M. Vallá ehf., which specialises in the production of cement, prefabricated housing units, walls and pumice, was sold to BMV Holding ehf. in October 2011. The sale was completed in June 2012, following approval from the Icelandic Competition Authority.
- The entire share capital of Penninn á Íslandi ehf., which owns and operates a range of stores in Iceland, was offered for sale at the beginning of 2012. In June 2012, the company was sold to a consortium of investors led by Ingimar Jónsson, Ólafur Stefán Sveinsson and Stefán D. Franklín.
- In March 2012, the Bank offered Fram Foods ehf. for sale. In April 2012, the Bank decided to sell each business unit separately as no satisfactory offer had been received. In July 2012, the subsidiary, Boyfood Oy in Finland, was sold to the Finnish company, Felix Abba Oy. In November 2012, the subsidiary, Fram Foods AB in Sweden, was sold to the Swedish company, Domstein Sverige AB. In March 2013 Fram Foods ehf. sold its subsidiary Fram Foods Ísland hf.
- In December 2013, Eik and the Bank signed an agreement relating to the acquisition by Eik of all of the share capital in Landfestar ehf. Eik financed the acquisition through the issuance of new share capital to the Bank, resulting in the Bank becoming the largest shareholder of Eik, owning 44% share in Eik. The Bank sold part of its shareholdings in Eik during 2014 and in April 2015 the Bank sold its remaining shares in Eik when the company was listed on the main list of NASDAQ OMX Iceland. The Bank currently holds no stake in Eik.
- In May 2014, HB Grandi hf. was listed on the main list of NASDAQ OMX Iceland. Following the sale of 18.8 per cent. of the Bank's shareholding in HB Grandi hf. in April 2014. Prior to the sale the Bank held 31% share in HB Grandi., the Bank owns approximately 5 per cent. of HB Grandi hf. as at the date of this Base Prospectus.
- In April 2015, Reitir was listed on the main market of NASDAQ OMX Iceland. Following Reitir's listing, the Bank sold approximately 17 per cent. of its shareholding in the company and owns approximately 9 per cent. of Reitir as at the date of this Base Prospectus.

- In October 2015, Siminn was listed on the main market of NASDAQ OMX Iceland. Following Siminn's listing, the Banks sold approximately 22 per cent. of its shareholding in the company and owns approximately 9 per cent. of Siminn as at the date of this Base Prospectus.

#### *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 2015 and 31 December 2014 classified by type of loan.

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

	<b>As at 31 December 2014</b>		
	<b>Individuals</b>	<b>Corporates</b>	<b>Total</b>
Overdrafts .....	17,955	24,420	42,375
Credit cards .....	11,065	943	12,008
Mortgage loans .....	271,639	10,406	282,045
Capital lease .....	2,469	3,607	6,076
Other loans .....	31,294	300,391	331,685
Provision on loans .....	(13,111)	(13,570)	(26,681)
<b>Loans to customers</b>	<b>321,311</b>	<b>326,197</b>	<b>647,508</b>

*The total book value of pledged loans that were pledged against amounts borrowed was ISK 199 billion at the end of the year (31.12.2014: ISK 197 billion). Pledged loans comprises mortgage loans to individuals, loans to real estate companies, wholesale and retail and industry and energy companies.*

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 2015 and 31 December 2014 classified by customer sector.

	<b>31 December 2014</b>	<b>31 December 2015</b>
Individuals .....	49.6%	47.7%
Real estate activities and construction.....	12.5%	15.1%
Fishing industry.....	11.8%	11.1%
Information and communication technology.....	3.6%	4.7%
Wholesale and retail trade .....	8.5%	7.6%
Financial and insurance activities.....	4.3%	4.9%
Industry, energy and manufacturing.....	3.9%	3.1%
Transportation.....	0.9%	0.9%
Services.....	2.8%	2.9%
Public sector .....	1.2%	1.2%
Agriculture and forestry.....	0.9%	0.8%
<b>Total</b>	<b>100%</b>	<b>100.0%</b>

As at 31 December 2015, the aggregate amount of the Bank's 10 largest customer loans equalled 13.3 per cent. of its total gross customer loans and receivables at that date.

In addition to its customer loans and receivables, the Bank has a portfolio of loans and receivables to credit institutions. The table below sets out details of the Bank's loans and receivables to credit institutions as at 31 December 2015 and 31 December 2014 classified by type of loan.

	<b>31 December 2014</b>	<b>31 December 2015</b>
	<i>(ISK million)</i>	
Bank accounts.....	79,587	74,533
Money market loans .....	23,007	7,976
Other loans .....	6,198	4,982
<b>Loans and receivables to credit institutions</b>	<b>108,792</b>	<b>87,491</b>

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

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

As at 31 December 2014				
	Neither past due nor impaired	Past due but not impaired	Individually impaired <sup>(1)</sup>	Total
	<i>(ISK million)</i>			
Cash and balances with Central Bank	21,063	-	-	21,063
Loans to credit institutions	108,792	-	-	108,792
Loans to customers				
Loans to corporates	308,588	15,114	2,495	326,197
Loans to individuals	277,859	32,847	10,605	321,311
Financial Instruments	70,704	-	-	70,704
Other assets with credit risk	3,514	-	-	3,514
<b>Credit quality of loans</b>	<b>790,520</b>	<b>47,961</b>	<b>13,100</b>	<b>851,581</b>

The table below shows the ageing of the Bank's past due but not impaired loans and receivables by class as at 31 December 2014 and 31 December 2013.

	Up to 3 days	4 to 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
<b>31 December 2015</b>						



	<i>(ISK million)</i>					
Loans to corporates.....	9,638	3,779	1,681	662	1,542	
Loans to individuals .....	<u>3,706</u>	<u>9,437</u>	<u>5,237</u>	<u>554</u>	<u>7,598</u>	
<b>Past due but not impaired loans</b>	<b><u>13,344</u></b>	<b><u>13,216</u></b>	<b><u>6,918</u></b>	<b><u>1,216</u></b>	<b><u>9,140</u></b>	

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

Loans past due up to three days are mainly overdrafts that were not renewed in time. The majority of the past due but not impaired loans are considered fully secured with collateral or have been acquired at discount. Loans acquired at discount are not considered to be impaired unless the specific allowance exceeds the discount received

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

<i>Impaired loans to customers</i>	2015		2014	
	Impairment amount	Gross carrying amount	Imapirment amount	Gross carrying amount
Individuals	10,593	17,403	11,016	21,621
Real estate activities and construction	1,515	1,867	1,396	1,981
Fishing industry	257	373	1,115	2,366
Information and communication technology	308	332	251	251
Wholesale and retail trade	681	893	751	831
Financial and insurance activities	5,953	6,011	6,739	6,756
Industry, energy and manufacturing	828	1,025	751	831
Transportation	4,433	4,440	18	18
Services	504	682	375	641
Public sector	143	215	27	35
Agriculture and forestry	126	186	230	340
	<u>25,341</u>	<u>33,427</u>	<u>22,214</u>	<u>35,314</u>

## **FUNDING AND LIQUIDITY**

### **Funding**

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

The Bank's funding profile changed significantly in 2012. In January 2012, the Bank acquired a mortgage portfolio from Kaupthing and was substituted as issuer under six series of Kaupthing 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.

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

In March 2015 the Bank issued euro-denominated bonds for a total of €300 million. This represented the first issue in euros by an Icelandic bank to a broad group of investors since the financial crisis. Offers were received from approximately 100 investors for more than €675 million, and demand outstripped supply more than twofold. The bonds are 3-year instruments and bear a fixed 3.125% coupon and were sold at terms equivalent to a 3.10% margin over interbank rates.

At the beginning of 2016 the Bank concluded a funding agreement with Kaupthing. Under the agreement Arion Bank will issue a bond amounting to \$747 million. The bond is a 7-year instrument and is callable on due interest dates the first two years. The bonds bear floating LIBOR + 2.6% margin in the first two years and after that the interest margin will be based on market rates. The bond will offset loans in foreign currency originally taken by the Bank from the Central Bank of Iceland and now owned by Kaupthing, and Kaupthing deposits in foreign currency at Arion Bank. The issue is part of the package of measures concerning Kaupthing and which are aimed at the lifting of the capital controls announced by the government on 8 June 2015.

In 2015 the Bank issued bonds denominated in Norwegian kroner. Five-year bonds totalling NOK 500 million were issued in June. The bonds bear floating NIBOR plus a 2.95% margin. The Bank has also entered a swap agreement under which part of the interest and principal are swapped into euros. The interest terms in euros are floating EURIBOR +2.74%. The issue attracted excess demand. In November the issue was tapped for an additional NOK 300 million at terms corresponding to NIBOR + 2.80%. The bonds were sold to investors in Norway, Sweden, Finland, Denmark and continental Europe.

### **Liquidity**

On 1 December 2013 new Central Bank rules on liquidity ratio came into effect. They are based on the same criteria as the liquidity requirements made since 2005 under the Basel III standard. The rules state that from 1 January 2014 liquidity coverage ratios of Icelandic financial institutions should be a minimum of 70% and 100% in foreign currency. The liquidity coverage ratio shall be increased by 10 percentage points a year until it reaches 100% in 2017.

The high liquidity ratio required by the FME reflects the uncertainty over the stability of deposits and the fact that a large proportion of the Bank's liabilities are primarily short-term or demand deposits, while the contractual maturity of the assets is long-term. The Icelandic banks are faced with particular uncertainties

linked to the possible outflow of capital triggered by the lifting of the capital controls. One of Arion Bank's key objectives is to maintain strong liquidity. At the end of 2015 the Bank's liquidity coverage ratio was 134% and the ratio for foreign currencies was 218%. Risk Management analyzes liquidity and the behaviour of its deposit base and reports its findings to ALCO (The Asset and Liability Committee).

As at 31 December 2015, the aggregate amount of the Bank's 10 largest deposits equalled 23 per cent. of the aggregate amount of the Bank's total deposits at that date. At the beginning of 2010, the Bank received a senior unsecured loan from the Central Bank amounting to ISK 61.3 billion and an ISK 29.5 billion subordinated loan from the Icelandic State that qualifies as Tier II capital. In June 2011, the Bank received a foreign currency subordinated loan from the Icelandic State in an amount equivalent to ISK 6.1 billion that qualifies as Tier II capital, see "*—Related Party Transactions*".

The Bank is focused on maintaining a large and stable deposit base originated from its clients. Deposits are expected to continue to form the core of the Bank's funding in the future. However, there are external factors that might affect the Bank's deposit base in the short to medium term, such as the lifting of capital controls and the increased availability of other investment opportunities for investors who currently hold deposits with the Bank. The Bank intends to continue diversifying its funding profile by issuing bonds in the domestic and international bond market when conditions permit.

## RISK MANAGEMENT

### Overview

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

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

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

The Bank operates the following committees to manage risk:

- Board Audit and Risk Committee (the **BARC**). This committee is responsible for supervising the Bank's risk management framework, risk appetite and ICAAP. The BARC regularly reviews reports on the Bank's risk exposures.
- Asset and Liability Committee (the **ALCO**). This committee is chaired by the CEO and is responsible for managing any asset-liability mismatches, liquidity risk, market risk, interest rate risk and capital management.
- Underwriting and Investment Committee (the **UIC**). This committee decides on underwriting and principal investments.

Credit Committees. The Bank operates four credit committees: The Board Credit Committee (BCC) which decides on all major credit risk exposures, the Arion Credit Committee (ACC) which operates within limits specified as a fraction of the Bank's capital, and the Corporate Credit Committee (CCC) and Retail Branch Committees (RBC) which operate within tighter credit granting limits. In addition the Bank operates five Collateral Valuation Committees, which set guidelines on collateral assessment and valuation, and Debt Cancellation Committee which deals with applications to reach composition with debtors.

The Bank's internal audit division conducts independent reviews of the Bank's operations, risk management framework, processes, policies and measurements. Internal audits examine both the adequacy and completeness of the Bank's control environment and processes as well as the Bank's compliance with its procedures, internal rules and external regulations. Internal audit results are discussed with the Bank's management and reported to the BARC.

The Bank's Risk Management division is headed by the Chief Risk Officer. It is independent and centralised and reports directly to the CEO. The division is divided into five units: Credit Analysis, which supports and monitors the credit granting process; Credit Control, which monitors credit exposures on a customer-by-customer basis; Economic Capital, which is responsible for the Bank's ICAAP; Portfolio Risk, which monitors liquidity risk and risks in the Bank's assets and liabilities at the portfolio level; and Operational Risk which monitors risks associated with the daily operation of the Bank.

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

### **Credit Risk**

Credit risk is managed and controlled by setting limits on the amount of risk the Bank is willing to accept for individual counterparties and groups of connected clients, and by monitoring exposures in relation to such limits.

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

The Bank seeks to limit its total credit risk through diversification of the loan portfolio across sectors and by limiting large exposures to groups of connected clients. Note 41 to the Bank's Consolidated Financial Statements as at 31 December 2014 shows the Bank's maximum exposure to credit risk by type of instrument. As at year ended 31 December 2014 and 31 December 2013, the Bank's total on and off balance sheet credit risk exposure totalled ISK 1,094,624 million and ISK 958,299 million respectively.

### ***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 committee with the highest lending authority. The BCC delegates lending authorities to the ACC which in turn delegates lending authorities and sets credit granting rules and guidelines for the business units. The Risk Management department is represented at credit committee meetings in an advisory role with a view to ensuring that all credit decisions are taken in line with the Bank's credit policy. Risk Management has the power to escalate a controversial credit committee decision to a higher authority.

For each credit application, the Bank gathers information and evaluates certain elements that serve as a basis for the decision, for example the borrower's profile, a financial analysis of the borrower, any proposed collateral, the borrower's credit rating and related parties and their total exposure.

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

Credit Analysis is also responsible for the approval of the corporate credit rating performed by account managers by challenging the qualitative input and verifying the quality of quantitative information used to produce the ratings.

The Bank generally requires collateral, but a central element in its assessment of a proposed borrower's creditworthiness is the borrower's ability to service debt. The main types of collateral obtained by the Bank are:

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

In addition to collateral, other important credit risk mitigating techniques are pledges, guarantees and master netting agreements.

To ensure consistent collateral value assessment, the Bank has five collateral valuation committees. The committees set guidelines on collateral valuation techniques, collateral value, valuation parameters and haircuts on the applied collateral value. The committees are divided by area of expertise as follows:

- Agriculture;
- Fishing vessels and fishing quotas;
- Real estate;
- Securities; and
- Inventory and trade receivables.

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

At 31 December 2015, the total value of the collateral that the Bank holds relating to loans individually impaired or more than 90 days past due but not impaired, was ISK 18,542 million, corresponding to a collateral coverage ratio above 100 per cent. Of this collateral, real estate collateral represents 98 per cent; fishing vessels represent 1 per cent. and the remaining 1 per cent. is made up of other types of collateral.

### ***Credit Monitoring***

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

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

To monitor the performance of its loan portfolio, the Bank relies on an Early Warning System (**EWS**), which is a forward-looking classification system for loans and borrowers. The monthly EWS classification is a prelude to the credit review by the Credit Control department. The need for impairment and/or financial restructuring is identified and evaluated during the review.

The classification is based on borrowers' contractual arrangements with the Bank, i.e. timeliness of payments and loan terms, financial ratios and credit rating. The table below shows an aggregation of the EWS to illustrate the different categories and underlying criteria.

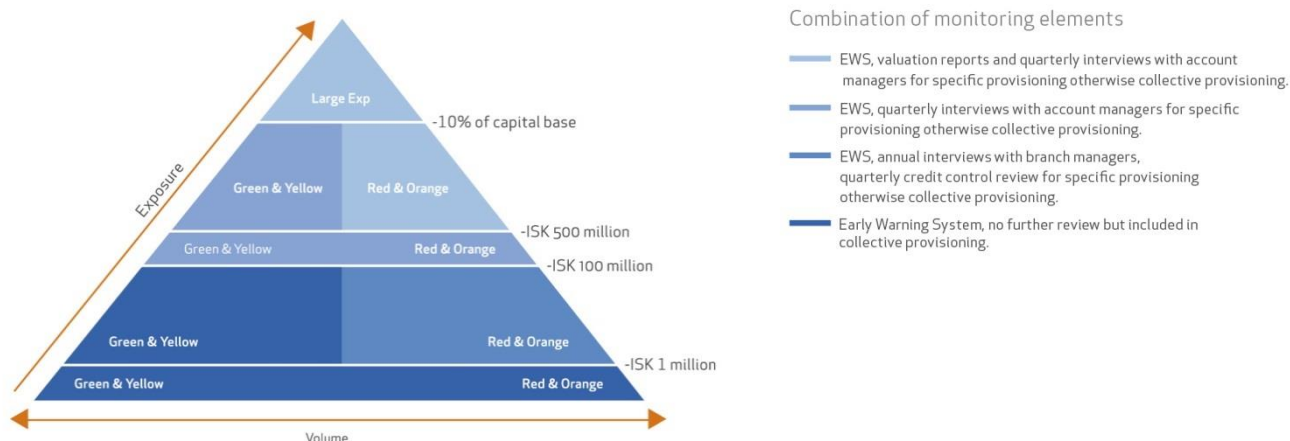
Category	Provision	Default	(Debt/EBITDA) /LTV	Equity ratio	Credit Rating	Covenant breach
Green	No	< 30	< 4.0 - 5.0 / < 75%-80%	> 15% - 25%	≥ B -	None
Yellow	No	30 - 90	4.0 - 6.0 / < 75%-90%	10% - 25%	CCC+	Minor
Orange	No	> 90	> 5.0 - 6.0 / 90% - 100%	< 10% - 20%	< CCC+	Serious
Red	Yes	> 90	> 5.0 - 6.0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

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

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

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

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



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

Collective provisioning is applied to credits other than those that have been specifically impaired. Also exempt from collective provisions are loans that are more than 90 days in default but have been determined not to require specific impairment. Collective provisions are estimates of expected loss based on the borrower's probability of default (PD), standardized loss given default values (LGD) and exposure at default (EAD).

### Counterparty Credit Risks

The Bank offers financial derivatives instruments to professional investors. The table below shows derivative trading activities that are currently permitted. The derivative instruments are classified according to primary risk factor and the type of derivative instrument.

Primary risk factor	Swaps	Forwards	Options
Interest rate	x		
Foreign exchange	x	x	x
Securities		x	x
Commodities		x	x

Value-changes are made in response to changes in interest rates, exchange rates, security prices and commodity prices.

The Bank sets limits to the total exposure and on the customer's negative value, net of collateral, to control the Bank's risk towards these instruments. These limits are generally client-specific and may refer specifically to different categories of derivative contract. Generally, collateral is required to cover potential losses on a contract. Should the net-negative position of the contract fall below a certain level, a call is made for additional collateral. If extra collateral is not supplied within a tightly specified deadline, the contract is closed. The margin-call process is monitored by Risk Management.

### Large Exposures

In accordance with applicable Icelandic regulations, a large exposure is defined as an exposure to a group of financially related borrowers which exceeds 10 per cent. of the Bank's capital base. The legal maximum for



individual large exposures is 25 per cent. of the Bank's capital base net of eligible collateral, and the sum of all large exposures cannot exceed 400 per cent. of the Bank's capital base. The Bank had no large exposures in excess of the legal limit of 25 per cent. at 31 December 2015. The largest exposure to a group of connected clients at the end of the period was ISK 22 billion before taking account of eligible collateral.

The bank has one large exposure at the end of the year 2015 net of eligible collateral.

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

	31.12.2015		31.12.2014	
	Gross	Net	Gross	Net
1 .....	11%	11%	<10%	<10%
2 .....	<10%	<10%	14%	14%
3 .....	<10%	<10%	11%	10%
<b>Sum of large exposure gross and net &gt;10%</b>	<b>11%</b>	<b>11%</b>	<b>65%</b>	<b>45%</b>

## 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's strategy towards market risk is 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. The market risk in the trading book arises from proprietary trading activities whereas market risk in the banking book arises from mismatches in assets and liabilities principally in relation to currencies, maturities and interest rates.

Market risk allowance is set by the Board in the Bank's risk appetite and the CEO decides on the limit framework for each trading desk and sets individual limits. The Asset and Liability Committee is responsible for managing the Bank's overall market risk. Risk management is responsible for measuring and monitoring market risk exposure, and reporting the exposure, usage and limit breaches.

## Interest Rate Risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Bank's operations are subject to interest rate risk associated with mismatches between interest bearing assets and interest bearing liabilities. The mismatch is characterised by a large gap between the interest fixing period of assets and liabilities, with a large amount of liabilities being

demand deposits while the interest rates of assets are generally fixed for a long period, resulting in a yield curve risk for the Bank. Note 42 to the Bank's Interim Consolidated Financial Statements as at 31 December 2015 provides further information on the Bank's maturity asset and liability gap. The Bank also faces interest basis risk between its interest bearing assets and interest bearing liabilities due to different types of floating rate in different currencies, of which the largest one is EUR.

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

#### *Indexation Risk*

The Bank is exposed to indexation risk when there is a mismatch between its index-linked assets and liabilities. As at 31 December 2015, the total amount of the Bank's indexed assets was ISK 311.6 billion and the total amount of its indexed liabilities was ISK 216.6 billion. See note 42 to the Interim Consolidated Financial Statements.

#### *Currency Risk*

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

There have been a number of court cases in which the legality of different types of foreign currency loan has been considered by the Icelandic courts in recent years. See "*Litigation*". Although these cases have clarified the law relating to these loans, there remains uncertainty regarding certain foreign currency linked loans. Nevertheless, the Bank considers that its portfolio of foreign currency linked loans is fully provisioned for the most likely outcome.

The table below indicates the currencies to which the Bank had significant exposure at 31 December 2015. The analysis calculates the effect of a 10 per cent. movement of the currency rate against the ISK (with +10% in the table denoting a depreciation of the ISK) on the Bank's income statement as a result of the change in fair value of currency sensitive non-trading monetary assets and liabilities. A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase.

The table assumes that all other variables remain constant.

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

As at 31 December 2014		
	-10%.	+10%
	<i>(ISK million)</i>	
EUR .....	(633)	633
USD .....	(333)	333
GBP .....	(486)	486
DKK .....	(104)	104
NOK .....	(157)	157
Other .....	(178)	178

### *Equity Price Risk*

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

### *Derivatives*

Customers can enter into derivatives contracts with the Bank. The types of derivatives currently offered by the Bank are FX swaps and forwards, interest rate swaps, cross-currency swaps, as well as options and forwards on equities, Treasury notes and bonds with Government guarantee. Limits on exposures and collateral are determined in accordance with the Bank's risk appetite. The Bank also uses derivatives to reduce market risk on its balance sheet. The Bank's exposure to derivative instruments has increased in the year 2014 but is not considered a material risk.

### *Prepayment Risk*

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall. The Bank was not materially exposed to prepayment risk at year ended 31 December 2014.

### **Liquidity Risk**

Liquidity risk is defined as the risk that the Group, though solvent, either does not have sufficient financial resources available to meet its liabilities when they fall due, or can secure them only at excessive cost. Liquidity risk arises from the inability to manage unplanned decreases or changes in funding sources. The Bank's primary source of funding is deposits from individuals, businesses and financial institutions. The Bank's liquidity risk stems from the fact that the maturity of its loans exceeds the maturity of its deposits, of which 60% is on-demand or with less than 30 days term.

The Bank's strategy is to seek to increase the maturity profile of its liabilities and to strengthen the Bank's liquidity reserve. The Bank has made significant process in converting its on demand deposits to term deposits. As at 31 December 2009, over 90 per cent. of the Bank's deposits were on demand compared to 76.9 per cent. as at 31 December 2011, 59.7 per cent. at 31 December 2012, 53 per cent. as at 31 December 2013, 58.5 per cent. as at 31 December 2014 and 57 per cent. as at 31 December 2015.

### ***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, i.e. the level of stickiness.

The table below shows the breakdown of the Banks deposit base according to the LCR categorization, with the associated expected stressed outflow weights as at year ended 31 December 2014 and 31 December 2013. Some similar categories are grouped together. The table contains deposits at the Bank and at banking subsidiaries. Thus, amounts due to Central Bank and amounts due to credit institutions at non-banking subsidiaries are excluded.

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

As at 31 December 2014

Deposits maturing within 30 days					
	Less stable	Weight (%)	Stable	Weight (%)	Term deposits*
<i>(ISK million)</i>					
Retail	78,659	10%	36,076	5%	53,803
SME	36,060	10%	3,895	5%	6,011
Operational relationship	-	25%	-	5%	1,190
Corporations	36,961	40%	830	20%	5,873
Sovereigns, central-banks and PSE	12,196	40%	-	-	2,870
Financial entities being wound up	19,796	100%	-	-	67,105
Pension funds	36,824	100%	-	-	19,765
Domestic financial entities	22,634	100%	-	-	16,752
Foreign financial entities	4,532	100%	-	-	522
Other foreign parties	3,425	100%	3,026	25%	2,082
<b>Total</b>	<b>251,087</b>		<b>43,827</b>		<b>175,973</b>

## Operational Risk

Operational risk is the risk of direct or indirect loss, or damage to the Bank's reputation resulting from inadequate or failed internal processes or systems, from human error or external events that affect the Bank's image and operational earnings.

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

Each business unit within the Bank is primarily responsible for taking and managing their own operational risk. Operational risk function is responsible for developing and maintaining tools for identifying, measuring, monitoring and reporting the Bank's operational risk. The Bank uses the Basel II basic indicator approach to the calculation of capital requirements for operational risk. The Bank's capital base for operational risk is measured as 15 per cent. of the average over three years of the sum of net interest income and net non-interest income, as required by applicable legislation.

The Bank's losses due to operational risk are registered in the Bank's loss database. Loss events are analysed to understand the cause of the event and any control failure and amendments to controls are made where applicable to reduce the risk of the event recurring. Losses are categorised according to the Basel II event categories Execution, Delivery and Process Management. Practices accounted for 60 per cent of total reported loss events. Measured by amount, Clients, Products & Business Practices accounted for 74 per cent of the total losses.

## CAPITAL ADEQUACY

The Bank's capital policy is to maintain a strong capital base to support business development and to meet regulatory capital requirements, even in times of stress.

Capital requirements according to Pillar 1 are based on the sum of risk weighted assets (**RWA**) for credit risk, market risk and operational risk, computed using formulas from the EU's Capital Requirements Directive (the **CRD**). The CRD offers different approaches for calculating RWA for these risk types.

The Bank uses the following approaches for its capital requirement calculations:

- The standardised approach is used to calculate the capital requirements for credit risk;
- The standardised method is used to calculate the capital requirements for market risk; and
- The basic indicator approach is used for 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 different books. Banking book RWA are measured by means of a hierarchy of risk weightings classified according to the nature of each asset and counterparty, taking into account eligible collateral or guarantees. Banking book off balance sheet items giving rise to credit, foreign exchange or interest rate risk are assigned risk weights appropriate to the category of the counterparty, taking into account eligible collateral or guarantees. Trading book RWA are determined by taking into account market related risks such as foreign exchange, interest rate and equity position risks, and counterparty risk.

The Bank carries out an ongoing process, the ICAAP, with the aim of ensuring that the Bank has in place sufficient risk management processes and systems to identify, manage and measure the Bank's total risk exposure. The ICAAP is aimed at identifying and measuring the Bank's risk across all risk types and ensuring that the Bank has sufficient capital in accordance to its risk profile. The FME supervises the Bank, reviews the Bank's ICAAP and sets capital requirements for the Group as a whole.

To measure the Pillar 2 capital requirement the Bank uses an internal economic capital model. Pillar 2 is based on Pillar 1 calculations, using internal models for credit risk calculations, and takes into consideration risks that are not under Pillar 1, including concentration risk, residual risk, country risk, settlement risk, liquidity risk, interest rate risk in the banking book, reputational risk, legal and compliance risk, business risk and political risk.

Stress tests are an important part of the ICAAP and show how the Bank's capital could be affected by sharp macro-economic changes, downturns in the Bank's core business or other major events.

The Group is subject to capital requirements which are specified by the FME following a supervisory review and evaluation process (**SREP**). The Group's capital base exceeded the FME's SREP requirements in each of 2013, 2012 and 2011.

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

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

	31.12.2015	31.12.2014
Capital Base	<i>(ISK million, except percentages)</i>	
Total Equity	201,894	162,212
Non controlling interest not eligible for inclusion in CET1 capital*	(9,108)	(1,385)
Intangible assets	(9,285)	(9,596)
Tax Assets	(205)	(655)
Other statutory deductions	(3,151)	(111)
<b>Common equity Tier 1 capital*</b>	<b>180,145</b>	<b>150,465</b>
Non controlling interest not eligible for inclusion in CET1 capital	9,108	1,385
<b>Tier 1 capital</b>	<b>189,253</b>	<b>151,850</b>
Subordinated liabilities	10,365	31,639
Regulatory adjustments to Tier 2 Capital	(771)	-
Other statutory deductions	(3,118)	(101)
<b>Tier 2 capital</b>	<b>6,476</b>	<b>31,538</b>
<b>Total capital base</b>	<b>195,729</b>	<b>183,388</b>

- \* CET 1 capital according to CRR definition while Tier1, capital base and RWA are calculated according to The Act on Icelandic Undertakings No. 161/202. Capital ratios according to CRR are generally lower than the ratios shown here.
- \*\*Straight-line amortization for maturities within five years.

## COMPLIANCE

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

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

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

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

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

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

## INVESTMENTS

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

The table below shows the classification of the Bank's investment portfolio at year end 31 December 2015 and 31 December 2014.

	As at 31 December 2015			
	Trading	Designated at fair value	Available to sale	Total
	<i>(ISK million)</i>			
Listed bonds and debt instruments	2,526	74,757		77,283
Unlisted bonds and debt instruments	99	1,412		1,511
<b>Total bonds and debt instruments</b>	<b>2,625</b>	<b>76,169</b>		<b>78,794</b>
Listed shares and equity instruments	2,138	13,869		16,007
Unlisted shares and equity instruments	1,668	10,665	5,852	18,185
Bond funds with variable income	1,090	222		1,312
<b>Total shares and equity instruments</b>	<b>4,896</b>	<b>24,756</b>	<b>5,852</b>	<b>35,504</b>



	As at 31 December 2014		
	Trading	Designated at fair value	Total
			(ISK million)
Listed bonds and debt instruments	3,157	61,421	64,578
Unlisted bonds and debt instruments	36	1,852	1,888
<b>Total bonds and debt instruments</b>	<b>3,193</b>	<b>63,273</b>	<b>66,466</b>
Listed shares and equity instruments	1,538	7,079	8,617
Unlisted shares and equity instruments	1,613	13,901	15,514
Bond funds with variable income	928	173	1,101
<b>Total shares and equity instruments</b>	<b>4,079</b>	<b>21,153</b>	<b>25,232</b>

## 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 IT division had 111 FTEs at 31 December 2014. 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

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

In April 2013 the ICA imposed a ISK 500 million fine on Valitor hf. for abusing its dominant position on the payment card market and violating conditions set out in an earlier decision of the Authority. Valitor hf. appealed the decision to the Competition Appeals Committee. In October 2013 the Committee confirmed the decision of the Competition Authority. Valitor hf. referred the case to the courts. In May 2015 the District Court of Reykjavik rejected Valitor's reasoning that the decision be nullified, but agreed to its claim to lower the fine to ISK 400 million. The case has been appealed to the Supreme Court. The final judgement of the Supreme Court is expected in 2016.

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

### **Legal proceedings regarding damages**

The former chairman of the Board of 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.

### **Other legal matters**

Recently, there were three cases being heard by the Icelandic courts for the purpose of verifying the legitimacy of loans linked to the Consumer Price Index (CPI). In short, these three cases revolve around whether, on the one hand, the provisions contained in the debt instrument, as regards the increase of the principal of the loan

due to linkage to the CPI, is an unfair contractual condition and on the other hand whether the loan provider was authorized to take “0% inflation” into account when calculating borrowing costs. The courts requested advisory opinions from the EFTA Court as regards certain issues in two of the cases, which the EFTA Court delivered on 28 August and 24 November 2014. By the decisions of the District Court of Reykjavík issued on 6 February 2015, the district court resolved two of the above cases, where the lender's reasoning was upheld in both cases. Both of the cases were appealed to the Supreme Court. With a judgment on 13 May 2015 (case no 160/2015), the Supreme Court stated that there were no grounds to consider the price indexation terms of the debt instrument to be unfair. The Supreme Court, moreover, was of the opinion that the lender had fulfilled its duty to provide information to the lender in regards to said loan. The Supreme Court, therefore, upheld the lender's reasoning as regards both issues that the borrower's contested as regards the price indexation. With a judgment of 26 November 2015 (case no.243/2015) a lender was acquitted of a borrowers' claim in a case which dealt to a large extent with the same issues covered in the previous case. The Bank is aware of at least one further case, which specifically deals with legal issues regarding the CPI, that is now before the District Court.

The Bank made no provision due to court cases regarding the CPI as the likelihood of the courts finding with the plaintiffs in the cases is considered to be remote.

### **The uncertainty regarding the book value of foreign currency loans**

The uncertainty of legality of FX loans has continued in 2015 and the Group constantly monitors judgments involving itself and others to refine its provisions on foreign currency loans. Although there is more clarity in the matters of FX loans there still remains uncertainty regarding foreign currency linked loans in certain respects, such as regarding the legality of particular loans and the recalculation and settlement of foreign currency linked loans. Nevertheless, the Group considers its portfolio of foreign currency linked loans fully provisioned for the most likely outcome.

#### *Legal matters concluded*

In 2012 Kortþjónustan hf. filed a suit against Valitor hf., Borgun hf. and Greiðsluveitan ehf., claiming damages for the alleged loss suffered by Kortþjónustan hf. due to alleged breaches of competition law based on a settlement made by Valitor hf., Borgun hf. and Greiðsluveitan ehf. with the ICA, published in an ICA Decision No 4/2008. The case was dropped in September 2014, and a new claim filed based on the findings of a court appointed evaluators on Kortþjónustan hf.'s alleged damage. The case was settled in early March 2015 with a payment of ISK 250 million to Kortþjónustan hf.

### **Visa Inc. acquisition of Visa Europe Ltd**

In November 2015 Visa Inc. and Visa Europe Ltd. announced a definitive agreement for Visa Inc. to acquire Visa Europe Ltd. The transaction consists of upfront consideration with the potential for an additional earn-out following the fourth anniversary of closing. Arion Bank is member of Visa Europe Ltd. through its subsidiary Valitor Holding hf. The transaction is subject to regulatory approvals and is expected to be completed in the second quarter of 2016. In relation to this transaction the Group reports AFS financial asset. The value of the AFS asset is based on the Group's expected share of profit from the sale of Visa Europe Ltd. The total gain from this transaction is estimated ISK 2,903 million after taking into account estimated tax effects and conditional payment to Landsbankinn hf., which was part of the agreement when Arion Bank acquired 38% shareholding in Valitor Holding hf. from Landsbankinn hf. in 2014.

### **Acquisition of the insurance company Vörður**

In October 2015 Arion Bank concluded a conditional purchase agreement with BankNordik according to which Arion Bank acquires 51% of shares in the Icelandic insurer Vörður. Parallel to the sale Arion Bank and BankNordik signed an agreement on the purchase of the remaining shareholding in Vörður, which will come into effect when restrictions on the sale of the remaining minority shareholding have been lifted and no later than in 2017. The purchase price for the 100% of the shares is EUR 37 million. Net earnings of Vörður

amounted to ISK 385 million in 2014 and total assets amounted to ISK 10,264 million at year end 2014. Vörður will be classified as a subsidiary of Arion Bank. The transactions are conditional on the approval of the relevant Icelandic authorities, and the parties expect to complete the sale of 51% of shares in the coming months.

## **RELATED PARTY TRANSACTIONS**

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

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

No unusual transactions took place with related parties during 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 2015, 2014, 2013 or 2012.

See note 40 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:

#### ***Monica Caneman, Chairman***

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

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

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

***Gudrún Johnsen, Vice-Chairman***

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

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

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

Gudrún is currently a lecturer in finance in the faculty of business administration at the University of Iceland.

***Benedikt Olgeirsson, Director***

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

Benedikt completed an MSc in construction engineering and project management at the University of Washington in Seattle in 1987. He has also completed courses in management, business and finance at Wharton Business School and Harvard Business School. Benedikt completed a degree in civil engineering from the University of Iceland in 1986.

Benedikt has been Deputy CEO of Landspítali University Hospital since 2010. Between 2005 and 2009 he was managing director of Atorka hf. He was managing director of Parlogis ehf. from 2004 to 2005. He was a manager at Eimskip between 1993 and 2004, most recently as head of Eimskip's operations in Hamburg. Between 1988 and 1992 Benedikt worked as a project manager in civil engineering. He was a board director at Promens from 2005 to 2010. He was also a board director at InterBulk Group, which is listed on the London Stock Exchange, from 2007 to 2010. Benedikt was also chairman of Icepharma hf. and Parlogis ehf. from 2005 to 2007.

***Brynjólfur Bjarnason, Director***

Brynjólfur was born in 1946. He was first elected as a Director at a shareholders' meeting on 20 November 2014. He is not a shareholder of Arion Bank and is an independent Director.

Brynjólfur graduated with an MBA from the University of Minnesota in 1973 and a cand. oecon. degree in business studies from the University of Iceland in 1971.

Brynjólfur was managing director of the Enterprise Investment Fund from 2012 to 2014. Between 2007 and 2010 he was the chief executive officer of Skipti. Brynjólfur was chief executive officer of Síminn from 2002

to 2007 and chief executive officer of Grandi hf. from 1984 to 2002. Between 1976 and 1983 he was managing director of the publisher AB bókaútgáfa. He was also head of the economics department of VSÍ from 1973 to 1976. Brynjólfur has broad experience as a director and has served on numerous boards and been chairman of several. Brynjólfur has served on the board of Genís since 2011 and the board of the Reykjavík Dramatic Society Playwright Fund since 2009.

***Kristín Th. Flygenring, Director***

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

Kristín completed an MA in economics from Northwestern University in Illinois in 1983. She graduated with a cand. oecon. degree in business administration from the University of Iceland in 1980. She completed a course in practical media studies at the University of Iceland in 1994 and gained a diploma in European competition law from Kings College London in 2004.

Kristín currently works as an independent consultant. From 2011 to 2013 she was a member of a three-person committee on the Icelandic parliament's investigative committee on the Housing Financing Fund. She was a part-time lecturer and adjunct at the University of Iceland between 2007 and 2012 and was a specialist at the Institute for Research in Finance and Economics at Reykjavík University from 2007 to 2009. Between 2001 and 2007 she worked as an economist, first at the National Economic Institute and then in the Department of Economics at the Central Bank of Iceland. She was appointed editor of the economics glossary at the Icelandic Language Institute at the University of Iceland in 1998, a position she held until the glossary was published in 2000. Between 1995 and 1998 she was an economist at the Fisheries Association of Iceland. She was an adviser and director of market research at Hagvangur from 1984 to 1986 and was then marketing manager at the Icelandic Freezing Plants Corporation (now Icelandic Group hf.) from 1986 to 1989. Kristín started her career as an economist at the Association of Icelandic Manufacturers and she later worked for OECD.

Kristín has held several positions on boards and committees and was, for example, the chairman of the Competition Committee from 2002 to 2005 and a board member of Midengi ehf, a holding company owned by Íslandsbanki, from 2009 to 2012. Kristín has also served on the Post and Telecommunications Arbitration Committee since 2008.

***Måns Höglund, Director***

Måns was born in 1951. He is Swedish and lives in Portugal. He was first elected as a Director at a shareholders' meeting on 24 March 2011. He is not a shareholder in Arion Bank and is an independent Director. Måns is Chairman of the Board Audit and Risk Committee and is a member of the Board Credit Committee.

Måns graduated from Stockholm School of Economics in 1975 where he became a lecturer and researcher after completing his studies. He served in various posts at Hambros Bank in London between 1977 and 1984 and was regional director for Denmark and Iceland for two years. In 1984 he started working for Götabanken in London and was transferred to the bank's Stockholm operation in 1989 where he was head of the international finance division until 1991. From 1991 to 1999 he worked for Swedbank, where his roles included director and head of the bank's large corporate business. In 1999 to 2002 he worked for both Unibank (as head of Sweden operation) and Nordea (as Head of Private Banking, Sweden).

From 2002 to 2011 Måns worked for Swedish Export Credit Corporation (SEK) as executive director and head of corporate and structured finance. He was also a member of SEK's Executive Committee.

***Thóra Hallgrímsdóttir, Director***

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

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

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

#### **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:

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

#### **Board's sub-committee members, other than Directors**

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

#### **Senior Management**

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

##### ***Höskuldur H. Ólafsson, CEO***

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

##### ***Freyr Thórdarson, Managing Director of Corporate Banking***

Freyr was born in 1973 and lives in Iceland. Freyr completed a Bachelor's degree in business administration at Reykjavík University in 2003 and earned an MBA degree from the Reykjavík University School of Business in 2010. Before that, he studied at Universität Salzburg in Austria and completed a Vor-diplom in Communication Science in 1999. Freyr has worked in banking and finance since 2001, both in Iceland and



abroad, at Straumur Investment Bank, Gnúpur investment company, and Íslandsbanki/Glínir. In 1999 to 2001, prior to his financial career, Freyr worked at a bottling company called IcelandSpring on plant development and management. Since 2009, Freyr has managed restructuring and asset recovery projects in Kaupthing hf.'s Scandinavian portfolio as a Senior Director. He currently sits on the board of Norvestia Oyj, which is listed on the NASDAQ OMX Helsinki, and also sits on the boards of two unlisted industrial companies in Scandinavia on behalf of Kaupthing. Freyr was previously a Board member of Arion's Board of Directors from 22 March 2012 until 13 May. He was hired as the Managing Director of Corporate Banking on 13 May 2013.

#### ***Helgi Bjarnason, Managing Director of Retail Banking***

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

#### ***Gísli S. Óttarsson, Chief Risk Officer and Managing Director***

Gísli received a Ph.D. in mechanical engineering from the University of Michigan in 1994. Gísli worked as a software designer and adviser for various engineering software companies in the United States before he joined Kaupthing's risk management division as head of research and development in January 2006. In April 2009, Gísli became the chief risk officer of the Bank.

#### ***Íða Brá Benediktsdóttir, Managing Director of Investment Banking***

Íða Brá was born in 1976. Íða Brá was appointed managing director of Investment Banking in February 2016.

Íða 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 and she was long head of department within treasury. Since 2013 Íða Brá has been head of Private Banking. Before taking over Private Banking Íða Brá was Head of Corporate Communications. Íða Brá served on the board of numerous companies, including Ólafsfjörður savings bank, AFL – savings bank, Landfestar and HB Grandi hf.

Íða Brá graduated with a degree in business administration from the University of Iceland in 1999 and has a Master's in finance from the Rotterdam School of Management. She is also a certified stockbroker.

#### ***Jónína S. Lárusdóttir, Managing Director of Legal Division***

Jónína graduated from the faculty of law at the University of Iceland in 1996 and qualified as a district court attorney the following year. In 2000, Jónína completed a master's degree from the London School of Economics and Political Science, including European competition law. In 1996, Jónína started working for the A&P law firm, but moved to the Ministry of Commerce in 2000 where she was a specialist in the financial markets department. She was appointed director of the general office of the Ministry of Industry and

Commerce in 2004. In 2007, she became permanent secretary of the Ministry of Commerce, now the Ministry of Economic Affairs, where she worked until late 2010 when she took over the post of managing director of the Bank's Legal Division. Jónína has served on and chaired numerous committees and has worked as a lecturer in several institutions, including the faculty of law of the University of Iceland. She was chairman of the Depositors' and Investors' Guarantee Fund in 2003 and 2004.

***Margrét Sveinsdóttir, Managing Director of Asset Management***

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

***Rakel Óttarsdóttir, Managing Director of Corporate Development & Marketing***

Rakel joined the IT division of Kaupthing Bank in 2005 where she was an account manager. In 2010 she became head of project management in the Corporate Development & Marketing division of the Bank. In December 2011 she was appointed managing director of Corporate Development & Marketing. Before joining the Bank, Rakel was head of development at TM Software. Rakel is a computer science graduate from the University of Iceland and has an MBA from Duke University in the United States.

***Stefán Pétursson, Chief Financial Officer and Managing Director***

Stefán graduated with an MBA from Babson College in Massachusetts in 1991 and a degree from the faculty of business of the University of Iceland in 1986. Stefán was appointed CFO at the Bank in August 2010. In 1986 to 1989, Stefán worked as head of administration at the Icelandic Fisheries Laboratories Institute. After completing his studies in the United States, Stefán joined Landsvirkjun. He began as head of funding but later took over as treasurer and finally CFO, a position he held from 2002. Stefán was on leave from Landsvirkjun in 2008 while serving as the CEO of the investment company HydroKraft Invest hf. Stefán has held a number of directorship positions and other positions of responsibility in recent years. He is currently a member of the board of Landfestar hf.

***Sigurjón Pálsson, Managing Director of Operations***

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

***Hákon Már Pétursson, Compliance Officer***

Hákon studied law at the University of Iceland and University of Copenhagen, and is also a certified stockbroker. From 2006 to 2009 he worked as a specialist in the Securities Market division at the FME. During this time he was, among other things, the FME's representative in the Takeover Directive expert group and the Markets in Financial Instruments Directive (MiFID) expert group at the Committee of European Securities Regulators. He was also a guest lecturer at the University of Iceland and University of Reykjavík. From 2009

to 2011 he worked for KVASIR Legal on various matters relating to banking and financial restructuring. Hákon joined Arion Bank's Compliance Division in 2011.

#### ***Lilja Steinhórsdóttir, Chief Audit Executive***

Lilja gained an MBA degree from the University of Edinburgh in 1998. She qualified as a chartered accountant in 1984 and graduated with a degree in business administration in 1980. Before she joined the Bank in late 2006 as chief audit executive, she was the chief auditor at the Central Bank for eight years. She established an accounting firm in Akureyri in 1986 and headed it for 13 years when it was sold to Deloitte. She is a member of the Institute of State Authorised Public Accountants and has served on the audit committee on behalf of the organisation. She also served on the audit committee of Icelandic Banks' Data Centre from 1998 to 2010, first on behalf of the Central Bank and then the Bank.

#### ***Helgi G. Björnsson, Customers' Ombudsman***

In 1993, Helgi was appointed deputy branch manager at Búnadarbanki (a predecessor of the Bank) in Akureyri and became branch manager at Höfði, Reykjavík, in 1999. He was then branch manager in Grafarvogur, Reykjavík, until spring 2010 when he joined the Customers' Ombudsman department as a specialist. Helgi was appointed Customers' Ombudsman of the Bank in April 2012. Between 1989 and 1993 Helgi worked for the Director of Tax Investigations and also advised on accounting for companies in north eastern Iceland. From 1987 to 1989 Helgi worked at Bifröst University in Iceland, teaching accounting, production management and human resource management. Helgi graduated with a diploma in industrial technology from the Technical College of Iceland (now Reykjavík University) in 1987.

There are no conflicts of interest between the duties of the members of senior management listed above to the Bank and their private interests or other duties. The address of each member of senior management is Borgartún 19, 105 Reykjavík.

### **Corporate Governance**

The Bank's Corporate Governance framework is based on law, the Bank's Articles of Association and the Guidelines on Corporate Governance issued by the Icelandic Chamber of Commerce, NASDAQ OMX Iceland hf. and the Confederation of Icelandic Employers in accordance with the Bank's Corporate Governance Statement. The Bank is directed and controlled by this framework. By establishing rules on corporate governance, the Bank sets forth criteria of conduct in key areas, which complement statutory rules. The Bank believes that a strong governance culture enhances trust, reduces risk and increases economic benefit for the Bank and its shareholders in the long term. The Bank continually seeks to update its corporate governance framework in response to new events, changes in statutory law and developments in domestic and international standards.

#### ***Management***

The CEO is appointed by the Board. He is in charge of the day-to-day operations of the Bank and represents it in all matters concerning normal operations. The CEO is assisted by an executive management committee, in which all nine managing directors hold a seat.

#### ***Customers' Ombudsman***

The Customers' Ombudsman is appointed by the Board in accordance with a government recommendation made at the end of 2008.

The role of the Ombudsman is to ensure fairness and objectivity when dealing with recovery cases, prevent discrimination between customers and to ensure that the process for handling cases is transparent and documented. In the case of companies, the Ombudsman must also ensure that competition perspectives are

taken into account, viable companies are entered into the restructuring process and rules on financial restructuring are adhered to.

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

### ***Internal Audit***

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

The internal audit is governed by the audit charter, an FME directive on the internal audit function in financial institutions and international standards on internal auditing. All internal audit work is completed by issuing an audit report with deadlines for the implementation of audit findings. Implementations are followed up by Internal Audit every quarter. Internal Audit had 8 employees at 31 December 2014.

### **Employees**

During 2015, the average number of FTEs at the Group was 1,139 (compared to 1,128 during 2014). At 31 December 2015, the number of FTEs at the Group was 1,147. The Bank had an average of 1,120 FTEs in 2014.

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

## 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. Kaupthing Bank, through its subsidiary Kaupskil ehf., now holds an 87% stake in the Issuer and the Ministry of Finance holds the remaining 13%. A similar agreement was reached between the government and Íslandsbanki hf., and the Glitnir Resolution Committee, through ISB Holding, now holds 95% of the shares in Íslandsbanki and the Ministry of Finance holds the remaining 5%. Landsbankinn hf. remains fully state-owned.

### *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.<sup>1</sup>

### *Other relevant institutions*

A new Housing Financing Fund ([www.ils.is](http://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

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

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](http://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](http://www.sedlabanki.is)) is responsible for implementing monetary policy consistent with the goal of maintaining price stability. The activities of the Central Bank are primarily governed by Act No. 36/2001, on The Central Bank 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 OMX Iceland) (<http://www.nasdaqomxnordic.com/nordic/Nordic.aspx>) operates under Act No. 110/2007, on Stock Exchanges. In the autumn of 2000, the Iceland Stock Exchange joined NOREX, a joint project of the Nordic stock exchanges. One of the main benefits from the NOREX Alliance is the SAXESS trading system, which is used by all NOREX participants. In September 2006, the Iceland Stock Exchange joined the OMX Nordic Exchange.

## 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 Depositary 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

The Dealers have, in a programme agreement dated 10 February 2012, as amended and restated on 11 June 2013 the **Programme Agreement**), agreed with the Issuer a basis upon which they or any of them may from time to time agree to purchase Bonds. Any such agreement will extend to those matters stated under "*Form of the Bonds*" and "*Terms and Conditions of the Bonds*". In the Programme Agreement, the Issuer has agreed to reimburse the Dealers for certain of their expenses in connection with the establishment and any future update of the Programme and the issue of Bonds under the Programme and to indemnify the Dealers against certain liabilities incurred by them in connection therewith.

In order to facilitate the offering of any Tranche of the 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 11 December 2013.

### 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 OMX Iceland hf. for Bonds issued under the Programme to be admitted to trading on the regulated market of the NASDAQ OMX Iceland hf. and to be listed on the Main Market of the NASDAQ OMX Iceland hf. The regulated market of the NASDAQ OMX 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 2013 and 2012 (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 OMX 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 OMX Iceland hf. and each document incorporated by reference are available on the NASDAQ OMX Iceland hf. website at [www.nasdaqomxnordic.com](http://www.nasdaqomxnordic.com) and on the Issuer's website: [arionbanki.is](http://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 2013 and there has been no material adverse change in the financial position or prospects of the Issuer since 31 December 2013.

### **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 Ernst & Young 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 2011 and 31 December 2012. 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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105 Reykjavík  
Iceland

**DEALER**

**Arion Bank hf.**  
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