Consolidated Financial Statements

– for the year 2015

Arion Bank

CONTENTS

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

The Financial Statements of Arion Bank for the year ended 31 December 2015 include the Financial Statements of Arion Bank ("the Bank") and its subsidiaries, together referred to as "the Group".

Outlook

The Icelandic economy performed strongly in 2015. GDP growth was 4.5% during the first nine months of the year and both investment and private consumption gained momentum. Unemployment measured 1.9% at the end of the year, compared with 4.3% the previous year. Inflation crept up slightly, with annual inflation measuring 2% in December, which was nevertheless below the Central Bank’s targets. The outlook for the Icelandic economy is reasonably bright. The most recent forecast from Arion Bank Research, from October 2015, projects GDP growth of 4.1% in 2016 and 3.1% in 2017. The average rate of unemployment can be expected to drop slightly and will be around 4% in 2016 and 3.7% in 2017. The increasd demand for labour will mainly be in the travel and construction industries. In January Arion Bank Research revised its inflation forecast downwards and now projects average inflation for 2016 of 2.3%, but this is expected to rise to 3.5% in 2017. The government's plan to lift the capital controls has gone mostly as scheduled. The Icelandic courts have approved stability contributions from the failed banks' estates and the government has already received part of these contributions from the estates, which are to be used exclusively towards the reduction of government debt. An auction releasing offshore ISK will likely be held this spring, after which capital controls will be lifted on the domestic economy. Standard & Poor’s recently upgraded Iceland’s sovereign credit rating to BBB+ with a stable outlook. At the same time it changed the outlook on Arion Bank's BBB- credit rating from stable to positive. Further ratings upgrades are expected for both Iceland and Arion Bank as the government's plan to lift capital controls materializes and as debt continues to be reduced.

Arion Bank is a leading relationship bank on the Icelandic financial market. The Bank enjoys a strong position in all its business segments: Retail Banking, Corporate Banking, Asset Management and Investment Banking. The Bank's subsidiaries further supplement its service offering and form an integral part of the Group. The main subsidiaries include Valitor hf., which is a market leader in Iceland for acquiring and payment solutions and is also with operation in Scandinavia and the United Kingdom. The Bank also owns Stefnir hf., Iceland's largest fund management company, and OKKAR Líftryggingar hf., Iceland's second largest life insurance company.

A milestone in Arion Bank's operations was reached in 2015 when the Bank largely completed the sale of direct and indirect ownership which had been acquired during the process of restructuring its clients’ debts. Arion Bank sold shares in three companies, Reitir fasteignafélag hf., Eik fasteignafélag hf. and Síminn hf., when they were listed on Nasdaq Iceland during the year. Arion Bank arranged the listing of these companies on the Icelandic stock market and they were all the IPOs in Iceland during the year. In addition a sizeable indirect holding in Refresco Gerber was sold during the year as the company was listed on the Euronext market in Amsterdam. At the end of the year the Bank also sold its interest in Klakki ehf. In January 2016 the Bank announced the sale by its subsidiary BG12 slhf. of a 46% shareholding in Bakkavor Group Ltd.

Arion Bank has not been unaffected by the prevailing situation on the global oil market as it has made loans to service companies in the industry. These loans are less than 1% of total loans to customers and have been adequately provisioned for in the Bank's accounts.

One of the proposals made by a group of restricted holders of Kaupthing claims and their advisors to the government leading up to a composition was that Kaupthing's foreign exchange exposure to Arion Bank would be termed out in an EMTN format and that Kaupthing would purchase at par the long-term FX financing provided by the Central Bank to Arion Bank, also to be changed into an EMTN format. In January 2016 the Bank reached an agreement with Kaupthing under which Arion Bank will issue a bond under its EMTN Programme in the amount of USD 747 million (ISK 97 billion). The bond is a 7-year instrument, callable on interest payment dates during the first two years. The bond bears floating LIBOR plus 2.6% for the first two years and will then, if it has not been called, be re-priced at market terms. This bond issue secures the long-term funding of Arion Bank in foreign currency.

On 22 January 2016 the Financial Stability Council published its recommendation for capital buffers which, if ratified by the FME, will impose 8.5% buffer requirements on Arion Bank when fully loaded as early as Q1 2017. Arion Bank already meets the combined Pillar 2 and fully loaded buffer requirements and does not expect to be required to increase its capital base in the coming years.

Arion Bank is financially robust as demonstrated by leverage ratio of 16.7% (see Note 45). Its liquidity position is strong, with LCR at 134%. All the ingredients are in place to enable Arion Bank to continue to offer its customers quality services in the areas which are important to them, whether in Retail Banking, Corporate Banking, Asset Management or Investment Banking.

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

Operations during the year

Net earnings amounted to ISK 49,679 million in 2015 and the Group's equity amounted to ISK 201,894 million at year end. The capital ratio of the Group, according to the Financial Undertakings Act No. 161/2002 was 24.2% and the Tier 1 ratio was 23.4%, which comfortably meets the requirements set by law and the Financial Supervisory Authority (FME). The liquidity position was also strong at year end and well above the regulatory minimum.

One of Arion Bank's main tasks in recent years has been to improve the quality of its loan portfolio and to reduce the amount of problem loans. The Bank has succeded in this as the distribution of loans between individuals and companies is satisfactory and the ratio of problem loans has decreased to 2.4%.

Operations in 2015 were significantly affected by one-off events, where the sale of shareholdings in Reitir fasteignafélag hf., Eik fasteignafélag hf., Síminn hf. and Refresco Gerber had a substantial impact. Additionally, valuation changes related to the shareholding in Bakkavor Group Ltd. affected the earnings positively in 2015 after the shareholding was sold at the beginning of 2016. Core operations were strong and the Bank is well funded. Net interest income increased by 11.4% compared with 2014. Net commission income increased between years, or by 8.8%, and the increase was generated across the Bank. Net financial income totalled ISK 12,844 million, a significant proportion of this relating to profit from sale and valuation change from the holding in Refresco Gerber and valuation changes relating to holdings in Reitir fasteignafélag hf. and Síminn hf. following the company's listing on Nasdaq Iceland. The Bank's equities and bond portfolios also performed well during the year.

The Board proposes that net earnings will be added to equity and that no dividend will be paid in 2016 for the fiscal year 2015.

In November Visa Inc. and Visa Europe Ltd. announced a definitive agreement for Visa Inc. to acquire Visa Europe Ltd. Arion Bank is member of Visa Europe Ltd. through its subsidiary Valitor Holding hf. The transaction is subject to appeal and regulatory approvals and is expected to be completed in the second quarter of 2016. The expected share of profit from the sale of Visa Europe Ltd. is estimated to be ISK 2,903 million after taking into account estimated tax effects and the conditional payment to Landsbankinn hf., which was part of the agreement when Arion Bank acquired a 38% shareholding in Valitor Holding hf. from Landsbankinn hf. in 2014 (see Note 34).

The merger of the savings bank AFL - sparisjóður with Arion Bank was approved by the FME on 15 October and was effective from that day. Arion Bank will offer quality services to the former customers of the savings bank and intends to be an active participant in the savings bank's home market.

The main change on the Balance Sheet from year end 2014 is related to the funding of the Bank, i.e. the issue of bonds and an increase in the deposit base after a slight reduction at the end of 2014. This increase is reflected on the asset side by an increase in liquid assets and Loans to customers. Loans to customers increased by ISK 32,842 million during the year. The increase is partly related to new lending to businesses in the real estate sector. In April Arion Bank paid a dividend to its shareholders of ISK 12,809 million.

In March Arion Bank launched its inaugural euro senior unsecured benchmark issue, when the Bank sold EUR 300 million, or ISK 45 billion, of 3-year fixed rate bonds to around 100 international investors. It was the Bank's first public transaction in euros and the single largest transaction by an Icelandic bank in recent years, and the most important step taken by an Icelandic bank to re-enter the international capital markets since 2008.

At the end of June Arion Bank completed a 5-year bond issue of 500 million Norwegian kroner, approximately ISK 8 billion. The Bank tapped this bond issue for an additional NOK 300 million in November, taking the overall issue size to NOK 800 million. The bonds bear floating NIBOR +2.95%. In relation to these bond issues Arion Bank has repurchased NOK 394 million of a NOK 500 million issue from 2013.

During the year Arion Bank prepaid ISK 20 billion of the approximately ISK 30 billion subordinated loan from the Icelandic treasury. The loan was granted at the beginning of 2010 in connection with the recapitalization of the Bank.

Arion Bank continued to issue covered bonds which are secured in accordance with the Covered Bond Act No. 11/2008. The Bank issued a total of ISK 23.6 billion of covered bonds in 2015 in the domestic market, of which ISK 15 billion were inflation-linked bonds and ISK 8.6 billion were fixed rate bonds. Arion Bank will continue to issue covered bonds on a regular basis on the domestic market in 2016.

The Group had 1,147 full-time equivalent positions at the end of the year compared with 1,120 at the end of 2014; 876 of these positions were at Arion Bank, compared with 865 at the end of 2014.

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

Group ownership

On behalf of its creditors Kaupthing ehf., through its subsidiary Kaupskil ehf., holds 87% of the shares in Arion Bank hf. The remaining shareholding of 13% is held by Icelandic State Financial Investments on behalf of the Icelandic government.

The Board of Directors has seven members, four women and three men. The ratio of men to women is therefore in compliance with the law which states that companies with more than 50 people should ensure that the ratio of either sex on the board of directors should not be less than 40%. Six Directors are appointed by Kaupskil ehf. and one by Icelandic State Financial Investments.

Risk management

The Group faces various risks arising from its day-to-day operations as a financial institution. Managing risk is therefore a core activity within the Group. The key to effective risk management is a process of on-going identification of significant risk, quantification of risk exposure, actions to limit risk and constant monitoring of risk. This process of risk management and the ability to evaluate, manage and correctly price the risk encountered is critical to the Group's continuing profitability as well as to be able to ensure that the Group's exposure to risk remains within acceptable levels. The Group's risk management, its structure and main risk factors are described in the notes, starting at Note 41.

Corporate governance

The Board of Directors of Arion Bank hf. is committed to good corporate governance and endeavors to promote responsible behavior and corporate culture within the Bank for the benefit of all stakeholders. Arion Bank has to this end devised a corporate governance statement which is designed to help foster open and honest communication between the Board of Directors, shareholders, customers and other stakeholders, such as the Bank's employees and the general public. In December 2015 Arion Bank was recognized as a company which had achieved excellence in corporate governance.

The Board of Directors is the supreme authority in the affairs of the Bank between shareholders’ meetings. The Board tends to those operations of the Bank which are not considered part of the Bank´s day-to-day business, i.e. it makes decisions on issues which are unusual or of a significant nature. One of the main duties of the Board of Directors is to appoint a Chief Executive Officer who is responsible for the day-to-day operations in accordance with a strategy set out by the Board. The CEO hires the Executive Management. There are three Board subcommittees: the Board Audit and Risk Committee, the Board Credit Committee and the Board Remuneration Committee. The committee members are all Directors and there is furthermore one external expert member of the Board Audit and Risk Committee.

The main roles of the Board, as further specified in the rules of procedure of the Board, include approving the Bank's strategy, supervising the financial affairs and accounting and ensuring that appropriate internal controls are in place. The Board ensures that the Bank has active Internal Audit, Compliance and Risk Management departments. The Internal Auditor is appointed by the Board of Directors and works independently of other departments of the Bank in accordance with a charter from the Board. The Internal Auditor provides independent and objective assurance and advice designed to add value and improve the Bank's operations. The Compliance Officer, who reports directly to the CEO, works independently within the Bank in accordance with a charter from the Board. The chief role of the Compliance Officer is to ensure that the Bank and its employees fulfil their obligations under the Securities Transactions Act and the Act on Measures against Money Laundering and Terrorist Financing.

Corporate governance at Arion Bank is described in more detail in the Bank's Corporate Governance Statement which is contained in the unaudited appendix to the Financial Statement and on the website www.arionbanki.is. The Corporate Governance Statement is based on the legislation, regulations and recognized guidelines in force when the Bank's annual financial statement are adopted by the Board of Directors. This statement is prepared in accordance with the Financial Undertakings Act No. 161/2002 and Guidelines on Corporate Governance, 5th edition, issued by the Icelandic Chamber of Commerce, SA – Business Iceland and Nasdaq Iceland in May 2015. Corporate governance at Arion Bank complies with the guidelines with a few exceptions, which are explained in more detail in the Corporate Governance Statement.

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

Endorsement of the Board of Directors and the Chief Executive Officer

The Financial Statements of Arion Bank for the year ended 31 December 2015 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union and additional requirements in the Icelandic Act on Financial Statements, Act on Financial Undertakings and rules on Accounting for Credit Institutions.

It is our opinion that the Financial Statements give a true and fair view of the financial performance of the Group for the year 2015 and its financial position as at 31 December 2015.

Further, in our opinion the Financial Statements and the Endorsement of the Board of Directors and the CEO give a fair view of the development and performance of the Group's operations and its position and describe the principal risks and uncertainties faced by the Group.

The Board of Directors and the CEO have today discussed the Financial Statements of Arion Bank for the year 2015 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the Financial Statements be approved at the Annual General Meeting of Arion Bank.

Reykjavík, 24 February 2016

Board of Directors

Monica Caneman
Chairman

Benedikt Olgeirsson

Guðrún Johnsen

Måns Höglund

Brynjólfur Bjarnason

Kirstín Þ. Flygenring

Þóra Hallgrímsdóttir

Chief Executive Officer

Höskuldur H. Ólafsson

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders of Arion Bank.

We have audited the accompanying Consolidated Financial Statements of Arion banki hf., which comprise the Consolidated Statement of Comprehensive Income for the year 2015, Consolidated Statement of Financial Position as at 31 December 2015, Consolidated Statement of Changes in Equity and Consolidated Statement of Cash Flow for the year 2015, and a summary of significant accounting policies and other explanatory information.

The Board of Directors and Management's Resposibility for the Consolidated Financial Statements

Management and the board of directors are responsible for the preparation and fair presentation of these Consolidated Financial Statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these Consolidated Financial Statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Consolidated Financial Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Consolidated Financial Statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Consolidated Financial Statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Consolidated Financial Statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Consolidated Financial Statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the Consolidated Financial Statements give a true and fair view, of the consolidated financial position of Arion banki hf. as of December 31, 2015, and its consolidated financial performance and its consolidated cash flows for the period then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Confirmation of Endorsement and Statement by the Board of Directors and the CEO

Pursuant to the requirements of Article 104 of the Icelandic Financial Statements Act No. 3/2006, we confirm to the best of our knowledge that the accompanying Endorsement and Statement by the Board of Directors and the CEO includes all information required by the Icelandic Financial Statements Act.

Kópavogur, 24 February 2016

Deloitte ehf.

Páll Grétar Steingrímsson
State Autorised Public Accountant

Gunnar Þorvarðarson
State Autorised Public Accountant

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR 2015

	Notes	2015	2014
Interest income		54,546	50,872
Interest expense		(27,554)	(26,652)
Net interest income	6	26,992	24,220
Fee and commission income		21,234	18,447
Fee and commission expense		(6,750)	(5,138)
Net fee and commission income	7	14,484	13,309
Net financial income	8	12,844	7,290
Share of profit of associates	24	29,466	3,498
Other operating income	9	2,769	5,673
Operating income		86,555	53,990
Salaries and related expense	10	(14,892)	(13,979)
Other operating expense	11	(13,304)	(13,063)
Bank levy	12	(2,818)	(2,643)
Net impairment	13	(3,087)	2,135
Earnings before tax		52,454	26,440
Income tax expense	14	(3,135)	(4,679)
Net earnings from continuing operations		49,319	21,761
Net gain from discontinued operations, net of tax	15	360	6,833
Net earnings		49,679	28,594
Other comprehensive income			
Net gain on AFS financial assets, net of tax		2,903	-
Exchange difference on translating foreign subsidiaries	32	13	(5)
Net other comprehensive income to be reclassified to profit or loss in subsequent periods		2,916	(5)
Total comprehensive income		52,595	28,589
Attributable to			
Shareholders of Arion Bank		44,884	28,465
Non-controlling interest		7,711	129
Total comprehensive income		52,595	28,594
Earnings per share from continuing operations			
Basic and diluted earnings per share attributable to the shareholders of Arion Bank (ISK)	16	22.26	10.82

The notes on pages 13 to 78 are an integral part of these Financial Statements.

Arion Bank Consolidated Financial Statements 2015 8 Amounts are in ISK millions

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DESEMBER 2015

Assets	Notes	2015	2014
Cash and balances with Central Bank	17	48,102	21,063
Loans to credit institutions	18	87,491	108,792
Loans to customers	19	680,350	647,508
Financial instruments	20-22	133,191	101,828
Investment property	22	7,542	6,842
Investments in associates	24	27,299	21,966
Intangible assets	25	9,285	9,596
Tax assets	26	205	655
Other assets	27	17,578	15,486
Total Assets		1,011,043	933,736
Liabilities			
Due to credit institutions and Central Bank	21	11,387	22,876
Deposits	21	469,347	454,973
Financial liabilities at fair value	21	7,609	9,143
Tax liabilities	26	4,922	5,123
Other liabilities	28	49,461	47,190
Borrowings	21,29	256,058	200,580
Subordinated liabilities	21,30	10,365	31,639
Total Liabilities		809,149	771,524
Equity			
Share capital and share premium	32	75,861	75,861
Other reserves	32	4,548	1,632
Retained earnings		112,377	83,218
Total Shareholders' Equity		192,786	160,711
Non-controlling interest		9,108	1,501
Total Equity		201,894	162,212
Total Liabilities and Equity		1,011,043	933,736

The notes on pages 13 to 78 are an integral part of these Financial Statements.

Arion Bank Consolidated Financial Statements 2015 9 Amounts are in ISK millions

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR 2015

	Share capital and share premium	Other reserves	Retained earnings	**Total share-holders' equity**	Non-controlling interest	**Total equity**
Equity 1 January 2015	75,861	1,632	83,218	160,711	1,501	162,212
Net earnings	-	-	41,968	41,968	7,711	49,679
Other comprehensive income	-	2,916	-	2,916	-	2,916
Total comprehensive income	-	2,916	41,968	44,884	7,711	52,595
Dividend paid	-	-	(12,809)	(12,809)	-	(12,809)
Decrease due to purchase of non-controlling interest	-	-	-	-	(104)	(104)
Equity 31 December 2015	75,861	4,548	112,377	192,786	9,108	201,894
Equity 1 January 2014	75,861	1,637	62,591	140,089	4,858	144,947
Net earnings	-	-	28,465	28,465	129	28,594
Other comprehensive income	-	(5)	-	(5)	-	(5)
Total comprehensive income	-	(5)	28,465	28,460	129	28,589
Dividend paid	-	-	(7,811)	(7,811)	-	(7,811)
Increase in non-controlling interests due to purchase of subsidiary	-	-	-	-	10	10
Decrease due to purchase of non-controlling interest	-	-	(27)	(27)	(3,496)	(3,523)
Equity 31 December 2014	75,861	1,632	83,218	160,711	1,501	162,212

The notes on pages 13 to 78 are an integral part of these Financial Statements.

Arion Bank Consolidated Financial Statements 2015 10 Amounts are in ISK millions

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR 2015

	2015	2014
Operating activities		
Net earnings	49,679	28,594
Non-cash items included in net earnings and other adjustments	(51,720)	(36,549)
Changes in operating assets and liabilities	16,109	(4,608)
Interest received	41,178	45,020
Interest paid*	(22,108)	(23,403)
Dividend received	7,954	875
Income tax paid	(4,499)	(6,545)
Net cash from operating activities	36,593	3,384
Investing activities		
Acqusition of associates	(262)	(123)
Proceeds from sale of associates	17,148	4,603
Dividend from associates	611	16
Acqusition of subsidiary	-	(3,100)
Acqusition of intangible assets	(790)	(603)
Acqusition of property and equipment	(711)	(1,866)
Proceeds from sale of property and equipment	30	563
Net cash from (used in) investing activities	16,026	(510)
Financing activities		
Payment of subordinated liabilities	(19,883)	-
Dividend paid to shareholders of Arion Bank	(12,809)	(7,811)
Acquisition of non-controlling interest	(118)	(3,516)
Net cash used in financing activities	(32,810)	(11,327)
Net increase (decrease) in cash and cash equivalents	19,809	(8,453)
Cash and cash equivalents at beginning of the year	91,715	99,683
Cash and cash equivalents acquired through business combinations	-	9
Effect of exchange rate changes on cash and cash equivalents	(1,524)	476
Cash and cash equivalents at the end of the year	110,000	91,715
Non-cash investing transactions		
Assets acquired through foreclosure on collateral from customers with view to resale	2,768	1,617
Settlement of loans through foreclosure on collateral from customers with view to resale	(2,768)	(1,617)
Changes due to the sale of Landfestar		
Changes in investment property	-	(23,131)
Changes in investment in asscociates	-	7,242
Changes in borrowings	-	14,769
Changes in tax liabilities	-	1,120

* Interest paid includes interest credited to deposit accounts at the end of the year.

The notes on pages 13 to 78 are an integral part of these Financial Statements.

Arion Bank Consolidated Financial Statements 2015 11 Amounts are in ISK millions

NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR 2015

	2015	2014
Non-cash items included in net earnings and other adjustments		
Net interest income	(26,992)	(24,220)
Net impairment	3,087	(2,135)
Income tax expense	3,135	4,679
Bank levy	2,818	2,643
Net foreign exchange loss (gain)	182	(813)
Net gain on financial instruments	(5,072)	(5,602)
Depreciation and amortisation	1,656	2,034
Share of profit of associates and fair value change	(29,466)	(3,498)
Investment property, fair value change	(422)	(2,026)
Net gain from discontinued operations, net of tax	(360)	(6,833)
Other changes	(286)	(778)
Non-cash items included in net earnings and other adjustments	(51,720)	(36,549)
Changes in operating assets and liabilities		
Mandatory reserve with Central Bank	(3,700)	52
Loans to credit institutions, excluding bank accounts	13,637	1,251
Loans to customers	(29,588)	(7,488)
Financial instruments and financial liabilities at fair value	(23,655)	(4,626)
Investment property	54	3,425
Other assets	2,660	14,013
Due to credit institutions and Central Bank	(11,266)	(5,094)
Deposits	19,704	(16,361)
Borrowings	53,070	6,785
Other liabilities	(4,807)	3,435
Changes in operating assets and liabilities	16,109	(4,608)
Cash and cash equivalents		
Cash in hand and demand deposits	48,102	21,063
Due from credit institutions	74,533	79,587
Mandatory reserve with Central Bank	(12,635)	(8,935)
Cash and cash equivalents	110,000	91,715

The notes on pages 13 to 78 are an integral part of these Financial Statements.

Arion Bank Consolidated Financial Statements 2015 12 Amounts are in ISK millions

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

GENERAL INFORMATION

Arion banki hf., the Parent Company, was established 18 October 2008 and is incorporated and domiciled in Iceland. The registered office of Arion banki hf. is located at Borgartún 19, Reykjavík. The Financial Statements for the year ended 31 December 2015 comprise the Parent Company and its subsidiaries (together referred to as "the Group").

1. Basis of preparation

Statement of compliance

The Financial Statements are consolidated and have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union and additional requirements in the Icelandic Act on Financial Statements, Act on Financial Undertakings and rules on Accounting for Credit Institutions.

The Financial Statements were approved and authorised for issue by the Board of Directors of Arion Bank on 24 February 2016.

Basis of measurement

The Financial Statements are prepared on the historical cost basis except for the following:

- financial assets and financial liabilities held for trading are measured at fair value;
- financial assets and financial liabilities at fair value are measured at fair value;
- financial assets classified as available-for-sale are measured at fair value;
- investment properties are measured at fair value; and
- non-current assets and disposal groups classified as held for sale are stated at the lower of their carrying amount and fair value, less costs to sell.

Functional and presentation currency

The Financial Statements are presented in Icelandic Krona (ISK), which is the Parent Company's functional currency, rounded to the nearest million, unless otherwise stated. At the end of the year the exchange rate of the ISK against the USD was 130.08 and 141.28 for the EUR (31.12.2014: USD 127.46 and EUR 154.28).

2. Significant accounting estimates and judgements in applying accounting policies

The preparation of the Financial Statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

The key sources of estimation uncertainty are within impairment losses and reversal of impairment losses on loans.

3. The Group

Shares in main subsidiaries in which Arion Bank held a direct interest at the end of the year

	Operating activity	Currency	Equity interest 2015	Equity interest 2014
AFL - sparisjóður, Aðalgata 34, Siglufjörður, Iceland	Retail banking	ISK	-	99.3%
Arion Bank Mortgages Instit. Investor Fund, Borgartún 19, Reykjavík, Iceland	Retail banking	ISK	100.0%	100.0%
BG12 slhf., Katrínartún 2, Reykjavík, Iceland	Holding company	ISK	62.0%	62.0%
EAB 1 ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Eignabjarg ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	-	100.0%
Eignarhaldsfélagið Landey ehf., Grófin 1, Reykjavík, Iceland	Real estate	ISK	100.0%	100.0%
Kolufell ehf., Borgartún 19, Reykjavík, Iceland	Real estate	ISK	68.9%	68.9%
Okkar líftryggingar hf., Laugavegur 182, Reykjavík, Iceland	Life insurance	ISK	100.0%	100.0%
Stefnir hf., Borgartún 19, Reykjavík, Iceland	Asset management	ISK	100.0%	100.0%
Valitor Holding hf., Dalshraun 3, Hafnarfjörður, Iceland	Payment solutions	ISK	100.0%	98.8%

In September Arion Bank had acquired 100% shareholding in AFL - sparisjóður and in October the two entities were merged.

Eignabjarg ehf. was liquidated at year end after having sold its shareholding in the associated company Reitir fasteignafélag hf. in 2015, see note 24.

In 2015 the Bank increased its shareholding in Valitor Holding hf. and holds 100% shareholding at year end.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

OPERATING SEGMENT REPORTING

Segment information is presented in respect of the Group's operating segments based on the Group's management and internal reporting structure. Segment performance is evaluated based on earnings before tax. In presenting the geographic information, segment revenue has been based on the geographic location of customers.

Inter segment pricing is determined on an arm's length basis. Operating segments pay and receive interest to and from Treasury on an arm's length basis to reflect the allocation of capital, funding cost and relevant risk premium.

Operating segments

The Group comprises six main operating segments:

Asset Management comprises Institutional Asset Management, Private Banking, Investment Services and Pension Fund Administration. Asset Management manages financial assets on behalf of its customers according to a pre-determined investment strategy. In addition the division is the main distributor of funds managed by Stefnir hf. to individuals, companies and institutional investors as well as distributing funds managed by international fund management companies. Asset Management also administers pension funds. Stefnir hf. is an independently operating financial company owned by Arion Bank. Stefnir manages a broad range of mutual funds, investment funds and institutional investor funds.

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

Investment Banking is divided into Corporate Advisory, Capital Markets and Research. Corporate Advisory advises customers on securities offerings and the admission of securities for trading on regulated securities markets and also provides M&A advisory services. Capital Markets handles securities brokerage and foreign exchange trading for the Bank's customers. Research publishes regular analyses of listed securities, the major business sectors, markets and the Icelandic economy and also produces economic forecasts. Investment Banking's customers are private individuals, companies and institutions. Investment Banking is responsible for the holding companies BG12 slhf., EAB 1 ehf. and Kolufell ehf.

Retail Banking, including Arion Bank Mortgages Institutional Investor Fund, provides a comprehensive range of services. This includes among other deposits and loans, savings, payment cards, pension savings, insurance, securities and funds. To maximize operational efficiency the branch network is divided into five clusters, with the smaller branches capitalizing on the strength of larger units within each cluster. Retail Banking's 23 branches all around Iceland have a total of more than 100,000 customers.

Treasury has the overall responsibility for the Bank's liquidity, currency and interest rate management. Other functions of Treasury are funds transfer pricing and hedging and pricing of financial products.

Other divisions and Subsidiaries include market making in domestic securities and currencies. The subsidiaries are Eignarhaldsfélagið Landey ehf., Okkar líftryggingar hf., Valitor Holding hf. and other smaller entities of the Group.

Headquarters include: Overhead, Risk Management, Accounting, Legal, Corporate Development and Marketing, Human Resources and Operations.

4. Operating segments

2015	Asset Manage- ment	Corporate Banking	Investment Banking	Retail Banking	Treasury	Other divisions and Sub- sidiaries	Head- quarters and Elimination	Total
Net interest income	462	6,023	101	13,877	5,803	708	18	26,992
Net fee and commission income	4,183	1,059	2,153	2,656	(313)	4,106	640	14,484
Net financial income	226	(37)	8,304	158	872	814	2,507	12,844
Share of profit of associates	-	-	25,436	-	-	513	3,517	29,466
Other operating income	11	(33)	440	(345)	396	1,505	795	2,769
Operating income	4,882	7,012	36,434	16,346	6,758	7,646	7,477	86,555
Operating expense	(1,451)	(547)	(1,152)	(6,011)	(256)	(6,001)	(12,778)	(28,196)
Bank levy	-	-	-	-	-	-	(2,818)	(2,818)
Net impairment	-	(3,074)	3,030	(2,258)	11	(868)	72	(3,087)
Earnings before tax	3,431	3,391	38,312	8,077	6,513	777	(8,047)	52,454
Net seg. rev. from ext. customers	2,589	14,245	37,119	26,947	(9,809)	8,033	7,431	86,555
Net seg. rev. from other segments	2,293	(7,233)	(685)	(10,601)	16,567	(387)	46	-
Operating income	4,882	7,012	36,434	16,346	6,758	7,646	7,477	86,555
Depreciation and amortisation	-	-	-	287	-	576	793	1,656
Total assets	5,884	236,621	62,904	448,547	179,375	50,166	27,546	1,011,043
Total liabilities	1,027	180,588	22,114	396,514	161,154	30,615	17,137	809,149
Allocated equity	4,857	56,033	40,790	52,033	18,221	19,551	10,409	201,894
2014								
Net interest income	449	7,001	135	12,612	4,871	191	(1,039)	24,220
Net fee and commission income	3,546	1,337	2,050	2,333	(126)	3,840	329	13,309
Net financial income	137	57	5,268	304	(290)	843	971	7,290
Share of profit of associates	-	-	179	-	-	3,384	(65)	3,498
Other operating income	12	1,086	8	28	(1)	3,828	712	5,673
Operating income	4,144	9,481	7,640	15,277	4,454	12,086	908	53,990
Operating expense	(1,409)	(570)	(722)	(6,047)	(268)	(5,226)	(12,800)	(27,042)
Bank levy	-	-	-	-	-	-	(2,643)	(2,643)
Net impairment	-	3,392	(497)	(1,037)	295	(45)	27	2,135
Earnings before tax	2,735	12,303	6,421	8,193	4,481	6,815	(14,508)	26,440
Net seg. rev. from ext. customers	2,349	17,762	8,146	23,614	(12,087)	12,043	2,163	53,990
Net seg. rev. from other segments	1,795	(8,281)	(506)	(8,337)	16,541	43	(1,255)	-
Operating income	4,144	9,481	7,640	15,277	4,454	12,086	908	53,990
Depreciation and amortisation	-	-	-	458	-	339	1,237	2,034
Total assets	5,230	231,575	33,730	416,912	160,210	65,459	20,620	933,736
Total liabilities	2,415	188,374	28,333	364,266	129,928	40,131	18,077	771,524
Allocated equity	2,815	43,201	5,397	52,646	30,282	25,328	2,543	162,212

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4. Operating segments, continued

Geographic information

2015	Iceland	Nordic	United Kingdom	Other Europe	North America	Other	Total
Net interest income	26,614	772	17	(851)	375	65	26,992
Net fee and commission income	8,376	1,731	605	3,672	95	5	14,484
Net financial income	10,315	(60)	(175)	2,850	(106)	20	12,844
Other income	11,390	-	20,845	-	-	-	32,235
Operating income	56,695	2,443	21,292	5,671	364	90	86,555

2014	Iceland	Nordic	United Kingdom	Other Europe	North America	Other	Total
Net interest income	23,117	126	42	559	347	29	24,220
Net fee and commission income	10,690	988	231	1,373	20	7	13,309
Net financial income	7,101	154	34	(206)	234	(27)	7,290
Other income	9,171	-	-	-	-	-	9,171
Operating income	50,079	1,268	307	1,726	601	9	53,990

Discontinued operations are excluded from the profit and loss segment information.

Arion Bank Consolidated Financial Statements 2015 18 Amounts are in ISK millions

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

QUARTERLY STATEMENTS

5. Operations by quarters

2015	Q4	Q3	Q2	Q1	Total
Net interest income	6,705	7,112	7,392	5,783	26,992
Net fee and commission income	3,758	3,292	3,677	3,757	14,484
Net financial income	2,668	453	2,184	7,539	12,844
Share of profit of associates	22,510	2,739	6	4,211	29,466
Other operating income	537	709	1,032	491	2,769
Operating income	36,178	14,305	14,291	21,781	86,555
Salaries and related expense	(4,572)	(3,153)	(3,675)	(3,492)	(14,892)
Other operating expense	(4,288)	(3,012)	(3,108)	(2,896)	(13,304)
Bank levy	(650)	(779)	(659)	(730)	(2,818)
Net impairment	(2,973)	(33)	(1,863)	1,782	(3,087)
Earnings before tax	23,695	7,328	4,986	16,445	52,454
Income tax expense	504	(1,272)	(647)	(1,720)	(3,135)
Net earnings from continuing operations	24,199	6,056	4,339	14,725	49,319
Net gain from discontinued operations, net of tax	83	15	79	183	360
Net earnings	24,282	6,071	4,418	14,908	49,679

2014					
Net interest income	5,911	6,343	6,483	5,483	24,220
Net fee and commission income	3,190	3,526	3,445	3,148	13,309
Net financial income	1,429	1,994	4,439	(572)	7,290
Share of profit of associates	3,525	53	(16)	(64)	3,498
Other operating income	1,683	636	2,372	982	5,673
Operating income	15,738	12,552	16,723	8,977	53,990
Salaries and related expense	(3,953)	(2,862)	(3,714)	(3,450)	(13,979)
Other operating expense	(4,465)	(2,787)	(3,064)	(2,747)	(13,063)
Bank levy	(635)	(633)	(715)	(660)	(2,643)
Net impairment	(742)	876	34	1,967	2,135
Earnings before tax	5,943	7,146	9,264	4,087	26,440
Income tax expense	(223)	(1,989)	(1,152)	(1,315)	(4,679)
Net earnings from continuing operations	5,720	5,157	8,112	2,772	21,761
Net gain from discontinued operations, net of tax	241	67	6,433	92	6,833
Net earnings	5,961	5,224	14,545	2,864	28,594

The half-year results were reviewed by the Bank's auditor. The quarterly statements and the split between quarters were not audited or reviewed by the Bank's auditor.

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NOTES TO THE CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

6. Net interest income

	2015	2014
Interest income		
Cash and balances with Central Bank	736	703
Loans	49,414	45,810
Securities	3,532	3,664
Other	864	695
Interest income	54,546	50,872
Interest expense		
Deposits	(15,453)	(15,982)
Borrowings	(11,344)	(9,270)
Subordinated liabilities	(701)	(1,291)
Other	(56)	(109)
Interest expense	(27,554)	(26,652)
Net interest income	26,992	24,220
Net interest income from assets and liabilities at fair value	3,532	3,664
Interest income from assets not at fair value	51,014	47,208
Interest expense from liabilities not at fair value	(27,554)	(26,652)
Net interest income	26,992	24,220
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	3.0%	2.8%

7. Net fee and commission income

	2015			2014		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	4,463	(218)	4,245	3,863	(162)	3,701
Cards	11,532	(5,945)	5,587	9,223	(4,150)	5,073
Collection and payment services	1,349	(93)	1,256	1,288	(93)	1,195
Investment banking	1,740	(56)	1,684	1,886	(40)	1,846
Lending and guarantees	1,431	-	1,431	1,430	-	1,430
Other	719	(438)	281	757	(693)	64
Net fee and commission income	21,234	(6,750)	14,484	18,447	(5,138)	13,309

Asset management fees are earned by the Group on trust and fiduciary activities where the Group holds or invests assets on behalf of the customers.

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8. Net financial income

	2015	2014
Dividend income	7,954	875
Net gain (loss) on financial assets and financial liabilities classified as held for trading	1,157	(150)
Net gain on financial assets and financial liabilities designated at fair value through profit or loss	3,915	5,752
Net foreign exchange (loss) gain	(182)	813
Net financial income	12,844	7,290

Net gain on financial assets and financial liabilities designated at fair value through profit or loss

Equity instruments designated at fair value	3,692	5,963
Interest rate instruments designated at fair value	223	(211)
Net gain on financial assets and financial liabilities designated at fair value through profit or loss	3,915	5,752

9. Other operating income

Rental income from investment property	40	1,236
Fair value changes on investment property	422	1,091
Realised gain on investment property	286	1,231
Earned premiums, net of reinsurance	1,145	1,005
Other income	876	1,110
Other operating income	2,769	5,673

10. Personnel and salaries

Number of employees

Average number of full time equivalent positions during the year	1,139	1,128
Full time equivalent positions at the end of the year	1,147	1,120

The Bank's number of employees

Average number of full time equivalent positions during the year	885	890
Full time equivalent positions at the end of the year	876	865

Salaries and related expense

Salaries	11,522	10,903
Defined contribution pension plans	1,637	1,539
Salary related expense	1,733	1,537
Salaries and related expense	14,892	13,979

Salaries and related expense for the Bank

Salaries	8,780	8,458
Defined contribution pension plans	1,216	1,164
Salary related expense	1,432	1,393
Salaries and related expense	11,428	11,015

In 2015 the Group made a provision of ISK 599 million (2014: ISK 542 million) for performance plan payments, including salary related expense, thereof the Bank made a provision of ISK 461 million (2014: ISK 477 million). Forty percent of the payment is deferred for three years in accordance with FME rules on remuneration policy for financial undertakings. At the end of the year the Group's accrual for performance plan payments amounts to ISK 1,056 million (31.12.2014: ISK 741 million), thereof the Bank's accrual amounts to ISK 852 million (31.12.2014: ISK 639 million).

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10. Personnel and salaries, continued

Compensation of key management personnel	2015 Fixed remuner-ation*	2015 Additional remuner-ation**	2015 Total	2014 Fixed remuner-ation*	2014 Additional remuner-ation**	2014 Total
Monica Caneman, Chairman of the Board	18.4	2.4	20.7	17.7	2.2	19.9
Guðrún Johnsen, Vice Chairman of the Board	6.9	4.7	11.6	6.6	5.4	12.0
Benedikt Olgeirsson, Director	4.6	1.8	6.4	4.4	1.4	5.8
Brynjólfur Bjarnason, Director from 20.11.2014	4.6	1.4	6.0	0.6	-	0.6
Kirstín Þ. Flygenring, Director from 20.3.2014	4.6	1.8	6.4	3.4	1.4	4.8
Måns Höglund, Director	9.3	4.2	13.5	8.9	4.0	12.9
Þóra Hallgrímsdóttir, Director	4.6	3.7	8.3	4.4	3.6	8.0
Agnar Kofoed-Hansen, Director until 20.3.2014	-	-	-	1.1	0.9	2.0
Björgvin Skúli Sigurðsson, Director until 9.10.2014	-	-	-	3.4	0.9	4.3
Alternate directors of the Board	2.5	-	2.5	1.6	0.9	2.5
Total remuneration	55.4	20.0	75.4	52.1	20.7	72.8

	2015 Salaries	2015 Performance based payments	2014 Salaries	2014 Performance based payments
Höskuldur H. Ólafsson, CEO	55.9	7.2	52.2	6.3
Nine managing directors of the Bank's divisions being members of the Bank's Executive Committee	254.7	26.4	227.5	24.0

Performance based payments in 2015 are based on the Group's performance in 2014.

Board Members receive remuneration for their involvement in board committees. In addition to 16 Board meetings (2014: 11), during the year 11 Board Credit Committee meetings (2014: 12), 7 Board Audit and Risk Committee meetings (2014: 5) and 7 Board Remuneration Committee meetings (2014: 7) were held. Four committee meetings with alternate directors of the Board were held in 2015 (2014: 4).

The 2015 Annual General Meeting of the Bank held on 19 March 2015 approved the monthly salaries for 2015 for the Chairman, Vice Chairman and for other Board Members of amounts ISK 770,000, ISK 577,500 and ISK 385,000 (2014: ISK 750,000; 562,500; 375,000) respectively. It was also approved that the salary of Alternate Board Members would be ISK 195,000 (2014: ISK 187,500) per meeting, up to a maximum of ISK 385,000 (2014: ISK 375,000) per month. For foreign Board Members, the aforementioned figures are doubled. In addition, it was approved to pay Board Members who serve on board committees of the Bank a maximum of ISK 154,000 (2014: ISK 150,000) per month for each committee they serve on and the Chairman of the board committees ISK 200,000 (2014: ISK 195,000).

* Fixed remuneration represents Board Member compensation for their attendance at meetings of the Board of Directors.

** Additional remuneration represents Board Member compensation for their participation in Board Committees.

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11. Other operating expense

	2015	2014
Administration expense	10,330	9,532
Depositors' and investors' guarantee fund	836	829
Depreciation of property and equipment	849	1,456
Amortisation of intangible assets	807	578
Direct operating expense derived from investment properties	97	327
Claims incurred, net of reinsurance	385	341
Other operating expense	13,304	13,063

Auditor's fee

	2015	2014
Audit and review of the Financial Statements for the relevant fiscal year	150	171
Other audit related services for the relevant fiscal year	3	16
Auditor's fee	153	187
Thereof fee to others than the auditor of the Parent company	3	8

12. Bank levy

The Bank levy is 0.376% on total debt excluding tax liabilities, in excess of ISK 50 billions. Non-financial subsidiaries are exempt from this tax. The tax is assessed on financial institutions to meet the funding of a special index and interest relief provided to individual tax payers.

13. Net impairment

	2015	2014
Increase in book value of loans to corporates	2,488	2,448
Increase in book value of loans to individuals	2,208	1,907
Increase in book value of other assets	-	715
Net change in impairment of loans to corporates	(3,818)	(148)
Net change in impairment of loans to individuals	(3,421)	(2,391)
Net change in collective impairment on loans	(517)	(367)
Impairment of intangible assets	(27)	(29)
Net impairment	(3,087)	2,135

Arion Bank Consolidated Financial Statements 2015 23 Amounts are in ISK millions

14. Income tax expense

	2015	2014
Current tax expense	1,659	4,474
Deferred tax expense	1,476	205
Income tax expense	3,135	4,679

Reconciliation of effective tax rate	2015		2014	
Earnings before tax		52,454		26,440
Income tax using the Icelandic corporation tax rate	20.0%	10,491	20.0%	5,288
Additional 6% tax on financial institutions	1.2%	628	3.4%	894
Non-deductible expenses	0.0%	13	0.8%	201
Tax exempt revenue	(16.4%)	(8,597)	(7.7%)	(2,047)
Non-deductible taxes	1.1%	564	2.0%	529
Other changes	0.1%	36	(0.7%)	(186)
Effective tax rate	6.0%	3,135	17.7%	4,679

Financial institutions pay 6% additional tax on taxable profit exceeding ISK 1 billion.

Tax exempt revenues consist mainly of profit from equity positions.

15. Net gain from discontinued operations, net of tax

	2015	2014
Net gain from associated companies	-	6,290
Net gain from real estates and other assets	360	543
Net gain from discontinued operations, net of tax	360	6,833

16. Earnings per share

	Discontinued operations			
	Excluded		Included	
	2015	2014	2015	2014
Net earnings attributable to the shareholders of Arion Bank	44,524	21,632	44,884	28,465
Weighted average number of outstanding shares for the year, million	2,000	2,000	2,000	2,000
Basic earnings per share	22.26	10.82	22.44	14.23

There were no instruments at the end of the year that could potentially dilute basic earnings per share (31.12.2014: none).

Arion Bank Consolidated Financial Statements 2015 24 Amounts are in ISK millions

NOTES TO THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION

17. Cash and balances with Central Bank

	2015	2014
Cash on hand	4,921	5,255
Cash with Central Bank	30,546	6,873
Mandatory reserve deposit with Central Bank	12,635	8,935
Cash and balances with Central Bank	48,102	21,063

The mandatory reserve deposit with Central Bank is not available for the Group to use in its daily operations.

18. Loans to credit institutions

	2015	2014
Bank accounts	74,533	79,587
Money market loans	7,976	23,007
Other loans	4,982	6,198
Loans to credit institutions	87,491	108,792

19. Loans to customers

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

2014			
Overdrafts	17,955	24,420	42,375
Credit cards	11,065	943	12,008
Mortgage loans	271,639	10,406	282,045
Other loans	33,763	303,998	337,761
Provision on loans	(13,111)	(13,570)	(26,681)
Loans to customers	321,311	326,197	647,508

The 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 comprised mortgage loans to individuals, loans to real estate companies, wholesale and retail and industry and energy companies.

Further analysis of loans is provided in Risk Management Disclosures.

Arion Bank Consolidated Financial Statements 2015 25 Amounts are in ISK millions

19. Loans to customers, continued

Changes in the provision for losses on loans to customers

2015	Specific	Collective	Total
Balance at the beginning of the year	22,214	4,467	26,681
Provision for losses	7,239	517	7,756
Write-offs	(5,492)	-	(5,492)
Payment of loans previously written off	1,380	-	1,380
Balance at the end of the year	25,341	4,984	30,325

2014			
Balance at the beginning of the year	25,126	4,100	29,226
Provision for losses	2,539	367	2,906
Write-offs	(5,937)	-	(5,937)
Payment of loans previously written off	486	-	486
Balance at the end of the year	22,214	4,467	26,681

Significant accounting estimates and judgements

Key sources of estimation uncertainty are impairment losses on loans.

The Group reviews its loan portfolios to assess impairment at least quarterly as further described in Note 54. The specific component of the total allowance for impairment applies to financial assets evaluated individually for impairment and is based on management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a debtor's financial situation and the net realisable value of any underlying collateral. Each impaired asset is assessed on its merits, the workout strategy and estimate of cash flows considered recoverable are independently reviewed by the Credit Risk function.

20. Financial instruments

	2015	2014
Bonds and debt instruments	78,794	66,466
Shares and equity instruments with variable income	35,504	25,232
Derivatives	2,401	1,026
Securities used for hedging	16,492	9,104
Financial instruments	133,191	101,828

Arion Bank Consolidated Financial Statements 2015 26 Amounts are in ISK millions

21. Financial assets and financial liabilities

2015	Amortised cost	Trading	Designated at fair value	Available for sale	Total
Loans					
Cash and balances with Central Bank	48,102	-	-	-	48,102
Loans to credit institutions	87,491	-	-	-	87,491
Loans to customers	680,350	-	-	-	680,350
Loans	815,943	-	-	-	815,943
Bonds and debt instruments					
Listed	-	2,526	74,757	-	77,283
Unlisted	-	99	1,412	-	1,511
Bonds and debt instruments	-	2,625	76,169	-	78,794
Shares and equity instruments with variable income					
Listed	-	2,138	13,869	-	16,007
Unlisted	-	1,668	10,665	5,852	18,185
Bond funds with variable income, unlisted	-	1,090	222	-	1,312
Shares and equity instruments with variable income	-	4,896	24,756	5,852	35,504
Derivatives					
OTC derivatives	-	2,401	-	-	2,401
Derivatives	-	2,401	-	-	2,401
Securities used for hedging					
Bonds and debt instruments, listed	-	1,519	-	-	1,519
Shares and equity instruments with variable income, listed	-	14,276	-	-	14,276
Shares and equity instruments with variable income, unlisted	-	697	-	-	697
Securities used for hedging	-	16,492	-	-	16,492
Other financial assets	4,581	-	-	-	4,581
Financial assets	820,524	26,414	100,925	5,852	953,715
Liabilities at amortised cost					
Due to credit institutions and Central Bank	11,387	-	-	-	11,387
Deposits	469,347	-	-	-	469,347
Borrowings	256,058	-	-	-	256,058
Subordinated liabilities	10,365	-	-	-	10,365
Liabilities at amortised cost	747,157	-	-	-	747,157
Financial liabilities at fair value					
Short position in bonds	-	4,616	-	-	4,616
Derivatives	-	2,993	-	-	2,993
Financial liabilities at fair value	-	7,609	-	-	7,609
Other financial liabilities	38,667	-	-	-	38,667
Financial liabilities	785,824	7,609	-	-	793,433

Arion Bank Consolidated Financial Statements 2015 27 Amounts are in ISK millions

21. Financial assets and financial liabilities, continued

2014	Amortised cost	Trading	Designated at fair value	Available for sale	Total
Loans					
Cash and balances with Central Bank	21,063	-	-	-	21,063
Loans to credit institutions	108,792	-	-	-	108,792
Loans to customers	647,508	-	-	-	647,508
Loans	777,363	-	-	-	777,363
Bonds and debt instruments					
Listed	-	3,157	61,421	-	64,578
Unlisted	-	36	1,852	-	1,888
Bonds and debt instruments	-	3,193	63,273	-	66,466
Shares and equity instruments with variable income					
Listed	-	1,538	7,079	-	8,617
Unlisted	-	1,613	13,901	-	15,514
Bond funds with variable income, unlisted	-	928	173	-	1,101
Shares and equity instruments with variable income	-	4,079	21,153	-	25,232
Derivatives					
OTC derivatives	-	1,026	-	-	1,026
Derivatives	-	1,026	-	-	1,026
Securities used for hedging					
Bonds and debt instruments, listed	-	3,212	-	-	3,212
Shares and equity instruments with variable income, listed	-	4,911	-	-	4,911
Shares and equity instruments with variable income, unlisted	-	981	-	-	981
Securities used for hedging	-	9,104	-		9,104
Other financial assets	3,514	-	-	-	3,514
Financial assets	780,877	17,402	84,426	-	882,705
Liabilities at amortised cost					
Due to credit institutions and Central Bank	22,876	-	-	-	22,876
Deposits	454,973	-	-	-	454,973
Borrowings	200,580	-	-	-	200,580
Subordinated liabilities	31,639	-	-	-	31,639
Liabilities at amortised cost	710,068	-	-	-	710,068
Financial liabilities at fair value					
Short position in bonds	-	8,238	-	-	8,238
Derivatives	-	905	-	-	905
Financial liabilities at fair value	-	9,143	-	-	9,143
Other financial liabilities	39,032	-	-	-	39,032
Financial liabilities	749,100	9,143	-	-	758,243

Arion Bank Consolidated Financial Statements 2015 28 Amounts are in ISK millions

21. Financial assets and financial liabilities, continued

Bonds and debt instruments designated at fair value specified by issuer	2015	2014
Financial and insurance activities	9,258	3,403
Public sector	59,246	58,730
Corporates	7,665	1,140
Bonds and debt instruments designated at fair value	76,169	63,273

The total amount of pledged bonds at the end of the year was ISK 21.5 billion (31.12.2014: ISK 18.0 billion). Pledged bonds comprise Icelandic Government Bonds that were pledged against funding received and included in Due to credit institutions and Central Bank as well as short positions included in Financial liabilities at fair value.

22. Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of assets and liabilities by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
Level 2: valuation techniques for which all significant inputs are market observable, either directly or indirectly; and
Level 3: valuation techniques which include significant inputs that are not based on observable market data.

For assets and liabilities that are recognised at fair value on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Assets and liabilities recorded at fair value by level of the fair value hierarchy

2015	Level 1	Level 2	Level 3	Total
Assets at fair value				
Bonds and debt instruments	32,813	45,799	182	78,794
Shares and equity instruments with variable income	14,331	15,299	5,874	35,504
Derivatives	-	2,401	-	2,401
Securities used for hedging	15,706	786	-	16,492
Investment property	-	-	7,542	7,542
Assets at fair value	62,850	64,285	13,598	140,733
Liabilities at fair value				
Short position in bonds	4,616	-	-	4,616
Derivatives	-	2,993	-	2,993
Liabilities at fair value	4,616	2,993	-	7,609

Arion Bank Consolidated Financial Statements 2015 29 Amounts are in ISK millions

22. Fair value hierarchy, continued

2014	Level 1	Level 2	Level 3	Total
Assets at fair value				
Bonds and debt instruments	26,677	38,611	1,178	66,466
Shares and equity instruments with variable income	8,072	17,062	98	25,232
Derivatives	-	1,026	-	1,026
Securities used for hedging	7,789	1,315	-	9,104
Investment property	-	-	6,842	6,842
Assets at fair value	42,538	58,014	8,118	108,670
Liabilities at fair value				
Short position in bonds	8,238	-	-	8,238
Derivatives	-	905	-	905
Liabilities at fair value	8,238	905	-	9,143

Transfers from Level 2 to Level 1 amounted to ISK 8,106 million during the year due to listing of companies on Nasdaq Iceland (2014: none). There have been no transfers from Level 1 to Level 2 during the year (2014: none).

The level of the fair value hierarchy of assets is determined at the end of each reporting period.

Fair value of assets and liabilities

The fair value of asset and liabilities is the amount at which the asset and liability could be exchanged in a current transaction between willing parties, i.e. not during a forced sale or liquidation. The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used by the Group to measure assets and liabilities. If quoted prices for a asset fail to represent actual and regularly occurring transactions in active market transactions or if quoted prices are not available at all, fair value is established by using an appropriate valuation technique.

Methods for establishing fair value

Level 1: Fair value established from quoted market prices

The best evidence of the fair value of a asset and liability at initial recognition is the transaction price, unless the fair value can be evidenced by comparison with other observable current market transactions, or is based on a valuation technique whose variables include only data from observable markets.

In some cases, the carrying value of a asset in Note 21 is used as an approximation for the fair value of the asset. This is straight forward for cash and cash equivalents but is also used for short term investments and borrowings to highly rated counterparties, such as credit institutions, on contracts that feature interest close to or equal to market rates and expose the Group to little or no credit risk.

For listed and liquid stocks and bonds, certain financial derivatives and other market traded securities, the fair value is derived directly from the market prices. These instruments are disclosed under Financial instruments and Financial liabilities at fair value in the Statement of Financial Position.

Level 2: Fair value established using valuation techniques with observable market information

For assets and liabilities, for which the market is not active, the Group applies specific working procedures and valuation techniques to attain a fair value using as much market information as available. Valuation techniques include using recent arm's length market transactions between knowledgeable and willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis, option pricing models or other commonly accepted valuation techniques used by market participants to price the instrument.

For assets and liabilities for which quoted prices on active markets are not available, the fair value is derived using various valuation techniques. This applies in particular to OTC derivatives such as options, swaps, futures and unlisted equities but also some other assets and liabilities.

Arion Bank Consolidated Financial Statements 2015 30 Amounts are in ISK millions

22. Fair value hierarchy, continued

In most cases the valuation is based on theoretical financial models, such as the Black Scholes model or variations thereof. These techniques also include forward pricing and swap models using present value calculations.

The fair value for deposits with stated maturities is calculated by discounting estimated cash flows using current market rates for similar maturities. For deposits that can be withdrawn immediately, the fair value is the amount payable on demand, which is equal to the carrying amount in the Statement of Financial Position.

Level 3: Fair value established using valuation techniques with significant unobservable market information

In many cases there is little or no market data to rely on for fair value calculations. The most common valuation technique is present value calculations. Such calculations involve the estimation of future cash flow and the assessment of appropriate discount rate. The discount rate should both reflect current market rates and the uncertainty in the future cash flow. In such cases internal models and methods are used to calculate the fair value. The models may be statistical in nature, based on internal or external history of assets with similar characteristics and/or based on internal knowledge and experience. For example, the credit margin on most loans to customers which, is added to the current and suitable interest rate to arrive at an appropriate discount rate, is estimated using credit rating and loss parameters in case of default that have been derived from internal models.

Equity instruments that do not have a quoted market price are evaluated using methods and guidelines from pertinent international organisations. In most cases intrinsic value is the basis for the assessment but other factors, such as cash flow analysis, can also modify the results.

The Group applies management valuation for determining fair value of investment properties. Management valuation is either based on recent transactions and offers for similar assets or present value calculations which involve estimation of future cash flow and the assessment of appropriate discount rate.

Movements in Level 3 assets measured at fair value	Investment property		Financial assets		Total	
	2015	2014	2015	2014	2015	2014
Balance at the beginning of the year	6,842	28,523	1,276	1,667	8,118	30,190
Net fair value changes	422	1,091	5,857	(373)	6,279	718
Additions	1,026	2,148	77	5	1,103	2,153
Disposal	(843)	(25,503)	(1,154)	(23)	(1,997)	(25,526)
Transfers into Level 3	95	583	-	-	95	583
Balance at the end of the year	7,542	6,842	6,056	1,276	13,598	8,118

Line items where effects of Level 3 assets are recognised in the Statement of Comprehensive Income	2015	2014
Net interest income	25	74
Net financial income	(20)	(447)
Other operating income	708	2,322
Net gain on AFS financial assets, net of tax	2,903	-
Effects recognised in the Statement of Comprehensive Income	3,616	1,949

Arion Bank Consolidated Financial Statements 2015 31 Amounts are in ISK millions

22. Fair value hierarchy, continued

Carrying values and fair values of financial assets and financial liabilities that are not carried at fair value in the Financial Statements. The table does not include the fair values of non-financial assets and non-financial liabilities.

2015	Carrying value	Fair value	Unrealised gain (loss)
Financial assets not carried at fair value			
Cash and balances with Central bank	48,102	48,102	-
Loans to credit institutions	87,491	87,491	-
Loans to customers	680,350	688,196	7,846
Other financial assets	4,581	4,581	-
Financial assets not carried at fair value	820,524	828,370	7,846
Financial liabilities not carried at fair value			
Due to credit institutions and Central bank	11,387	11,387	-
Deposits	469,347	469,347	-
Borrowings	256,058	264,839	(8,781)
Subordinated loans	10,365	10,365	-
Other financial liabilities	38,667	38,667	-
Financial liabilities not carried at fair value	785,824	794,605	(8,781)

2014	Carrying value	Fair value	Unrealised gain (loss)
Financial assets not carried at fair value			
Cash and balances with Central bank	21,063	21,063	-
Loans to credit institutions	108,792	108,792	-
Loans to customers	647,508	657,261	9,753
Other financial assets	3,514	3,514	-
Financial assets not carried at fair value	780,877	790,630	9,753
Financial liabilities not carried at fair value			
Due to credit institutions and Central bank	22,876	22,876	-
Deposits	454,973	455,133	(160)
Borrowings	200,580	197,115	3,465
Subordinated loans	31,639	31,639	-
Other financial liabilities	39,032	39,032	-
Financial liabilities not carried at fair value	749,100	745,795	3,305

Financial assets and financial liabilities predominantly bear interest at floating rates. For assets and liabilities not at floating rates fair value is determined by Level 2 methods for which the valuation input is market observable interest rates.

Retail mortgages are estimated by using the discount cash flow method with the interest rates offered on new loans, taking into account mortgaging. Defaulted loans are presented at book value as no future cash flow is expected on them. Instead they are written down according to their estimated potential recovery value. Other loans, including corporate loans, are presented at book value as they are generally of a shorter duration than retail mortgages and the interest rate risk on them is therefore limited.

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22. Fair value hierarchy, continued

Derivatives	Notional	Fair value	
2015	value	Assets	Liabilities
Forward exchange rate agreements, unlisted	49,435	231	287
Interest rate and exchange rate agreements, unlisted	103,369	1,948	710
Bond swap agreements, unlisted	3,811	43	28
Share swap agreements, unlisted	13,099	178	1,934
Options - purchased agreements, unlisted	66	1	34
Derivatives	169,780	2,401	2,993

2014			
Forward exchange rate agreements, unlisted	17,625	63	172
Interest rate and exchange rate agreements, unlisted	21,961	215	271
Bond swap agreements, unlisted	3,976	40	34
Share swap agreements, unlisted	6,942	230	397
Options - purchased agreements, unlisted	475	478	31
Derivatives	50,979	1,026	905

Arion Bank Consolidated Financial Statements 2015 33 Amounts are in ISK millions

23. Offsetting financial assets and financial liabilities

Financial assets subject to enforceable master netting arrangements and similar arrangements

2015	Assets subject to netting arrangements: Gross assets before balance sheet nettings	Assets subject to netting arrangements: Balance sheet nettings with gross liabilities	Assets subject to netting arrangements: Assets recognised on balance sheet, net	Netting potential not recognized in the balance sheet: Financial liabilities	Netting potential not recognized in the balance sheet: Collateral received	Assets after consideration of netting potential	Assets not subject to enforceable netting arr-angements	Total assets re-cognised on balance sheet
Reverse repurchase agreements	22,100	(490)	21,610	(4,929)	-	16,681	-	21,610
Derivatives	964	-	964	(400)	-	564	1,437	2,401
Total assets	23,064	(490)	22,574	(5,329)	-	17,245	1,437	24,011
2014								
Reverse repurchase agreements	10,044	-	10,044	(8,238)	-	1,806	-	10,044
Derivatives	117	-	117	(1)	-	116	909	1,026
Total assets	10,161	-	10,161	(8,239)	-	1,922	909	11,070

Financial liabilities subject to enforceable master netting arrangements and similar arrangements

2015	Liabilities subject to netting arrangements: Gross liabilities before balance sheet nettings	Liabilities subject to netting arrangements: Balance sheet nettings with gross assets	Liabilities subject to netting arrangements: Liabilities recognised on balance sheet, net	Netting potential not recognized in the balance sheet: Financial assets	Netting potential not recognized in the balance sheet: Collateral pledged	Liabilities after consideration of netting potential	Liabilities not subject to enforceable netting arr-angements	Total liabilities recognised on balance sheet
Repurchase agreements	4,929	-	4,929	(4,929)	-	-	-	4,929
Derivatives	400	-	400	(400)	-	-	2,593	2,993
Total liabilities	5,329	-	5,329	(5,329)	-	-	2,593	7,922
2014								
Repurchase agreements	8,238	-	8,238	(8,238)	-	-	-	8,238
Derivatives	1	-	1	(1)	-	-	904	905
Total liabilities	8,239	-	8,239	(8,239)	-	-	904	9,143

Accounting policies for offsetting are provided in Note 54.

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24. Investments in associates

The Group's interest in its principal associates	2015	2014
Auðkenni hf., Borgartún 31, Reykjavík, Iceland	22.4%	20.9%
Bakkavor Group Ltd., West Marsh Road, Spalding, Lincolnshire, United Kingdom	46.0%	46.0%
Farice ehf., Smáratorg 3, Kópavogur, Iceland	39.3%	39.3%
Klakki ehf., Ármúli 1, Reykjavík, Iceland	-	31.8%
Reiknistofa bankanna hf., Katrínartún 2, Reykjavík, Iceland	23.0%	21.7%
Reitir fasteignafélag hf., Kringlan 4-12, Reykjavík, Iceland	-	25.6%
Síminn hf., Ármúli 25, Reykjavík, Iceland	-	38.3%
Urriðaland ehf., Laugavegur 182, Reykjavík, Iceland	41.4%	41.4%
220 Fjörður ehf., Fjarðargötu 13-15, Hafnarfjörður, Iceland	38.5%	-

Investments in associates		
Carrying amount at the beginning of the year	21,966	17,929
Acquisitions	262	7,557
Dividend received	(611)	(16)
Transfers	(6,458)	(2,636)
Disposals	(17,148)	(4,603)
Exchange difference	(178)	237
Share of profit of associates and reversal of impairment	29,466	3,498
Investment in associates	27,299	21,966

The Bank's subsidiary BG12 slhf. has valued the shareholding in its associated company Bakkavor Group Ltd. according to the equity method, less impairment. In January 2016 BG12 slhf. sold its entire shareholding in Bakkavor Group Ltd. resulting in a change in valuation of the shareholding at year end 2015 when it was presented at sales value, less cost of sale. The total revaluation of the shareholding during the year was ISK 20,845 million, presented as Share of profit of associates in the Statement of Comprehensive Income in 2015. Arion Bank's shareholding in BG12 slhf. is 62% and thus a Non-controlling interest of ISK 7,921 million is presented in the Statement of Comprehensive income due to aforementioned change in valuation. The revaluation resulted in net earnings attributable to shareholders of Arion Bank for the amount of ISK 12,924 million in 2015.

Prior to the listing of Síminn hf. the Bank sold a 10% shareholding in the company and around 20% in connection with the listing of Síminn hf. on Nasdaq Iceland in October. The total effect from the sale on the Statement of Comprehensive Income is ISK 4,185 million. The remaining shareholding in Síminn hf. is classified as Financial instruments at year end.

In January the Group sold 3.5% shareholding in Reitir fasteignafélag hf. and 13.3% shareholding was sold in connection with the listing of the company on Nasdaq Iceland in April. The total effect on the Statement of Comprehensive Income in the first half of 2015 is ISK 4,224 million. The remaining shareholding in Reitir fasteignafélag hf. is classified as Financial instruments at year end.

The subsidiary Eignarhaldsfélagið Landey ehf. established the entity 220 Fjörður ehf. in partnership with others to manage specific investment property.

In 2015 the Bank sold its shareholding in Klakki ehf. with minor effects on the Statement of Comprehensive Income.

The Group accounts for investments in associates based on the equity method less applicable impairment. The impairment testing uses management valuation techniques and assumptions such as EBITDA multiples. Alternative assumptions could potentially result in significantly different carrying values but the management is of the opinion that the impaired value is based on the most probable outcomes under current market conditions.

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25. Intangible assets

Intangible assets comprise four categories: Goodwill, Infrastructure, Customer relationships and related agreements and Software. Goodwill arises on the acquisition of subsidiaries. Infrastructure and Customer relationships and related agreements originate as a premium in connection with the acquisition of business activities in subsidiaries, while Software originates from the acquisition of software licenses and the introduction of the software into the Group's operations.

Towards the end of 2014 Valitor Holding hf. acquired the Danish group AltaPay A/S. The acquisition was designed to support Valitor's strategy to expand its online business in the Nordic region. Total of ISK 4,217 million intangible assets were recognized, mainly related to the expertise of the employees of AltaPay A/S and the business opportunities inherent in a rapidly growing market, and the synergy with Valitor hf. in the future. When distributing the purchase price to separate assets the free cash flow method and management forecasts on the operations of AltaPay A/S were used. The original distribution of purchase price was revisited in 2015, and thus within the 12 months permitted timeframe from the acquisition date. Following this revisit there was a transfer of ISK 506 million from Customer relationship and related agreements to Goodwill.

Infrastructure, which is capitalized as an intangible asset, is connected to two business segments at the Group, namely Asset Management within the Bank and within the Bank's subsidiary Stefnir hf. and credit card operation at the Bank's subsidiary Valitor Holding hf. In both cases the business activity is based on years of building up expertise and systems, during which a valuable platform has been created for future growth. An impairment test is performed annually as described below.

Customer relationships and related agreements are connected to business relationships and agreements which the Bank acquired in subsidiaries and agreements bought. The asset is based on the assumption that business relationships and agreements generate regular payments and earnings to the relevant business segments. The business activities in question are mainly the business relationships related to individual customers through SPRON and the subsidiary Okkar líftryggingar. The customer relationship is tested for impairment and related agreements are amortized over a period of 5 years.

Software is acquired computer software licenses and is capitalized on the basis of the cost of acquiring them and bringing them into service. Computer software licenses recognized as intangible assets are amortized over their useful life, which is estimated to be 3-10 years.

2015	Goodwill	Infra-structure	Customer relation-ship and related agreements	Software	Total
Balance at the beginning of the year	2,171	3,046	1,539	2,840	9,596
Additions and transfers	506	-	(435)	530	601
Additions, internally developed	-	-	-	289	289
Exchange difference	(270)	-	(40)	(57)	(367)
Impairment	-	(25)	(2)	-	(27)
Amortisation	-	-	(208)	(599)	(807)
Intangible assets	2,407	3,021	854	3,003	9,285

2014					
Balance at the beginning of the year	-	3,075	1,144	1,164	5,383
Acquisition through business combination	2,171	-	598	1,448	4,217
Additions	-	-	-	562	562
Additions, internally developed	-	-	-	41	41
Impairment	-	(29)	-	-	(29)
Amortisation	-	-	(203)	(375)	(578)
Intangible assets	2,171	3,046	1,539	2,840	9,596

Impairment testing

The methodology for impairment testing on the Infrastructure, which is part of intangible assets, is based on discounted cash flow model which uses inputs that consider features of the business and the environment.

The model used, to determine the recoverable amount, is most sensitive to changes in the forecast earnings available to shareholders over a five-year period, the cost of equity and to changes in the growth rate. As a result of this analysis impairment of ISK 27 million was recognized in 2015 (2014: ISK 29 million).

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25. Intangible assets, continued

Discount and growth rates	2015 Discount rates	2015 Growth rates	2014 Discount rates	2014 Growth rates
Asset Management operation	12.6%	2.5%	14.7%	2.5%
Credit card operation	12.6%	3-25%	14.7%	3-14%

26. Tax assets and tax liabilities

	2015 Assets	2015 Liabilities	2014 Assets	2014 Liabilities
Current tax	-	3,272	-	4,499
Deferred tax	205	1,650	655	624
Tax assets and tax liabilities	205	4,922	655	5,123

Deferred tax assets and tax liabilities are attributable to the following:

	2015 Assets	2015 Liabilities	2014 Assets	2014 Liabilities
Foreign currency denominated assets and liabilities	4	(222)	7	(205)
Investment property and property and equipment	101	(271)	95	(333)
Financial assets	494	(1,171)	564	-
Other assets and liabilities	256	(495)	188	(529)
Deferred tax related to foreign exchange gain	-	(141)	-	(78)
Tax loss carry forward	-	-	322	-
	855	(2,300)	1,176	(1,145)
Set-off of deferred tax assets together with tax liabilities of the same taxable entities	(650)	650	(521)	521
Deferred tax assets and tax liabilities	205	(1,650)	655	(624)

Subsidiaries own tax loss carry forward with asset value of the amount of ISK 546 million (31.12.2014: ISK 726 million) that is not recognised in the Financial Statements, due to uncertainty about the utilisation possibilities of the loss.

Changes in deferred tax assets and tax liabilities

2015	At 1 Jan.	Addition / disposal	Recognised through equity	Recognised in profit or loss	At 31 Dec.
Foreign currency denominated assets and liabilities	(198)	-	-	(20)	(218)
Investment property and property and equipment	(238)	-	-	68	(170)
Financial assets	564	-	(1,171)	(70)	(677)
Other assets and liabilities	(341)	-	-	102	(239)
Deferred foreign exchange differences	(78)	-	-	(63)	(141)
Tax loss carry forward	322	-	-	(322)	-
Change in deferred tax assets and tax liabilities	31	-	(1,171)	(305)	(1,445)

2014	At 1 Jan.	Addition / disposal	Recognised through equity	Recognised in profit or loss	At 31 Dec.
Foreign currency denominated assets and liabilities	(187)	-	-	(11)	(198)
Investment property and property and equipment	(1,626)	1,102	-	286	(238)
Financial assets	580	-	-	(16)	564
Other assets and liabilities	424	(458)	-	(307)	(341)
Deferred foreign exchange differences	79	-	-	(157)	(78)
Tax loss carry forward	322	-	-	-	322
Change in deferred tax assets and tax liabilities	(408)	644	-	(205)	31

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27. Other assets

	2015	2014
Non-current assets and disposal groups held for sale	5,082	3,958
Property and equipment	6,766	7,080
Accounts receivable	2,433	2,474
Unsettled securities trading	685	138
Sundry assets	2,612	1,836
Other assets	17,578	15,486

Vast majority of the Non-current assets and disposal groups held for sale consist of real estates that are generally the result of foreclosures on companies and individuals.

Property and equipment	Real estate	Equip-ment	Total 2015	Total 2014
Gross carrying amount at the beginning of the year	6,214	6,211	12,425	10,904
Additions	2	709	711	1,866
Disposals and transfers	(65)	(168)	(233)	(335)
Gross carrying amount at the end of the year	6,151	6,752	12,903	12,435
Accumulated depreciation at the beginning of the year	(1,408)	(3,947)	(5,355)	(3,961)
Depreciation	(149)	(700)	(849)	(1,456)
Disposals and transfers	12	55	67	62
Accumulated depreciation at the end of the year	(1,545)	(4,592)	(6,137)	(5,355)
Property and equipment	4,606	2,160	6,766	7,080

The official real estate value (Registers Iceland) amounts to ISK 4,603 million at the end of the year (31.12.2014: ISK 4,781 million) and the insurance value amounts to ISK 9,597 million (31.12.2014: ISK 9,479 million).

28. Other liabilities

	2015	2014
Accounts payable	23,296	20,909
Provision for settled FX loans	2,882	2,791
Unsettled securities trading	754	217
Depositors' and investors' guarantee fund	2,873	2,880
Insurance claim	2,574	2,402
Withholding tax	1,643	1,507
Bank levy	2,811	2,688
Sundry liabilities	12,628	13,796
Other liabilities	49,461	47,190

Arion Bank Consolidated Financial Statements 2015 38 Amounts are in ISK millions

29. Borrowings

	Issued	Maturity	Maturity type	Terms of interest	2015	2014
Covered bond in ISK	2012	2015	At maturity	Fixed, 6.50%	-	14,493
Covered bond in ISK	2013	2019	At maturity	Fixed, CPI linked, 2.50%	4,483	4,508
Covered bond in ISK	2014	2021	At maturity	Fixed, CPI linked, 3.50%	5,096	1,134
Covered bond in ISK	2015	2022	At maturity	Fixed, 6.50%	7,737	-
Covered bond in ISK	2014	2029	At maturity	Fixed, CPI linked, 3.50%	15,279	5,232
Covered bond in ISK	2005	2033	Amortizing	Fixed, CPI linked, 3.75%	17,108	17,428
Covered bond in ISK	2012	2034	Amortizing	Fixed, CPI linked, 3.60%	2,249	2,541
Covered bond in ISK	2008	2045	Amortizing	Fixed, CPI linked, 4.00%	6,182	6,165
Covered bond in ISK	2006	2048	Amortizing	Fixed, CPI linked, 3.75%	77,916	77,557
Covered bonds					136,050	129,058
Senior unsecured bond in NOK	2013	2016	At maturity	Floating, NIBOR +5.00%	1,547	8,478
Senior unsecured bond in EUR	2009	2018	Amortizing	Floating, EURIBOR +1.00%	1,177	1,714
Senior unsecured bond in ISK	2010	2018	Amortizing	Floating, REIBOR +1.00%	1,600	2,130
Senior unsecured bond in EUR	2015	2018	At maturity	Fixed, 3.125%	43,350	-
Senior unsecured bond in NOK	2015	2020	At maturity	Floating, NIBOR +2.95%	11,900	-
Bonds issued					59,574	12,322
Central Bank, secured, various curr.	2010	2022	At maturity	Floating, LIBOR + 3.00%	56,024	55,102
Bills issued					4,081	3,186
Other					329	912
Other loans/bills					60,434	59,200
Borrowings					256,058	200,580

Book value of listed bonds was ISK 196,927 million at the end of the year (31.12.2014: ISK 140,721 million). Market value of those bonds was ISK 205,720 million (31.12.2014: ISK 137,715 million).

The Group repurchased own debts during the year for the amount of ISK 10 billion (2014: ISK 20 billion) with minor effects on the Statement of Comprehensive Income.

30. Subordinated liabilities

	Issued	Maturity	Maturity type	Terms of interest	2015	2014
Tier II capital in various currencies	2010	2020	At maturity	Floating, EURIBOR/LIBOR + 5.00%	10,365	31,639
Subordinated liabilities					10,365	31,639

At the end of March Arion Bank prepaid ISK 10 billion of the subordinated liabilities with the Ministry of Finance and Economic Affairs. Additional prepayment was made at end of June for the same amount. Arion Bank aims to pay the remaining subordinated liability when conditions are favourable.

Arion Bank Consolidated Financial Statements 2015 39 Amounts are in ISK millions

31. Pledged assets

Pledged assets against liabilities	2015	2014
Assets, pledged as collateral against borrowings	222,046	233,191
Assets, pledged as collateral against loans from credit institutions and short positions	21,611	17,973
Pledged assets against liabilities	243,657	251,164

The Group has pledged assets against borrowings, both issued covered bonds and other issued bonds and loan agreements. The total value of those pledged assets was ISK 222 billion at the end of the period (31.12.2014: ISK 233 billion). Those assets were mainly pool of mortgage loans to individuals, loans to real estate companies, wholesale and retal and industry and energy companies. The book value of those borrowings was ISK 192 billion at the end of the year (31.12.2014: ISK 184 billion).

Assets are primarily pledged against borrowings associated with the acquisition of the pledged assets. Two major events are most significant. Assets were acquired from the Central Bank of Iceland in conjunction with the recapitalization of Arion Bank on 8 January 2010 and a portfolio of mortgages was acquired from Kaupthing hf. and is pledged against a structured covered bond that Arion Bank took over as issuer of from Kaupthing hf. at the end of 2011.

The Group has pledged bonds against short term lending from the Central Bank of Iceland and against short positions, related to swap agreements, to hedge market risk of those assets.

32. Equity

Share capital and share premium

According to the Bank's Articles of Association, total share capital amounts to ISK 2,000 million, with par value of ISK 1 per share. The holders of ordinary shares are entitled to receive dividends as approved by the general meeting and are entitled to one vote per share at Shareholders' meetings.

	Number (million)	2015	Number (million)	2014
Issued share capital	2,000	75,861	2,000	75,861

Share premium represents excess of payment above nominal value that Shareholders have paid for shares issued by Arion Bank hf.

Other reserves	2015	2014
Statutory reserve	1,637	1,637
Available-for-sale reserve	2,903	-
Foreign currency translation reserve	8	(5)
Other reserves	4,548	1,632

OTHER INFORMATION

33. Legal matters

The Group has formal controls and policies for managing legal claims. Once professional advice has been obtained and the amount of loss reasonably estimated, the Group makes adjustments, if appropriate, to account for any adverse effects which the claims may have on its financial standing. When the Group is of the opinion that it is to the detriment of the Group's case to disclose potential amounts relating to legal claims, it elects not to do so. At the end of the year, the Group had several unresolved legal claims.

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, Kortaþjónustan 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 Kortaþjónustan 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 Kortaþjónustan's claims. The case has been put on hold as Kortaþjónustan's court-appointed evaluator prepares its report on Kortaþjónustan'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

Legal proceedings regarding CPI loans

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 borrowrs' 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.

33. Legal matters, continued

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 Kortaþjónustan hf. filed a suit against Valitor hf., Borgun hf. and Greiðsluveitan ehf., claiming damages for the alleged loss suffered by Kortaþjónustan 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 Kortaþjónustan hf.'s alleged damage. The case was settled in early March 2015 with a payment of ISK 250 million to Kortaþjónustan hf.

34. 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.

35. Acquisition of the insurance company Vörður

In October 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

OFF BALANCE SHEET INFORMATION

36. Obligations

Guarantees, unused overdraft and loan commitments the Group has granted its customers	2015	2014
Guarantees	19,162	9,542
Unused overdrafts	42,100	38,890
Loan commitments	126,068	56,363

Depositors' and Investors' Guarantee fund

The Icelandic parliament has discussed a bill on a new Depositors' and Investors' Guarantee Fund, without conclusion of the matter. Even though the law has not been amended Icelandic bank's have made quarterly payments to a separate division within the fund since 2010. Despite this change in execution and due to uncertainty of the shape of future legislation the liability brought forward from previous years is not changed from the balance of ISK 2,669 million. The Group has granted the Fund a guarantee for obligations amounting to ISK 3,210 million.

37. Operating lease commitments

Group as a lessee

The Group has concluded lease agreements regarding some of the real estate it uses for its operations. These lease agreements are for a period of up to 10 years. The majority of the contracts include renewal options for various periods of time.

	2015	2014
Less than one year	279	292
Over 1 year and up to 5 years	684	829
Over 5 years	346	606
Future minimum lease payments under non-cancellable leases	1,309	1,727

Group as a lessor

The Group has entered lease agreements on its investment properties and real estates. The lease agreements are for a period of up to 8 years, with majority being non-cancellable agreements.

	2015	2014
Less than one year	120	93
Over 1 year and up to 5 years	127	125
Over 5 years	25	16
Future minimum lease payments under non-cancellable leases	272	234

38. Assets under management and under custody

Assets under management	996,648	923,599
Assets under custody	1,427,269	1,337,561

Assets under management represent the total market value of the financial assets which the Group manages on behalf of its customers.

The Group, acting as custodian, is responsible for safeguarding a firm's or individual's financial assets, hold in safekeeping securities such as stocks, bonds and securities funds, arrange the settlement of trades and movements of securities, process corporate actions such as income on bonds and dividends on shares; and pricing on securities.

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39. Events after Balance Sheet date

Arion Bank and Kaupthing reach funding agreement

Arion Bank reached an agreement with Kaupthing ehf. under which Arion Bank will issue a bond in the amount of USD 747 million (ISK 97 billion). The bond is being issued under Arion Bank's EMTN programme. It is a 7-year instrument and is callable on interest payment dates during the first two years. The bond bears floating LIBOR plus 2.6% for the first two years and will then be repriced at market terms.

The bond will offset loans in foreign currency taken by Arion Bank from the Central Bank of Iceland and Kaupthing deposits in foreign currency at Arion Bank. This transaction will have no effect on the asset side of the Statement of Financial Position but the liability side will be affected as stated in the table below.

	31.12.2015	Trans-actions	12.01.2016
Due to credit institutions and Central Bank	11,387	-	11,387
Deposits	469,347	(41,149)	428,198
Financial liabilities at fair value	7,609	-	7,609
Tax liabilities	4,922	-	4,922
Other liabilities	49,461	-	49,461
Borrowings	256,058	41,149	297,207
Central Bank, secured in various currencies	-	(56,024)	(56,024)
New EMTN issuance	-	97,173	97,173
Subordinated liabilities	10,365	-	10,365
Total Liabilities	809,149	-	809,149

The loan from Central Bank was covered by assets on the Balance Sheet of Arion Bank, mainly mortgage loans to individuals and other loans to large Icelandic corporates. With this loan settled the encumbrance ratio of the Group decreases from 24% to 18%.

Disposal of shareholding in Bakkavor Group Ltd.

In January 2016 the Bank's subsidiary BG12 slhf. completed the sale of its 46% shareholding in the associated company Bakkavor Group Ltd. The net effects on the Statement of Comprehensive Income in 2015 was ISK 20,845 million as the shareholding was revalued at year end based on the sales value, less cost to sell. See Note 24.

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RELATED PARTY

40. Related party

The Group has a related party relationship with Kaupskil ehf., being the ultimate controlling party with 87% stake in Arion Bank, the Board of Directors of Kaupskil ehf. and Kaupthing hf., being the parent company of Kaupskil ehf.

Icelandic State Financial Investments (ISFI, a separate state institution under the Ministry of Finance) manages a 13% stake in Arion Bank and thus has influence over the Group. ISFI and related entities are defined as related parties.

The Board of Directors of Arion Bank and key Management personnel of the Bank are defined as related parties, as well as close family members of individuals referred to above and legal entities controlled by them. The Group's associates are also defined as related parties.

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

2015

Balances with related parties	Assets	Liabilities	Net balance
Shareholders with control over the Group	212	(50,158)	(49,946)
Board of Directors and key Management personnel	232	(59)	173
Associates and other related parties	2,132	(241)	1,891
Balances with related parties	2,576	(50,458)	(47,882)

Transactions with related parties	Interest income	Interest expense	Other income	Other expense
Shareholders with control over the Group	-	(762)	16	-
Shareholders with influence over the Group	-	(4)	15	(13)
Board of Directors and key Management personnel	12	(2)	5	-
Associates and other related parties	1,288	(617)	344	(276)
Transactions with related parties	1,300	(1,385)	380	(289)

2014

Balances with related parties	Assets	Liabilities	Net balance
Shareholders with control over the Group	577	(53,970)	(53,393)
Board of Directors and key Management personnel	260	(67)	193
Associates and other related parties	20,060	(22,861)	(2,801)
Balances with related parties	20,897	(76,898)	(56,001)

Transactions with related parties	Interest income	Interest expense	Other income	Other expense
Shareholders with control over the Group	-	(1,184)	10	-
Shareholders with influence over the Group	-	-	26	(30)
Board of Directors and key Management personnel	13	(1)	3	-
Associates and other related parties	2,807	(804)	282	(377)
Transactions with related parties	2,820	(1,989)	321	(407)

Through the ownership of ISFI the Group has a related party relationship with Landsbankinn hf. Landsbankinn hf. provides banking services to the Bank's subsidiary Valitor hf. and has a traditional bank to bank relationship with Arion Bank hf. The Group holds assets amounting to ISK 14,038 million (31.12.2014: ISK 28,881 million) by Landsbankinn hf. and liabilities amounting to ISK 1,499 million at the end of the year (31.12.2014: ISK 7,332 million). Total interest income was ISK 120 million in 2015 (2014: ISK 73 million) and interest expense ISK 48 million (2014: ISK 172 million). Other income was ISK 500 million during the year (2014: ISK 301 million) and other expense was ISK 1,192 million (2014: ISK 347 million). Those amounts are not included in the table above.

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RISK MANAGEMENT DISCLOSURES

The Group faces various risks arising from its day to day operations. Managing risk is therefore a core activity within the Group. The key to effective risk management is a process of on-going identification of significant risk, quantification of risk exposure, actions to limit risk and constant monitoring of risk. This process of risk management and the ability to evaluate, manage and correctly price the risk encountered is critical to the Group's continuing profitability as well as to be able to ensure that the Group's exposure to risk remains within acceptable levels.

The Board of Directors is ultimately responsible for the Group's risk management framework and ensuring that satisfactory risk policies and governance for controlling the Group's risk exposure are in place. The Board allocates risk management of subsidiaries to the relevant subsidiary. For the parent company (the Bank) the Board sets risk appetite, which is translated into exposure limits and targets monitored by the Bank's Risk Management division.

The Chief Executive Officer (CEO) is responsible for sustaining an effective risk management framework, processes and control as well as maintaining a high level of risk awareness among the employees, making risk everyone's business.

The Bank operates several committees to manage risk. The Board Audit and Risk Committee (BARC) is responsible for supervising the Bank's risk management framework, risk appetite and the internal capital adequacy assessment process (ICAAP). The Asset and Liability Committee (ALCO), is responsible for managing the asset-liability mismatch, liquidity risk, market risk, and interest rate risk and capital management. The Underwriting and Investment Committee (UIC) decides on underwriting and principal investments. 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.

The Bank's Internal Audit conducts independent reviews of the Bank's and several subsidiaries' operations, risk management framework, processes and measurements. Internal Audit discusses its results with management and reports its findings and recommendations to the BARC.

The Bank's Risk Management division is headed by the Chief Risk Officer. It is independent and centralised and reports directly to the CEO. The division is divided into four units: Credit Analysis, which supports and monitors the credit granting process; Credit Control, which monitors credit exposures on a customer-by-customer basis; Balance Sheet Risk, which oversees all risks related to asset and liability mismatch, including capital and is reponsible for the Bank's ICAAP; and Operational Risk which monitors risks associated with the daily operation of the Bank. The Bank's Security Officer is a part of the Risk Management division.

The most significant risks the Group is exposed to are credit risk, including concentration risk, liquidity risk, currency risk, interest rate risk and legal risk. These risk factors are to the largest extent encountered within the Bank. Subsidiaries bear risk arising from real estate market and private equity prices and from asset management and insurance activities.

The total sum of large exposures is 11% compared to 24% in the previous year.

The Group is exposed to currency risk due to a net currency position on the balance sheet. The Group's operations are subject to interest rate risk associated with a mismatch between interest bearing assets and interest bearing liabilities.

Liquidity risk is a large risk factor in the Group's operation due to maturity mismatch between assets and liabilities. The maturity of loans exceeds the maturity of deposits, of which 67% is on-demand or with less than 30 day term.

Further information on risk management and capital adequacy is provided in the annual Financial Statements for 2015 and in the Pillar 3 Risk Disclosures for 2015. The Pillar 3 Risk Disclosures 2015 will be published in March 2016 and be available on the Bank's website, www.arionbanki.is. The Pillar 3 Risk Disclosures will not be subject to external audit.

41. Credit risk

Credit risk is the risk that the Group will incur a loss because its customers or counterparties fail to discharge their contractual obligations.

Credit risk arises anytime the Group commits its funds, resulting in capital or earnings being dependent on counterparty, issuer or borrower performance. Loans to customers and credit institutions are the largest source of credit risk. Credit risk is also inherent in other types of assets, such as bonds and debt instruments, and off balance sheet items such as commitments and guarantees.

Managing and analysing the Group's 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 Group grants credit based on well informed lending decisions and seeks business with strong parties with strong collaterals and good repayment capacity. The risk level of each credit is considered in the pricing.

Credit risk is managed and controlled by setting limits on the amount of risk the Group is willing to accept for individual counterparties and group of connected clients, and by monitoring exposures in relation to such limits. The Group seeks to limit its total credit risk through diversification of the loan portfolio across sectors and by limiting large exposures to group of connected clients.

41. Credit risk, continued

Maximum exposure to credit risk and credit concentration by industry sectors

The following table shows the maximum exposure to credit risk for the components of the Statement of Financial Position, by industry classification at the end of the year before the effect of mitigation due to collateral agreements or other credit enhancements. The Group uses an internal industry classification which is based on the ISAT08 standard classification. ISAT08 is based on the NACE Rev. 2 classification standard.

2015

Maximum exposure to credit risk related to on-balance sheet assets

	Individuals	Real estate activities and construction	Fishing industry	Information and communication technology	Wholesale and retail trade	Financial and insurance activities	Industry, energy and manufacturing	Transportation	Services	Public sector	Agriculture and forestry	Total
Cash & balances with Central Bank	-	-	-	-	-	48,102	-	-	-	-	-	48,102
Loans to credit institutions	-	-	-	-	-	87,491	-	-	-	-	-	87,491
Loans to customers	324,629	102,624	75,850	30,802	51,784	33,460	21,384	6,001	19,864	8,193	5,759	680,350
Financial instruments	135	175	72	11	-	14,894	9,430	29	400	61,624	-	86,770
Other assets with credit risk	289	564	29	80	67	3,018	3	1	455	65	10	4,581
Total on-balance sheet maximum exposure to credit risk	325,053	103,363	75,951	30,893	51,851	186,965	30,817	6,031	20,719	69,882	5,769	907,294

Maximum exposure to credit risk related to off-balance sheet items

	Individuals	Real estate activities and construction	Fishing industry	Information and communication technology	Wholesale and retail trade	Financial and insurance activities	Industry, energy and manufacturing	Transportation	Services	Public sector	Agriculture and forestry	Total
Financial guarantees	1,352	3,032	1,253	1,225	4,145	729	3,299	2,244	1,855	22	6	19,162
Unused overdrafts	24,373	1,977	596	632	5,093	1,622	2,013	377	2,403	2,639	375	42,100
Loan commitments	188	39,196	27,711	11,463	14,083	3,544	14,017	10,618	2,183	3,000	65	126,068
Total off-balance sheet maximum exposure to credit risk	25,913	44,205	29,560	13,320	23,321	5,895	19,329	13,239	6,441	5,661	446	187,330
Maximum exposure to credit risk	350,966	147,568	105,511	44,213	75,172	192,860	50,146	19,270	27,160	75,543	6,215	1,094,624

Amounts are in ISK millions

41. Credit risk, continued

2014

Maximum exposure to credit risk related to on-balance sheet assets

	Individuals	Real estate activities and construction	Fishing industry	Information and communication technology	Wholesale and retail trade	Financial and insurance activities	Industry, energy and manufacturing	Transportation	Services	Public sector	Agriculture and forestry	Total
Cash & balances with Central Bank	-	-	-	-	-	21,063	-	-	-	-	-	21,063
Loans to credit institutions	-	-	-	-	-	108,792	-	-	-	-	-	108,792
Loans to customers	321,311	81,228	76,340	23,314	55,034	27,693	25,284	5,529	18,382	7,746	5,647	647,508
Financial instruments	82	80	86	12	-	6,181	1,189	529	1,235	63,233	-	72,627
Other assets with credit risk	399	440	34	22	24	1,854	9	15	626	87	4	3,514
Total on-balance sheet maximum exposure to credit risk	321,792	81,748	76,460	23,348	55,058	165,583	26,482	6,073	20,243	71,066	5,651	853,504

Maximum exposure to credit risk related to off-balance sheet items

	Individuals	Real estate activities and construction	Fishing industry	Information and communication technology	Wholesale and retail trade	Financial and insurance activities	Industry, energy and manufacturing	Transportation	Services	Public sector	Agriculture and forestry	Total
Financial guarantees	390	2,300	784	573	1,128	1,201	1,322	709	1,101	27	7	9,542
Unused overdrafts	22,621	2,007	578	561	4,554	1,491	1,952	264	2,038	2,384	440	38,890
Loan commitments	392	7,281	9,010	3,587	9,040	1,797	6,183	10,679	970	7,392	32	56,363
Total off-balance sheet maximum exposure to credit risk	23,403	11,588	10,372	4,721	14,722	4,489	9,457	11,652	4,109	9,803	479	104,795
Maximum exposure to credit risk	345,195	93,336	86,832	28,069	69,780	170,072	35,939	17,725	24,352	80,869	6,130	958,299

Amounts are in ISK millions

41. Credit risk, continued

Loans to customers specified by sectors	2015	2014
Individuals	47.7%	49.6%
Real estate activities and construction	15.1%	12.5%
Fishing industry	11.1%	11.8%
Information and communication technology	4.7%	3.6%
Wholesale and retail trade	7.6%	8.5%
Financial and insurance activities	4.9%	4.3%
Industry, energy and manufacturing	3.1%	3.9%
Transportation	0.9%	0.9%
Services	2.9%	2.8%
Public sector	1.2%	1.2%
Agriculture and forestry	0.8%	0.9%
	100.0%	100.0%

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty and the exposure type. The main types of collateral obtained are as follows:

- 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.

The value of collateral is based on estimated market value. The valuation of real estate is built on market price, official valuation of the Icelandic Property Registry, or the opinion of internal or external specialists. The valuation of fishing vessels takes into account related fishing quota.

Collateral value is monitored and additional collateral requested in accordance with the underlying agreement. Collateral value is reviewed in line with the adequacy of the allowance for impairment losses.

The collateral value in the table below is capped by the exposure amount.

Collateral held against different types of financial assets

2015	Cash and securities	Real estate	Fishing vessels	Other collateral	Total
Cash and balances with Central Bank	-	-	-	-	-
Loans to credit institutions	-	-	-	-	-
Loans to customers					
Individuals	428	289,862	24	4,107	294,421
Real estate activities and construction	1,032	89,039	8	1,025	91,104
Fishing industry	53	7,956	57,945	7,037	72,991
Information and communication technology	76	2,369	-	18,630	21,075
Wholesale and retail trade	210	20,424	7	22,912	43,553
Financial and insurance activities	15,947	4,367	-	1,577	21,891
Industry, energy and manufacturing	461	12,792	3	4,416	17,672
Transportation	91	875	173	3,891	5,030
Services	13	4,847	40	2,623	7,523
Public sector	73	3,732	-	99	3,904
Agriculture and forestry	5	3,493	-	112	3,610
Financial instruments	7,474	-	-	-	7,474
Guarantees	885	4,232	623	1,445	7,185
Collateral held against different types of financial assets	26,748	443,988	58,823	67,874	597,433

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41. Credit risk, continued

2014	Cash and securities	Real estates	Fishing vessels	Other collateral	Total
Cash and balances with Central Bank	-	-	-	-	-
Loans to credit institutions	-	-	-	-	-
Loans to customers					
Individuals	440	282,871	43	1,093	284,447
Real estate activities and construction	635	66,910	11	2,976	70,532
Fishing industry	70	7,513	57,190	3,176	67,949
Information and communication technology	14	2,059	-	18,327	20,400
Wholesale and retail trade	261	16,522	5	30,173	46,961
Financial and insurance activities	12,108	2,584	-	2,886	17,578
Industry, energy and manufacturing	5,977	9,823	3	4,171	19,974
Transportation	42	587	153	3,019	3,801
Services	144	3,147	96	1,110	4,497
Public sector	18	3,700	-	152	3,870
Agriculture and forestry	5	2,546	-	124	2,675
Financial instruments	3,330	-	-	-	3,330
Guarantees	741	2,641	316	1,199	4,897
Collateral held against different types of financial assets	23,785	400,903	57,817	68,406	550,911

Collateral repossessed

During the year the Group took possession of assets due to foreclosures. The total amount of real estates the Group took possession of during the year and still holds at period end amount to ISK 2,761 million (31.12.2014: ISK 1,607 million) and other assets ISK 7 million (31.12.2014: ISK 10 million). The assets are held for sale, see Note 27.

Credit quality by class of financial assets

2015	Neither past due nor impaired	Past due but not impaired	Individually impaired	Total
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
Credit quality by class of financial assets	851,318	43,834	8,086	903,238

2014	Neither past due nor impaired	Past due but not impaired	Individually impaired	Total
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
Credit quality by class of financial assets	790,520	47,961	13,100	851,581

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41. Credit risk, continued

Neither past due nor impaired loans

The Bank uses internal credit rating models to monitor the development of credit risk and to estimate customers' probability of default (PD). The Bank rates customers with one of three models. For large corporates the Bank uses quantitative information based on financial statements as well as qualitative data. Credit ratings of individuals and SMEs are based on statistical models using historical information which has been found to be predictive. The models are updated annually and recalibrated with current data with the aim of improving their predictive power. Year-on-year changes in risk classification of loans may in part be due to model refinement.

The table below shows loans to customers that are neither past due nor impaired, broken down by the Bank's classification scale, where 5 denotes the highest risk.

	Risk classification						
2015	1	2	3	4	5	Not rated	Total
Individuals	54,822	148,472	63,027	18,553	4,693	1,710	291,277
Real estate activities and construction	36,550	23,792	29,776	3,790	154	3,279	97,341
Fishing industry	21,807	33,232	7,657	5,415	1,249	1,341	70,701
Information and communication technology	17,346	4,252	8,949	126	-	-	30,673
Wholesale and retail trade	9,447	18,356	18,260	2,064	198	33	48,358
Financial and insurance activities	3,012	17,784	11,308	223	-	456	32,783
Industry, energy and manufacturing	3,088	14,256	2,930	324	135	-	20,733
Transportation	3,320	1,094	1,040	274	28	-	5,756
Services	2,326	4,805	9,918	539	19	-	17,607
Public sector	357	3,396	2,342	1,038	133	545	7,811
Agriculture and forestry	336	1,558	2,887	609	-	-	5,390
Neither past due nor impaired loans	152,411	270,997	158,094	32,955	6,609	7,364	628,430

2014	1	2	3	4	5	Not rated	Total
Individuals	57,039	139,569	51,547	17,397	6,818	5,489	277,859
Real estate activities and construction	2,898	13,931	49,417	5,679	98	4,767	76,790
Fishing industry	25,757	26,757	13,681	2,182	1,599	1,596	71,572
Information and communication technology	371	19,469	3,205	219	-	-	23,264
Wholesale and retail trade	7,248	20,332	21,292	2,843	160	381	52,256
Financial and insurance activities	679	1,907	14,707	90	-	8,032	25,415
Industry, energy and manufacturing	7,804	8,017	6,996	517	363	621	24,318
Transportation	268	3,575	958	593	3	62	5,459
Services	820	9,848	3,577	533	13	2,571	17,362
Public sector	209	3,427	1,817	340	35	1,422	7,250
Agriculture and forestry	225	1,283	1,754	386	388	866	4,902
Neither past due nor impaired loans	103,318	248,115	168,951	30,779	9,477	25,807	586,447

Exposures that are 'Not rated' are typically due to newly formed entities and entities for which the Bank's rating models are not applicable.

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41. Credit risk, continued

Past due but not impaired loans by class of loans 2015	Up to 3 days	4 to 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
Loans to corporates	9,638	3,779	1,681	662	1,542	17,302
Loans to individuals	3,706	9,437	5,237	554	7,598	26,532
Past due but not impaired loans	13,344	13,216	6,918	1,216	9,140	43,834
2014						
Loans to corporates	6,553	2,434	2,267	565	3,295	15,114
Loans to individuals	3,436	10,589	5,974	847	12,001	32,847
Past due but not impaired loans	9,989	13,023	8,241	1,412	15,296	47,961

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 aquired at discount are not considered to be impaired unless the specific allowance exceeds the discount received.

Impaired loans to customers specified by sector	2015 Impair-ment amount	2015 Gross carrying amount	2014 Impair-ment amount	2014 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	296	474
Transportation	4,433	4,440	18	18
Services	504	682	375	641
Public sector	143	215	27	35
Agriculture and forestry	126	186	230	340
	25,341	33,427	22,214	35,314

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41. Credit risk, continued

Large exposure

A large exposure is defined as an exposure to a group of financially related borrowers which exceeds 10% of the Group's capital base according to FME rule No. 625/2013. The legal maximum for individual large exposures is 25% of the capital base, net of eligible collateral.

The largest exposure to a group of connected clients at the end of the period was ISK 22 billion (31.12.2014: ISK 25 billion) before taking account of eligible collateral.

The Group has one large exposure at the end of the year (31.12.2014: two exposures) net of eligible collateral.

	2015		2014	
No.	Gross	Net	Gross	Net
1	11%	11%	<10%	<10%
2	<10%	<10%	14%	14%
3	<10%	<10%	11%	10%
Sum of large exposure gross and net > 10%	11%	11%	25%	24%

No large exposure exceeds the legal limit of 25% of the Group's capital base at the end of the year.

42. 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.

Market risk arises from imbalances in the Group's balance sheet as well as in market making activities and position taking in bonds, equities, currencies, derivatives, and other commitments which are marked to market.

The Group keeps firm track of market risk and separates its exposures for trading book and banking book. Market risk in the trading book arises from proprietary trading activities and non-strategic derivatives positions arising from the Bank's operations of meeting customers' investment and risk management needs.. Market risk in the banking book arises from various mismatches in assets and liabilities in e.g. currencies, maturities and interest rates. Market risk in the trading book and in the banking book is managed separately by Treasury.

Market risk allowance is set by the Board in the Bank's risk appetite and limit frameworks are in place for each trading desk. The Asset and Liability Committee (ALCO) is responsible for managing the Bank's overall market risk. Risk Management is responsible for measuring and monitoring market risk exposure, and reporting the exposure, usage and limit breaches.

The Group's strategy towards market risk is to limit the risk exposure due to imbalances in the Group's balance sheet but accept limited risk in its trading book.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair value of financial instruments. The Group's operations are subject to interest rate risk associated with a mismatch between interest bearing assets and interest bearing liabilities. This mismatch is characterised by a 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 predominantly fixed to some extent, resulting in a repricing risk for the Group. The Group also faces interest basis risk between interest bearing assets and interest bearing liabilities due to different types of floating rate indices in different currencies, of which the largest one is EUR.

The Group's strategy for managing its interest rate risk is to strive to contain interest rate mismatches within acceptable levels by maintaining partly matched funding for its loans to customers, offering deposit incentives and by targeted lending practices.

Arion Bank Consolidated Financial Statements 2015 54 Amounts are in ISK millions

42. Market risk, continued

Interest rate risk in the banking book

The following table shows the Group's interest bearing assets and liabilities by interest fixing periods. The figures for loans to customers and borrowings are shown on a fair value basis, see Note 22, and are therefore different from the amounts shown in the Financial Statements. Defaulted loans are presented at book value, which is based on the value of the underlying collateral, and are therefore assumed to be independent of interest adjustment periods and placed in the 'Up to 3 months' category.

The Group's interest bearing assets and liabilities by interest rate adjustement periods

2015 Assets	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	43,181	-	-	-	-	43,181
Loans to credit institutions	87,491	-	-	-	-	87,491
Loans to customers	347,571	64,594	127,907	5,255	142,869	688,196
Financial instruments	43,925	10,002	8,556	7,786	242	70,511
Assets	522,168	74,596	136,463	13,041	143,111	889,379
Liabilities						
Due to credit institutions and Central Bank	11,387	-	-	-	-	11,387
Deposits	464,998	3,501	848	-	-	469,347
Borrowings	72,010	4,509	48,705	12,982	126,632	264,838
Subordinated loans	10,365	-	-	-	-	10,365
Liabilities	558,760	8,010	49,553	12,982	126,632	755,937
Derivatives and other off-balance sheet items (net position)	(46,330)	(1,802)	49,346	-	-	1,214
Net interest gap	(82,922)	64,784	136,256	59	16,479	134,656

2014 Assets	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	15,808	-	-	-	-	15,808
Loans to credit institutions	108,792	-	-	-	-	108,792
Loans to customers	358,943	56,338	78,887	2,845	160,248	657,261
Financial instruments	39,963	1,552	12,609	4,672	1,046	59,842
Assets	523,506	57,890	91,496	7,517	161,294	841,703
Liabilities						
Due to credit institutions and Central Bank	22,876	-	-	-	-	22,876
Deposits	449,638	2,124	3,270	-	101	455,133
Borrowings	62,821	18,307	7,313	1,124	107,550	197,115
Subordinated loans	31,639	-	-	-	-	31,639
Liabilities	566,974	20,431	10,583	1,124	107,651	706,763
Derivatives and other off-balance sheet items (net position)	56	(2,760)	2,778	-	-	74
Net interest gap	(43,412)	34,699	83,691	6,393	53,643	135,014

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42. Market risk, continued

Sensitivity analysis of interest rate risk in the banking book

The following table shows the sensitivity of the Group's net present value of interest bearing assets and liabilities to changes in interest rates by currencies. Sensitivity is quantified as the net change in value of interest bearing assets and liabilities when assuming a simultaneous parallel shift upwards and downwards of all yield curves by 100 basis points. The sensitivity does not relate to variation of annual net interest income and is not an estimate of risk.

	2015		2014	
Currency	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI indexed linked	1,850	(1,763)	5,278	(4,525)
ISK, Non Indexed linked	751	(735)	995	(955)
EUR	185	(178)	321	(296)
Other	522	(494)	405	(380)

Interest rate risk in the trading book

The following table shows the total basis point value (BPV) of the Group's bond and derivatives in the trading book at market value (MV). BPV denotes the change in value given a basis point (0.01%) yield change.

	2015			2014		
Trading financial instruments, long positions	MV	Duration	BPV	MV	Duration	BPV
ISK, CPI Indexed linked	4,544	3.6	(1.6)	1,924	6.3	(1.2)
ISK, Non Indexed linked	5,849	(1.8)	1.1	3,353	(2.1)	0.7
FX	64,226	(0.6)	3.9	22,844	0.1	(0.2)
Total	74,619	(0.5)	3.4	28,121	0.3	(0.7)
Trading financial instruments, short positions						
ISK, CPI Indexed linked	393	9.7	(0.4)	1,003	6.1	(0.6)
ISK, Non Indexed linked	7,953	0.3	(0.3)	7,139	0.4	(0.3)
FX	64,172	(0.5)	2.9	22,243	0.1	(0.2)
Total	72,518	(0.3)	2.3	30,385	0.4	(1.1)

Sensitivity analysis of interest rate risk in the trading book

The following table shows the interest sensitivity of the Group's net positions in the trading book by currencies. Sensitivity is quantified as the net change in value when assuming a simultaneous parallel shift upwards and downwards of all yield curves by 100 basis points. The sensitivity does not relate to variation of annual net interest income and is not an estimate of risk. The calculations are based on duration and convexity in this table.

	2015		2014	
Currency	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI indexed linked	126	(121)	62	(58)
ISK, Non Indexed linked	(142)	130	(104)	93
EUR	19	(20)	13	(12)
Other	(122)	115	(13)	13

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42. Market risk, continued

Indexation risk

The Group is exposed to indexation risk when there is a mismatch between index-linked assets and liabilities. The total amount of indexed assets is ISK 311.6 billion (31.12.2014: ISK 289.2 billion) and the total amount of indexed liabilities is ISK 216.6 billion (31.12.2014: ISK 204.0 billion).

Transaction maturity profile of indexed assets and liabilities

2015 Assets, CPI indexed linked	Up to 1 year	1 to 5 years	Over 5 years	Total
Loans to customers	13,629	76,393	209,485	299,507
Financial instruments	3,412	-	-	3,412
Off-balance sheet position	749	7,940	-	8,689
Assets, CPI indexed linked	17,790	84,333	209,485	311,608
Liabilities, CPI indexed linked				
Deposits	72,352	12,899	1,916	87,167
Borrowings	2,128	14,164	112,350	128,642
Other	-	-	782	782
Liabilities, CPI indexed linked	74,480	27,063	115,048	216,591
Net on-balance sheet position	(57,439)	49,330	94,437	86,328
Net off-balance sheet position	749	7,940	-	8,689
CPI Balance	(56,690)	57,270	94,437	95,017

2014 Assets, CPI indexed linked	Up to 1 year	1 to 5 years	Over 5 years	Total
Loans to customers	9,566	74,705	200,030	284,301
Financial instruments	2,090	-	-	2,090
Off-balance sheet position	825	1,952	-	2,777
Assets, CPI indexed linked	12,481	76,657	200,030	289,168
Liabilities, CPI indexed linked				
Deposits	66,489	19,615	2,415	88,519
Borrowings	2,019	13,703	99,277	114,999
Off-balance sheet position	524	-	-	524
Liabilities, CPI indexed linked	69,032	33,318	101,692	204,042
Net on-balance sheet position	(56,852)	41,387	98,338	82,873
Net off-balance sheet position	301	1,952	-	2,253
CPI Balance	(56,551)	43,339	98,338	85,126

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42. Market risk, continued

Currency risk

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

Breakdown of assets and liabilities by currency

2015

Assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with Central Bank	47,357	252	167	37	96	37	156	48,102
Loans to credit institutions	20,923	24,741	19,478	7,260	3,182	4,125	7,782	87,491
Loans to customers	568,196	44,532	37,395	6,487	11,357	9	12,374	680,350
Financial instruments	84,752	24,852	13,227	6,145	63	3,248	904	133,191
Investment property	7,542	-	-	-	-	-	-	7,542
Investments in associates	1,043	-	-	26,256	-	-	-	27,299
Intangible assets	5,575	-	-	-	3,710	-	-	9,285
Tax assets	205	-	-	-	-	-	-	205
Other assets	16,711	482	170	177	22	14	2	17,578
Assets	752,304	94,859	70,437	46,362	18,430	7,433	21,218	1,011,043
Liabilities and equity								
Due to credit inst. and Central Bank ..	9,471	381	74	6	1	-	1,454	11,387
Deposits	388,228	18,041	50,913	6,865	1,523	2,156	1,621	469,347
Financial liabilities at fair value	6,790	584	104	10	4	-	117	7,609
Tax liabilities	4,501	-	-	-	422	-	(1)	4,922
Other liabilities	41,098	2,648	1,484	1,432	832	347	1,620	49,461
Borrowings	142,060	44,526	33,442	8,511	-	13,447	14,072	256,058
Subordinated liabilities	-	3,942	2,603	3,820	-	-	-	10,365
Shareholders' equity	192,786	-	-	-	-	-	-	192,786
Non-controlling interest	9,108	-	-	-	-	-	-	9,108
Liabilities and equity	794,042	70,122	88,620	20,644	2,782	15,950	18,883	1,011,043
Net on-balance sheet position	(41,738)	24,737	(18,183)	25,718	15,648	(8,517)	2,335	
Net off-balance sheet position	9,619	(13,684)	20,273	(1,470)	(17,856)	5,481	(2,363)	
Net position	(32,119)	11,053	2,090	24,248	(2,208)	(3,036)	(28)	

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42. Market risk, continued

2014 Assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with Central Bank	19,472	5	904	178	107	46	351	21,063
Loans to credit institutions	35,076	16,570	13,141	13,646	2,946	11,084	16,329	108,792
Loans to customers	538,828	40,526	27,606	6,605	14,734	5,376	13,833	647,508
Financial instruments	73,851	14,963	7,776	3,436	47	1,736	19	101,828
Investment property	6,842	-	-	-	-	-	-	6,842
Investments in associates	16,052	-	-	5,914	-	-	-	21,966
Intangible assets	5,469	-	-	-	4,127	-	-	9,596
Tax assets	655	-	-	-	-	-	-	655
Other assets	14,665	485	128	123	26	52	7	15,486
Assets	710,910	72,549	49,555	29,902	21,987	18,294	30,539	933,736
Liabilities and equity								
Due to credit inst. and Central Bank ..	16,752	2,103	958	5	1	-	3,057	22,876
Deposits	374,063	25,949	16,247	11,348	9,306	8,075	9,985	454,973
Financial liabilities at fair value	8,971	43	127	-	1	-	1	9,143
Tax liabilities	4,642	-	-	-	481	-	-	5,123
Other liabilities	37,336	2,217	3,470	975	2,199	174	819	47,190
Borrowings	135,285	1,714	22,475	8,812	-	8,478	23,816	200,580
Subordinated liabilities	-	25,133	2,550	3,956	-	-	-	31,639
Shareholders' equity	160,711	-	-	-	-	-	-	160,711
Non-controlling interest	1,501	-	-	-	-	-	-	1,501
Liabilities and equity	739,261	57,159	45,827	25,096	11,988	16,727	37,678	933,736
Net on-balance sheet position	(28,351)	15,390	3,728	4,806	9,999	1,567	(7,139)	
Net off-balance sheet position	9,454	(9,065)	(397)	56	(8,963)	-	8,915	
Net position	(18,897)	6,325	3,331	4,862	1,036	1,567	1,776	

Sensitivity analysis on currency risk

The table below indicates the currencies to which the Group had significant exposure at the end of the year. The analysis calculates the effect of a reasonably possible movement of the currency rate against the ISK, with all other variables held constant, on the income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase. An equivalent decrease in each of the below currencies against the ISK would have resulted in an equivalent but opposite impact (+10% denotes a depreciation of the ISK).

	2015		2014	
Currency	-10%	+10%	-10%	+10%
EUR	(1,105)	1,105	(633)	633
USD	(209)	209	(333)	333
GBP	(2,425)	2,425	(486)	486
DKK	221	(221)	(104)	104
NOK	304	(304)	(157)	157
Other	3	(3)	(178)	178

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42. Market risk, continued

Equity risk

Equity 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 Group's assets i.e. restructuring of troubled companies which the Group has taken over. For information on assets seized and held for sale and equity exposures, see Notes 27 and 21 respectively.

Sensitivity analysis on equity risk

The analysis below calculates the effect of a reasonable possible movement in equity prices on the income statement. 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. Investments in associates are excluded.

	2015		2014	
Equity	-10%	+10%	-10%	+10%
Trading book - listed	(214)	214	(154)	154
Banking book - listed	(1,387)	1,387	(708)	708
Banking book - unlisted	(1,819)	1,819	(1,551)	1,551

Derivatives

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

Prepayment risk

Prepayment risk is the risk that the Group 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 Group is not materially exposed to prepayment risk at year end 2015.

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43. Liquidity and Funding risk

Liquidity risk is defined as the risk that the Group, though solvent, either does not have sufficient financial resources available to meet its liabilities when they 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 Group's primary source of funding is deposits from individuals, businesses and financial institutions. The Group's liquidity risk stems from the fact that the maturity of loans exceeds the maturity of deposits, of which 57% is on-demand.

Liquidity risk is one of the Group's most significant risk factors and a great deal of emphasis is placed on managing it. The Asset and Liability Committee (ALCO) is responsible for managing liquidity and funding risk within the risk appetite the Board sets. The Bank's Treasury manages liquidity positions on a day-to-day basis. Risk Management measures, monitors and reports the Bank's liquidity and funding risk.

The Group's strategy is to always maintain sufficient liquidity by maintaining a high ratio of liquid assets and available funding to near term liabilities and possible payment outflows. Uncertainties in relation to the capital controls have been significantly reduced and in January 2016 Kaupthing's deposits in foreign currency with the Group were termed out into EMTN funding. As a result, liquidity risk due to entities in winding-up has been reduced.

Group's assets and liabilities at carrying amount by residual maturity

2015 Assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity
Cash and balances with Central Bank	48,102	35,467	-	12,635	-	-	-
Loans to credit institutions	87,491	50,151	37,340	-	-	-	-
Loans to customers	680,350	3,984	42,429	90,014	234,035	309,888	-
Financial instruments	133,191	4,765	1,711	10,861	54,392	10,985	50,477
Derivatives - assets leg	*56,171*	-	*24,671*	*1,478*	*29,509*	*513*	-
Derivatives - liabilities leg	*(53,770)*	-	*(24,262)*	*(1,421)*	*(27,688)*	*(399)*	-
Investment property	7,542	-	-	-	-	-	7,542
Investments in associates	27,299	-	-	-	-	-	27,299
Intangible assets	9,285	-	-	-	-	-	9,285
Tax assets	205	-	-	-	205	-	-
Other assets	17,578	1,017	2,592	174	793	-	13,002
Assets	1,011,043	95,384	84,072	113,684	289,425	320,873	107,605
Liabilities							
Due to credit institutions and Central Bank	11,387	9,881	-	1,481	25	-	-
Deposits	469,347	268,727	95,191	89,937	13,575	1,917	-
Financial liabilities at fair value	7,609	-	6,346	536	631	96	-
Derivatives - assets leg	*(49,199)*	-	*(36,552)*	*(5,662)*	*(6,518)*	*(467)*	-
Derivatives - liabilities leg	*52,192*	-	*38,282*	*6,198*	*7,149*	*563*	-
Short position bonds and derivatives	*1,309*	-	*1,309*	-	-	-	-
Short position bonds used for hedging	*3,307*	-	*3,307*	-	-	-	-
Tax liabilities	4,922	-	-	3,274	1,648	-	-
Other liabilities	49,461	17,002	14,724	5,192	3,529	6	9,008
Borrowings	256,058	-	7,081	4,308	69,933	174,736	-
Subordinated liabilities	10,365	-	-	-	3,942	6,423	-
Liabilities	809,149	295,610	123,342	104,728	93,283	183,178	9,008
Off-balance sheet items							
Guarantees	19,162	3,402	2,371	7,589	3,954	1,846	-
Unused overdraft	42,100	842	10,071	14,984	15,768	435	-
Loan commitments	126,068	-	50,628	35,542	34,506	5,392	-
Off-balance sheet items	187,330	4,244	63,070	58,115	54,228	7,673	-
Net assets (liabilities)	14,564	(204,470)	(102,340)	(49,159)	141,914	130,022	98,597

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43. Liquidity and Funding risk, continued

2014 Assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity
Cash and balances with Central Bank	21,063	12,285	-	8,778	-	-	-
Loans to credit institutions	108,792	52,119	56,673	-	-	-	-
Loans to customers	647,508	11,678	50,642	89,332	230,055	265,801	-
Financial instruments	101,828	7,562	742	2,203	52,527	7,670	31,124
Derivatives - assets leg	*28,234*	-	*6,654*	*15,659*	*5,921*	-	-
Derivatives - liabilities leg	*(27,209)*	-	*(5,912)*	*(15,524)*	*(5,773)*	-	-
Investment property	6,842	-	-	-	-	-	6,842
Investments in associates	21,966	-	-	-	-	-	21,966
Intangible assets	9,596	-	-	-	-	-	9,596
Tax assets	655	-	-	-	655	-	-
Other assets	15,486	47	2,283	46	1,121	17	11,972
Assets	933,736	83,691	110,340	100,359	284,358	273,488	81,500
Liabilities							
Due to credit institutions and Central Bank	22,876	13,652	2,238	6,962	24	-	-
Deposits	454,973	263,899	96,009	46,412	45,102	3,551	-
Financial liabilities at fair value	9,143	-	8,663	227	253	-	-
Derivatives - assets leg	*(15,693)*	-	*(4,525)*	*(10,504)*	*(664)*	-	-
Derivatives - liabilities leg	*16,598*	-	*4,950*	*10,731*	*917*	-	-
Short position bonds and derivatives	*5,478*	-	*5,478*	-	-	-	-
Short position bonds used for hedging	*2,760*	-	*2,760*	-	-	-	-
Tax liabilities	5,123	-	1,125	3,374	624	-	-
Other liabilities	47,190	667	30,372	5,192	2,680	120	8,159
Borrowings	200,580	-	1,776	20,057	24,908	153,839	-
Subordinated liabilities	31,639	-	-	-	-	31,639	-
Liabilities	771,524	278,218	140,183	82,224	73,591	189,149	8,159
Off-balance sheet items							
Guarantees	9,542	2,373	1,234	2,389	1,753	1,793	-
Unused overdraft	38,890	658	10,163	17,738	10,273	58	-
Loan commitments	56,363	2,432	21,419	15,705	16,807	-	-
Off-balance sheet items	104,795	5,463	32,816	35,832	28,833	1,851	-
Net assets (liabilities)	57,417	(199,990)	(62,659)	(17,697)	181,934	82,488	73,341

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43. Liquidity and Funding risk, continued

The net stable funding ratio (NSFR) measures the amount of available stable funding (ASF) at the Group against the required stable funding (RSF) as per definition of the Central Bank of Iceland rules No. 1032. In general, RSF is determined by applying different weights to different asset classes depending on the level of liquidity. ASF however is calculated by applying weights to the Group's liabilities depending on maturity and/or stickiness. In 2016, the ratio for foreign currency shall be at least 90% and from 2017 the ratio shall exceed 100%.

Calculations of the NSFR are based on consolidated figures for the Bank and Arion Bank Mortgages Institutional Investor Fund. When calculating the FX ratio, a negative FX imbalance is subtracted from the numerator and a positive FX imbalance is subtracted from the denominator. The FX imbalance discrepancy between the Group's official FX imbalance and the imbalance reported in the NSFR is due to the fact that the Bank's subsidiaries have a substantial positive FX imbalance but are settled in ISK.

When calculating the FX ratio, a negative FX imbalance is subtracted from the numerator and a positive FX imbalance is subtracted from the denominator.

2015	ISK	FX	Total
Available stable funding	540,864	129,273	670,137
Required stable funding	539,841	95,511	635,352
FX imbalance		(11,363)	
Net stable funding ratio	100%	123%	105%

2014			
Available stable funding	494,300	103,542	597,842
Required stable funding	553,205	70,850	624,055
FX imbalance		3,444	
Net stable funding ratio	89%	154%	96%

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43. Liquidity and Funding risk, continued

Liquidity coverage ratio

The liquidity coverage ratio (LCR) is part of the standards introduced in the Basel III Accord. The LCR is the result of a stress test that is designed to ensure that banks have the necessary assets on hand to withstand short-term liquidity disruptions. More accurately, LCR represents the balance between highly liquid assets and the expected net cash outflow of the Group in the next 30 days under stressed conditions.

To qualify as highly liquid assets under the LCR rules, assets must be non-pledged, liquid and easily priced on the market, repoable at the Central Bank and not issued by the Group or related entities.

The Central Bank has set rules for minimum LCR. In 2015, the LCR requirement was 100% in foreign currency and 80% in total (ISK and foreign currency). The latter minimum is 90% in 2016 and 100% from 2017.

The following table shows the breakdown for the Group's LCR calculations broken down on currencies; ISK , FX and total. All amounts are weighted by their respective LCR weights as defined by the Central Bank.

Liquidity coverage ratio

2015	ISK	FX	Total
Liquid Assets	98,647	30,850	129,497
Liquid assets level 1 *	98,647	24,981	123,628
Liquid assets level 2 **	-	5,869	5,869
Cash outflows	140,073	56,511	196,584
Deposits	122,275	21,640	143,915
Market Borrowing	1,502	122	1,624
Other Cash outflows	16,296	34,749	51,045
Cash inflows	12,961	87,338	100,299
Short term deposits in other banks ***	3,768	57,881	61,649
Other Cash inflows	9,193	29,457	38,650
Liquidity coverage ratio (LCR) ****	78%	218%	134%

2014	ISK	FX	Total
Liquid Assets	77,859	21,874	99,733
Liquid assets level 1 *	77,859	20,831	98,690
Liquid assets level 2 **	-	1,043	1,043
Cash outflows	121,271	34,454	155,725
Deposits	107,948	20,472	128,420
Market Borrowing	1,474	-	1,474
Other Cash outflows	11,849	13,982	25,831
Cash inflows	22,571	75,802	98,373
Short term deposits in other banks ***	16,953	62,937	79,890
Other Cash inflows	5,618	12,865	18,483
Liquidity coverage ratio (LCR) ****	79%	254%	174%

* Level 1 assets receive a 100% weight in LCR calculations and include the Groups Cash and Central Bank deposits, domestic bonds eligable as collateral at the Central Bank, foreign government bonds and the government liquidity facility.

** Level 2 assets include the Group's covered bonds with a minimum rating of AA- and receive a 85% weight in LCR calculations.

*** Short term deposits in other banks are defined as cash inflows in LCR calculations.

**** LCR is defined as: LCR = Weighted liquid assets / (weighted cash ouflows - weighted cash inflows) where weighted cash inflows are capped at 75% of weighted cash ouflows.

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43. Liquidity and Funding risk, continued

Composition of liquid assets

2015	ISK	USD	EUR	Other	Total
Cash and Cenral Bank deposits	46,521	349	531	759	48,160
Short term deposits in other banks	3,768	16,741	20,824	20,316	61,649
Domestic bonds eligable as collateral at the Central Bank	22,614	-	-	-	22,614
Foreign government bonds	-	10,658	8,700	3,984	23,342
Government liquidity facility	29,513	-	-	-	29,513
Covered bonds with a minimum rating of AA-	-	-	2,122	4,783	6,905
Total liquidity reserve	102,416	27,748	32,177	29,842	192,183

2014	ISK	USD	EUR	Other	Total
Cash and Cenral Bank deposits	18,787	1,059	500	1,069	21,415
Short term deposits in other banks	16,953	8,354	12,696	41,887	79,890
Domestic bonds eligable as collateral at the Central Bank	19,722	-	-	-	19,722
Foreign government bonds	-	7,053	8,082	3,067	18,202
Government liquidity facility	39,350	-	-	-	39,350
Covered bonds with a minimum rating of AA-	-	-	-	1,228	1,228
Total liquidity reserve	94,812	16,466	21,278	47,251	179,807

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43. Liquidity and Funding risk, continued

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 Group 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 Group's deposit base according to the LCR categorization, with the associated expected stressed outflow weights. 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.

LCR categorization - amounts and LCR outflow weights

	Deposits maturing within 30 days					
2015	Less Stable	Weight (%)	Stable	Weight (%)	Term deposits*	Total deposits
Retail	86,095	10%	39,598	5%	53,599	179,292
SME	37,884	10%	3,928	5%	4,327	46,139
Operational relationship	-	25%	-	5%	-	-
Corporations	36,300	40%	823	20%	4,945	42,068
Sovereigns, central-banks and PSE	11,900	40%	-	-	1,304	13,204
Financial entities being wound up	16,948	100%	-	-	47,062	64,010
Pension funds	41,609	100%	-	-	35,104	76,713
Domestic financial entities	32,727	100%	-	-	11,016	43,743
Foreign financial entities	5,193	100%	-	-	-	5,193
Other foreign parties	3,707	100%	3,260	25%	1,923	8,890
Total	272,363		47,609		159,280	479,252
2014						
Retail	78,659	10%	36,076	5%	53,803	168,538
SME	36,060	10%	3,895	5%	6,011	45,966
Operational relationship	-	25%	-	5%	1,190	1,190
Corporations	36,961	40%	830	20%	5,873	43,664
Sovereigns, central-banks and PSE	12,196	40%	-	-	2,870	15,066
Financial entities being wound up	19,796	100%	-	-	67,105	86,901
Pension funds	36,824	100%	-	-	19,765	56,589
Domestic financial entities	22,634	100%	-	-	16,752	39,386
Foreign financial entities	4,532	100%	-	-	522	5,054
Other foreign parties	3,425	100%	3,026	25%	2,082	8,533
Total	251,087		43,827		175,973	470,887

* Here term deposits refer to deposits with maturities greater than 30 days.

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44. Operational risk

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

Each business unit within the Group 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 Group's operational risk.

The Group uses the standardised approach to the calculation of capital requirements for operational risk.

45. Capital management

The capital base amounts to ISK 195,729 million at the end of the period. The capital adequacy ratio, calculated in accordance with Article 84 of the Act on Financial Undertakings was 24,2%, exceeding the minimum legal requirement of 8%.

The Group uses the standardised approach to calculate the capital requirements for credit risk, market risk, and operational risk.

The Bank carries out an on-going process, the Internal Capital Adequacy Assessment Process (ICAAP), with the aim to ensure 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 Groups risk across all risk types and ensure that the Group has sufficient capital in accordance to its risk profile. FME supervises the Group, receives the Group's internal estimation on the capital adequacy and sets capital requirements for the Group as a whole.

The Group is subject to capital requirements which are specified by the FME following the Supervisory Review and Evaluation Process (SREP). The Group's capital base exceeds the FME's SREP requirements.

Capital Base	2015	2014
Total equity	201,894	162,212
Non-controlling interest not eligible for inclusion in CET1 capital*	(9,108)	(1,385)
Intangible assets	(9,285)	(9,596)
Tax assets	(205)	(655)
Other statutory deductions	(3,151)	(111)
Common equity Tier 1 capital*	180,145	150,465
Non-controlling interest not eligible for inclusion in CET1 capital*	9,108	1,385
Tier 1 capital	189,253	151,850
Subordinated liabilities	10,365	31,639
Regulatory adjustments to Tier 2 capital**	(771)	-
Other statutory deductions	(3,118)	(101)
Tier 2 capital	6,476	31,538
Total capital base	195,729	183,388

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

** Straight-line amortization for maturities within five years.

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45. Capital management, continued

Risk weighted assets	2015	2014
Credit risk	681,034	591,994
Market risk FX	38,401	18,915
Market risk other	7,035	2,890
Operational risk	81,441	82,211
Total risk weighted assets	807,911	696,010

Capital ratios		
CET1 ratio using current RWA *	22.3%	21.6%
Tier 1 ratio	23.4%	21.8%
Capital adequacy ratio	24.2%	26.3%

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

Leverage ratio

As part of the Basel III regulatory framework, the leverage ratio is seen as a complementary measure to the risk-based Capital adequacy ratio.

	2015	2014
On-balance sheet exposures	982,348	912,303
Derivative exposures	3,789	1,348
Securities financing transaction exposures	16,287	10,044
Off-balance sheet exposures	127,675	59,922
Total exposure	1,130,099	983,617
Tier 1 capital	189,253	151,850
Leverage ratio	16.7%	15.4%

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SIGNIFICANT ACCOUNTING POLICIES

The accounting policies adopted in the preparation of these Consolidated Financial Statements are consistent with those followed in the preparation of the Group's Consolidated Financial Statements for the year ended 31 December 2014 except for new and amended IFRS adopted by the European Union, that became effective as of 1 January 2015, see Note 71, and amendmends to Icelandic Act on Financial Statements, Act on Financial Undertakings and rules on Accounting for Credit Institutions.

46. Going concern assumption

The Group's management has made an assessment of the ability to continue as a going concern and is satisfied that the Group has the resources to continue. In making this assessment, management has taken into consideration the risk exposures facing the Group which are further described in the Risk Management Disclosures. The Financial Statements are prepared on a going concern basis.

47. Principles underlying the consolidation

Subsidiaries

Subsidiaries are entities controlled by the Group. The Financial Statements of subsidiaries are included in the Financial Statements from the date that control commences until the date that control ceases. The Financial Statements of the subsidiaries are prepared for the same reporting period as the parent entity, using consistent accounting policies.

Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date, i.e. when control is transferred to the Group. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if, and only if, the Group has:

- power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect its returns.

Generally, there is a presumption that a majority of voting rights result in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including (i) the contractual arrangement with the other vote holders of the investee, (ii) rights arising from other contractual arrangements and (iii) the Group's voting rights and potential voting rights. The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.

The Group measures goodwill at the acquisition date as:

- the fair value of the consideration transferred; plus
- the recognised amount of any non-controlling interests in the acquiree; less
- if the business combination is achieved in stages, the fair value of the pre-existing equity interest in the acquiree; less
- the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

When the excess is negative, a bargain purchase gain is recognised immediately in profit or loss.

Transaction costs incurred are expensed and included in administration expense.

Non-controlling interests

Non-controlling interests represent the portion of profit or loss and equity not owned, directly or indirectly, by the Group; such interests are presented separately in the Statement of Comprehensive Income and are included in equity in the Statement of Financial Position, separately from equity attributable to owners of the Group.

For each business combination, the Group elects to measure any non-controlling interests in the acquiree either:

- at fair value; or
- at their proportionate share of the acquiree's identifiable net assets, which are generally at fair value.

Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

47. Principles underlying the consolidation, continued

Loss of control

On the loss of control, the Group derecognises the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control is recognised in profit or loss.

Transactions eliminated on consolidation

Intragroup balances, income and expenses arising from intragroup transactions, are eliminated in preparing the Financial Statements.

If an investment in subsidiary is classified as held for sale the investment is accounted for, as non-current asset and disposal groups held for sale from the date of classification.

Funds management

The Group manages and administers assets held in unit trusts and investment vehicles on behalf of investors. The Financial Statements of these entities are not included in these Financial Statements except when the Group controls the entity.

When assessing whether to consolidate investment funds, the Group reviews all facts and circumstances to determine whether the Group, as fund manager, is acting as agent or principal. The Group is deemed to be a principal, and hence controls and consolidates a fund, when the Group acts as fund manager and cannot be removed without cause, has variable returns through significant holdings, and is able to influence the returns of the funds by exercising its power. The Group is defined as agent in all instances.

48. Associates

Associates are those entities over which the Group has significant influence, i.e. the power to participate in the financial and operating policy decisions of the associates but not control or joint control over those policies. Significant influence generally exists when the Group holds 20% or more of the voting power, including potential voting rights, unless it can be clearly demonstrated that this is not the case. Investments in associates are initially recognised at cost. The carrying amount of investments in associates includes intangible assets and accumulated impairment loss.

The considerations made in determining significant influence are similar to those necessary to determine control over subsidiaries.

The Group's investments in its associate are accounted for using the equity method.

The Financial Statements include the Group's share of the total recognised income and expenses of associates from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its carrying value of associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the Group resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

Upon loss of significant influence over the associate, the Group measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognised in profit or loss.

Impairment on investments in associates

After applying the equity method to account for investments in associates, the Group determines whether it is necessary to recognise any impairment loss with respect to its investments in associates. The Group first determines whether there is any objective evidence that an investment in an associate is impaired. If such evidence exists, the Group then tests the entire carrying amount of the investment for impairment, by comparing its recoverable amount, which is the higher of value in use and fair value less costs to sell, with its carrying amount. The recoverable amount of an investment in an associate is assessed for each associate, unless the associate does not generate cash inflows from continuing use that are largely independent of those from other assets of the Group. The excess of the carrying amount over the recoverable amount is recognised in the Statement of Comprehensive Income as an impairment loss. Impairment losses are subsequently reversed through the Statement of Comprehensive Income if the reasons for the impairment loss no longer apply.

49. Foreign currency

Items included in the Financial Statements of each of the Group's subsidiaries are measured using the functional currency of the respective entity.

Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. All differences arising on settlement or translation of monetary items are taken to the Statement of Comprehensive Income. Non-monetary assets and liabilities denominated in foreign currencies are reported at historic cost.

50. Interest

Interest income and expense are recognised in the Statement of Comprehensive Income using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and financial liability and is not revised subsequently.

The calculation of the effective interest rate includes all transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Interest income and expense presented in the Statement of Comprehensive Income include:

- interest on financial assets and liabilities at amortised cost on an effective interest rate basis;
- interest on financial assets and liabilities held for trading; and
- interest on financial assets designated at fair value through profit or loss.

51. Fee and commission

The Group provides various services to its clients and earns income therefrom, such as income from Corporate banking, Retail banking, Capital Markets, Corporate Finance, Asset Management and Private banking. Fees earned from services that are provided over a certain period of time are recognised as the services are provided. Fees earned from transaction type services are recognised when the service has been completed. Fees that are performance linked are recognised when the performance criteria are fulfilled.

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

52. Net financial income

Net financial income comprises Dividend income, Net gain on financial assets and financial liabilities classified as held for trading, Net gain on financial assets and liabilities at fair value, Net foreign exchange gain.

i) Dividend income is recognised when the right to receive dividend is established. Usually this is the ex-dividend date for equity securities.

ii) Net gain on financial assets and liabilities at fair value comprises all realised and unrealised fair value changes in trading portfolio and assets and liabilities designated at fair value through profit or loss, except for interest (which is included in Interest income and Interest expense) and foreign exchange gain and losses (which are included in Net foreign exchange gains as described below).

iii) Net foreign exchange gain comprise all foreign exchange differences arising on the settlement of foreign currency monetary assets and liabilities and on translating foreign currency monetary assets and liabilities at rates different from those at which they were translated on initial recognition during the year or in previous Financial Statements.

Net foreign exchange gain also include foreign exchange differences arising on translating non-monetary assets and liabilities which are measured at fair value in foreign currencies and whose other gain and loss are also recognised in profit or loss.

53. Income tax expense

Tax expense comprises current and deferred tax. Income tax for the year has been calculated and recognised in the Financial Statements.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities and the realization of foreign exchange gain or loss, for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantively enacted at the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realised.

54. Financial assets and financial liabilities

Recognition

The Group initially recognises loans, deposits, debt securities issued and subordinated liabilities on the date that they are originated. Regular way purchases and sales of financial assets are recognised on the trade date at which the Group commits to purchase or sell the asset. All other financial assets and liabilities are recognised on the trade date, which is the date that the Group becomes a party to the contractual provision of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

Classification

The Group classifies its financial assets in one of the following categories:

- amortised cost;
- at fair value through profit or loss and within the category as:
  - held for trading; or
  - designated at fair value through profit or loss; or
- AFS financial assets at fair value through other comprehensive income.

The Group classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or held for trading.

Designation at fair value through profit or loss

The Group has designated financial assets and liabilities at fair value through profit or loss in either of the following circumstances:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise; or
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

54. Financial assets and financial liabilities, continued

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Financial liabilities are derecognised when the obligation of the Group specified in the contract is discharged or cancelled or expires.

Offsetting

Financial assets and liabilities are set off and the net amount reported in the Statement of Financial Position when, and only when, the Group has a legal right to offset the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains or losses arising from a group of similar transactions such as in the Group's trading activity.

Disclosures on offsetting are provided in Note 23.

Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

All consumer price indexed assets and liabilities are revalued based on the index rate at the end of the year.

Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the Group establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses, and option pricing models. The Group uses widely recognised valuation models for determining the fair value of common and more simpler financial instruments like options and interest rate and currency swaps. For these financial instruments, inputs into models are market observable.

The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuation techniques cannot appropriately reflect all factors market participants take into account when entering into a transaction. Valuation adjustments are recorded to allow for model risks, bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state financial instruments carried at fair value in the Statement of Financial Position.

Identification and measurement of impairment

At each reporting date the Group assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the assets, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

54. Financial assets and financial liabilities, continued

The Group considers evidence of impairment for loans at both a borrower-specific and a collective level. Borrowers for specific assessment are sampled based on a combination of the borrowers' exposure, days in default and an internal classification where customers are classified according to financial position, defaults and credit rating. In determining specific provisions for impairment on individually assessed borrowers, the following factors are considered:

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

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

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

In assessing collective impairment, two deciding, quantitative components need to be addressed in order to perform the calculation i.e. probability of default (PD) and loss given default (LGD). The Group uses internally developed probability-of-default models, which are regularly benchmarked against actual outcomes to ensure the predictive power of the models. For loss given default the Group uses internally developed models as well.

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

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

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

55. Cash and cash equivalents

Cash and cash equivalents in the Statement of Cash Flows consist of cash, demand deposits with the Central Bank and demand deposits with other credit institutions. Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition. Cash and cash equivalents are carried at amortised cost in the Statement of Financial position.

56. Loans

Loans are financial instruments with fixed or determinable payments that are not quoted in an active market and that the Group does not intend to sell immediately or in the near term. Loans include loans provided by the Group to credit institutions and to its customers, participation in loans from other lenders and purchased loans.

Loans are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

When the Group is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of the asset to the lessee, the arrangement is classified as a capital lease and a receivable equal to the net investment in the lease is recognised and presented within loans.

When the Group purchases a asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date reverse repo or stock borrowing, the arrangement is accounted for as a loan, and the underlying asset is not recognised in the Group's Financial Statements.

57. Financial instruments

Trading assets and liabilities

Trading assets and liabilities are financial instruments acquired principally for the purpose of generating profits from short term price fluctuations or from a dealer's margin, and derivative financial instruments.

Securities used for hedging are trading securities acquired exclusively in order to hedge against market risk of asset swap derivative contracts.

Financial assets designated at fair value through profit or loss

Assets classified designated at fair value through profit or loss consist of equity and debt instruments which are acquired by the Group with a view to profiting from their total return and which are managed and evaluated on a fair value basis.

Financial instruments and trading liabilities are initially and subsequently measured at fair value in the Statement of Financial position, with transaction costs recognised in profit or loss. All changes in fair value are recognised as part of net financial income in profit or loss.

Interest and dividend income that arises from these assets are included in Interest income and Net financial income, respectively.

Available-for-sale financial assets designated at fair value through Other comprehensive income

AFS financial assets include equity investments. Equity investments classified as AFS are those that are neither classified as held for trading nor designated at fair value through profit or loss. After initial measurement, AFS financial assets are subsequently measured at fair value with unrealised gains or losses recognised in OCI and credited in the AFS reserve until the investment is derecognised, at which time, the cumulative gain or loss is recognised in other operating income, or the investment is determined to be impaired, when the cumulative loss is reclassified from the AFS reserve to the statement of profit or loss in finance costs.

58. Derivatives

A derivative is a financial instrument or other contract, the value of which changes in response to a change in an underlying variable, such as share, commodity or bond prices, an index value or an exchange or interest rate, which requires no initial net investment or initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors and which is settled at a future date.

Derivatives are recognised at fair value. Fair value changes are recognised in the Statement of Comprehensive Income. Changes in fair values of derivatives are split into interest income, foreign exchange differences and net financial gain or loss. Interest income is recognised on an accrual basis. Derivatives with positive fair values are recognised as Financial instruments and derivatives with negative fair values are recognised as Financial liabilities at fair value.

59. Intangible assets

Goodwill
Goodwill that arises on the acquisition of subsidiaries is presented with intangible assets. Subsequent to initial recognition goodwill is measured at cost less accumulated impairment losses.

Infrastucture and customer relationship
Infrastructure and customer relationship and related agreements are measured at cost less any accumulated impairment losses.

Software

Software acquired by the Group is measured at cost less accumulated amortisation and any accumulated impairment losses.

Subsequent expenditure on software is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation of intangible assets

Amortisation of intangible assets is recognised in the Statement of Comprehensive Income on a straight-line basis over the estimated useful life, from the date that it is available for use. The estimated useful life of intangible assets for the current and comparative periods is three to ten years.

60. Investment property

An investment property is a property which is held either to earn rental income or for capital appreciation or for both.

Investment property is initially measured at cost and subsequently at fair value. Gains or losses arising from changes in the fair values of investment properties are included in the statement of comprehensive income.

61. Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets, other than non-current assets held for resale, investment property and deferred tax assets, are reviewed at each reporting date to determine, whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. The recoverable amount of intangible assets is assessed annually.

An impairment loss is recognised if the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in profit or loss.

The recoverable amount of an asset is the greater of its value in use and its fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss in respect of other assets, where impairment losses have been recognised in prior periods, are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

62. Deposits

Deposits are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective interest method.

63. Borrowings

Some of the borrowings of the Group are classified as other financial liabilities and are initially recognised at fair value less attributable transaction costs. Subsequent to initial recognition, borrowings are measured at amortised cost with any difference between cost and redemption amount being recognised in the Statement of Comprehensive Income over the period of the borrowings on an effective interest basis. Accrued interest is included in the carrying amount of the borrowings.

64. Subordinated liabilities

Subordinated liabilities are financial liabilities in the form of subordinated capital which, in case of the Group's voluntary or compulsory winding-up, will not be repaid until after the claims of ordinary creditors have been met. In the calculation of the capital ratio, they are included within Tier II, as shown in Note 45. The Group may only retire subordinated liabilities with the permission of the Icelandic Financial Supervisory Authority.

Subordinated liabilities are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, subordinated liabilities are stated at principal amount due plus accrued interest, which is recognised in the Statement of Comprehensive Income based on the contractual terms of the borrowing.

65. Other assets and other liabilities

Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses. When parts of an item of property and equipment have different useful lives, they are accounted for as separate items of property and equipment.

Subsequent expenditure is capitalised only when it is probable that the future economic benefits of the expenditure will flow to the Group. Ongoing repairs and maintenance are expensed as incurred.

The depreciable amount of property and equipment is determined after deducting its residual value. Depreciation is charged to the Statement of Comprehensive Income on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. The estimated useful lives are as follows:

Buildings	10-33 years
Equipment	3-8 years

The depreciation methods, useful lives and residual values are reassessed annually.

Non-current assets and disposal groups held for sale

The Group classifies a non-current asset or disposal group as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case the asset or disposal group must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such asset or disposal group and the sale must be highly probable.

Immediately before classification as held for sale, the measurement of the qualifying assets and all assets and liabilities in a disposal group is brought up-to-date in accordance with applicable IFRS. Then, on initial classification as held for sale, non-current assets and disposal groups are recognised at the lower of carrying amount and fair value less costs to sell. Impairment losses on initial classification as held for sale are included in the Statement of Comprehensive Income, even when there is a revaluation. The same applies to gains and losses on subsequent remeasurement. Revaluation through the reversal of impairment in subsequent periods is limited so that the carrying amount of the held for sale, non-current assets or disposal group does not exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

Other assets and other liabilities

Other assets and other liabilities are stated at cost less impairment.

66. Equity

Dividends

Dividends on shares are recognised in equity in the period in which they are approved by Arion Bank's shareholders.

Statutory reserve

According to the Icelandic companies Act No. 2/1995 at least 10% of the profit of the Group which is not devoted to meeting losses from previous years and is not contributed to other legal reserves must be contributed to the statutory reserve until it amounts to 10% of the share capital. When that limit has been reached the contribution must be at least 5% of the profit until the statutory reserve amounts to 25% of the share capital of the Bank.

Available-for-sale reserve

AFS reserve cpmprises all unrealised gain or losses related to fair value measurements of AFS financial assets.

Foreign currency translation reserve

The foreign currency translation reserve comprises all foreign exchange differences arising from the translation of the Financial Statements of foreign operations.

67. Earnings per share

Earnings per share are calculated by dividing the net earnings attributable to the shareholders of Arion Bank hf. by the weighted average number of ordinary shares outstanding during the year.

68. Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the Financial Statements at fair value, being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amount initially recognised less, when appropriate, cumulative amortisation recognised in the Statement of Comprehensive Income, and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee. Any increase in the liability relating to financial guarantees is recorded in the Statement of Comprehensive Income. The premium received is recognised in the Statement of Comprehensive Income in Net fees and commission income on a straight line basis over the life of the guarantee.

69. Fiduciary activities

The Group provides asset custody, asset management, investment management and advisory services to its clients. These services require the Group to make decisions on the treatment, acquisition or disposal of financial instruments. Assets in the Group's custody are not reported in its Statement of Financial Position.

70. Employee benefits

All entities with employees within the Group have defined contribution plans. The entities pay fixed contribution to publicly or privately administered pension plans on a mandatory and contractual basis. The Group has no further payment obligations once these contributions have been paid. The contributions are recognised as an expense in the Statement of Comprehensive Income when they become due. The Group does not operate any pension fund which confers pension rights.

71. New standards and amendments to standards

New and amended standards and interpretations

The Consolidated Financial Statements are presented in accordance with the new and revised IFRS standards and new interpretations (IFRIC), applicable in the year 2015. These new and revised IFRSs did not have material effect on amounts nor information's reported in the Consolidated Financial Statements.

A number of new standards , amendments to standards and interpretations have been issued but are not yet effective for the year ended 31 December 2015, and have not been applied in preparing these Financial Statements. Relevant to the Group's reporting are:

IFRS 9 Financial Instruments. In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. The Group is currently assessing the impact of the new standard on its Financial Statements and is expecting to have completed that work late 2016. The Group will not early adopt the standard. This standard has not been adopted by the European Union.

IFRS 15 Revenue from Contracts with Customers. The standard was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognising revenue. The new revenue standard will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2018 with early adoption permitted. The Group is currently assessing the impact of IFRS 15.

IFRS 5 Non-current assets held for sale and discontinued operations. Assets (or disposal groups) are generally disposed of either through sale or distribution to owners. The amendment clarifies that changing from one of these disposal methods to the other would not be considered a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in IFRS 5. This improvement is effective for annual periods beginning on or after 1 January 2016. The improvement is not expected to have impact on the financial position or performance of the Group.

5 YEAR OVERVIEW

INCOME STATEMENT

	2015	2014	2013	2012	2011
Net interest income	26,992	24,220	23,800	27,142	23,388
Net fee and commission income	14,484	13,309	11,223	10,748	10,685
Net financial income	12,844	7,290	1,675	2,017	2,347
Share of profit or loss of associates	29,466	3,498	1,986	2,405	8
Other operating income	2,769	5,673	5,664	7,190	5,497
Operating income	86,555	53,990	44,348	49,502	41,925
Salaries and related expense	(14,892)	(13,979)	(13,537)	(12,459)	(11,254)
Other operating expense	(13,304)	(13,063)	(11,858)	(12,209)	(10,762)
Bank levy	(2,818)	(2,643)	(2,872)	(1,062)	(1,046)
Net impairment	(3,087)	2,135	(680)	(4,690)	(8,649)
Earnings before tax	52,454	26,440	15,401	19,082	10,214
Income tax expense	(3,135)	(4,679)	(3,143)	(3,633)	(1,912)
Net earnings from continuing operations	49,319	21,761	12,258	15,449	8,302
Net gain (loss) from discontinued operations, net of tax	360	6,833	399	1,607	2,792
Net earnings	49,679	28,594	12,657	17,056	11,094

STATEMENT OF FINANCIAL POSITION

	31.12.2015	31.12.2014	31.12.2013	31.12.2012	31.12.2011
Assets					
Cash and balances with Central Bank	48,102	21,063	37,999	29,746	29,200
Loans to credit institutions	87,491	108,792	102,307	101,011	69,103
Loans to customers	680,350	647,508	635,774	566,610	561,550
Financial instruments	133,191	101,828	86,541	137,800	157,659
Investment property	7,542	6,842	28,523	28,919	27,100
Investments in associates	27,299	21,966	17,929	7,050	2,987
Intangible assets	9,285	9,596	5,383	4,941	4,765
Tax assets	205	655	818	463	724
Other assets	17,578	15,486	23,576	24,135	39,033
Total Assets	1,011,043	933,736	938,850	900,675	892,121
Liabilities and Equity					
Due to credit institutions and Central Bank	11,387	22,876	28,000	32,990	16,160
Deposits	469,347	454,973	471,866	448,683	489,995
Financial liabilities at fair value	7,609	9,143	8,960	13,465	4,907
Tax liabilities	4,922	5,123	4,924	3,237	3,421
Other liabilities	49,461	47,190	43,667	42,117	43,772
Borrowings	256,058	200,580	204,568	195,085	187,203
Subordinated liabilities	10,365	31,639	31,918	34,220	32,105
Total liabilities	809,149	771,524	793,903	769,797	777,563
Shareholders' equity	192,786	160,711	140,089	127,072	110,448
Non-controlling interest	9,108	1,501	4,858	3,806	4,110
Total equity	201,894	162,212	144,947	130,878	114,558
Total Liabilities and Equity	1,011,043	933,736	938,850	900,675	892,121

Arion Bank Consolidated Financial Statements 2015 79 Amounts are in ISK millions

Appendix

Unaudited

Corporate Governance Statement

Corporate governance statement of Arion Bank for 2015

Arion Bank

Good corporate governance helps to foster open and honest relations between the Board of Directors, shareholders, customers and other stakeholders, such as the Bank's employees and the general public. Corporate governance also provides the foundations for responsible management and decision-making, with the objective of generating lasting value. The Board of Directors places great importance on good corporate governance and re-evaluates its governance practices annually on the basis of recognized guidelines on corporate governance.

The Corporate Governance Statement of Arion Bank hf. (Arion Bank or the Bank) is based on the legislation, regulations and recognized guidelines which are in force at the time the Bank's financial statement is adopted by the Board of Directors.

Excellence in corporate governance

In December 2015 Arion Bank was recognized as a company which has achieved excellence in corporate governance. The Icelandic Chamber of Commerce, SA – Business Iceland, Nasdaq Iceland and the Center for Corporate Governance at the University of Iceland have signed a partnership agreement under which companies are given the opportunity to undergo a formal assessment of their corporate governance. Arion Bank received this recognition following an in-depth survey of corporate governance at the Bank, including governance by the Board of Directors, sub-committees and management, performed by KPMG ehf. in the autumn of 2015. The recognition applies for three years unless significant changes are made to the Bank's management or ownership.

Compliance with guidelines on good corporate governance

According to the Financial Undertakings Act No. 161/2002 Arion Bank is obliged to comply with recognized guidelines on good corporate governance. The Bank complies with the fifth edition of the Icelandic Guidelines on Corporate Governance issued by Iceland Chamber of Commerce, SA – Business Iceland and Nasdaq Iceland, published in May 2015 and viewable on the website www.leidbeiningar.is. According to the guidelines a company shall state whether it has deviated from the guidelines, if so, which parts and also explain why it has done so. The Bank complies with the guidelines but because of the current shareholder structure certain deviations have been made from the guidelines. The section below specifies in which instances the Bank has deviated from the guidelines.

Article 1.1.6. assumes that the board of a company shall post certain information on the candidates to the board on the company's website. This has not been considered necessary given the current shareholder structure but the information in question has been sent to shareholders before the AGM.

Article 1.5. assumes that a shareholders' meeting shall appoint a nomination committee or decide how it should be appointed. The Bank has not considered it necessary to appoint such a nomination committee given the current shareholder structure.

Article 5.1.2. assumes that the rules of procedure of sub-committees of the Board shall be posted on the Bank's website. The Board sub-committees have established rules of procedure which have been confirmed by the Board, but these rules have not been published on the Bank's website. The Board's rules of procedure are, however, published on the Bank's website and cover the role of sub-committees and this has been considered sufficient.

Articles 5.1.3. assumes that the sub-committees shall annually evaluate their own work and that of individual committee members under a pre-determined arrangement. The Board Audit and Risk Committee performed such an evaluation in the period December 2015 to January 2016. However, the Board Credit Committee and the Board Remuneration Committee have not performed such an evaluation.

Legal and regulatory framework

Arion Bank is a financial institution which operates in accordance with the Financial Undertakings Act No. 161/2002. Acts of law which apply to the Bank's operations include the Financial Undertakings Act No. 161/2002, the Securities Transactions Act No. 10/2007 and Public Limited Companies Act No. 2/1995 and the Competition Act No. 44/2005. The Bank is a universal bank which provides a comprehensive range of financial services relating to savings, loans, asset management, corporate finance and capital markets. The Bank has issued financial instruments which have been admitted for trading on regulated securities markets, in Iceland, Norway and Luxembourg, and is therefore subject to the disclosure requirements of issuers pursuant to the Securities Transactions Act No. 108/2007 and the rules of the relevant stock exchanges.

The Financial Supervisory Authority (FME) supervises the operations of Arion Bank in accordance with the provisions of Act No. 87/1998 on the Official Supervision of Financial Operations. Further information on the FME and an overview of the legal and regulatory framework applicable to the Bank, and the FME's guidelines, can be seen on the FME's website, www.fme.is. Numerous other pieces of legislation apply to the Bank's operations. The relevant legislation can be found on the website of the Icelandic parliament, the Althing, www.althingi.is.

Internal controls, auditing and accounting

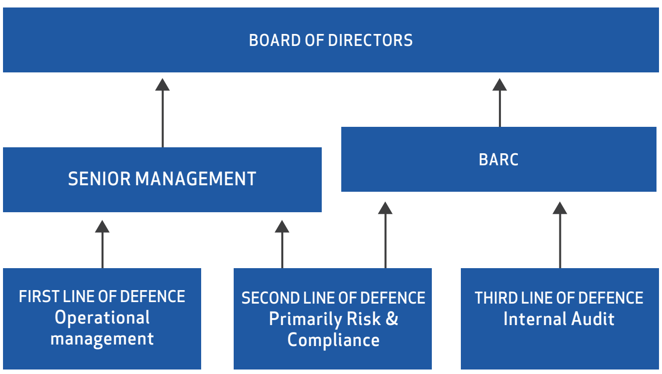
Internal control

Internal control at Arion Bank is organized into three lines of defence with the aim of ensuring effectiveness, defining responsibility and coordinating risk management. This structure is also designed to foster a sense of risk awareness and responsibility among all employees of the Bank.

The set-up distinguishes between the following roles:

- People who bear responsibility for risk and manage risk
- People who monitor and check internal controls
- People who perform independent surveys of the effectiveness of internal controls

The first line of defence is made up of people who have day-to-day supervision of operations and its organization. They are responsible for establishing and maintaining effective internal controls and managing risk in day-to-day operations. This involves identifying and evaluating risk and putting in place appropriate countermeasures to reduce risk. The first line of defence is responsible for supervising the implementation of internal rules and processes in compliance with the law, regulations and the Bank's strategy and it must ensure that all actions are in compliance with established procedures and that corrective action is taken if any deficiencies are detected.



The second line of defence is set up to ensure that the first line of defence has established adequate internal controls which work as intended. Risk Management and Compliance are the main participants in the second line of defence, although other units may also be assigned specific monitoring roles.

The third line of defence is Internal Audit, which keeps the Board and management informed of the quality of corporate governance, risk management and internal controls, including by performing independent and objective audits.

Compliance and measures against money laundering and terrorist financing

Arion Bank seeks to detect any risk of failure to fulfil its legal obligations and has taken appropriate measures to minimize such risks.

The Bank employs an independent compliance officer according to a special charter from the Board. The Compliance Officer reports directly to the CEO and provides the CEO with regular reports about his work. The Compliance Officer may refer cases directly to the Board if deemed necessary. The main roles of Compliance are:

- To monitor and regularly assess the adequacy and effectiveness of measures designed to minimize the risk of failure to fulfil the Bank's obligations under the Securities Transactions Act and the Act on Measures against Money Laundering and Terrorist Financing.
- To provide the employees with the necessary training and advice to enable them to fulfil their and the Bank's obligations under the Securities Transactions Act and the Act on Measures against Money Laundering and Terrorist Financing.
- To investigate and notify the authorities of any suspicion of money laundering or terrorist financing or suspicion of market abuse. The Compliance Officer also conducts independent investigations if there is any suspicion of a violation of the Competition Act.
- The Compliance Officer also undertakes outsourced tasks from Stefnir hf. and certain pension funds.

Compliance had seven employees at the end of 2015.

Risk management

A central feature of the activities of all financial companies is carefully calculated risk-taking according to a predetermined strategy. Arion Bank thus takes risk which is compatible with its risk appetite which is regularly reviewed and approved by the Board of Directors. The Bank's risk appetite, set by the Board, is translated into exposure limits and targets that are monitored by Risk Management. The Board is responsible for Arion Bank's internal capital adequacy assessment process, the main objective of which is to ensure that Arion Bank understands its risk profile and has systems in place to assess, quantify and monitor its total risk exposure.

The Bank's Risk Management division is headed by the Chief Risk Officer. It is independent and centralized and reports directly to the CEO. Risk Management comprises five departments whose role is to analyze, monitor and regularly report to the CEO and Board of Directors on the risks faced by the Bank.

Further information on risk management and capital management is contained in the section on Risk Management and in the Bank's risk report.

Internal audit

The Internal Auditor is appointed by the Board of Directors 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 the work. The mission of the Internal Auditor is to provide independent and objective assurance and advice 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 Arion Bank.

The audit is governed by the audit charter, directive No. 3/2008 issued by the FME on the internal audit function in financial institutions and international standards on internal auditing. All audit work is completed by issuing an audit report with deadlines for the implementation of audit findings. Implementations are followed up by the Internal Audit every quarter.

Internal Audit had seven employees at the end of 2015.

Auditing and accounting

The Bank's Finance division is responsible for the preparing the accounts and this is done in accordance with the International Financial Reporting Standards (IFRS). The Bank publishes its financial statement on a quarterly basis and management statements are generally submitted to the Board 10 times a year. The Board Audit and Risk Committee examines the annual financial statement and interim financial statements, while the external auditors review and audit the accounts twice a year. The Board Audit and Risk Committee gives its opinion on the accounts to the Board of Directors, which then approves and endorses the accounts.

Customers' ombudsman

The Customers' Ombudsman is appointed by the Chief Executive Officer. The role of the Ombudsman is to ensure fairness and objectivity, prevent discrimination against the customer and make certain that the process for handling cases is transparent and documented. The Customers' Ombudsman examined 185 cases in 2015, compared with 202 cases in 2014.

Cornerstones, code of ethics and corporate social responsibility

Arion Bank's Cornerstones is the name used to describe the Bank's core values. The Cornerstones are designed to provide guidance when making decisions and in everything else employees say and do. They refer to the Bank's role, attitude and conduct. Arion Bank's Cornerstones are: We make a difference. We get things done. We say what we mean.

The management and employees of Arion Bank are conscious of the fact that the Bank's activities affect different stakeholders and society at large. The Bank's code of ethics is designed to serve as a key to responsible decision-making at Arion Bank. The code of ethics is approved by the Board of Directors.

One of the fundamental principles of corporate social responsibility is to align the interests of companies with those of the wider community. Arion Bank is a responsible member of Icelandic society and as such takes an active role in its construction and future development. Corporate social responsibility means that the Bank must perform its role conscientiously, ensuring that its customers receive first-rate services and get the support they need. The Bank also supports a select number of causes which it believes benefit and improve the community. Many of these projects require the active participation of employees, which is the key to achieving results.

Board of directors and committees

The main duties of the Board of Directors of Arion Bank are to manage the Bank between shareholders' meetings and as further described in the law, regulations and articles of association. The Board tends to those operations of the Bank which are not considered part of the day-to-day business, i.e. it makes decisions on issues which are unusual or of a significant nature. One the Board's main duties is to supervise the Bank's activities. The Board of Directors meets at least ten times a year. The rules of procedure of the Board of Directors and its subcommittees take into account the law and the aforementioned Guidelines on Corporate Governance. The rules of procedure of the Board of Directors can be found on the Bank's website. In other respects the Board of Directors works in accordance with the laws and regulations in effect at any particular time and its role is defined in detail in the rules of procedure of the Board of Director, which have been established on the basis of Article 54 (2) of the Financial Undertakings Act, Article 70 (5) of the Public Limited Companies Act No. 3/1995, FME Guidelines No. 1/2010, and the articles of association of the Bank.

One of the main duties of the Board of Directors is to appoint a Chief Executive Officer who is responsible for the day-to-day operations in accordance with a strategy set out by the Board. The Board of Directors and the Chief Executive Officer shall carry out their duties with integrity and ensure that the Bank is run in a sound and reasonable manner in the interests of the customers, the community, the shareholders and the Bank itself, cf. Article 1 (1) of the Financial Undertakings Act. The Chief Executive Officer shall ensure that the Board receives sufficient support to carry out its duties.

The Board of Directors is elected for a term of one year at the company's annual general meeting. At Arion Bank's last annual general meeting on 19 March 2015, seven Directors and three Alternates were elected to the Board of Directors. The elected Board Directors have diverse backgrounds and extensive skills, experience and expertise. In July Gudjón Gústafsson resigned as a member of the Board Audit and Risk Committee. Gudjón was replaced in the Board Audit and Risk Committee by Lúdvík Karl Tómasson.

Information on the independence of Directors was sent to shareholders before the shareholders' meeting and the information was published on the Bank's website after the general meeting. The meetings of the AGM and shareholders' meetings are sent to the shareholders following the meeting but have not been published on the Bank's website because of the current shareholder structure.

In 2015 the Board of Directors met on 16 occasions. An Alternate was asked to attend one meeting during the year due to the absence of a Director.

The Chairman directs and is responsible for the work of the Board. The Chairman chairs Board meetings and ensures that there is enough time allocated to the discussion of important issues and that strategy issues are discussed thoroughly. The Chairman is not permitted to undertake any other work for the Bank unless part of the normal duties of the Chairman.

At the first scheduled meeting of the new Board following the AGM the Board appoints members to each of its sub-committees and assesses whether it is necessary to appoint external members to certain committees in order to bring in a greater level of expertise. One of the committee members in the Board Audit and Risk Committee, Lúdvík Karl Tómasson, is not a Board Director and is independent of the Bank and its shareholders. The Board sub-committees are as follows:

- Board Audit and Risk Committee: Its main task is to examine issues concerning auditing and risk which the Board needs to make a decision on. The regular tasks of the committee include examining reports of internal regulators, reviewing the risk policy, examining the annual and interim financial statements to ensure the quality of the information contained in them and the independence of the company's auditors. The risk committee shall also assess whether incentives which may be part of the Bank's remuneration system are consistent with the Bank's risk policy.
- Board Credit Committee: Its main task is to attend to credit issues which exceed the credit limits of its sub-committees.
- Board Remuneration Committee: Its main task is to advise the Board on the terms of remuneration to the Chief Executive Officer and other employees hired directly by the Board. Regular tasks at committee meetings are to review the remuneration policy, the human resources policy, salary distribution and the incentive system if one is in place. The Bank's remuneration policy shall be examined and approved by a shareholders' meeting annually.

The Board has decided to go further than stipulated in the Guidelines on Corporate Governance with respect to the disclosure requirements of sub-committees. At every meeting the Board receives the minutes of the previous meeting of each sub-committee and are given access to all the information from the meetings of the sub-committees.

The Board Credit Committee met 11 times during the year, the Board Audit and Risk Committee met seven times and the Board Remuneration Committee met seven times. Below is an overview of the attendance of individual Directors:

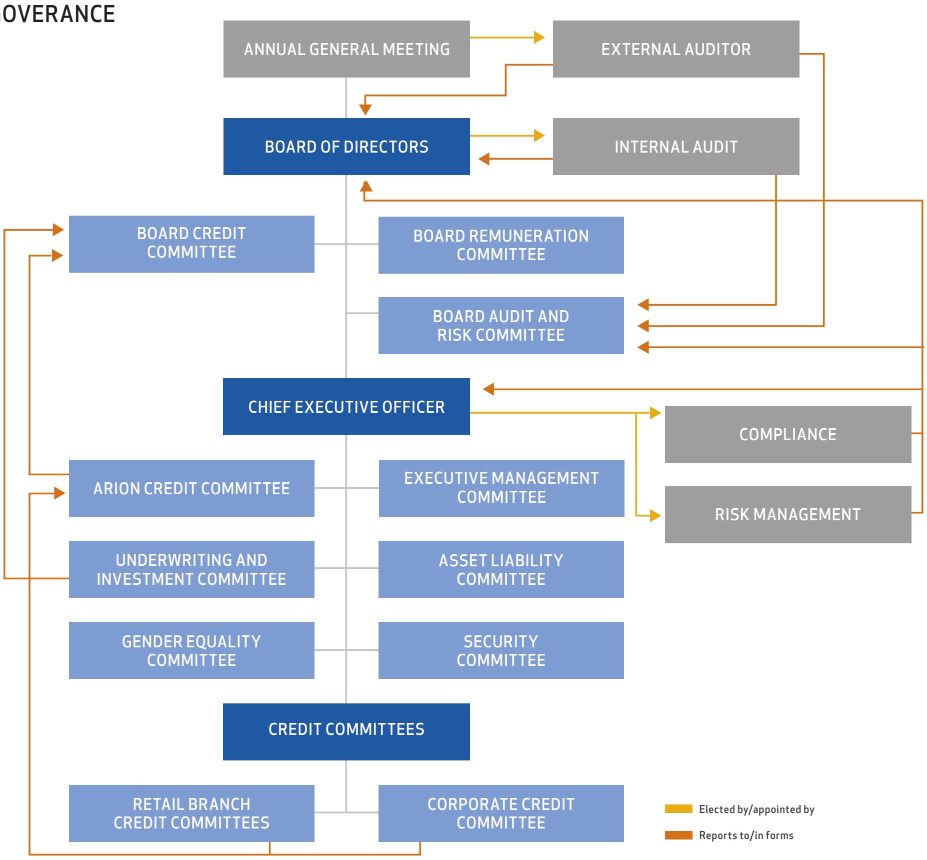
The Board carries out an annual performance appraisal, at which it assesses its work, the necessary number of Board Directors, the Board structure, achievements and work of the sub-committees with respect to the aforementioned. This appraisal was last performed by the Board at its meetings and between meetings during the period 16 December 2015 to 21 January 2016.

Director	Period	Board (16)	BARC (7)	BCC(11)	BRC(7)
Monica Caneman	1 Jan - 31 Dec	16	-	11	-
Guðrún Johnsen	1 Jan - 31 Dec	15	6	5	7
Brynjólfur Bjarnason	1 Jan - 31 Dec	15	-	7	-
Benedikt Olgeirsson	1 Jan - 31 Dec	16	-	9	-
Þóra Hallgrímsdóttir	1 Jan - 31 Dec	16	7	-	7
Kirstín Flygenring	1 Jan - 31 Dec	16	-	-	7
Måns Höglund	1 Jan - 31 Dec	15	7	11	-
Ólafur Örn Svansson	1 Jan - 31 Dec	0	-	-	-
Björg Arnardóttir	1 Jan - 31 Dec	1	-	-	-
Sigurbjörg Ásta Jónsdóttir	1 Jan - 31 Dec	0	-	-	-
Guðjón Gústafsson	1 Jan - 30 June	-	3	-	-
Lúðvík Karl Tómasson	19 Aug - 31 Dec	-	2	-	-

Gudrún Johnsen resigned from the Board Credit Committee in April and was replace by Brynjólfur Bjarnason.
Gudjón Gústafsson resigned from the Board Audit and Risk Committee. He was replaced in August by Lúdvík Karl Tómasson.
Björg Arnardóttir attended one board meeting in the absence of Gudrún Johnsen.

THE BOARD OF DIRECTORS OF ARION BANK

CORPORATE GOVERANCE STRUCTURE



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 Chairman of the Board Credit Committee.

She graduated with a BSc in business and economics from the Stockholm School of Economics in 1976.

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

Gudrún Johnsen, Vice Chairman

Gudrún was born in 1973 and lives in the United States. 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 a dependent Director. Gudrún is Chairman of the Board Remuneration Committee and is also a member of the Board Audit and Risk Committee.

Gudrún completed an MA in applied economics at the University of Michigan, Ann Arbor in the United States in 2002 and gained an MA in statistics from the same university the following year. She graduated with a BA in economics from the University of Iceland in 1999.

Gudrún is currently a lecturer in finance in the faculty of business administration at the University of Iceland. 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 system in 2008. She was assistant professor in the school of business at Reykjavík University from 2006 to 2013. Between 2004 and 2006 she worked as a specialist in the Financial Systems Department of the International Monetary Fund. She was a teaching and research assistant at the University of Michigan, Ann Arbor from 2002 to 2003. Gudrún worked as a securities broker at the Icelandic Investment Bank (FBA) between 1999 and 2001. She has served on the board of a fund management company of MP Bank and is the current chairman of the research and development company THOR.

Benedikt Olgeirsson

Benedikt has been the executive director of development at Landspítali University Hospital since 2015. Before that he was the Deputy CEO of Landspitali since 2010. 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

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

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

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 bookpublisher 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.

Kirstín Þ. Flygenring

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

Kirstín 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.

Kirstín 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. Kirstín started her career as an economist at the Association of Icelandic Manufacturers and she later worked for OECD.

Kirstín 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. Kirstín has also served on the Post and Telecommunications Arbitration Committee since 2008.

Måns Höglund

MMåns was born in 1951. He is Swedish and lives in Portugal. He was first elected as a Director at Arion Bank's Annual General 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 with a BSc in business and economics from the Stockholm School of Economics in 1975.

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. In 1999 to 2002 he worked for both Unibank (as head of the Sweden operation) and Nordea (as head of private banking, Sweden). From 1991 to 1999 he worked at Swedbank where his roles included head of the corporate division. In 1984 he joined 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 1977 to 1984 he worked for Hambros Bank in London, where he was regional director for Iceland and Denmark for two years. He previously worked as a lecturer and researcher at the Stockholm School of Economics.

Thóra Hallgrímsdóttir

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

Thóra completed a degree in law at the University of Iceland in 2000 and qualified as an attorney to the district court in 2002.

Since 2011 she has worked as a specialist in the faculty of law at Reykjavík University as a lecturer and researcher in insurance law, contract law and law of tort. Before that Thóra worked as a lawyer for two Icelandic insurance companies: Tryggingamidstödin hf. from 2000 to 2005 and Sjóvá-Almennar tryggingar hf. from 2005 to 2011. Thóra is currently a board member of the rehabilitation fund Virk-Starfsendurhaefingarsjódur ses, appointed by the Confederation of Icelandic Employers and she is also on the board of the Association of Icelandic Lawyers and CEO for the Icelandic Law Journal (Tímarit Lögfraedinga). She is also chairman of the insurance complaints committee and the chairman of the seamen's and fishermen's arbitration committee, appointed by the government.

Alternate directors:

Björg Arnardóttir, business studies graduate, Sigurbjörg Ásta Jónsdóttir, lawyer and Ólafur Örn Svansson, supreme court attorney.

Communications between the shareholders and the board of directors

The Chairman of the Board of Directors communicates with shareholders on behalf of the Board of Directors and the Bank between legally convened shareholders' meetings, which are the main venue at which the Board and the Bank report information to the shareholders. Shareholders have also at the Board's request, arranged quarterly meetings at which the Chief Executive Officer presents the interim financial results.

Chief executive officer

Höskuldur H. Ólafsson

Höskuldur was born in 1959. He was appointed CEO of Arion Bank in June 2010. Höskuldur is not a shareholder of Arion Bank and no stock option agreements have been entered into with him. Höskuldur joined the Bank from Valitor hf. where he had been CEO since 2006. Prior to that he worked at the Icelandic transportation company Eimskip hf. for 17 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 organizations in Iceland and abroad. Höskuldur graduated with a cand. oecon. degree in business administration from the University of Iceland in 1987.

The chief executive officer is responsible for the daily operations of the Bank. The CEO shall provide the Board with reports on the Bank's operations and financial position and all important issues which may affect the Bank's operations and finances. With respect to other duties responsibilities and duties of the CEO please refer to Chapter VII of the Financial Undertakings Act and Chapter IX of the Public Limited Companies Act. The duties of the Chief Executive Officer and his responsibilities take into account the legal environment in which the Bank operates at any given time and the rules which the Board of Directors may establish.

Information on violations of laws and regulations

Arion Bank has not been denied registration, authorization, membership or permission to conduct certain business, activity or operations. The Bank has not been subject to withdrawal, revocation or dismissal of registration, authorization, membership or permission.

Information on legal cases relating to Arion Bank can be found in the notes to the annual financial statement.

This corporate governance statement was examined and approved at meeting of the Board of Directors on 24 February 2016.