Interim Consolidated Financial Statements

1 January - 30 September 2015

Unaudited

Arion Bank

CONTENTS

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

The Interim Financial Statements of Arion Bank for the period ended 30 September 2015 include the Interim Financial Statements of Arion Bank ("the Bank") and its subsidiaries, together referred to as "the Group".

Outlook

The outlook for the Icelandic economy is positive. Arion Bank currently forecasts that economic growth will be above 5% in 2015, decreasing to approximately 3% in 2017. Measured unemployment is currently low at 4.0% and is expected to fall even further in the coming years. Inflation is still below target at 1.9%, but average annual inflation is expected to rise to 4.0% in 2016 and to peak at 4.5% in 2017, following the latest wage round between employers and major labour unions in Iceland, which has mostly been concluded. A major milestone was reached on 8 June when the government introduced a plan to lift the capital controls which have been in place since 2008. According to the plan, controls will be lifted in 2016 and the Icelandic government will be able to drastically reduce its debt in the coming years. This represents a significant step towards reducing major uncertainties relating to the economy. Rating upgrades followed the government's announcement for both Iceland and Arion Bank, which currently has a credit rating of BBB- (stable outlook).

One of the proposals made by a group of restricted holders of Kaupthing claims and their advisors to the government was that Kaupthing's foreign exchange exposure to Arion Bank would be termed out in an EMTN format with a minimum term of seven years 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 EMTN format and termed out to a minimum of seven years. Agreements between Arion Bank and Kaupthing in this respect on funding amounting to approximately ISK 100 billion have been concluded.

Arion Bank is a leading universal bank on the Icelandic market and has as such actively contributed to the recovery of the Icelandic economy. In recent years Arion Bank has systematically reduced risk in the Bank's loan portfolio by increasing the proportion of loans to individuals, most of which have been first lien mortgages. Loans are now evenly split between individuals and corporate. Furthermore, the distribution of the corporate loan book reflects the relative size of sectors in the Icelandic economy. The quality of the loan portfolio has continued to improve and the ratio of problem loans is now close to levels seen at banks in the other Nordic countries.

The Bank has strategically positioned itself as a market leader in Iceland in loans to new businesses in the export sector, health care and energy-intensive industries. The Bank aims to further strengthen its position in these areas. The Bank has also augmented its international loan portfolio by lending to businesses involved in fish-processing and the fisheries in neighboring countries, thus supporting growth while at the same time reducing geographical risk.

The Bank has successfully sold a number of shareholdings acquired by the Bank while restructuring the finances of some of its corporate clients. The Bank has, furthermore, actively managed a small number of such holdings and now aims to concentrate on selling them. During 2015 Arion Bank has sold a large part of its shareholding in real estate companies Reitir fasteignafélag hf. and Eik fasteignafélag hf. in connection with the listing of the companies on NASDAQ Iceland in April. The Bank has furthermore sold part of its direct and indirect shareholding in Refresco Gerber, also in connection with the listing of the company. Furthermore, the majority of the Bank's shareholding in the telecommunications company Síminn hf. was sold in third and fourth quarter of 2015 in connection with the listing of the company on NASDAQ Iceland in October.

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 37.3 million.

The Bank is financially robust as demonstrated by the new leverage ratio of 15.0% (see Note 41). The Bank's capital strength, the upgraded rating of S&P from BB+ to BBB- and new funding, enable Arion Bank to provide financial backing for its retail and corporate customers as their businesses expand, both domestically and internationally.

Operations during the period

Net earnings amounted to ISK 25,397 million for the period ended 30 September 2015. The Group's equity amounted to ISK 174,795 million at period end. The capital ratio, based on the reported capital base at 30 September 2015, was 23.5% and the corresponding Tier 1 ratio was 22.2%. According to the Act on Financial Undertakings no. 161/2002 the official capital ratio shall be based on audited or reviewed capital base. Since the interim financial statements for the first nine months are not audited the official capital ratio is based on audited capital base at 30 June 2015 and risk weighted assets at 30 September 2015. The official capital ratio at 30 September 2015 was 22.7% and the Tier 1 ratio was 21.4%, which comfortably meets the requirements set by law and the Financial Supervisory Authority (FME). The liquidity position was also strong at period end and well above the regulatory minimum.

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

The Group performed well during the period and operations were characterized by greater stability. Net interest income increased by 11% compared with the same period in 2014. Net commission income increased between years, or by 6%, and the increase was generated across the Bank. Net financial income totalled ISK 10,176 million, an increase of 74% compared with the same period in 2014.

Net earnings in the first quarter were positively affected by the sale and listing of the Group's direct and indirect shareholding in Refresco Gerber and Reitir fasteignafélag hf. Net earnings in the second quarter were negatively affected by an ISK 1,749 million impairment of the loan portfolio of the savings fund AFL - sparisjóður, a subsidiary of the Bank. Net valuation change of other loans in the Group was positive by ISK 1,635 million during the first nine months of 2015 which bears witness to the successful restructuring of the loan portfolio. Thus net impairment during the period amounts to ISK 114 million. The sale and valuation changes of shareholding in Síminn hf. in connection with the listing of the company in the beginning of October affect net earnings positively in the third quarter.

The merger of 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 economic activities 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 Bank accounts and Loans to customers. Loans to customers increased by ISK 31,299 million during the period. The increase is partly related to new lending to businesses in the real estate and service sectors. In April Arion Bank paid a dividend to its shareholders amounting to ISK 12,809 million.

In March Arion Bank launched its inaugural euro senior unsecured benchmark transaction, when the Bank sold EUR 300 million, ISK 45 billion, 3-year fixed rate bonds to around 100 international investors. The Bank's inaugural bond is the first EUR public transaction and the single largest transaction, 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 bond issue in Norwegian kroner, when issuing NOK 500 million, approximately ISK 8 billion, of 5-year instruments. The bonds bear floating NIBOR +2.95% interest. Arion Bank simultaneously entered a swap agreement, whereby part of the interest and principal are in euros. Interest in euros is floating EURIBOR +2.74%. At the same time, Arion Bank bought back NOK 260 million of bonds from a 2013 issue and has now bought back NOK 319 million of a NOK 500 million issue.

During the period Arion Bank has paid ISK 20 billion of the approximately ISK 30 billion subordinated loan from the Icelandic treasury before the due date. 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. In August new series of non-indexed covered bonds were issued, amounting to ISK 4.3 billion. The new series bears 6.5% fixed interest rate, with settlement date in September 2022. In 2015 the Bank has issued covered bonds amounting to ISK 11,420 million.

The Group had 1,151 full-time equivalent positions at the end of the period, compared with 1,120 at the end of 2014; 850 of these positions were at Arion Bank, compared with 865 at the end of 2014.

Group ownership

Arion Bank is a group of financial undertakings which provide comprehensive financial services to companies, institutions and private customers. These services include corporate banking, retail banking, investment banking and asset management. The Group includes subsidiaries in the real estate sector, card services and insurance.

Kaupskil ehf., a company owned by Kaupthing hf., holds 87% of the shares in Arion Bank. The remaining shareholding of 13% is held by Icelandic State Financial Investments on behalf of the Icelandic government.

ENDORSEMENT AND STATEMENT BY THE BOARD OF DIRECTORS AND THE CEO

Endorsement of the Board of Directors and the Chief Executive Officer

The Interim Financial Statements of Arion Bank for the period ended 30 September 2015 have been prepared in accordance with International Financial Reporting Standards (IAS 34 Interim Financial Reporting) 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 Interim Financial Statements give a true and fair view of the financial performance of the Group for the period ended 30 September 2015 and its financial position as at 30 September 2015.

Further, in our opinion the Interim 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 Interim Financial Statements of Arion Bank for the period ended 30 September 2015 and confirm them by means of their signatures.

Reykjavík, 11 November 2015

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

INTERIM CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE PERIOD FROM 1 JANUARY TO 30 SEPTEMBER 2015

	Notes	2015 1.1.-30.9.	2014 1.1.-30.9.	2015 1.7.-30.9.	2014 1.7.-30.9.
Interest income		42,808	40,036	15,148	13,155
Interest expense		(22,521)	(21,727)	(8,036)	(6,812)
Net interest income	6	20,287	18,309	7,112	6,343
Fee and commission income		15,609	13,679	5,373	4,762
Fee and commission expense		(4,883)	(3,560)	(2,081)	(1,236)
Net fee and commission income	7	10,726	10,119	3,292	3,526
Net financial income	8	10,176	5,861	453	1,994
Other operating income	9	9,188	3,963	3,448	689
Operating income		50,377	38,252	14,305	12,552
Salaries and related expense	10	(10,320)	(10,026)	(3,153)	(2,862)
Other operating expense	11	(9,016)	(8,598)	(3,012)	(2,787)
Bank levy	12	(2,168)	(2,008)	(779)	(633)
Net impairment	13	(114)	2,877	(33)	876
Earnings before tax		28,759	20,497	7,328	7,146
Income tax expense	14	(3,639)	(4,456)	(1,272)	(1,989)
Net earnings from continuing operations		25,120	16,041	6,056	5,157
Net gain from discontinued operations, net of tax	15	277	6,592	15	67
Net earnings		25,397	22,633	6,071	5,224
Attributable to					
Shareholders of Arion Bank		25,559	22,369	6,262	5,106
Non-controlling interest		(162)	264	(191)	118
Net earnings		25,397	22,633	6,071	5,224
Other comprehensive income					
Exchange difference on translating foreign subsidiaries	32	47	(4)	277	(2)
Total comprehensive income for the period		25,444	22,629	6,348	5,222
Earnings per share from continuing operations					
Basic and diluted earnings per share attributable to the shareholders of Arion Bank (ISK)	16	12.64	7.89	3.12	2.52

The notes on pages 11 to 54 are an integral part of these Interim Financial Statements.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 6 Amounts are in ISK millions

INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 2015

Assets	Notes	30.9.2015	31.12.2014
Cash and balances with Central Bank	17	73,289	21,063
Loans to credit institutions	18	93,326	108,792
Loans to customers	19	678,807	647,508
Financial instruments	20-22	111,191	101,828
Investment property	22	7,817	6,842
Investments in associates	24	13,847	21,966
Intangible assets	25	9,194	9,596
Tax assets	26	987	655
Other assets	27	21,018	15,486
Total Assets		1,009,476	933,736
Liabilities			
Due to credit institutions and Central Bank	21	11,470	22,876
Deposits	21	503,155	454,973
Financial liabilities at fair value	21	5,511	9,143
Tax liabilities	26	6,773	5,123
Other liabilities	28	49,222	47,190
Borrowings	21,29	248,172	200,580
Subordinated liabilities	21,30	10,378	31,639
Total Liabilities		834,681	771,524
Equity			
Share capital and share premium	32	75,861	75,861
Other reserves	32	1,679	1,632
Retained earnings		95,968	83,218
Total Shareholders' Equity		173,508	160,711
Non-controlling interest		1,287	1,501
Total Equity		174,795	162,212
Total Liabilities and Equity		1,009,476	933,736

The notes on pages 11 to 54 are an integral part of these Interim Financial Statements.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 7 Amounts are in ISK millions

INTERIM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE PERIOD 1 JANUARY TO 30 SEPTEMBER 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
Total comprehensive income for the period	-	47	25,559	25,606	(162)	25,444
Dividend paid	-	-	(12,809)	(12,809)	-	(12,809)
Acquisition of non-controlling interest	-	-	-	-	(52)	(52)
Equity 30 September 2015	75,861	1,679	95,968	173,508	1,287	174,795
Equity 1 January 2014	75,861	1,637	62,591	140,089	4,858	144,947
Total comprehensive income for the period	-	(4)	22,369	22,365	264	22,629
Dividend paid	-	-	(7,811)	(7,811)	-	(7,811)
Equity 30 September 2014	75,861	1,633	77,149	154,643	5,122	159,765

The notes on pages 11 to 54 are an integral part of these Interim Financial Statements.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 8 Amounts are in ISK millions

INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE PERIOD 1 JANUARY TO 30 SEPTEMBER 2015

	2015 1.1.-30.9.	2014 1.1.-30.9.
Operating activities		
Net earnings	25,397	22,633
Non-cash items included in net earnings and other adjustments	(24,521)	(26,604)
Changes in operating assets and liabilities	39,629	(14,333)
Interest received	29,085	29,891
Interest paid*	(9,639)	(10,919)
Dividend received	6,798	874
Income tax and Bank levy paid	(2,321)	(1,999)
Net cash from (used in) operating activities	64,428	(457)
Investing activities		
Net investment in associated companies	10,728	3,283
Net investment in property and equipment and intangible assets	(1,003)	(698)
Net cash from investing activities	9,725	2,585
Financing activities		
Payment of subordinated liabilities	(19,883)	-
Dividend paid to shareholders of Arion Bank	(12,809)	(7,811)
Acquisition of non-controlling interest	(58)	-
Net cash used in financing activities	(32,750)	(7,811)
Net increase (decrease) in cash and cash equivalents	41,403	(5,683)
Cash and cash equivalents at beginning of the period	91,715	99,683
Effect of exchange rate changes on cash and cash equivalents	(1,320)	(291)
Cash and cash equivalents at the end of the period	131,798	93,709
Non-cash investing transactions		
Assets acquired through foreclosure on collateral from customers with view to resale	1,425	898
Settlement of loans through foreclosure on collateral from customers with view to resale	(1,425)	(898)
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 period.

The notes on pages 11 to 54 are an integral part of these Interim Financial Statements.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 9 Amounts are in ISK millions

NOTES TO THE INTERIM CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE PERIOD 1 JANUARY TO 30 SEPTEMBER 2015

	2015 1.1.-30.9.	2014 1.1.-30.9.
Non-cash items included in net earnings and other adjustments		
Net interest income	(20,287)	(18,309)
Net impairment	114	(2,877)
Income tax expense	3,639	4,456
Bank levy	2,168	2,008
Net foreign exchange gain (loss)	393	(564)
Net gain on financial instruments	(3,771)	(4,423)
Depreciation and amortisation	1,218	1,045
Share of (profit) loss of associates and fair value change	(6,956)	27
Net gain from discontinued operations, net of tax	(277)	(6,592)
Other changes	(762)	(1,375)
Non-cash items included in net earnings and other adjustments	(24,521)	(26,604)

Changes in operating assets and liabilities		
Mandatory reserve with Central Bank	185	(177)
Loans to credit institutions, excluding bank accounts	750	(7,351)
Loans to customers	(22,547)	(7,718)
Financial instruments and financial liabilities at fair value	(12,903)	(7,556)
Investment property	(213)	3,570
Other assets	1,949	11,506
Due to credit institutions and Central Bank	(11,177)	(6,931)
Deposits	47,915	4,139
Borrowings	38,401	(1,973)
Other liabilities	(2,731)	(1,842)
Changes in operating assets and liabilities	39,629	(14,333)

Cash and cash equivalents		
Cash in hand and demand deposits	73,289	33,335
Due from credit institutions	67,259	69,538
Mandatory reserve with Central Bank	(8,750)	(9,164)
Cash and cash equivalents	131,798	93,709

The notes on pages 11 to 54 are an integral part of these Interim Financial Statements.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 10 Amounts are in ISK millions

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS CONTENTS

NOTES TO THE INTERIM 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 Interim Financial Statements for the period ended 30 September 2015 comprise the Parent Company and its subsidiaries (together referred to as "the Group").

1. Basis of preparation

Statement of compliance

The Interim Financial Statements are consolidated and have been prepared in accordance with International Financial Reporting Standard IAS 34, Interim Financial Reporting, 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 Interim Financial Statements do not include all the information and disclosures required in the Annual Financial Statements, and should be read in conjunction with Arion Bank's Annual Financial Statements for the year 2014. The statements are available at Arion Bank's website www.arionbanki.is.

The Interim Financial Statements were approved and authorised for issue by the Board of Directors of Arion Bank on 11 November 2015.

Basis of measurement

The Interim 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;
- 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 Interim 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 period the exchange rate of the ISK against the USD was 127.65 and 142.65 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 Interim 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; and
- investments in associates.

3. The Group

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

	Operating activity	Currency	Equity interest 30.9.2015	Equity interest 31.12.2014
AFL - sparisjóður ses., Aðalgata 34, Siglufjörður, Iceland	Retail banking	ISK	100.0%	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%	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	99.4%	98.8%

In September Arion Bank increased its shareholding in AFL - sparisjóður and holds 100% shareholding at the end of the period. The boards of Arion Bank and AFL - sparisjóður have signed an agreement for the merger of the two entities. In October FME approved the merger.

In April 2015 the Bank increased its shareholding in Valitor Holding hf. when it purchased 0.6% shareholding from the non-controlling party Landsbankinn hf.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 13 Amounts are in ISK millions

NOTES TO THE INTERIM 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.

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 and Investment Services. Asset Management manages financial assets on behalf of its customers according to a pre-determined investment strategy. Asset Management also administers pension funds. 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. 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 comprises the subsidiaries Eignabjarg ehf., BG12 slhf. and EAB 1 ehf.

Retail Banking, including Arion Bank Mortgages Institutional Investor Fund and AFL - sparisjóður, provides a comprehensive range of services. This includes among other advice on deposits and loans, savings, payment cards, pension savings, insurance, securities and funds. To maximize operational efficiency the branch network is divided into six clusters, with the smaller branches capitalizing on the strength of larger units within each cluster. Retail Banking's 25 branches all around Iceland have a total of more than 100,000 customers.

Treasury is responsible for the Bank's liquidity management as well as currency and interest rate management for the Bank. The other main functions of Treasury are the internal pricing of interest rates and currency and liaison with other financial institutions.

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: Overhead, Risk Management, Accounting, Legal, Corporate Development and Marketing and Operations.

4. Operating segments

1.1.-30.9.2015	Asset Manage-ment and Stefnir	Corporate Banking	Investment Banking	Retail Banking	Treasury	Other divisions and Sub-sidiaries	Head-quarters and Elimination	Total
Net interest income	333	4,407	29	10,190	4,782	497	49	20,287
Other income	2,912	801	12,174	2,338	213	5,554	6,098	30,090
Operating income	3,245	5,208	12,203	12,528	4,995	6,051	6,147	50,377
Operating expense	(1,033)	(386)	(746)	(4,302)	(184)	(4,276)	(8,409)	(19,336)
Bank levy	-	-	-	-	-	-	(2,168)	(2,168)
Net impairment	-	1,435	1,492	(2,733)	407	(762)	47	(114)
Earnings before tax	2,212	6,257	12,949	5,493	5,218	1,013	(4,383)	28,759
Net seg. rev. from ext. customers	1,261	10,885	12,773	22,371	(9,266)	6,245	6,100	50,377
Net seg. rev. from other segments	1,984	(5,677)	(570)	(9,843)	14,261	(194)	39	-
Operating income	3,245	5,208	12,203	12,528	4,995	6,051	6,139	50,377
Depreciation and amortisation	-	-	-	217	-	419	582	1,218
30.9.2015								
Total assets	5,492	238,439	43,943	440,274	212,676	49,857	18,795	1,009,476
Total liabilities	1,166	182,968	31,660	386,929	192,964	30,149	8,845	834,681
Allocated equity	4,326	55,471	12,283	53,345	19,712	19,708	9,950	174,795

1.1.-30.9.2014	Asset Manage-ment and Stefnir	Corporate Banking	Investment Banking	Retail Banking	Treasury	Other divisions and Sub-sidiaries	Head-quarters and Elimination	Total
Net interest income	380	5,479	218	9,339	3,643	(728)	(22)	18,309
Other income	2,753	965	6,658	1,917	(772)	6,917	1,505	19,943
Operating income	3,133	6,444	6,876	11,256	2,871	6,189	1,483	38,252
Operating expense	(1,030)	(446)	(536)	(4,183)	(195)	(3,613)	(8,621)	(18,624)
Bank levy	-	-	-	-	-	-	(2,008)	(2,008)
Net impairment	-	2,841	(398)	(223)	683	(55)	29	2,877
Earnings before tax	2,103	8,839	5,942	6,850	3,359	2,521	(9,117)	20,497
Net seg. rev. from ext. customers	1,523	13,068	7,159	18,850	(11,087)	7,302	1,437	38,252
Net seg. rev. from other segments	1,610	(6,624)	(283)	(7,594)	13,958	(1,113)	46	-
Operating income	3,133	6,444	6,876	11,256	2,871	6,189	1,483	38,252
Depreciation and amortisation	-	-	-	226	-	245	574	1,045
30.9.2014								
Total assets	4,996	240,775	31,504	411,823	175,998	56,803	20,272	942,171
Total liabilities	2,452	202,251	26,463	367,403	138,631	27,686	17,520	782,406
Allocated equity	2,544	38,524	5,041	44,420	37,367	29,117	2,752	159,765

The vast majority of the revenues from external customers is attributable to customers in Iceland.

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

Arion Bank Interim Consolidated Financial Statements 30 September 2015 15 Amounts are in ISK millions

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

QUARTERLY STATEMENTS

5. Operations by quarters

2015	Q3	Q2	Q1	Total
Net interest income	7,112	7,392	5,783	20,287
Net fee and commission income	3,292	3,677	3,757	10,726
Net financial income	453	2,184	7,539	10,176
Other operating income	3,448	1,038	4,702	9,188
Operating income	14,305	14,291	21,781	50,377
Salaries and related expense	(3,153)	(3,675)	(3,492)	(10,320)
Other operating expense	(3,012)	(3,108)	(2,896)	(9,016)
Bank levy	(779)	(659)	(730)	(2,168)
Net impairment	(33)	(1,863)	1,782	(114)
Earnings before tax	7,328	4,986	16,445	28,759
Income tax expense	(1,272)	(647)	(1,720)	(3,639)
Net earnings from continuing operations	6,056	4,339	14,725	25,120
Net gain from discontinued operations, net of tax	15	79	183	277
Net earnings	6,071	4,418	14,908	25,397

2014	Q3	Q2	Q1	Total
Net interest income	6,343	6,483	5,483	18,309
Net fee and commission income	3,526	3,445	3,148	10,119
Net financial income	1,994	4,439	(572)	5,861
Other operating income	689	2,356	918	3,963
Operating income	12,552	16,723	8,977	38,252
Salaries and related expense	(2,862)	(3,714)	(3,450)	(10,026)
Other operating expense	(2,787)	(3,064)	(2,747)	(8,598)
Bank levy	(633)	(715)	(660)	(2,008)
Net impairment	876	34	1,967	2,877
Earnings before tax	7,146	9,264	4,087	20,497
Income tax expense	(1,989)	(1,152)	(1,315)	(4,456)
Net earnings from continuing operations	5,157	8,112	2,772	16,041
Net gain from discontinued operations, net of tax	67	6,433	92	6,592
Net earnings	5,224	14,545	2,864	22,633

Arion Bank Interim Consolidated Financial Statements 30 September 2015 16 Amounts are in ISK millions

NOTES TO THE INTERIM CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

6. Net interest income

	2015	2014	2015	2014
Interest income	1.1.-30.9.	1.1.-30.9.	1.7.-30.9.	1.7.-30.9.
Cash and balances with Central Bank	467	501	183	169
Loans	39,102	36,227	13,801	11,953
Securities	2,593	2,824	984	845
Other	646	484	180	188
Interest income	42,808	40,036	15,148	13,155
Interest expense				
Deposits	(11,968)	(12,808)	(4,508)	(4,024)
Borrowings	(9,855)	(7,876)	(3,361)	(2,413)
Subordinated liabilities	(603)	(974)	(100)	(324)
Other	(95)	(69)	(67)	(51)
Interest expense	(22,521)	(21,727)	(8,036)	(6,812)
Net interest income	20,287	18,309	7,112	6,343
Net interest income from assets and liabilities at fair value	2,593	2,824	942	845
Interest income from assets not at fair value	40,215	37,212	14,165	12,311
Interest expense from liabilities not at fair value	(22,521)	(21,727)	(7,995)	(6,813)
Net interest income	20,287	18,309	7,112	6,343
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	3.0%	2.9%	3.1%	2.9%

7. Net fee and commission income

	Income	Expense	Net income	Income	Expense	Net income
	1.1.-30.9.2015			1.1.-30.9.2014		
Asset management	3,099	(210)	2,889	2,918	(151)	2,767
Cards	8,545	(4,384)	4,161	6,657	(2,776)	3,881
Collection and payment services	991	(63)	928	942	(63)	879
Investment banking	1,274	(36)	1,238	1,692	(30)	1,662
Lending and guarantees	1,070	-	1,070	896	-	896
Other	630	(190)	440	574	(540)	34
Net fee and commission income	15,609	(4,883)	10,726	13,679	(3,560)	10,119
	1.7.-30.9.2015			1.7.-30.9.2014		
Asset management	1,028	(87)	941	938	(61)	877
Cards	3,239	(1,885)	1,354	2,505	(1,051)	1,454
Collection and payment services	330	(21)	309	343	(21)	322
Investment banking	180	(15)	165	640	(6)	634
Lending and guarantees	388	-	388	281	-	281
Other	208	(73)	135	55	(97)	(42)
Net fee and commission income	5,373	(2,081)	3,292	4,762	(1,236)	3,526

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.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 17 Amounts are in ISK millions

8. Net financial income

	2015 1.1.-30.9.	2014 1.1.-30.9.	2015 1.7.-30.9.	2014 1.7.-30.9.
Dividend income	6,798	874	-	216
Net gain (loss) on financial assets and financial liabilities classified as held for trading	740	(394)	654	(21)
Net gain on financial assets and financial liabilities designated at fair value through profit or loss	3,031	4,817	814	1,387
Net foreign exchange (loss) gain	(393)	564	(1,015)	412
Net financial income	10,176	5,861	453	1,994

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

Equity instruments designated at fair value	2,818	5,500	700	1,442
Interest rate instruments designated at fair value	213	(683)	114	(55)
Net gain on financial assets and financial liabilities designated at fair value through profit or loss	3,031	4,817	814	1,387

9. Other operating income

Share of profit (loss) of associates and reversal of impairment	6,956	(27)	2,739	53
Rental income from investment property	24	1,226	7	55
Fair value changes on investment property	555	935	129	3
Realised gain on investment property	207	144	81	138
Earned premiums, net of reinsurance	810	739	280	247
Other income	636	946	212	193
Other operating income	9,188	3,963	3,448	689

10. Personnel and salaries

Number of employees

Average number of full time equivalent positions during the period	1,131	1,130	1,147	1,119
Full time equivalent positions at the end of the period	1,151	1,135	1,151	1,135

The Bank's number of employees

Average number of full time equivalent positions during the period	849	898	843	887
Full time equivalent positions at the end of the period	850	899	850	899

Salaries and related expense

Salaries	8,003	7,791	2,473	2,270
Defined contribution pension plans	1,138	1,097	349	320
Salary related expense	1,179	1,138	331	272
Salaries and related expense	10,320	10,026	3,153	2,862

Salaries and related expense for the Bank

Salaries	5,882	6,082	1,808	1,759
Defined contribution pension plans	876	880	288	290
Salary related expense	868	971	246	248
Salaries and related expense	7,626	7,933	2,342	2,297

During the period the Group made a provision of ISK 164 million (9M 2014: ISK 239 million) for performance plan payments, including salary related expense, thereof the Bank made a provision of ISK 111 million (9M 2014: ISK 193 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 period the Group's accrual for performance plan payments amounts to ISK 656 million (31.12.2014: ISK 741 million), thereof the Bank's accrual amounts to ISK 538 million (31.12.2014: ISK 639 million).

Arion Bank Interim Consolidated Financial Statements 30 September 2015 18 Amounts are in ISK millions

11. Other operating expense

	2015 1.1.-30.9.	2014 1.1.-30.9.	2015 1.7.-30.9.	2014 1.7.-30.9.
Administration expense	6,841	6,354	2,267	2,083
Depositors' and investors' guarantee fund	631	623	211	208
Depreciation of property and equipment	672	743	213	273
Amortisation of intangible assets	546	302	172	103
Direct operating expense derived from rental-earning investment properties	-	315	-	35
Claims incurred, net of reinsurance	265	254	123	81
Other expense	61	7	26	4
Other operating expense	9,016	8,598	3,012	2,787

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 1.1.-30.9.	2014 1.1.-30.9.	2015 1.7.-30.9.	2014 1.7.-30.9.
Increase in book value of loans to corporates	2,111	2,245	87	591
Increase in book value of loans to individuals	1,667	1,276	679	966
Increase in book value of other assets	-	683	-	-
Net change in impairment of loans to corporates	767	17	248	(210)
Net change in impairment of loans to individuals	(3,148)	(1,469)	(861)	(534)
Net change in collective impairment on loans	(1,486)	125	(186)	63
Impairment of intangible assets	(25)	-	-	-
Net impairment	(114)	2,877	(33)	876

14. Income tax expense

Current tax expense	3,844	4,042	1,424	1,968
Deferred tax expense	(205)	414	(152)	21
Income tax expense	3,639	4,456	1,272	1,989

Reconciliation of effective tax rate	1.1.-30.9.2015		1.1.-30.9.2014	
Earnings before tax		28,759		20,497
Income tax using the Icelandic corporation tax rate	20.0%	5,752	22.0%	4,501
Additional 6% tax on financial institutions	3.0%	877	4.2%	869
Non-deductible expenses	2.1%	602	0.1%	23
Tax exempt revenue	(12.8%)	(3,675)	(4.2%)	(865)
Other changes	0.3%	83	(0.4%)	(72)
Effective tax rate	12.7%	3,639	21.7%	4,456

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

Tax exempt revenues consist mainly of profit from equity positions.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 19 Amounts are in ISK millions

15. Net gain from discontinued operations, net of tax

	2015 1.1.-30.9.	2014 1.1.-30.9.	2015 1.7.-30.9.	2014 1.7.-30.9.
Net gain from associated companies	-	6,290	-	66
Net gain from real estates and other assets	277	302	15	1
Net gain from discontinued operations, net of tax	**277**	**6,592**	**15**	**67**

16. Earnings per share

	Discontinued operations			
	Excluded		Included	
	2015 1.1.-30.9.	2014 1.1.-30.9.	2015 1.1.-30.9.	2014 1.1.-30.9.
Net earnings attributable to the shareholders of Arion Bank	25,282	15,777	25,559	22,369
Weighted average number of outstanding shares for the period, million	2,000	2,000	2,000	2,000
Basic earnings per share	12.64	7.89	12.78	11.18

There were no instruments at the end of the period that could potentially dilute basic earnings per share (2014: none).

Arion Bank Interim Consolidated Financial Statements 30 September 2015 20 Amounts are in ISK millions

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTES TO THE INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION

17. Cash and balances with Central Bank

	30.9.2015	31.12.2014
Cash on hand	7,032	5,255
Cash with Central Bank	57,507	6,873
Mandatory reserve deposit with Central Bank	8,750	8,935
Cash and balances with Central Bank	73,289	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

Bank accounts	67,259	79,587
Money market loans	21,404	23,007
Other loans	4,663	6,198
Loans to credit institutions	93,326	108,792

19. Loans to customers

30.9.2015	Individuals	Corporates	Total
Overdrafts	17,809	23,699	41,508
Credit cards	10,574	994	11,568
Mortgage loans	272,841	12,516	285,357
Capital lease	3,142	5,778	8,920
Other loans	31,843	325,980	357,823
Provision on loans	(13,823)	(12,546)	(26,369)
Loans to customers	322,386	356,421	678,807

31.12.2014			
Overdrafts	17,955	24,420	42,375
Credit cards	11,065	943	12,008
Mortgage loans	271,639	10,406	282,045
Capital lease	2,469	3,607	6,076
Other loans	31,294	300,391	331,685
Provision on loans	(13,111)	(13,570)	(26,681)
Loans to customers	321,311	326,197	647,508

The total book value of pledged loans that were pledged against amounts borrowed was ISK 196 billion at the end of the period (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 Interim Consolidated Financial Statements 30 September 2015 21 Amounts are in ISK millions

19. Loans to customers, continued

Changes in the provision for losses on loans to customers

1.1.-30.9.2015	Specific	Collective	Total
Balance at the beginning of the year	22,214	4,467	26,681
Provision for losses	2,381	1,486	3,867
Write-offs	(4,443)	-	(4,443)
Payment of loans previously written off	264	-	264
Balance at the end of the period	20,416	5,953	26,369

1.1.-30.9.2014			
Balance at the beginning of the year	25,126	4,100	29,226
Provision for losses	1,579	(252)	1,327
Write-offs	(4,201)	(68)	(4,269)
Payment of loans previously written off	829	-	829
Balance at the end of the period	23,333	3,780	27,113

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 53 in the Annual Financial Statements for 2014. 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

	30.9.2015	31.12.2014
Bonds and debt instruments	69,471	66,466
Shares and equity instruments with variable income	26,834	25,232
Derivatives	2,285	1,026
Securities used for hedging	12,601	9,104
Financial instruments	111,191	101,828

Arion Bank Interim Consolidated Financial Statements 30 September 2015 22 Amounts are in ISK millions

21. Financial assets and financial liabilities

30.9.2015	Amortised cost	Trading	Designated at fair value	Total
Loans				
Cash and balances with Central Bank	73,289	-	-	73,289
Loans to credit institutions	93,326	-	-	93,326
Loans to customers	678,807	-	-	678,807
Loans	845,422	-	-	845,422
Bonds and debt instruments				
Listed	-	2,940	65,054	67,994
Unlisted	-	99	1,378	1,477
Bonds and debt instruments	-	3,039	66,432	69,471
Shares and equity instruments with variable income				
Listed	-	2,310	10,072	12,382
Unlisted	-	1,310	11,878	13,188
Bond funds with variable income, unlisted	-	1,016	248	1,264
Shares and equity instruments with variable income	-	4,636	22,198	26,834
Derivatives				
OTC derivatives	-	2,285	-	2,285
Derivatives	-	2,285	-	2,285
Securities used for hedging				
Bonds and debt instruments, listed	-	1,179	-	1,179
Shares and equity instruments with variable income, listed	-	10,257	-	10,257
Shares and equity instruments with variable income, unlisted	-	1,165	-	1,165
Securities used for hedging	-	12,601	-	12,601
Other financial assets	8,854	-	-	8,854
Financial assets	854,276	22,561	88,630	965,467
Liabilities at amortised cost				
Due to credit institutions and Central Bank	11,470	-	-	11,470
Deposits	503,155	-	-	503,155
Borrowings	248,172	-	-	248,172
Subordinated liabilities	10,378	-	-	10,378
Liabilities at amortised cost	773,175	-	-	773,175
Financial liabilities at fair value				
Short position in bonds	-	3,459	-	3,459
Derivatives	-	2,052	-	2,052
Financial liabilities at fair value	-	5,511	-	5,511
Other financial liabilities	41,196	-	-	41,196
Financial liabilities	814,371	5,511	-	819,882

Arion Bank Interim Consolidated Financial Statements 30 September 2015 23 Amounts are in ISK millions

21. Financial assets and financial liabilities, continued

31.12.2014	Amortised cost	Trading	Designated at fair value	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 Interim Consolidated Financial Statements 30 September 2015 24 Amounts are in ISK millions

21. Financial assets and financial liabilities, continued

Bonds and debt instruments designated at fair value specified by issuer	30.9.2015	31.12.2014
Financial and insurance activities	10,070	3,403
Public sector	55,198	58,730
Corporates	1,164	1,140
Bonds and debt instruments designated at fair value	66,432	63,273

The total amount of pledged bonds at the end of the period was ISK 14.9 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

30.9.2015	Level 1	Level 2	Level 3	Total
Assets at fair value				
Bonds and debt instruments	30,125	39,167	179	69,471
Shares and equity instruments with variable income	11,935	14,875	24	26,834
Derivatives	-	2,285	-	2,285
Securities used for hedging	11,436	1,165	-	12,601
Investment property	-	-	7,817	7,817
Assets at fair value	53,496	57,492	8,020	119,008
Liabilities at fair value				
Short position in bonds	3,459	-	-	3,459
Derivatives	-	2,052	-	2,052
Liabilities at fair value	3,459	2,052	-	5,511

Arion Bank Interim Consolidated Financial Statements 30 September 2015 25 Amounts are in ISK millions

22. Fair value hierarchy, continued

31.12.2014	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 6,936 million during the period due to listing of companies on NASDAQ Iceland (2014: none). There have been no transfers from Level 1 to Level 2 during the period (2014: none).

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

Movements in Level 3 assets measured at fair value	Investment property		Financial assets		Total	
	30.9.2015	31.12.2014	30.9.2015	31.12.2014	30.9.2015	31.12.2014
Balance at the beginning of the year	6,842	28,523	1,276	1,667	8,118	30,190
Recognised in Statement of Comprehensive Income	555	1,091	4	(373)	559	718
Additions	1,113	2,148	77	5	1,190	2,153
Disposal	(693)	(25,503)	(1,154)	(23)	(1,847)	(25,526)
Transfers into Level 3	-	583	-	-	-	583
Balance at the end of the period	7,817	6,842	203	1,276	8,020	8,118

Line items where effects of Level 3 assets are recognised in the Statement of Comprehensive Income	2015	2014
	1.1.-30.9.	1.1.-30.9.
Net interest income	21	54
Net financial income	(17)	(374)
Other operating income	762	935
Effects recognised in the Statement of Comprehensive Income	766	615

Arion Bank Interim Consolidated Financial Statements 30 September 2015 26 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.

30.9.2015	Carrying value	Fair value	Unrealised gain (loss)
Financial assets not carried at fair value			
Cash and balances with Central bank	73,289	73,289	-
Loans to credit institutions	93,326	93,326	-
Loans to customers	678,807	684,952	6,145
Other financial assets	8,854	8,854	-
Financial assets not carried at fair value	854,276	860,421	6,145
Financial liabilities not carried at fair value			
Due to credit institutions and Central bank	11,470	11,470	-
Deposits	503,155	503,155	-
Borrowings	248,172	256,129	(7,957)
Subordinated loans	10,378	10,378	-
Other financial liabilities	41,196	41,196	-
Financial liabilities not carried at fair value	814,371	822,328	(7,957)

31.12.2014			
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.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 27 Amounts are in ISK millions

22. Fair value hierarchy, continued

Derivatives	Fair value	
30.9.2015	Assets	Liabilities
Forward exchange rate agreements, unlisted	236	28
Interest rate and exchange rate agreements, unlisted	1,364	636
Bond swap agreements, unlisted	87	4
Share swap agreements, unlisted	129	1,355
Options - purchased agreements, unlisted	469	29
Derivatives	2,285	2,052

31.12.2014		
Forward exchange rate agreements, unlisted	63	172
Interest rate and exchange rate agreements, unlisted	215	271
Bond swap agreements, unlisted	40	34
Share swap agreements, unlisted	230	397
Options - purchased agreements, unlisted	478	31
Derivatives	1,026	905

Arion Bank Interim Consolidated Financial Statements 30 September 2015 28 Amounts are in ISK millions

23. Offsetting financial assets and financial liabilities

Financial assets subject to enforceable master netting arrangements and similar arrangements

	Assets subject to netting arrangements			Netting potential not recognized in the balance sheet				
30.9.2015	Gross assets before balance sheet nettings	Balance sheet nettings with gross liabilities	Assets recognised on balance sheet, net	Financial liabilities	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	7,005	-	7,005	(3,459)	-	3,546	-	7,005
Derivatives	1,047	-	1,047	(400)	-	647	1,238	2,285
Total assets	8,052	-	8,052	(3,859)	-	4,193	1,238	9,290
31.12.2014								
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

	Liabilities subject to netting arrangements			Netting potential not recognized in the balance sheet				
30.9.2015	Gross liabilities before balance sheet nettings	Balance sheet nettings with gross assets	Liabilities recognised on balance sheet, net	Financial assets	Collateral pledged	Liabilities after consideration of netting potential	Liabilities not subject to enforceable netting arr- angements	Total liabilities recognised on balance sheet
Repurchase agreements	3,459	-	3,459	(3,459)	-	-	-	3,459
Derivatives	400	-	400	(400)	-	-	1,652	2,052
Total liabilities	3,859	-	3,859	(3,859)	-	-	1,652	5,511
31.12.2014								
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 53 in the Annual Financial Statements for 2014.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 29 Amounts are in ISK millions

24. Investments in associates

The Group's interest in its principal associates	30.9.2015	31.12.2014
Auðkenni hf., Borgartún 31, Reykjavík, Iceland	20.9%	20.9%
Bakkavör 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%	31.8%
Reiknistofa bankanna hf., Katrínartún 2, Reykjavík, Iceland	21.7%	21.7%
Reitir fasteignafélag hf., Kringlan 4-12, Reykjavík, Iceland	-	25.6%
Síminn hf., Ármúli 25, Reykjavík, Iceland	27.8%	38.3%
Urriðaland ehf., Laugavegur 182, Reykjavík, Iceland	41.4%	41.4%
220 Fjörður ehf., Fjarðargata 13-15, 220 Hafnarfjörður, Iceland	38.5%	-

Investments in associates		
Carrying amount at the beginning of the year	21,966	17,929
Acquisitions	306	7,557
Dividend received	(506)	(16)
Transfers	(4,203)	(2,636)
Disposals	(10,528)	(4,603)
Exchange difference	(144)	237
Share of profit of associates and reversal of impairment	6,956	3,498
Investment in associates	13,847	21,966

In August Arion Bank sold 5.5% shareholding in Síminn hf. and additional 5.0% shareholding in September. A profit of ISK 2,714 million from the sale and fair value changes on the remaining 27.8% shareholding is recognised in the Statement of Comprehensive Income.

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

In January the Bank 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 effects 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 period end.

Significant accounting estimates and judgements

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 management considers that the impaired value is based on the most probable outcomes under current market conditions.

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

25. Intangible assets

Intangible assets comprise four categories: Goodwill, Infrastructure, Customer relationship and related agreements and Software. Goodwill arises on the acquisition of subsidiaries. Infrastructure and Customer relationship 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.

30.9.2015	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	-	-	-	547	547
Exchange difference	(168)	-	(46)	(164)	(378)
Impairment	-	(25)	-	-	(25)
Amortisation	-	-	(150)	(396)	(546)
Intangible assets	2,003	3,021	1,343	2,827	9,194
31.12.2014					
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	-	-	-	603	603
Impairment	-	(29)	-	-	(29)
Amortisation	-	-	(203)	(375)	(578)
Intangible assets	2,171	3,046	1,539	2,840	9,596

26. Tax assets and tax liabilities

	30.9.2015		31.12.2014	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	6,022	-	4,499
Deferred tax	987	751	655	624
Tax assets and tax liabilities	987	6,773	655	5,123

27. Other assets

	30.9.2015	31.12.2014
Non-current assets and disposal groups held for sale	4,040	3,958
Property and equipment	6,864	7,080
Accounts receivable	2,361	2,474
Unsettled securities trading	5,356	138
Sundry assets	2,397	1,836
Other assets	21,018	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.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 31 Amounts are in ISK millions

28. Other liabilities

	30.9.2015	31.12.2014
Accounts payable	17,175	20,909
Provision for settled FX loans	2,886	2,791
Unsettled securities trading	1,020	217
Depositors' and investors' guarantee fund	2,879	2,880
Insurance claim	2,393	2,402
Withholding tax	361	1,507
Bank levy	4,856	2,688
Sundry liabilities	17,652	13,796
Other liabilities	49,222	47,190

29. Borrowings

	Issued	Maturity	Maturity type	Terms of interest		
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%	4,608	4,508
Covered bond in ISK	2014	2021	At maturity	Fixed, CPI linked, 3.50%	4,647	1,134
Covered bond in ISK	2015	2022	At maturity	Fixed, 6.50%	4,235	-
Covered bond in ISK	2014	2029	At maturity	Fixed, CPI linked, 3.50%	14,214	5,232
Covered bond in ISK	2005	2033	Amortizing	Fixed, CPI linked, 3.75%	17,394	17,428
Covered bond in ISK	2012	2034	Amortizing	Fixed, CPI linked, 3.60%	2,493	2,541
Covered bond in ISK	2008	2045	Amortizing	Fixed, CPI linked, 4.00%	6,251	6,165
Covered bond in ISK	2006	2048	Amortizing	Fixed, CPI linked, 3.75%	78,745	77,557
Covered bonds					132,587	129,058
Senior unsecured bond in NOK	2013	2016	At maturity	Floating, NIBOR +5.00%	2,694	8,478
Senior unsecured bond in EUR	2009	2018	Amortizing	Floating, EURIBOR +1.00%	1,398	1,714
Senior unsecured bond in ISK	2010	2018	Amortizing	Floating, REIBOR +1.00%	1,904	2,130
Senior unsecured bond in EUR	2015	2018	At maturity	Fixed, 3.125%	43,421	-
Senior unsecured bond in NOK	2015	2020	At maturity	Floating, NIBOR +2.95%	7,554	-
Bonds issued					56,971	12,322
Central Bank, secured, various curr.	2010	2022	At maturity	Floating, LIBOR + 3.00%	55,346	55,102
Bills issued					2,941	3,186
Other					327	912
Other loans/bills					58,614	59,200
Borrowings					248,172	200,580

Book value of listed bonds was ISK 189,197 million at the end of the period (31.12.2014: ISK 140,721 million). Market value of those bonds was ISK 197,168 million (31.12.2014: ISK 137,715 million).

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

Arion Bank Interim Consolidated Financial Statements 30 September 2015 32 Amounts are in ISK millions

30. Subordinated liabilities

	Issued	Maturity	Maturity type	Terms of interest	30.9.2015	31.12.2014
Tier II capital in various currencies	2010	2020	At maturity	Floating, EURIBOR/LIBOR + 5.00%	10,378	31,639
Subordinated liabilities					10,378	31,639

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

31. Pledged assets

Pledged assets against liabilities	30.9.2015	31.12.2014
Assets, pledged as collateral against borrowings	215,810	233,191
Assets, pledged as collateral against loans from credit institutions and short positions	14,947	17,973
Pledged assets against liabilities	230,757	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 216 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 188 billion at the end of the period (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)	30.9.2015	Number (million)	31.12.2014
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 banki hf.

Other reserves	30.9.2015	31.12.2014
Statutory reserve	1,632	1,637
Foreign currency translation reserve	47	(5)
Other reserves	1,679	1,632

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

OFF BALANCE SHEET INFORMATION

33. Obligations

Guarantees, unused overdraft and loan commitments the Group has granted its customers	30.9.2015	31.12.2014
Guarantees	13,545	9,542
Unused overdrafts	41,602	38,890
Loan commitments	93,434	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.

34. Assets under management and under custody

	30.9.2015	31.12.2014
Assets under management	974,476	923,599
Assets under custody	1,413,650	1,337,561

35. 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 period, 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 as any effect on the Group. However, if the Bank were deemed to have violated the Competition Act, it could result in a fine or restrictions by the ICA.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 34 Amounts are in ISK millions

35. Legal matters, continued

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 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 confirmed the decision but lowered 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.

Legal proceedings regarding damages

The former chairman of the Board of BM Vallá hf., together with Lindarflöt ehf., has filed two cases against the Bank claiming damages in the amount 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 plaintiff's claims in both cases and hasn't 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 within the meaning of the Act No 7/1936 on contracts and, on the other hand, whether the presentation of the price indexation was in accordance with the Act No 121/1994 on consumer loans, i.e. whether the loan provider was authorised to take “0% inflation” into account when calculating borrowing costs. The courts requested an advisory opinion from the EFTA Court as regards certain issues in two of the cases. The EFTA Court delivered two advisory opinions on 9 April 2014 and on 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. One of these cases was appealed to the Supreme Court which issued its decision on 13 May 2015. In its decision, the Supreme Court stated that there were no grounds to consider the price indexation terms of the debt instrument to be unfair within the meaning of Article 36c of Act No. 7/1936 on contracts, as the provision is clarified to accord with the first and second paragraph of Directive 93/13/EEC. The Supreme Court, moreover, was of the opinion, taking into account the payment schedule signed by the borrower in conjunction with the bond and the overview attached to it, that the lender had fulfilled its duty to provide information as provided for in the then effective Act No. 121/1994 on consumer loans. The Supreme Court, therefore, upheld the lender's reasoning as regards both issues that the borrowers contested as regards the price indexation. The Bank is aware that at least one of the two cases are now before the District Court.

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

35. Legal matters, continued

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 three respects. Firstly, there is uncertainty over the legality of certain loans. Secondly, there is disagreement over the recalculation and settlement of the loans, i.e. what interest rates should be used when recalculating the periods when the borrower did not actually pay any interest, for example during so-called “freeze-periods”. Thirdly, there is uncertainty over which interest rate should apply to currency-linked loans in the future, i.e. whether they should bear the Central Bank's non-indexed rate or the contractual interest rate for each loan.

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.

36. Events after Balance Sheet date

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 37.3 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.

In October 2015 Arion Bank sold a 21% shareholding in its associated company Síminn hf., in a public offering, in connection with the listing of Síminn hf. on NASDAQ Iceland. The profit from the sale and valuation changes on the remaining shareholding in Síminn hf. amount to ISK 1,471 million and will be recognised in the Statements of Comprehensive Income in the fourth quarter of 2015.

RELATED PARTY

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

No unusual transactions took place with related parties during the period. 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.

Balances with related parties			Net
30.9.2015	Assets	Liabilities	balance
Shareholders with control over the Group	225	(53,609)	(53,384)
Board of Directors and key Management personnel	224	(69)	155
Associates and other related parties	19,605	(14,086)	5,519
Balances with related parties	20,054	(67,764)	(47,710)
31.12.2014			
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)

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 14,000 million (31.12.2014: ISK 28,881 million) by Landsbankinn hf. and liabilities amounting to ISK 1,002 million at the end of the period (31.12.2014: ISK 7,332 million). Those amounts are not included in the table above.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 37 Amounts are in ISK millions

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.

Further information regarding risk management is available in the Annual Financial Statements for 2014 and in the Pillar 3 Risk Disclosures for 2014, published on the Bank's website, www.arionbanki.is. The Pillar 3 Risk Disclosures are not audited.

38. 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.

Maximum exposure to credit risk

The following table shows the maximum exposure to credit risk for the components of the Interim Statement of Financial Position, at the end of the reporting period before the effect of mitigation due to collateral agreements or other credit enhancements.

Maximum exposure to credit risk related to on-balance sheet items	30.9.2015	31.12.2014
Cash and balances with Central Bank	73,289	21,063
Loans to credit institutions	93,326	108,792
Loans to corporates	356,421	326,197
Loans to individuals	322,386	321,311
Financial instruments	72,935	70,704
Other assets with credit risk	8,854	3,514
Total on-balance sheet maximum exposure to credit risk	927,211	851,581
Maximum exposure to credit risk related to off-balance sheet items		
Financial guarantees	13,545	9,542
Unused overdrafts	41,602	38,890
Loan commitments	93,434	56,363
Total off-balance sheet maximum exposure to credit risk	148,581	104,795
Maximum exposure to credit risk	1,075,792	956,376

Arion Bank Interim Consolidated Financial Statements 30 September 2015 38 Amounts are in ISK millions

38. Credit risk, continued

Loans to customers specified by sectors	30.9.2015	31.12.2014
Individuals	47.5%	49.6%
Real estate activities and construction	14.9%	12.5%
Fishing industry	11.3%	11.8%
Information and communication technology	3.8%	3.6%
Wholesale and retail trade	8.2%	8.5%
Financial and insurance activities	4.7%	4.3%
Industry, energy and manufacturing	3.2%	3.9%
Transportation	1.5%	0.9%
Services	2.9%	2.8%
Public sector	1.1%	1.2%
Agriculture and forestry	0.9%	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 by the Bank against different types of financial assets

30.9.2015	Cash and securities	Real estate	Fishing vessels	Other collateral	Total
Cash and balances with Central Bank	-	-	-	-	-
Loans to credit institutions	-	-	-	-	-
Loans to customers					
Individuals	376	251,846	14	964	253,200
Real estate activities and construction	949	80,977	8	2,019	83,953
Fishing industry	959	9,216	57,744	4,387	72,306
Information and communication technology	5	2,253	-	17,812	20,070
Wholesale and retail trade	254	18,449	3	24,911	43,617
Financial and insurance activities	15,604	2,632	-	1,602	19,838
Industry, energy and manufacturing	753	11,546	552	3,451	16,302
Transportation	101	674	168	3,228	4,171
Services	21	3,257	40	699	4,017
Public sector	40	3,414	-	4	3,458
Agriculture and forestry	5	2,330	-	14	2,349
Financial instruments	6,530	-	-	-	6,530
Guarantees	765	2,539	555	939	4,798
Collateral held against different types of financial assets	26,362	389,133	59,084	60,030	534,609

Arion Bank Interim Consolidated Financial Statements 30 September 2015 39 Amounts are in ISK millions

38. Credit risk, continued

31.12.2014	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

Information on collateral held at subsidiaries is not available.

Credit quality by class of financial assets

30.9.2015	Neither past due nor impaired	Past due but not impaired	Individually impaired	Total
Cash and balances with Central Bank	73,289	-	-	73,289
Loans to credit institutions	93,326	-	-	93,326
Loans to customers				
Loans to corporates	334,863	19,374	2,184	356,421
Loans to individuals	284,977	29,153	8,256	322,386
Financial instruments	72,935	-	-	72,935
Other assets with credit risk	8,854	-	-	8,854
Credit quality by class of financial assets	868,244	48,527	10,440	927,211

31.12.2014				
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

Arion Bank Interim Consolidated Financial Statements 30 September 2015 40 Amounts are in ISK millions

38. 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						
30.9.2015	1	2	3	4	5	Not rated	Total
Individuals	51,918	144,925	59,549	18,823	4,911	4,851	284,977
Real estate activities and construction	38,068	10,652	25,967	2,873	151	17,881	95,592
Fishing industry	12,257	28,829	7,601	2,578	1,279	18,722	71,266
Information and communication technology	17,398	3,985	3,595	43	68	433	25,522
Wholesale and retail trade	8,213	21,655	14,387	1,613	41	5,649	51,558
Financial and insurance activities	1,541	12,518	9,192	543	15	6,554	30,363
Industry, energy and manufacturing	3,420	11,556	2,456	342	102	2,458	20,334
Transportation	2,551	1,687	5,319	283	-	285	10,125
Services	1,669	4,052	9,067	736	14	1,883	17,421
Public sector	173	3,403	1,779	830	160	1,338	7,683
Agriculture and forestry	105	1,025	1,637	553	361	1,318	4,999
Neither past due nor impaired loans	137,313	244,287	140,549	29,217	7,102	61,372	619,840

31.12.2014	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. Unrated exposures are elevated at period end as ratings often expire in the third quarter and are not renewed whitin the quarter.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 41 Amounts are in ISK millions

38. Credit risk, continued

Past due but not impaired loans by class of loans

30.9.2015	Up to 3 days	4 to 30 days	31 to 60 days	61 to 90 days	More than 90 days	Total
Loans to corporates	8,004	6,008	2,199	316	2,847	19,374
Loans to individuals	4,677	9,695	5,464	618	8,699	29,153
Past due but not impaired loans	12,681	15,703	7,663	934	11,546	48,527
31.12.2014						
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.

Collateral repossessed

During the period the Group took possession of assets due to foreclosures. The total amount of real estates the Group took possession of during the period and still holds at period end amount to ISK 1,415 million (31.12.2014: ISK 1,607 million) and other assets ISK 10 million (31.12.2014: ISK 10 million). The assets are held for sale, see Note 27.

Impaired loans to customers specified by sector	30.9.2015		31.12.2014	
	Impairment amount	Gross carrying amount	Impairment amount	Gross carrying amount
Individuals	9,893	18,149	11,016	21,621
Real estate activities and construction	1,322	1,542	1,396	1,981
Fishing industry	848	2,072	1,115	2,366
Information and communication technology	242	242	251	251
Wholesale and retail trade	637	944	751	831
Financial and insurance activities	6,481	6,564	6,739	6,756
Industry, energy and manufacturing	240	278	296	474
Transportation	21	29	18	18
Services	492	632	375	641
Public sector	99	177	27	35
Agriculture and forestry	141	227	230	340
	20,416	30,856	22,214	35,314

Arion Bank Interim Consolidated Financial Statements 30 September 2015 42 Amounts are in ISK millions

38. 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, and the sum of all large exposures cannot exceed 400% of the capital base.

The largest exposure to a group of connected clients at the end of the period was ISK 25 billion (31.12.2014: ISK 25 billion) before taking account of eligible collateral. The Group has two large exposures at the end of the period (31.12.2014: two exposures) net of eligible collateral. Nostro accounts are excluded.

	30.9.2015		31.12.2014	
no.	Gross	Net	Gross	Net
1	14%	14%	14%	14%
2	11%	11%	11%	10%
Sum of large exposure gross and net > 10%	25%	25%	25%	24%

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

The sum of exposures exceeding 10% of capital base is 25% of the Group's capital base before collateral mitigation or 25% net of eligible collateral, which is well below the 400% legal maximum.

39. 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.

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.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 43 Amounts are in ISK millions

39. 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

30.9.2015 Assets	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	66,257	-	-	-	-	66,257
Loans to credit institutions	93,326	-	-	-	-	93,326
Loans to customers	369,730	52,456	114,313	5,046	143,408	684,953
Financial instruments	40,842	7,363	9,411	1,295	224	59,135
Assets	570,155	59,819	123,724	6,341	143,632	903,671
Liabilities						
Due to credit institutions and Central Bank	11,470	-	-	-	-	11,470
Deposits	498,877	966	3,206	-	106	503,155
Borrowings	69,746	2,197	48,741	9,042	126,403	256,129
Subordinated loans	-	10,378	-	-	-	10,378
Liabilities	580,093	13,541	51,947	9,042	126,509	781,132
Derivatives and other off-balance sheet items (net position)	(48,945)	-	49,791	-	-	846
Net interest gap	(58,883)	46,278	121,568	(2,701)	17,123	123,385

31.12.2014 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

Arion Bank Interim Consolidated Financial Statements 30 September 2015 44 Amounts are in ISK millions

39. Market risk, continued

Interest rate risk in the trading book

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

	30.9.2015			31.12.2014		
Trading financial instruments, long positions	MV	Duration	BPV	MV	Duration	BPV
ISK, CPI Indexed linked	2,639	4.2	(1.1)	1,924	6.3	(1.2)
ISK, Non Indexed linked	9,727	0.1	(0.1)	3,353	(2.1)	0.7
FX	32,106	(1.0)	3.2	22,844	0.1	(0.2)
Total	44,472	(0.4)	1.9	28,121	0.3	(0.7)
Trading financial instruments, short positions						
ISK, CPI Indexed linked	325	4.8	(0.2)	1,003	6.1	(0.6)
ISK, Non Indexed linked	5,581	(0.1)	0.1	7,139	0.4	(0.3)
FX	35,048	(0.9)	3.2	22,243	0.1	(0.2)
Total	40,954	(0.8)	3.1	30,385	0.4	(1.1)

Arion Bank Interim Consolidated Financial Statements 30 September 2015 45 Amounts are in ISK millions

39. 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 304.7 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

30.9.2015 Assets, CPI indexed linked	Up to 1 year	1 to 5 years	Over 5 years	Total
Loans to customers	13,029	78,717	202,210	293,956
Financial instruments	3,079	-	-	3,079
Off-balance sheet position	844	6,819	-	7,663
Assets, CPI indexed linked	16,952	85,536	202,210	304,698
Liabilities, CPI indexed linked				
Deposits	68,276	17,030	2,496	87,802
Borrowings	2,131	14,305	112,243	128,679
Other	-	-	792	792
Liabilities, CPI indexed linked	70,407	31,335	115,531	217,273
Net on-balance sheet position	(54,299)	47,382	86,679	79,762
Net off-balance sheet position	844	6,819	-	7,663
CPI Balance	(53,455)	54,201	86,679	87,425

31.12.2014 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

Arion Bank Interim Consolidated Financial Statements 30 September 2015 46 Amounts are in ISK millions

39. 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

30.9.2015

Assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with Central Bank	72,173	298	461	37	99	39	182	73,289
Loans to credit institutions	20,921	23,720	12,179	14,451	2,238	17,275	2,542	93,326
Loans to customers	561,929	42,286	39,209	6,821	12,046	4,496	12,020	678,807
Financial instruments	78,724	18,785	6,476	2,174	57	3,318	1,657	111,191
Investment property	7,817	-	-	-	-	-	-	7,817
Investments in associates	8,401	-	-	5,445	-	-	1	13,847
Intangible assets	5,411	-	-	-	3,783	-	-	9,194
Tax assets	987	-	-	-	-	-	-	987
Other assets	20,610	104	120	92	22	28	42	21,018
Assets	776,973	85,193	58,445	29,020	18,245	25,156	16,444	1,009,476
Liabilities and equity								
Due to credit inst. and Central Bank	9,649	209	75	4	-	-	1,533	11,470
Deposits	423,232	26,808	16,478	11,533	1,568	14,540	8,996	503,155
Financial liabilities at fair value	4,990	510	7	-	2	2	-	5,511
Tax liabilities	6,353	-	-	-	420	-	-	6,773
Other liabilities	38,542	2,592	3,401	1,440	1,211	243	1,793	49,222
Borrowings	137,758	44,819	32,813	8,564	-	10,248	13,970	248,172
Subordinated liabilities	-	3,980	2,554	3,844	-	-	-	10,378
Shareholders' equity	173,508	-	-	-	-	-	-	173,508
Non-controlling interest	1,287	-	-	-	-	-	-	1,287
Liabilities and equity	795,319	78,918	55,328	25,385	3,201	25,033	26,292	1,009,476
Net on-balance sheet position	(18,346)	6,275	3,117	3,635	15,044	123	(9,848)	
Net off-balance sheet position	13,236	(6,368)	(2,212)	(1,000)	(14,647)	(269)	11,260	
Net position	(5,110)	(93)	905	2,635	397	(146)	1,412	

Arion Bank Interim Consolidated Financial Statements 30 September 2015 47 Amounts are in ISK millions

39. Market risk, continued

31.12.2014

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	

Arion Bank Interim Consolidated Financial Statements 30 September 2015 48 Amounts are in ISK millions

40. Liquidity risk

Liquidity risk is defined as the risk that the Group, though solvent, either does not have sufficient financial resources available to meet its liabilities when they fall due, or can secure them only at excessive cost. Liquidity risk arises from the inability to manage unplanned decreases or changes in funding sources.

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

30.9.2015 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	73,289	64,449	-	8,840	-	-	-
Loans to credit institutions	93,326	45,969	47,357	-	-	-	-
Loans to customers	678,807	4,470	35,981	101,431	241,916	295,009	-
Financial instruments	111,191	4,311	817	7,480	54,794	5,533	38,256
Derivatives - assets leg	*46,437*	*179*	*21,281*	*947*	*23,797*	*233*	-
Derivatives - liabilities leg	*(44,152)*	*(163)*	*(20,473)*	*(843)*	*(22,510)*	*(163)*	-
Investment property	7,817	-	-	-	-	-	7,817
Investments in associates	13,847	-	-	-	-	-	13,847
Intangible assets	9,194	-	-	-	-	-	9,194
Tax assets	987	-	-	-	987	-	-
Other assets	21,018	463	6,152	1,325	910	4	12,164
Assets	1,009,476	119,662	90,307	119,076	298,607	300,546	81,278
Liabilities							
Due to credit institutions and Central Bank	11,470	9,163	1,193	1,089	25	-	-
Deposits	503,155	280,916	125,091	76,557	17,584	3,007	-
Financial liabilities at fair value	5,511	16	4,647	216	595	37	-
Derivatives - assets leg	*(17,464)*	*(29)*	*(10,512)*	*(1,882)*	*(4,878)*	*(163)*	-
Derivatives - liabilities leg	*19,516*	*45*	*11,700*	*2,098*	*5,473*	*200*	-
Short position bonds and derivatives	*453*	-	*453*	-	-	-	-
Short position bonds used for hedging	*3,006*	-	*3,006*	-	-	-	-
Tax liabilities	6,773	-	2,007	3,011	1,755	-	-
Other liabilities	49,222	278	35,019	702	5,038	158	8,027
Borrowings	248,172	-	3,223	7,832	66,689	170,428	-
Subordinated liabilities	10,378	-	-	-	3,980	6,398	-
Liabilities	834,681	290,373	171,180	89,407	95,666	180,028	8,027
Off-balance sheet items							
Guarantees	13,545	3,172	2,473	3,372	2,960	1,568	-
Unused overdraft	41,602	1,005	11,402	14,075	15,093	27	-
Loan commitments	93,434	1,665	38,160	24,617	24,992	4,000	-
Off-balance sheet items	148,581	5,842	52,035	42,064	43,045	5,595	-
Net assets (liabilities)	26,214	(176,553)	(132,908)	(12,395)	159,896	114,923	73,251

Arion Bank Interim Consolidated Financial Statements 30 September 2015 49 Amounts are in ISK millions

40. Liquidity risk, continued

31.12.2014 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

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 a guideline for minimum LCR. In 2015, the LCR requirement is 100% in foreign currency and 80% in total (ISK and foreign currency). The latter benchmark increases by 10% every year until a 100% requirement is implemented in 2017.

Liquidity coverage ratio	30.9.2015	31.12.2014
FX	188%	254%
Total	145%	174%

The Group has anticipated an outflow of deposit in relation to the prospective lifting of capital controls.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 50 Amounts are in ISK millions

40. Liquidity 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					
30.9.2015	Less Stable	Weight (%)	Stable	Weight (%)	Term deposits*	Total deposits
Retail	81,946	10%	35,568	5%	55,706	173,220
SME	36,783	10%	4,495	5%	5,408	46,686
Operational relationship	146	25%	-	5%	108	254
Corporations	40,883	40%	870	20%	4,496	46,249
Sovereigns, central-banks and PSE	15,612	40%	-	-	6,974	22,586
Financial entities being wound up	23,783	100%	-	-	64,522	88,305
Pension funds	61,011	100%	-	-	19,062	80,073
Domestic financial entities	27,320	100%	-	-	15,395	42,715
Foreign financial entities	4,796	100%	-	-	-	4,796
Other foreign parties	3,587	100%	3,187	25%	1,879	8,653
Total	295,867		44,120		173,550	513,537
31.12.2014						
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.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 51 Amounts are in ISK millions

41. Capital management

The capital base amounts to ISK 173,984 million at the end of the period. The capital adequacy ratio, calculated in accordance with Article 84 of the Act on Financial Undertakings was 23.5%, exceeding the minimum legal requirement of 8%.

The Group uses the standardised approach to calculate the capital requirements for credit risk and market risk and basic indicator approach for 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	30.9.2015	31.12.2014
Total equity	174,795	162,212
Non-controlling interest not eligible for inclusion in CET1 capital*	(1,257)	(1,385)
Intangible assets	(9,194)	(9,596)
Tax assets	(987)	(655)
Other statutory deductions	(222)	(111)
Common equity Tier 1 capital*	163,135	150,465
Additional Tier 1 capital*	1,257	1,385
Tier 1 capital	164,392	151,850
Subordinated liabilities	10,378	31,639
Regulatory adjustments to Tier 2 capital**	(597)	-
Other statutory deductions	(189)	(101)
Tier 2 capital	9,592	31,538
Total Capital base	173,984	183,388

Risk weighted assets		
Credit risk	645,358	591,994
Market risk FX	5,255	18,915
Market risk other	7,317	2,890
Operational risk	82,211	82,211
Total risk weighted assets	740,141	696,010

Capital ratios		
CET1 ratio	22.0%	21.1%
Tier 1 ratio	22.2%	21.8%
Capital adequacy ratio	23.5%	26.3%
Official Tier 1 ratio***	21.4%	21.8%
Official Capital adequacy ratio***	22.7%	26.3%

* CET1 according to Basel III definition while Tier 1 and total capital base are calculated according to The Act on Icelandic Undertakings no. 161/2002. Thus Additional Tier 1 is here presented as the difference between Basel II Tier 1 and Basel III CET1.

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

*** Official capital ratios are based on reviewed earnings at 30 June 2015.

Arion Bank Interim Consolidated Financial Statements 30 September 2015 52 Amounts are in ISK millions

41. Capital management, continued

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.

	30.9.2015	31.12.2014
On-balance sheet exposures	989,972	912,303
Derivative exposures	3,664	1,348
Securities financing transaction exposures	7,005	10,044
Off-balance sheet exposures	95,076	59,922
Total exposure	1,095,717	983,617
Tier 1 capital	164,392	151,850
Leverage ratio	15.0%	15.4%

Arion Bank Interim Consolidated Financial Statements 30 September 2015 53 Amounts are in ISK millions

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

SIGNIFICANT ACCOUNTING POLICIES

The accounting policies adopted in the preparation of these Interim Financial Statements are consistent with those followed in the preparation of the Annual Financial Statements for the year 2014.

41. 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 Interim Financial Statements are prepared on a going concern basis.