Consolidated annual financial results 2011

Highlights:

- Profit after tax from regular operations was ISK 13.9bn, compared to ISK 17.8bn in 2010. Profit after tax, including one-off items like goodwill impairment, costs associated with the Byr merger, loan portfolio net valuation change, and fair value gains from shares, was ISK 1.9bn, compared to ISK 29.4bn in 2010.
- The entire goodwill from the acquisition of Byr was impaired at year-end 2011 which resulted in a one-off charge to the comprehensive income statement of ISK 17.9bn.
- Net valuation change of the loan portfolio resulted in a loss of ISK 1.3bn in 2011, compared to a gain of ISK 14.5bn in 2010. The expected cost of the Supreme Court ruling of 15 February 2012 is ISK 12.1bn. Significant uncertainty still remains on the ruling's precedential value and the method of recalculating the interest on loans affected by the ruling.
- Return on equity of regular operations was 11.0%. Taking into account one-off items, return on equity was 1.5%.
- Around 17,600 individuals and 2,700 corporates have received write offs, debt forgiveness or some form of debt correction since the Bank's establishment, totalling ISK 343bn.
- Total assets were ISK 795.9bn at year-end 2011, compared to ISK 683.2bn in 2010. The increase is a result of the Byr merger.
- Total deposits were 525.8bn at year-end 2011, compared to ISK 423.4bn in 2010.
- An important step towards funding diversification reached when Íslandsbanki was the first bank to list ISK 4bn worth of covered bonds in the NASDAQ OMX Iceland.
- Equity was ISK 123.7bn at year-end and increased by 2% throughout the year. Total capital ratio was 22.6%, which is well above the 16% regulatory minimum set by the Icelandic Financial Services Authority.

Birna Einarsdóttir, Chief Executive Officer of Íslandsbanki

"2011 was an eventful year for Íslandsbanki and important milestones were reached in strengthening operations. The merger of Íslandsbanki and Byr was a great success, increasing market share significantly and setting the scene for future income and synergy effects that have started to emerge in 2012 but will be fully realised in 2013. Furthermore, an important step towards funding diversification was reached when Íslandsbanki was the first bank to list covered bonds on the NASDAQ OMX Iceland since the fall of 2008.

The full-year results show an acceptable return on equity for regular operations. The Bank´s balance sheet and capital position is sound which has allowed us to efficiently meet challenges in our ever changing operating environment. The entire goodwill from the acquisition of Byr was impaired at year end 2011, resulting in a one-off charge to the comprehensive income statement. The fourth quarter was also affected by the recent Supreme Court's ruling on FX loans. It is of great importance, that the uncertainty regarding FX loans be resolved as quickly as possible.

We have strived to work with our customers in restructuring in such a way that they continue as good customers and value our customer relationship. Our effort has proved well as Íslandsbanki's customers were the most satisfied in the Icelandic financial sector according to customer satisfaction survey Ánægjuvogin. I firmly believe that 2012 will mark the turnaround where our hard work over the past three years will start to bear fruit and render a more normalised business environment."

For further information:

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Review of operations

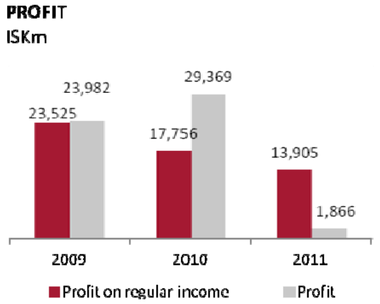
INCOME STATEMENT – highlights

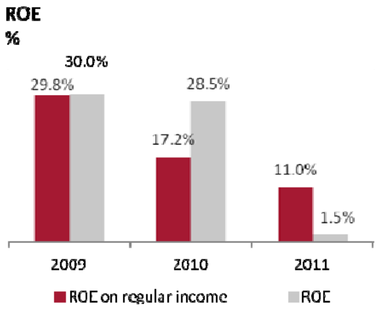
ISK million	FY 2011	FY 2010
Net interest income	31,225	34,874
Net valuation changes on loans and receivables	(1,296)	14,507
Provision for latent impairment	76	(514)
Net fee and commission income	5,966	7,380
Net financial income (expenses)	2,649	(910)
Net foreign exchange gain (loss)	937	(963)
Other net operating income	894	1,186
Total operating income	40,451	55,560
Administrative expenses	(19,870)	(17,866)
Impairment of goodwill	(17,873)	-
Contribution to the Depositors' and Investors' Guarantee Fund	(965)	(607)
Share of profit of associates	39	-
Profit before tax	1,782	37,087
Income tax	(75)	(7,214)
Bank tax	(682)	(221)
Profit for the year from continuing operations	1,025	29,652
Profit (loss) from discontinued operations, net of income tax	841	(283)
Profit for the year	1,866	29,369

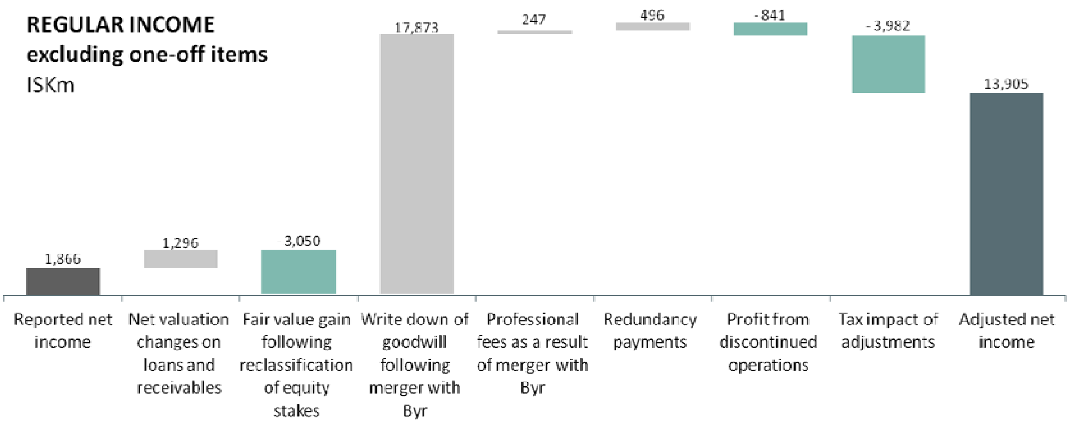
PROFIT

Earnings from regular operations resulted in a pre-tax profit of ISK 13,902m and a return on equity of 11.0%. Regular income is defined as earnings excluding one-off items such as net valuation changes from the loan portfolio, net gains from unrealised fair value adjustments of equities, costs associated with the Byr merger and the goodwill impairment, and net gains from discontinued operations.

Profit after tax was ISK 1,866m in 2011, compared to ISK 29,369m in 2010. The difference is largely explained by the impairment at year end of goodwill arising on the acquisition of Byr totalling ISK 17,873m. The goodwill which arose from the acquisition of Byr consisted largely of the synergies and economies of scale expected from combining the operations of Byr and the Bank which will start to come through in 2012 and more markedly in 2013. The Bank impaired the entire goodwill from the acquisition at year end 2011 which resulted in a one-off charge to the comprehensive income statement. The fourth quarter was also affected by the Supreme Court's ruling on FX loans. The expected effect is ISK 12.1bn, however, significant uncertainty still remains on the ruling's interpretation and the method of recalculating the interest on loans affected by the ruling.







INCOME

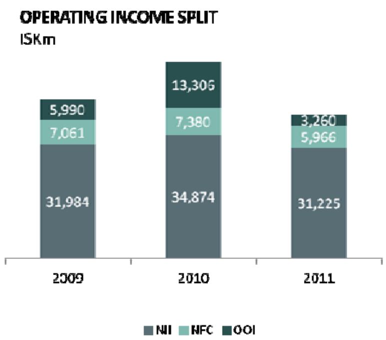
Net interest income amounted to ISK 31,225m in 2011, compared to ISK 34,874m in 2010. The difference between the years is largely explained by gradually decreasing interest rates, i.e. the average Central Bank policy was 4.4% in 2011, compared to 7.8% in 2010. The net interest margin, as the ratio of net interest income to the average carrying amount of total assets, was 4.5% in 2011, compared to 5% in 2010.

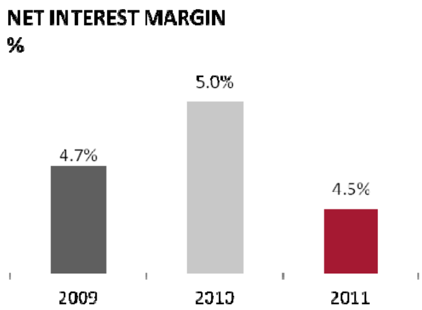
Net fee and commission income amounted to ISK 5,966m in 2011, compared to ISK 7,380m for the previous year, which is a decrease of 19%. The difference is largely explained by the Bank's subsidiary Borgun hf. leaving the Bank at the end of March 2011 when the Bank sold part of its shareholding in the entity. Borgun hf. became a subsidiary again on 1 December 2011 through increased shareholding attributable to the acquisition of Byr. Advisory and trading fees were somewhat lower than expected due to a slower than expected recovery of the financial markets and restructuring of companies having taken longer than anticipated.

Net financial income amounted to ISK 2,649m in 2011 compared to a loss of ISK 910m in 2010. The difference is due to a realised fair value gain of 3,050m after a reclassification of equity shares from non-current assets held for sale to shares and equity instruments. The reclassification came as a result of a sale of a part of the total equity shares held.

Foreign exchange gain in 2011 amounted to ISK 937 million, compared with a loss of ISK 963 million in 2010. Other net operating income, mainly rental income and service fees, was ISK 894m in 2011 compared to ISK 1,186 in 2010.

Other net operating income, which was mainly rental income and fees from service agreements, amounted to ISK 894m in 2011, compared to ISK 1,186m in 2010. The Bank saw a profit of ISK 841m from discontinued operations, net of income tax, compared to a loss of ISK 283m in 2010.





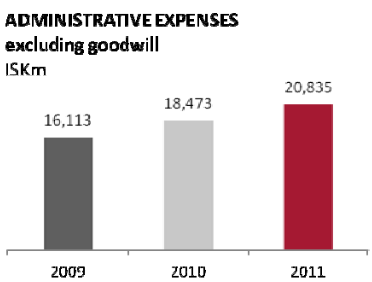
EXPENSES

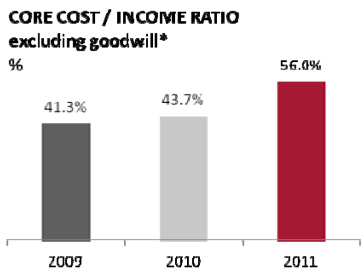
Cost to income ratio, calculated as total operating expense (excluding one-off item of the goodwill impairment) as a ratio of net interest income and net fee and commission income was 56% in 2011, compared to 44% in 2010.

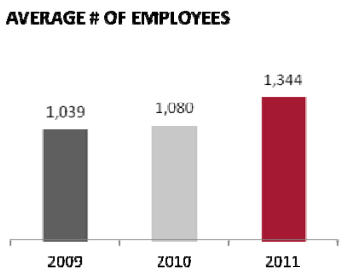
Administrative expenses excluding impairment of goodwill amounted to ISK 20,835m in 2011 compared to ISK 18,473m in 2010. A third of the increase is attributable to the acquisition of Byr which incurred additional costs, in particular in relation to professional fees and IT services, as part of the planning and integration of the merger. Contributions to the Depositors' and Investors' Guarantee Fund also increased by ISK 358m between years due to a change in the legislation as well as an increased deposit base.

Salaries and related expenses amounted to ISK 10,531m in 2011, compared to ISK 9,207m in 2010. The increase is partly explained by a collective salary increase during the year. In addition, increased costs were associated with more staff needed in the financial restructuring of households and corporates, as well as redundancy costs due to necessary reduction in the number of employees following the Byr merger. Salaries of Íslandsbanki employees, excluding subsidiaries, increased by 6.2% when taking out one-off items due to contractual agreements on redundancies due to the Byr merger.

The average number of full time employees at the Bank was 1,344 in 2011, compared to 1,080 in the previous year. The increase is largely attributable to subsidiaries acquired in 2011.







*Administrative expenses excluding impairment of goodwill

TAXES

Taxation in 2011 increased considerably from the previous year with the corporation income tax rate increasing from 18% to 20%. The year 2011 also saw an implementation of a two year temporary taxation of 0.0875% of the previous year's total liabilities, effective for tax periods after 1 January

2011. This temporary taxation is shown in a separate line, bank tax, on the face of the statement of comprehensive income together with the bank tax introduced in 2010 which is calculated as 0.041% of the previous year's total liabilities.

The effective income tax rate for 2011 was 4.2% compared to 19.6% in 2010. The income tax for the year 2011 was calculated as ISK 75m, compared to ISK 7,214m for the previous year, a difference mainly explained by the difference in profit before tax and an adjustment for income not subject to tax.

BALANCE SHEET – highlights

Assets ISKm	31.12.2011	31.12.2010
Cash and balances with CB	**57,992**	30,799
Derivatives	**339**	70
Bonds and debt instruments	**58,662**	68,024
Shares and equity instruments	**11,107**	3,022
Loans to credit institutions	**43,655**	30,870
Loans to customers	**564,394**	515,161
Investment in associates	**1,070**	354
Property and equipment	**5,276**	5,419
Intangible assets	**544**	187
Deferred tax assets	**2,629**	283
Non-current assets held for sale	**42,690**	23,489
Other assets	**7,557**	5,544
Total assets	**795,915**	683,222

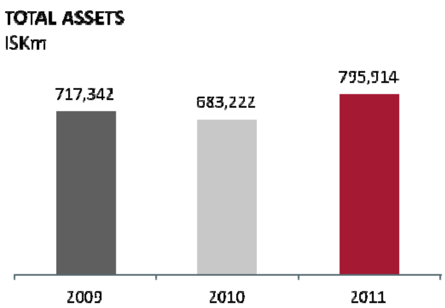
Liabilities ISKm	31.12.2011	31.12.2010
Financial liabilities	**9,346**	9,090
Derivatives	**4,027**	429
Deposits from CB and credit inst.	**62,845**	96,238
Deposits from customers	**462,943**	327,158
Debt issued and other borrowings	**63,221**	55,425
Subordinated loans	**21,937**	21,241
Current tax liabilities	**2,670**	9,024
Deferred tax liabilities	**17**	18
Non-current liabilities held for sale	**7,317**	16,442
Other liabilities	**37,889**	26,694
Total liabilities	**672,212**	561,759
Total equity	**123,703**	121,463
Total liabilities and equity	**795,915**	683,222

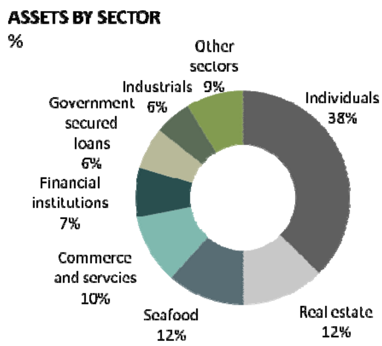
ASSETS

The Bank's total assets amounted to ISK 795,915m at year-end 2011, compared to ISK 683,222m at year-end 2010. The increase is mainly explained by the inclusion of Byr assets following the merger on 1 December 2011.

Loans to customers and credit institutions amounted to ISK 608,049m at year-end 2011, compared to 546,031m at the beginning of the year, representing an increase of 11.4%.

Great progress was made during 2011 in financial restructuring as many customers accepted standardised options made available to borrowers, e.g. principal adjustment, and many large and often complex corporate restructures were completed. Restructuring of the largest corporate clients' loan portfolio is expected to complete by the end of 2012 and by the end of 2013 for the remaining loan portfolios





Intangible assets minimised

The goodwill which arose from the acquisition of Byr consisted largely of the synergies and economies of scale expected from combining the operations of Byr and the Bank. The Bank impaired the entire goodwill from the acquisition at year end 2011 which resulted in a one-off charge to the comprehensive income statement of ISK 17.9bn. This one-off charge will not impact the Bank's cash flow, liquidity or the total capital ratio.

Special provision following the Supreme Court ruling

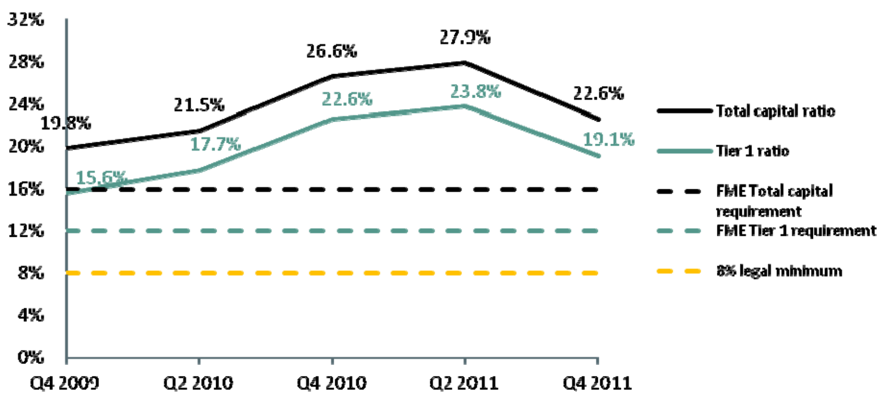
Each quarter, the book value of assets is subject to an impairment test to evaluate if any fair value adjustments are required. This evaluation resulted in a provision due to the recent Supreme Court's ruling on interest rate calculations on illegitimate FX loans. Bank initiated a recalculation of all affected foreign currency-linked loan contracts in accordance with legislation set in December 2010 stipulating that the lowest offered Central Bank rates for non-indexed loans should be applied to the contracts affected by the rulings.

A Supreme Court ruling on 15 February 2012 disputed the proposed recalculation methods set out in the legislative changes, as it violated the borrower's constitutional right to an adequate compensation for previously paid up principal. The interpretation of this ruling and how it affects the Bank is uncertain. The Bank therefore made an assessment based on given assumptions and subsequently recognised a provision at year end 2011 amounting to ISK 12.1bn. The estimated effect of the court rulings is therefore reflected in the financial statements. Affected loan contracts may therefore need to go through a second recalculation in the coming months.

LIABILITIES AND EQUITY

Total liabilities amounted to ISK 672,212m at year-end 2011, compared to ISK 561,759m in 2010. The increase of 19.7% is predominately attributed to the assimilation of deposits totalling ISK 117,614m through the Byr merger. The total deposit to loan ratio thus increased from 77.5% at year-end 2010 to 86.5% at year-end 2011.

At year-end 2011 the Bank's total equity was ISK 123,703m, compared to ISK 121,463m at year-end 2010, which is an increase of 2%. At year-end 2011 the Bank's Tier 1 ratio was 19.1%, compared to 22.6% at year-end 2010. The Bank's total capital ratio was 22.6% at year-end 2011, compared to 26.6% at year-end 2010, and sits well above the 16% regulatory minimum set by the Icelandic Financial Services Authority.



FUNDING AND LIQUIDITY POSITION

The Bank has been largely funded with deposits since its incorporation in 2008.The ratio of total deposits against total loans was 86.5% at the end of 2011, while customer deposits to customer loans was 82%. In the medium term, investors are expected to diversify into other investment products, leaving deposit-to-loan ratios at a level of 50-60%. The lowering of those ratios will come through both an increase in the size of the loan book and increased debt issuance by the Bank. The Bank's liquidity position is sound and all liquidity ratios well above regulatory requirements.

Íslandsbanki was the first bank to list securities on the NASDAQ OMX Iceland since the fall of 2008, which was an important step towards diversification of funding for the Bank. Under the ISK 100bn covered bond programme that's in place, Íslandsbanki plans to issue up to ISK 10bn of covered bonds annually. To date, Íslandsbanki has issued three CPI-linked covered bonds, the five year ISLA CBI 16, the 7 year ISLA CBI 19, and the 12 year ISLA CBI 24. All issuances were oversubscribed and sold to a broad group of institutional investors.

The Bank is not reliant on foreign currency funding and does not have a need to raise such funds in the short to medium term. The Bank has however been exploring its options and will take advantage of opportunities to fund a potential loan book growth should they arise.

FY2011 results presentation

Íslandsbanki will present its 2011 consolidated financial results to investors and market participants on 20 March 2012 at 4pm. Birna Einarsdóttir, CEO of Íslandsbanki, and Jón Guðni Ómarsson, CFO, will present the FY2011 financial results followed by a Q&A session. The meeting is held at the Bank's HQ at Kirkjusandur 2 and will be conducted in Icelandic. Due to strict access controls, please make sure to complete your registration on the Bank's website.

All presentation material will subsequently be available and archived on www.islandsbanki.is/ir.

Financial calendar 2012

Íslandsbanki plans to publish its interim and annual financial statements according to the below financial calendar. Please note that the dates may change so please refer to the Bank's website for correct dates.

1Q2012	31 May 2012
2Q2012	31 August 2012
3Q2012	29 November 2012
4Q2012	7 March 2013
AGM	April 2013

All information on Íslandsbanki's reports and financials is available on www.islandsbanki.is/ir.