Consolidated Financial Statements
31 December 2014

MP banki hf. • Ármúli 13a • 108 Reykjavík • Iceland • Reg. no. 540502-2930

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Endorsement and Statement
by the Board of Directors and the CEO

The Consolidated Financial Statements of MP banki hf. for the year 2014 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, and additional Icelandic disclosure requirements where applicable. The Consolidated Financial Statements comprise MP banki hf. and its subsidiaries.

According to the Consolidated Income Statement, profit in 2014 amounted to ISK 335 million. According to the Consolidated Statement of Financial Position, the Group's equity at the end of the year 2014 amounted to ISK 5,597 million. As at 31 December 2014, the Group's total assets amounted to ISK 49,344 million.

The Bank's Board of Directors propose that no dividend will be paid in the year 2015 on 2014 operations.

Share capital and shareholders

The Bank's issued share capital amounted to ISK 1,171 million as at 31 December 2014 (2013: ISK 5,854 million). At year-end the Bank held treasury shares with a nominal value of ISK 800 thousand (2013: ISK 4 million). The Bank's share capital was reduced in April 2014 as outlined in note 35.

The Bank had 49 shareholders at year-end (2013: 49), of which 1 held more than 10% of shares in the Bank (2013: 0). The ten largest shareholders are as follows:

Shareholder	31.12.2014	31.12.2013
Straumur fjárfestingabanki hf.	19.54%	-
Títan B ehf.	9.91%	9.91%
Lífeyrissjóður verslunarmanna	9.74%	9.74%
Mízar ehf.	9.40%	9.40%
Fagfjárfestasjóðurinn Norðurljós	8.20%	8.20%
Tryggingamiðstöðin hf.	5.12%	5.12%
Eignasafn Seðlabanka Íslands ehf.	4.36%	-
Klakki ehf.	4.27%	4.27%
MP Canada Iceland Ventures Inc	3.42%	3.42%
Alkor ehf.	2.76%	2.76%
	76.71%	52.82%

Further information about the shareholders of the Bank is provided in note 69.

Rationalisation delivers results

The Bank implemented rationalisation measures in Q4 2013 to adjust the cost base to a smaller equity base than initial plans had assumed. The rationalisation measures continued in 1H 2014 and included the sale of the Bank‘s equipment financing assets (Lykill) and a redundancy plan. As a result of these measures the cost base of the parent company going forward was reduced by approximately 25%. In 2H 2014 the Bank continued to streamline its operations by disposing of non-core assets, including two of its subsidiaries in Lithuania.

Results in 1H 2014 were tainted by rationalisation cost. The Bank firmly returned to profitability in the second half of the year, posting profits for six consecutive months. As a result the Group's profit in 2H 2014 was ISK 494 million compared with losses of ISK 159 million in 1H 2014.

Consolidation in the Icelandic financial market

The Bank has actively sought opportunities for external growth in the past few years and is in a key position to lead the consolidation that is inevitable in the Icelandic financial market. In February 2015 the Bank disclosed its intentions to commence a formal merger process with Straumur fjárfestingabanki hf. based on heads of terms mutually agreed by the two banks. This merger, which is expected to be completed later in the year 2015, will substantially increase the Bank's presence in asset management and investment banking as well as strengthening its capabilities to service its banking clients.

Risk management

In addition to improving operational efficiency by lowering the cost base, the Bank has also reduced risk-weighted assets and is maintaining high capitalization and liquidity. The Capital Adequacy Ratio (Tier 1) of the Group was 17.4% at the end of the year, compared with 15.1% at the end of 1H 2014. The Bank's minimum regulatory capital requirement is 11.8%. The Bank is also prepared for implementation of additional CRD IV regulatory capital buffers in the near future.

The Bank is exposed to various types of risk in its operations. The Bank enforces a risk management framework which is further structured and outlined in the Bank‘s risk policy guide and rules on risk management. We refer to notes 42-56 on analysis of exposure to various types of risk.

Endorsement and Statement
by the Board of Directors and the CEO

Corporate Governance

The Board of Directors emphasizes good corporate governance and following accepted guidelines on corporate governance. The Board has laid down comprehensive rules in which the authority of the Board is defined and its scope of work in conjunction with the CEO. They cover e.g. order at meetings, competence of Board members to participate in individual decisions, confidentiality and information disclosure between the CEO and the Board. Majority of Board members are independent of the Bank and there are no executive directors on the Board. The Bank aims to promote gender equality and two out of five board members and two out of three alternate board members are women.

The Board determines compensation for the CEO. The Board of Directors has delegated certain tasks to two subcommittees, the Remuneration Committee and the Audit Committee. Each committee has three members appointed by the Board, the majority of which is independent of the Bank.

More information about the Bank's Corporate Governance, including a signed statement, can be found on the Bank's website, www.mp.is.

Statement by the Board of Directors and the CEO

To the best of our knowledge the Consolidated Financial Statements of MP banki hf. for the year 2014 comply with International Financial Reporting Standards as adopted by the EU, and give a true and fair view of the Group's assets, liabilities and financial position as at 31 December 2014 and the financial performance of the Group and changes of cash flows for the year 2014.

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

The Board of Directors and the CEO of the Bank have today discussed the Consolidated Financial Statements for the year 2014, and confirm them by the means of their signatures.

Reykjavík, 24 February 2015.

Board of Directors | CEO

Independent Auditor's Report

To the Board of Directors and Shareholders of MP banki hf.

We have audited the accompanying consolidated financial statements of MP banki hf., which comprise the consolidated statement of financial position as at December 31, 2014, the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

The Board of Directors and CEO´s Responsibility for the Consolidated Financial Statements

The Board of Directors and CEO are responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as they determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of MP banki hf. as at December 31, 2014, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Report on the Board of Directors report

Pursuant to the legal requirement under Article 104, Paragraph 2 of the Icelandic Financial Statement Act No. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the consolidated financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the consolidated financial statements.

Reykjavík, 24 February 2015.

KPMG ehf.

Sigurður Jónsson
Hrafnhildur Helgadóttir

MP banki hf. Amounts are in ISK thousands

Consolidated Income Statement
For the year 2014

	Notes	2014	2013
Interest income		2,898,890	3,644,118
Interest expense		(1,596,869)	(2,160,603)
Net interest income	3	1,302,021	1,483,515
Fee and commission income	4	1,819,211	1,847,843
Fee and commission expense		(89,486)	(93,342)
Net fee and commission income		1,729,725	1,754,501
Net financial income	5-6	180,312	275,383
Share in profit (loss) of associates, net of income tax	21	22,427	(3,715)
Other operating income		93,773	94,871
Other operating income		296,512	366,538
Net operating income		3,328,258	3,604,554
Administrative expenses	7-11	(3,070,905)	(3,669,276)
Impairment of loans and receivables	18	10,692	46,834
Impairment of intangible assets		0	(771,930)
Profit from assets held for sale	28, 100	14,531	9,927
Profit (loss) before taxes		282,576	(779,891)
Income tax	12	52,438	302,948
Profit (loss) for the year		335,014	(476,943)

	Notes	2014	2013
Attributable to the shareholders of MP banki hf.		312,441	(486,220)
Attributable to non-controlling interest	20	22,573	9,276
Profit (loss) for the year		335,014	(476,943)

The notes on pages 10 to 56 are an integral part of these Consolidated Financial Statements.

MP banki hf. Amounts are in ISK thousands

Consolidated Statement of Comprehensive Income

For the year 2014

	Notes	2014	2013
Profit (loss) for the year		335,014	(476,943)
Available for sale financial assets			
Fair value changes		4,677	18,261
Reclassified to profit and loss on sale of securities		(3)	(43,002)
Translation of foreign operations			
Exchange difference on translation of foreign operations		(32,263)	10,709
Reclassified to profit and loss on sale of subsidiaries		16,824	0
Other comprehensive income that are or may be reclassified to profit and loss, net of tax		(10,765)	(14,032)
Total comprehensive income (loss) for the year		324,249	(490,975)

	Notes	2014	2013
Attributable to the shareholders of MP banki hf.		301,676	(500,252)
Attributable to non-controlling interest		22,573	9,276
Total comprehensive income (loss) for the year		324,249	(490,975)

The notes on pages 10 to 56 are an integral part of these Consolidated Financial Statements.

MP banki hf. Amounts are in ISK thousands

Consolidated Statement of Financial Position
As at 31 December 2014

Assets	Notes	31.12.2014	31.12.2013
Cash and cash equivalents	13	12,970,418	17,795,993
Receivables from Central Bank	90	98,832	4,510,503
Fixed income securities	14	4,196,330	4,284,835
Shares and other variable income securities	15	790,723	953,747
Securities used for hedging	16	6,856,641	2,853,272
Loans to customers	17-18	22,287,138	27,242,120
Derivatives	19	233,685	504,341
Investment in associates	21	0	309,021
Intangible assets	24	248,766	305,028
Property and equipment	25	74,873	99,465
Deferred tax asset	26	578,080	613,777
Other assets	18, 27	718,188	731,371
Assets classified as held for sale	28	290,651	305,390
Total assets		49,344,327	60,508,862
Liabilities			
Deposits from customers	29	26,764,581	35,229,708
Deposits from credit institutions	30	2,711,342	2,346,121
Borrowings	31	9,854,731	8,327,416
Short positions used for trading	32	2,988,256	4,492,682
Short positions used for hedging	33	249,158	3,174,046
Derivatives	19	154,196	184,109
Current tax liabilities	26	13,589	20,045
Deferred tax liabilities	26	3,973	334
Other liabilities	34	1,007,996	1,697,634
Total liabilities		43,747,821	55,472,095
Equity			
Share capital	35	1,170,000	5,850,000
Share premium		9,069	8,088
Option reserve	66	4,541	2,388
Warrants reserve	37	11,070	0
Deficit reduction reserve	35	3,850,917	0
Other reserves		(10,659)	22,420
Retained earnings (accumulated deficit)		288,853	(851,402)
Total equity attributable to the shareholders of MP banki hf.		5,323,792	5,031,493
Non-controlling interest		272,714	5,274
Total equity		5,596,506	5,036,767
Total liabilities and equity		49,344,327	60,508,862

The notes on pages 10 to 56 are an integral part of these Consolidated Financial Statements.

MP banki hf. Amounts are in ISK thousands

Consolidated Statement of Changes in Equity

For the year 2014

1 January 2014 to 31 December 2014	Notes	Share capital	Share premium	Option reserve	Warrants reserve	Deficit reduction reserve	Equity instrument reserve	Translation reserve	Fair value reserve	Accumulated deficit	Total shareholders' equity	Non-controlling interest	Total equity
Equity as at 1 January 2014		5,850,000	8,088	2,388	0	0	23,482	4,780	(5,842)	(851,402)	5,031,493	5,274	5,036,767
Profit for the year										312,441	312,441	22,573	335,014
Available for sale financial assets													
Fair value changes									5,846	(1,169)	4,677		4,677
Reclassified to profit and loss on sale of securities									(4)	1	(3)		(3)
Translation of foreign operations													
Exchange difference on translation of foreign operations								(32,263)			(32,263)		(32,263)
Reclassified to profit and loss on sale of subsidiaries								16,824			16,824		16,824
Total comprehensive income for the year		0	0	0	0	0	0	(15,439)	5,842	311,273	301,676	22,573	324,249
Transactions with owners of the Bank													
Reduction in share capital	35	(4,680,000)				3,850,917				828,983	(100)		(100)
Treasury shares acquired	36	(25,000)	2,500								(22,500)		(22,500)
Equity instrument converted to equity	36	25,000	(1,518)				(23,482)				0		0
Share-based payment transactions	66			2,154							2,154		2,154
Warrants issued	37				11,070						11,070		11,070
Other transactions													
Acquisition of a subsidiary with a non-controlling interest	23										0	249,817	249,817
Dividend paid by subsidiary to non-controlling interest											0	(4,950)	(4,950)
Equity as at 31 December 2014		1,170,000	9,069	4,541	11,070	3,850,917	0	(10,659)	0	288,853	5,323,792	272,714	5,596,506

The notes on pages 10 to 56 are an integral part of these Consolidated Financial Statements.

Amounts are in ISK thousands

Consolidated Statement of Changes in Equity

For the year 2013

1 January 2013 to 31 December 2013	Notes	Share capital	Share premium	Option reserve	Warrants reserve	Deficit reduction reserve	Equity instrument reserve	Trans-lation reserve	Fair value reserve	Accumu-lated deficit	Total share-holders' equity	Non-controlling interest	Total equity
Equity as at 1 January 2013		5,550,000	7,500	518	0	0	47,819	(5,930)	25,085	(371,368)	5,253,625	(4,003)	5,249,622
Loss for the year										(486,220)	(486,220)	9,276	(476,943)
Available for sale financial assets													
Fair value changes									22,826	(4,565)	18,261		18,261
Reclassified to profit and loss on sale of securities									(53,753)	10,751	(43,002)		(43,002)
Translation of foreign operations													
Exchange difference on translation of foreign operations								10,709			10,709		10,709
Reclassified to profit and loss on sale of subsidiaries								0			0		0
Total comprehensive loss for the year		0	0	0	0	0	0	10,709	(30,927)	(480,034)	(500,252)	9,276	(490,975)
Transactions with owners of the Bank													
New share capital sold		300,000									300,000		300,000
Treasury shares acquired		(25,000)	1,250								(23,750)		(23,750)
Equity instrument converted to equity	36	25,000	(662)				(24,338)				0		0
Share-based payment transactions	66			1,870							1,870		1,870
Equity as at 31 December 2013		5,850,000	8,088	2,388	0	0	23,482	4,780	(5,842)	(851,402)	5,031,493	5,274	5,036,767

The notes on pages 10 to 56 are an integral part of these Consolidated Financial Statements.

MP banki hf. Amounts are in ISK thousands

Consolidated Statement of Cash Flows

For the year 2014

Cash flows from operating activities	Notes	2014	2013
Profit (loss) for the year		335,014	(476,943)
Adjustments for:			
Indexation and exchange rate difference		(182,035)	79,127
Share in profit (loss) of associates, net of income tax	21	(22,427)	3,715
Depreciation and amortisation	24-25	95,129	124,359
Net interest income	3	(1,302,021)	(1,483,515)
Impairment of loans and receivables	18	(10,692)	(46,834)
Impairment of intangible assets		0	771,930
Income tax	12	(52,438)	(302,948)
Other adjustments		6,766	(57,820)
		(1,132,704)	(1,388,928)
Changes in:			
Receivables from Central Bank		4,411,671	(1,222,761)
Securities		(3,509,101)	4,980,487
Loans to customers		4,939,678	559,070
Derivatives - assets		270,656	(191,545)
Other financial assets		3,505	(24,742)
Deposits from customers		(8,324,679)	(6,822,325)
Deposits from credit institutions		365,220	(1,168,933)
Short positions		(4,429,314)	(319,723)
Derivatives - liabilities		(29,913)	(37,409)
Other financial liabilities		(15,439)	(24,338)
Other assets and liabilities		(578,776)	(951,928)
		(8,029,196)	(6,613,075)
Interest received		2,785,506	3,426,957
Interest paid		(1,584,180)	(1,983,406)
Income tax paid		0	(3,180)
Special tax on financial institutions paid		0	(81,516)
Net cash to operating activities		(6,827,870)	(5,254,220)
Cash flows from investing activities			
Disposal of shares in associates	21	0	348,614
Acquisition of intangible assets	24	(1,635)	(28,874)
Acquisition of property and equipment	25	(24,584)	(57,526)
Proceeds from the sale of property and equipment		7,102	575,249
Proceeds from the sale (acquisition) of assets classified as held for sale	28, 100	14,886	129,129
Cash acquired through business combinations	23	425,472	0
Net cash from investing activities		421,241	966,592
Cash flows from financing activities			
Proceeds from borrowings		87,055,931	95,245,252
Repayment of borrowings		(85,528,616)	(93,504,703)
Dividend paid by subsidiary to non-controlling interest		(4,950)	0
Treasury share transactions		982	588
Sale of warrants	37	11,070	0
Proceeds from issue of new share capital		0	300,000
Net cash from financing activities		1,534,417	2,041,137
Cash and cash equivalents at the beginning of the year	13	17,795,993	20,405,530
Net decrease in cash and cash equivalents		(4,872,212)	(2,246,492)
Effects of exchange rate fluctuations on cash and cash equivalents held		46,637	(363,046)
Cash and cash equivalents at the end of the year	13	12,970,418	17,795,993
Operating and investing activities without cash flows			
Changes in loans to customers		670,000	0
Acquisition of assets classified as held for sale		(670,000)	0

The notes on pages 10 to 56 are an integral part of these Consolidated Financial Statements.

Notes to the Consolidated Financial Statements

General information

1. Reporting entity

MP banki hf. (the Bank) is a limited liability company incorporated and domiciled in Iceland, with registered offices at Ármúli 13a, Reykjavík. The Consolidated Financial Statements for the year ended 31 December 2014 comprise MP banki hf. and its subsidiaries (together referred to as the Group). The Group is primarily involved in investment, corporate and retail banking, and in providing asset management services.

The Consolidated Financial Statements were approved and authorised for issue by the Board of Directors and CEO on 24 February 2015.

2. Basis of preparation

a. Statement of compliance
The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union.

b. Basis of measurement
The Consolidated Financial Statements have been prepared using the historical cost basis except for the following:
- Financial assets and liabilities classified as held for trading are measured at fair value
- Financial assets and liabilities designated at fair value through profit and loss are measured at fair value
- Non-current assets classified as held for sale are measured at the lower of cost or fair value less cost to sell

A breakdown of the accounting classification of financial assets and financial liabilities is provided in note 58.

c. Functional and presentation currency
The Consolidated Financial Statements are prepared in Icelandic Krona (ISK), which is the Bank's functional currency. All financial information has been rounded to the nearest thousand, unless otherwise stated.

d. Going concern
The Bank's management has assessed the Group's ability to continue as a going concern and it is satisfied that the Group has the resources to continue its operations.

e. Estimates and judgements
The preparation of financial statements in accordance with IFRSs 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.

The estimates and underlying assumptions are based on historical result and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources.

The estimates and underlying assumptions are reviewed on an on going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period and future periods if the revision affects both current and future periods.

Information about areas of estimation uncertainty and critical judgements made by management in applying accounting policies that can have a significant effect on the amounts recognised in the Consolidated Financial Statements is provided in note 109.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Income statement

3. Net interest income

Interest income is specified as follows:

	2014	2013
Cash and cash equivalents	645,699	665,377
Fixed income securities	37,576	105,366
Derivatives	285,221	258,233
Loans to customers	1,903,677	2,601,451
Other interest income	26,717	13,690
Total	2,898,890	3,644,118

Interest expense is specified as follows:

	2014	2013
Deposits from customers	918,899	1,388,328
Deposits from credit institutions	114,771	247,045
Borrowings	481,734	481,807
Other interest expense	81,464	43,424
Total	1,596,869	2,160,603

4. Fee and commission income

Fee and commission income is specified as follows:

	2014	2013
Banking	346,322	413,916
Capital Markets	582,564	455,093
Asset Management	584,591	671,217
Other	305,734	307,617
Total	1,819,211	1,847,843

5. Net financial income

Net financial income is specified as follows:

	2014	2013
Financial assets held for trading		
Fixed income securities	(88,419)	170,811
Shares and other variable income securities	58,398	102,491
Derivatives	28,075	(310)
Financial assets designated at fair value through profit and loss		
Fixed income securities	10,704	41,495
Shares and other variable income securities	(24,095)	1,299
Available for sale financial assets		
Fixed income securities	3	43,002
Net gain on disposal of subsidiaries	175,791	0
Foreign currency exchange difference	19,855	(76,187)
Other fair value changes	0	(7,219)
Total	180,312	275,383

Gains and losses on the sale of subsidiaries are discussed in note 20.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

6. Foreign currency exchange difference

Foreign currency exchange difference is specified as follows:

	2014	2013
Loss on financial instruments at fair value through profit and loss	(43,196)	(70,486)
Gain (loss) on other financial instruments	63,051	(5,701)
Total	19,855	(76,187)
Change in the ISK trade index during the year	-1.7%	-9.7%

Note 55 provides information about the development of foreign exchange rates against the Icelandic krona.

7. Administrative expenses

Administrative expenses are specified as follows:

	2014	2013
Salaries and related expenses	1,769,230	2,051,622
Other operating expenses	1,134,827	1,372,598
Depositors' and Investors' Guarantee Fund contributions	71,610	100,283
Depreciation and amortisation	95,129	124,359
Special tax on financial institutions	109	20,413
Total	3,070,905	3,669,276

8. Salaries and related expenses

Salaries and related expenses are specified as follows:

	2014	2013
Salaries	1,377,250	1,578,369
Performance based payments excluding share-based payments	0	3,451
Share-based payment expenses	2,154	1,870
Pension fund contributions	203,730	198,117
Tax on financial activity	90,534	110,654
Other salary related expenses	95,562	159,162
Total	1,769,230	2,051,622
Average number of full time employees during the year	98	129
Total number of full time employees at year-end	75	117

According to Act No. 165/2011, passed in 2011, banks and other financial institutions providing VAT exempt services, must pay a tax based on salary payments, called tax on financial activity. The current tax rate is 5.50% (2013: 6.75%).

9. Special tax on financial institutions

According to Act No. 155/2010 on Special Tax on Financial Institutions, certain types of financial institutions, including banks, must pay annually a tax based on the carrying amount of their liabilities as determined for tax purposes in excess of ISK 50 billion. The tax rate is set at 0.376% (2013: 0.376%) for taxes payable in 2014 and beyond. This tax is not a deductible expense for income tax purposes.

Notes to the Consolidated Financial Statements

10. Employment terms of the board of directors and management

Salaries paid to the Board of Directors, the CEO and Managing Directors of the Bank for their work for companies within the Group, and their shareholding in the Bank, are specified as follows:

			31.12.2014			31.12.2013
	Salaries and benefits	Number of shares	Warrants and options	Salaries and benefits	Number of shares	Warrants and options
Sigurður Atli Jónsson, CEO	42,141	10,000	17,300	47,813	37,500	25,000
Þorsteinn Pálsson, Chairman of the Board	6,600	0	0	6,600	0	0
Skúli Mogensen, Deputy Chairman of the Board	3,240	116,060	0	3,338	580,300	0
Hanna Katrín Friðriksson, Board member	4,156	0	0	4,422	0	0
Inga Björg Hjaltadóttir, Board member	3,300	0	0	3,312	0	0
Vilmundur Jósefsson, alternate Board member	3,300	4,000	0	3,318	20,000	0
Ástríður Þórðardóttir, alternate Board member	2,332	0	0	0	0	0
Mario Espinosa, former Board member	2,700	0	0	3,440	0	0
Michael Wright, former alternate Board member	0	0	0	1,740	0	0
Managing Directors (2014: 4, 2013: 7)	134,766	0	57,300	182,011	0	112,000
Total	202,535	130,060	74,600	255,994	637,800	137,000

Salaries and benefits are substantially all short-term employee benefits.

Figures for shares, share options and warrants are in thousands and include shares held by companies owned by or under the control of the respective parties as at 31 December 2014 and 31 December 2013. The Bank's share capital was reduced in April 2014 as outlined in note 35.

The Bank has defined one Managing Director as Key Employee, as defined in Act No. 161/2002 on Financial Undertakings. Furthermore the Bank has approved and published internal rules covering the qualification requirements, evaluation process and conduct of Key Employees, in accordance with requirements set forth by the Icelandic Financial Supervisory Authority.

The Bank has adopted a remuneration policy at the proposal of the Remuneration Committee. The policy covers three remuneration components, base pay, performance based incentive scheme and other benefits, including pension fund contributions. Further information about the remuneration policy is provided in notes 64-66.

11. Auditor's fees

Remuneration to the Group's auditors is specified as follows:

	2014	2013
Audit of annual accounts	27,751	30,768
Review of interim accounts	7,006	7,126
Other audit related services	7,950	5,754
Total	42,708	43,649
Thereof to the auditors of the Bank	39,222	41,823

12. Income tax

Income tax recognized in the income statement is specified as follows:

	2014	2013
Current income tax	(13,589)	(20,045)
Deferred tax income	66,027	322,993
Total	52,438	302,948

Reconciliation of effective tax rate:

		2014		2013
Profit (loss) before income tax		282,576		(779,891)
Income tax using the domestic corporation tax rate	20.0%	(56,515)	20.0%	155,978
Effect of tax rates in foreign jurisdictions	(0.0%)	23	(1.2%)	(9,527)
Non-deductible expenses	0.7%	(1,897)	(10.1%)	(79,090)
Non-taxable income	(52.5%)	148,419	21.3%	165,816
Recognition of previously unrecognised tax losses	0.0%	0	9.6%	74,506
Other changes	13.3%	(37,592)	(0.6%)	(4,735)
Effective income tax	(18.6%)	52,438	38.8%	302,948

Profit before taxes amounts to ISK 282.6 million. Income tax amounts to ISK -52.4 million, resulting in an effective tax rate of -18.6%. This is substantially different from the Icelandic corporate tax rate of 20%, mainly due to non-taxable income from shares.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Statement of Financial Position

13. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	31.12.2014	31.12.2013
Deposits	8,643,487	3,898,984
Certificates of deposit	0	7,517,655
Balances with the Central Bank of Iceland	8,643,487	11,416,638
Cash on hand	89,691	71,056
Balances with banks	3,678,258	4,185,962
Treasury bills	558,982	2,122,337
Total	12,970,418	17,795,993

14. Fixed income securities

Fixed income securities are specified as follows:

	31.12.2014	31.12.2013
Held for trading		
Government bonds and bonds with government guarantees	2,471,713	1,248,117
Treasury bills	84,637	0
Listed bonds	1,367,033	1,168,028
Designated at fair value		
Unlisted bonds	272,946	197,537
Available for sale		
Government bonds and bonds with government guarantees	0	1,671,154
Total	4,196,330	4,284,835

Further discussion about the accounting classification of financial assets is provided in notes 58-60.

15. Shares and other variable income securities

Shares and other variable income securities are specified as follows:

	31.12.2014	31.12.2013
Held for trading		
Listed shares	338,712	400,662
Listed unit shares	220	221
Unlisted shares	4,418	0
Unlisted unit shares	97,467	292,010
Designated at fair value		
Unlisted shares	287,082	182,379
Unlisted unit shares	62,825	78,475
Total	790,723	953,747

Further discussion about the accounting classification of financial assets is provided in notes 58-60.

16. Securities used for hedging

Securities used for hedging are specified as follows:

	31.12.2014	31.12.2013
Government bonds and bonds with government guarantees	3,675,958	0
Listed bonds	53,418	54,241
Listed shares	3,123,620	2,799,031
Unlisted unit shares	3,645	0
Total	6,856,641	2,853,272

Securities used for hedging are designated at fair value. Further discussion about the accounting classification of financial assets is provided in notes 58-60.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

17. Loans to customers

Loans to customers are specified as follows:

	31.12.2014	31.12.2013
Loans to customers, gross amount	22,577,554	27,747,012
Specific allowance for impairment losses	(108,761)	(294,306)
Collective allowance for impairment losses	(181,654)	(210,587)
Total	22,287,138	27,242,120

18. Allowance for impairment losses

Change in allowance for impairment losses is specified as follows:

a. Loans to customers

31.12.2014	Specific	Collective	Total
Balance as at 1 January 2014	294,306	210,587	504,893
Charge to the income statement for the year	58,712	1,345	60,057
Recoveries	(72,036)	0	(72,036)
Write-offs	(172,220)	0	(172,220)
Sold loans	0	(30,278)	(30,278)
Balance as at 31 December 2014	108,761	181,654	290,415

31.12.2013	Specific	Collective	Total
Balance as at 1 January 2013	661,360	169,190	830,550
Charge to the income statement for the year	196,273	41,397	237,669
Recoveries	(288,134)	0	(288,134)
Write-offs	(275,193)	0	(275,193)
Reclassification	0	0	0
Translation difference	0	0	0
Balance as at 31 December 2013	294,306	210,587	504,893

b. Other assets - accounts receivable

31.12.2014	Specific	Collective	Total
Balance as at 1 January 2014	23,251	10,608	33,859
Charge to the income statement for the year	(2,958)	4,246	1,288
Write-offs	(20,294)	(11,800)	(32,094)
Balance as at 31 December 2014	0	3,053	3,053

31.12.2013	Specific	Collective	Total
Balance as at 1 January 2013	23,251	6,977	30,228
Charge to the income statement for the year	0	3,631	3,631
Balance as at 31 December 2013	23,251	10,608	33,859

19. Derivatives

Derivatives are specified as follows:

			31.12.2014			31.12.2013
	Notional	Assets	Liabilities	Notional	Assets	Liabilities
Interest rate derivatives	500,000	34,527		2,500,000	216,918	
Currency forwards				454,052	20,620	
Bond and equity total return swaps	10,098,940	176,084	134,275	6,823,240	265,884	174,019
Equity options	903,240	17,670	19,921	228,387	919	10,089
Bond options	405,200	5,405				
	11,907,380	233,685	154,196	10,005,679	504,341	184,109

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

20. Group entities

The Group included 9 subsidiaries at year-end (31.12.2013: 10), all of which are included in the Consolidated Financial Statements. They are specified as follows:

Entity	Nature of operations	Domicile	Share 31.12.2014	Share 31.12.2013
Axia Asset Management UAB	Dormant	Lithuania	-	100%
Ármúli fasteignir ehf.	Holding company	Iceland	100%	100%
Fasteignastýring ehf.	Dormant	Iceland	100%	-
FÍ Fasteignafélag GP ehf.	Real estate fund management	Iceland	70%	70%
Heildun UAB	Holding company	Lithuania	100%	100%
Horn Florida Ltd.	Holding company	UK	100%	100%
Júpíter rekstrarfélag hf.	Fund management	Iceland	100%	100%
Lykillán ehf.	Dormant	Iceland	-	100%
M-Investments ehf.	Holding company	Iceland	100%	100%
Mánatún GP ehf.	Dormant	Iceland	100%	100%
MP Pension Funds Baltic UAB	Private pension plans	Lithuania	-	100%
Teris	Holding company	Iceland	54%	-

Several Group entities were disposed of in 2014. The disposals had an immaterial effect on the statement of financial position but resulted in a substantial gain posted under financial income as disclosed in note 5. During the year the name of LV31 ehf. was changed to Ármúli fasteignir ehf.

At year-end 2013 the Group held a 50% share in Teris, which was classified as an associate. See further discussion in note 23.

The Bank does not consider any of its subsidiaries material as they, as a group, account for only 12% of the Net operating income of the Group and 2% of total assets. There are no significant restrictions on the Bank's ability to access or use the assets of the subsidiaries or settle their liabilities.

21. Investment in associates

a. Investment in associates is accounted for using the equity method and is specified as follows:

Entity	Nature of operations	Domicile	Share 31.12.2014	Share 31.12.2013
Londonderry Associates LLC	Holding company	USA	38%	38%
Teris	Holding company	Iceland	-	50%

The Group's share in Londonderry Associates is classified and presented as an asset held for sale in the Statement of Financial Position. Teris has been reclassified as a subsidiary, see further discussion in note 23.

The Bank does not consider its associates material, neither individually nor as a group.

b. Changes in investments in associates are specified as follows:

	31.12.2014	31.12.2013
Balance at the beginning of the year	309,021	560,825
Disposal of shares in associates	0	(332,518)
Reclassification	(331,448)	88,552
Share in profit (loss) of associates, net of income tax	22,427	(3,715)
Translation difference	0	(4,122)
Total	0	309,021

22. Unconsolidated structured entities

The Group engages in various business activities with structured entities which are designed to achieve a specific business purpose. These entities are primarily UCITS funds or other types of investment funds where a Group entity acts as a fund manager or custodian and is entitled to receive management fees based on the assets under management. In some cases a Group entity also holds a minor share in the entity. Total assets of unconsolidated structured entities managed by the Group totalled ISK 24.6 billion at year-end 2014 (2013: 15.2 billion). The Group retained holdings of ISK 101 million (2013: 293 million) and received management fees amounting to ISK 121 million (2013: 94 million). Other exposure of the Group towards these entities is immaterial.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

23. Teris

When the Bank acquired the assets and operations of EA fjárfestingarfélag hf. (EAF) in 2011, it acquired a minority interest in Teris, an IT provider which provided services to EAF and other financial institutions. Teris was subsequently classified as an associate of the Bank. The Bank's share in Teris increased in 2012 when other shareholders in Teris abandoned their holdings, and exceeded 50% at year-end 2012.

As Teris had sold all material assets and operations to Reiknistofa Bankanna hf. in 2012, and subsequently initiated a voluntary dissolution process, and taking into account other factors, such as the legal structure of Teris, the holding did not qualify as a subsidiary in 2012 and 2013.

The adoption of IFRS 10 in 2014 changed the definition of a control. Due to these changes, and changes in the articles of association of Teris and renewed business activity, the Bank has reclassified Teris as a subsidiary as of 1 January 2014. This reclassification constitutes a business combination which falls under the scope of IFRS 3 Business Combination, with the Bank as the acquirer and 1 January 2014 as the acquisition date. There was no consideration transferred and the reclassification did not have any effect on the statement of profit and loss. Prior to the transaction the Bank's share in Teris was accounted for using the equity method.

a. Consideration transferred and acquisition related costs
There was no consideration transferred and no costs related to the acquisition.

b. Identifiable assets acquired and liabilities assumed
Assets acquired and liabilities assumed on 1 January 2014 are specified as follows:

	Assets
Cash and cash equivalents	425,472
Fixed income securities	41,598
Shares and other variable income securities	11,946
Investment in associates	50,386
Other assets	27,762
Total	557,164

	Liabilities
Other liabilities	14,013
Total	14,013
Net fair value of assets acquired	543,151

There were no new assets or liabilities identified and the book value of all assets and liabilities was determined to be equal to their fair value.

c. Non-controlling interest
The reclassification of Teris as a subsidiary resulted in the recognition of a non-controlling interest.

Net fair value of assets acquired	543,151
The Bank's share in Teris's equity at the acquisition date	(293,334)
Non-controlling interest acquired	249,817

d. Goodwill
No goodwill was recognised as a result of the acquisition.

Consideration transferred	0
Non-controlling interest	249,817
Fair value of the Bank's pre-existing interest in Teris	293,334
Net fair value of assets acquired	(543,151)
Goodwill	0

24. Intangible assets

Intangible assets are specified as follows:

31.12.2014	**Software**	**Goodwill**	**Other**	**Total**
Balance as at 1 January 2014	171,519	0	133,509	305,028
Acquisitions	1,741	0	0	1,741
Disposals	(106)	0	0	(106)
Amortisation	(39,476)	0	(18,415)	(57,891)
Translation difference	(5)	0	0	(5)
Balance as at 31 December 2014	133,673	0	115,094	248,766
Gross carrying amount	264,508	0	184,150	448,658
Accumulated amortization and impairment losses	(130,835)	0	(69,056)	(199,892)
Balance as at 31 December 2014	133,673	0	115,094	248,766

Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

24. Intangible assets (cont.)

31.12.2013	Software	Goodwill	Other	Total
Balance as at 1 January 2013	179,975	599,930	323,924	1,103,829
Acquisitions	28,874	0	0	28,874
Impairment losses	0	(599,930)	(172,000)	(771,930)
Amortisation	(37,330)	0	(18,415)	(55,745)
Translation difference	(0)	0	0	(0)
Balance as at 31 December 2013	171,519	0	133,509	305,028
Gross carrying amount	248,651	599,930	356,150	1,204,732
Accumulated amortization and impairment losses	(68,676)	0	(32,226)	(100,902)
Balance as at 1 January 2013	179,975	599,930	323,924	1,103,829
Gross carrying amount	262,767	599,930	184,150	1,046,848
Accumulated amortization and impairment losses	(91,248)	(599,930)	(50,641)	(741,820)
Balance as at 31 December 2013	171,519	0	133,509	305,028

25. Property and equipment

Property and equipment is specified as follows:

31.12.2014	Real estate	Other	Total
Balance as at 1 January 2014	0	99,465	99,465
Acquisitions	0	24,584	24,584
Disposals	0	(11,714)	(11,714)
Reclassified to assets classified as held for sale	0	(147)	(147)
Depreciation	0	(37,238)	(37,238)
Translation difference	0	(76)	(76)
Balance as at 31 December 2014	0	74,873	74,873
Gross carrying amount	0	194,207	194,207
Accumulated depreciation	0	(119,334)	(119,334)
Balance as at 31 December 2014	0	74,873	74,873

31.12.2013	Real estate	Other	Total
Balance as at 1 January 2013	613,923	124,176	738,099
Acquisitions	33,000	24,526	57,526
Disposals	(525,078)	(6,684)	(531,762)
Reclassified to assets classified as held for sale	(94,456)	0	(94,456)
Depreciation	(26,159)	(42,349)	(68,508)
Translation difference	(1,230)	(205)	(1,434)
Balance as at 31 December 2013	0	99,465	99,465
Gross carrying amount	694,982	183,788	878,770
Accumulated depreciation	(81,059)	(59,612)	(140,671)
Balance as at 1 January 2013	613,923	124,176	738,099
Gross carrying amount	0	196,484	196,484
Accumulated depreciation	0	(97,019)	(97,019)
Balance as at 31 December 2013	0	99,465	99,465

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

26. Deferred tax assets/liabilities

Change in deferred tax is specified as follows:

	31.12.2014	31.12.2013
Balance at the beginning of the year	613,443	292,108
Calculated income tax	52,438	302,948
Current income tax payable	13,589	20,045
Income tax recognized in other comprehensive income and equity	(1,168)	6,185
Other changes	(104,194)	(7,843)
Net	574,107	613,443

The Group's deferred tax assets (liabilities) are attributable to the following items:

	31.12.2014	31.12.2013
Property and equipment	2,136	4,250
Intangible assets	(10,990)	(10,947)
Assets and liabilities denominated in foreign currencies	(2,558)	(456)
Other items	2,971	2,607
Tax losses carried forward	582,548	617,989
Total	574,107	613,443

At year end 2014, tax losses carried forward amount to ISK 2,913 million, and are set to expire as follows:

	Losses	Tax asset
Tax losses 2009, expiring in 2019	193,520	38,704
Tax losses 2011, expiring in 2021	561,705	112,341
Tax losses 2012, expiring in 2022	640,623	128,125
Tax losses 2013, expiring in 2023	1,214,992	242,998
Tax losses 2014, expiring in 2024	301,902	60,380
Total	2,912,742	582,548

The Bank's medium-term financial planning indicates that the tax losses carried forward will be fully offset by taxable income from the Bank's operations in the years to come.

27. Other assets

Other assets are specified as follows:

	31.12.2014	31.12.2013
Unsettled securities transactions	379,024	0
Accounts receivable	314,839	339,403
Sundry assets	24,325	391,968
Total	718,188	731,371

28. Assets classified as held for sale

The Group has classified certain assets as held for sale. The Group intends to dispose of the majority of these assets in 2015, and they are included in Other operations for segment reporting purposes as disclosed in note 62.

Assets classified as held for sale are specified as follows:

	31.12.2014	31.12.2013
Buildings and land	251,025	270,327
Unlisted shares	39,626	35,063
Total	290,651	305,390

Assets classified as held for sale include foreclosed assets as specified in note 46.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

29. Deposits from customers

Deposits from customers are specified as follows:

	31.12.2014	31.12.2013
Demand deposits	19,848,388	26,480,832
Time deposits	6,916,193	8,748,877
Total	26,764,581	35,229,708

30. Deposits from credit institutions

Deposits from credit institutions consist primarily of funds held by the Bank on behalf of savings banks who signed a payment and settlement services agreement with the Bank in 2012.

31. Borrowings

Borrowings are specified as follows:

	31.12.2014	31.12.2013
Loans from credit institutions	2,922	0
Money market deposits	9,851,810	8,327,416
Total	9,854,731	8,327,416

Money market deposits typically have a principal of ISK 5-200 million and maturity between 1 week and 3 months and pay fixed interest rates.

32. Short positions used for trading

Short positions used for trading are specified as follows:

	31.12.2014	31.12.2013
Government bonds and bonds with government guarantees	2,875,806	4,431,398
Listed bonds	64,152	0
Listed shares	48,290	57,594
Unlisted shares	7	6
Unlisted unit shares	0	3,683
Total	2,988,256	4,492,682

Short position used for trading are classified as held for trading. Further discussion about the accounting classification of financial assets is provided in notes 58-60.

33. Short positions used for hedging

Short positions used for hedging are specified as follows:

	31.12.2014	31.12.2013
Government bonds and bonds with government guarantees	217,637	3,174,046
Listed shares	31,521	0
Total	249,158	3,174,046

Short position used for hedging are classified as held for trading. Further discussion about the accounting classification of financial assets is provided in notes 58-60.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

34. Other liabilities

Other liabilities are specified as follows:

	31.12.2014	31.12.2013
Unsettled securities transactions	0	336,538
Accounts payable and accrued expenses	127,537	329,913
Taxes, other than income tax	0	20,515
Withholding taxes	288,376	335,579
Salaries and salary related expenses	160,897	131,156
Other liabilities	431,186	543,933
Total	1,007,996	1,697,634

35. Equity

a. Share capital

The nominal value of shares issued by the Bank is ISK 1 per share or a multiple thereof. All currently issued shares have a nominal value of ISK 1 per share, and are fully paid. The holders of shares are entitled to receive dividends as approved by the general meeting and are entitled to one vote per nominal value of ISK 1 at shareholders' meetings.

	31.12.2014	31.12.2013
Share capital according to the Bank's Articles of Association	1,170,800	5,854,000
Nominal amount of treasury shares	800	4,000
Authorised but not issued shares	1,500,000	1,000,000

b. Capital management

A capital plan is prepared on an annual basis and approved by the Board, with the objective of maintaining both the optimal amount of capital and the mix between the different components of capital. The Bank’s policy is to hold capital in a range of different forms and from diverse sources.

c. Share capital reduction

The Bank's Annual General Meeting in April 2014 approved a resolution reducing the share capital of the Bank from ISK 5,854.0 million to ISK 1,170.8 million, a 1-for-5 reverse stock split. The reduction was used to create a special equity reserve (deficit reduction reserve), of ISK 3,850.9 million, which can only be used with the approval of a shareholders' meeting, to reduce accumulated deficit by ISK 829.0 million and to pay out ISK 100 thousand to shareholders in proportion to their holdings. The share capital reduction resulted in a net decrease in equity of only ISK 100 thousand and as such did not have a material effect on the Bank's financial strength or equity ratio.

d. Share capital increase authorisations

The Bank's Annual General Meeting in April 2014 approved five temporary provisions to the Bank's Articles of Association, which authorise the Board of Directors to issue new share capital, issue warrants, buy own shares (subscription rights), issue convertible debt and issue compensation shares. The provisions were amended at a shareholder's meeting in December 2014. The amended provisions expire in 2019 and authorise the Board of Directors to issue up to ISK 1 billion in new share capital. A copy of the Bank's Articles of Association, including the temporary provisions, can be found on the Bank's website, www.mp.is.

36. Acquisition of treasury shares to settle a share-based payment obligation

The Bank purchased 25 million treasury shares during the year to settle an obligation arising from the acquisition of ALFA verðbréf hf. in 2011. There are no further outstanding obligations related to this acquisition.

37. Warrants

In December 2014 the Bank sold warrants for ISK 61.5 million in new share capital, with an exercise price of ISK 2.60 per share. The warrants were outstanding as at 31 December 2014 and expire on 15 December 2016.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

38. Capital adequacy ratio (CAD)

Equity at the end of the year was ISK 5,597 million (31.12.2013: 5,037 million), equivalent to 11.3% (31.12.2013: 8.3%) of total assets according to the statement of financial position. The capital adequacy ratio of the Group, calculated in accordance with Article 84 of Act No. 161/2002 on Financial Undertakings, was 17.4% (31.12.2013: 14.2%). The minimum according to the Act is 8.0%. The ratio is calculated as follows:

Tier 1 capital base	**31.12.2014**	**31.12.2013**
Total equity	5,596,506	5,036,767
Goodwill and intangibles	(248,766)	(305,028)
Shares in financial institutions	(3,709)	(2,595)
Subordinated fixed income securities	(97,907)	(61,851)
Deferred tax asset	(578,080)	(613,777)
Total	4,668,044	4,053,515

Capital requirements	**31.12.2014**	**31.12.2013**
Credit risk	1,431,518	1,703,380
Market risk	168,464	110,200
Operational risk	546,350	471,455
Total	2,146,333	2,285,035

Surplus capital	2,521,711	1,768,480
Capital adequacy ratio (CAD)	17.4%	14.2%

The Icelandic Financial Supervisory Authority (FME) supervises the Bank on a consolidated basis and, as such, receives information on the capital adequacy of, and sets capital requirements for, the Bank as a whole. The Bank's regulatory capital calculations for credit risk and market risk are based on the standardised approach and the capital calculations for operational risk are based on the basic indicator approach.

Minimum capital requirement is based on the Bank's Internal Capital Adequacy Assessment Process (ICAAP) and is reviewed by the FME through the Supervisory Review and Evaluation Process (SREP). The Bank's minimum regulatory capital requirement based on SREP in 2014 is 11.8%.

Notes to the Consolidated Financial Statements

Risk management

39. Risk management framework

a. Board of Directors
The Bank's Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework and risk appetite setting. Risk management policies are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

b. Board of Directors sub-committees
The Bank's Board of Directors has established two sub-committees, Remuneration Committee and Audit committee. The Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures. The Audit Committee is assisted in its oversight role by Internal Audit.

c. CEO
The CEO is responsible for the effective implementation through the corporate governance structure and committees. The CEO has established three committees, which are responsible for developing and monitoring risk management policies in their specified areas.

d. Committees
The Bank operates three committees that are involved in risk management: an Asset and Liability Committee (ALCO), a Credit Committee and a Quality and Security Committee.

The ALCO Committee meets regularly and each department reports on its operations and positions activity since the previous meeting. The committee addresses matters regarding the Bank's risk management, financing, capital management and proprietary trading.

The Credit Committee addresses matters regarding the Bank's loan activities. The committee is responsible for the approval of individual loans as well as deciding on credit limits for individual clients in derivative trades, and is the primary forum for the discussion of loan activity policy.

The Quality and Security Committee is responsible for supervision and implementation of the Bank‘s security and quality policies. The security policy mainly addresses data security and operational security in IT systems, physical security for the personnel and proper access controls and monitoring in the Bank‘s premises. The quality work is aimed at upholding proper quality in work processes, IT systems and services to support performance and profitability, lower operational risk and increase the customer experience.

e. Risk management
The purpose of the Bank's risk management unit is to identify, quantify, control and report on the risks that the Group is exposed to in its daily activities. The unit also participates in drafting the overall risk policy and has representatives on the ALCO committee, Credit committee and the Quality and Security committee. The unit’s main activities include monitoring and managing credit risk, market risk, liquidity risk and operational risk. The Board of Directors sets the rules and guidelines regarding the Group's risk policy and the obligations of risk management and credit control. The division reports regularly on the Group’s positions and exposure to risk to the Board of Directors, the CEO and to the ALCO committee.

f. Compliance Officer
The Compliance unit ensures that the Group adheres to its rules on securities trading and insider trading and operation comply with the Act on Securities Transactions, the Act on Actions to Combat Money Laundering and Terrorist Financing and other relevant legislation and regulations.

g. Internal audit
Internal audit has the role to give objective opinion on the Group's operations and advisory that aims to increase its value, and to strengthen risk management and internal control. The tasks of internal audit and main emphasis are to estimate whether processes and systems are in place, and whether they are relevant and efficient. Internal auditor is recruited by the board and is located accordingly in the hierarchy. It's operations cover all units of operations, including subsidiaries.

40. Hedging

A part of the Group’s portfolio consists of securities held as a hedge against derivatives positions of customers. The Group hedges currency exposure between the Group's loan portfolio and debts to the extent possible, but does not apply hedge accounting.

Notes to the Consolidated Financial Statements

41. Credit risk - overview

a. Definition

One of the Group’s primary sources of risk is counterparty credit risk. Credit risk is defined as the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

b. Management

The risk management unit is responsible for managing and reporting on credit risk. The Group uses a variety of tools and processes to manage credit risk, including collaterals, hedges and loan portfolio management.

c. Credit approval process

The originating department prepares a proposal for each loan or credit line which is presented to the credit committee for approval. The proposal consists of a basic description of the client, the purpose of the loan, a simple credit assessment and arguments for or against granting the loan. The committee decides whether there is need for further credit assessment and on what terms the loan may be granted.

A more thorough credit assessment may be conducted if considered appropriate and can include an assessment of a borrower’s fundamental credit strength as well as the value of any collateral. To assess the borrower’s capacity to meet his or her obligations the committee can request stress test analysis of the borrower’s cash flow or call for third party assessments.

d. Collateral

Securing loans with collateral is a traditional method to reduce credit risk. The Group uses different methods to reduce credit risk by obtaining collateral from customers where appropriate. Such collateral gives the Group right to the collateralised assets for current and future obligations incurred by the customer.

The Group places emphasis on ensuring that loans are secured with collateral that can be marked to market, and that asset coverage exceeds 100%. The Group applies appropriate haircuts on all collateral in order to ensure proper risk mitigation. For all collateral in listed securities, the Group maintains the right to liquidate collateral in case its market value falls below a predefined limit.

To a very large extent the Group’s loan portfolio consists of senior loans, most of which are highly collateralised.

e. Credit rating, control and provisioning

The risk management unit is responsible for credit rating and reviewing the loan portfolio. In case of any significant delay of payments or defaults the unit carefully analyses the underlying assets and loan documents and organizes the process of collection.

The Group monitors the value of collateral by listed securities on a real time basis, and takes prompt action when necessary.

Provisioning for loan impairments is estimated on the basis of models assessing a portfolio as a whole based on the seniority of the loans, the degree of collateralisation and the Group's history of defaulted loans. Risk management suggest a provisioning percentage for the portfolio, based on the loss assessment. Risk management reassess impairments in the event of collateral decay, delayed payments or other early warning signs. Provisions require approval by the CEO and the credit committee.

f. Loan portfolio management

To ensure an effective diversification of the loan portfolio the board has set a limit framework defining maximum exposure as a ratio of the Group’s equity and/or the total size of the loan portfolio. These limits include limitation on joint exposure to associated clients, exposure to individual and associated industries, single regions and countries etc. It is the responsibility of risk management to monitor that these limits are not being violated and to report discrepancies to the credit committee.

g. Impairment

The Group's impairment policy is discussed in notes 80-81.

h. Renegotiation of terms and forbearance

The Group's forbearance policy is discussed in note 81.

i. Derivatives

The Group offers derivative contracts in the form of swap contracts on listed, highly liquid securities. On the day when the contract is entered into, the Group purchases the underlying security and hedges its exposure to price changes. Collateral is in the form of cash or listed, highly liquid securities. The risk management sets rules about the level of collateralisation and monitors the compliance to these rules. Contracts are closed if required levels of collateralisation are not met.

j. Securities used for hedging

The Group hedges itself for market risk of derivative contracts by purchasing the underlying securities at the commencement of the contract. Since the contracts require delivery of the underlying securities to the customer on the settlement day, the credit risk towards the issuer is immaterial.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

42. Maximum exposure to credit risk

The maximum exposure to credit risk of on-balance sheet and off-balance sheet financial instruments, before taking into account any collateral held or other credit enhancements, is specified as follows:

	Public entities	Financial institutions	Corporate customers	Individuals	31.12.2014
Cash and cash equivalents	9,292,160	3,678,258			12,970,418
Receivables from Central Bank	98,832				98,832
Fixed income securities	2,806,395	1,207,858	182,077		4,196,330
Securities used for hedging	3,675,958	53,418			3,729,376
Loans to customers	3,835	497,665	15,899,159	5,886,479	22,287,138
Derivatives		108,151	116,114	9,420	233,685
Other assets	3,764	48,355	563,914	77,831	693,863
	15,880,943	5,593,706	16,761,263	5,973,730	44,209,642
Loan commitments	234	83,641	1,991,361	794,775	2,870,010
Financial guarantee contracts			334,054	10,568	344,622
Total	15,881,177	5,677,346	19,086,678	6,779,072	47,424,274

	Public entities	Financial institutions	Corporate customers	Individuals	31.12.2013
Cash and cash equivalents	13,610,031	4,185,962			17,795,993
Receivables from Central Bank	4,510,503				4,510,503
Fixed income securities	3,183,738	716,713	384,384		4,284,835
Securities used for hedging		54,241			54,241
Loans to customers	156,402	1,777,378	16,932,143	8,376,197	27,242,120
Derivatives		282,480	209,517	12,344	504,341
Other assets	10,414	24,050	251,073	53,865	339,403
	21,471,087	7,040,824	17,777,117	8,442,407	54,731,435
Loan commitments	962	4,100	2,069,324	1,159,671	3,234,058
Financial guarantee contracts			517,932	24,522	542,453
Total	21,472,050	7,044,924	20,364,373	9,626,600	58,507,946

43. Credit quality of financial assets

a. Breakdown

Credit quality of financial assets is specified as follows:

31.12.2014	Neither past due nor individually impaired	Past due but not individually impaired	Individually impaired	Total	Less specific impairment allowance	Less collective impairment allowance	Carrying amount
Cash and cash equivalents	12,970,418			12,970,418			12,970,418
Receivables from Central Bank	98,832			98,832			98,832
Fixed income securities	4,196,330			4,196,330			4,196,330
Securities used for hedging	3,729,376			3,729,376			3,729,376
Loans to customers	21,471,192	954,285	152,077	22,577,554	(108,761)	(181,654)	22,287,138
Derivatives	233,685			233,685			233,685
Other assets	687,063		9,853	696,916		(3,053)	693,863
Total	43,386,896	954,285	161,930	44,503,110	(108,761)	(184,707)	44,209,642

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

43. Credit quality of financial assets (cont.)

31.12.2013	**Neither past due nor individually impaired**	**Past due but not individually impaired**	**Individually impaired**	**Total**	**Less specific impairment allowance**	**Less collective impairment allowance**	**Carrying amount**
Cash and cash equivalents	17,795,993			17,795,993			17,795,993
Receivables from Central Bank	4,510,503			4,510,503			4,510,503
Fixed income securities	4,284,835			4,284,835			4,284,835
Securities used for hedging	54,241			54,241			54,241
Loans to customers	24,228,954	3,124,583	393,476	27,747,012	(294,306)	(210,587)	27,242,120
Derivatives	504,341			504,341			504,341
Other assets	344,881		28,381	373,262	(23,251)	(10,608)	339,403
Total	51,723,746	3,124,583	421,857	55,270,186	(317,557)	(221,194)	54,731,435

b. Past due but not individually impaired

Past due but not impaired financial assets are those assets where contractual payments are 1 or more days past due but the Group believes that impairment is not appropriate on the basis of the level of security or future cash flows of the borrower. Past due loans are reported as the total claim value and not only those payments that are past due.

	31.12.2014	**31.12.2013**
Past due 1-30 days	629,911	1,858,208
Past due 31-60 days	159,759	772,756
Past due 61-90 days	5,561	211,380
Past due 91-180 days	44,831	246,575
Past due 180-360 days	94,757	27,867
Past due more than 360 days	19,466	7,797
Total	954,285	3,124,583

c. Individually impaired

Individually impaired financial assets are those assets where there is objective evidence of impairment, the asset has been individually assessed and comparison of the carrying amount and the present value of the expected cash flow from the asset reveals a need for impairment. All individually impaired assets are considered non-performing.

31.12.2014	**Past due 1-30 days**	**Past due 31-60 days**	**Past due 60-90 days**	**Past due over 90 days**	**Claim value**
Services				4,653	4,653
Individuals	13,400	821		56,411	70,633
Holding companies				19,843	19,843
Retail				9,662	9,662
Real estate, construction and industry				57,139	57,139
Total	13,400	821	0	147,708	161,930

31.12.2013	**Past due 1-30 days**	**Past due 31-60 days**	**Past due 60-90 days**	**Past due over 90 days**	**Claim value**
Services				14,594	14,594
Individuals		1,422	686	120,425	122,533
Holding companies	19,666	464	95	212,016	232,242
Retail				10,317	10,317
Other			1,559	40,612	42,171
Total	19,666	1,886	2,340	397,964	421,857

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

44. Breakdown of loans to customers

a. By industry

The breakdown of the loan portfolio by industries is specified as follows:

31.12.2014	**Claim value**	**Impairment allowance**	**Carrying amount**	**%**
Services	8,722,923	(73,166)	8,649,758	38.8%
Individuals	5,991,953	(105,474)	5,886,479	26.4%
Holding companies	3,436,347	(33,810)	3,402,537	15.3%
Retail	2,350,508	(28,436)	2,322,072	10.4%
Financial institutions	501,723	(4,058)	497,665	2.2%
Real estate, construction and industry	1,189,373	(42,360)	1,147,013	5.1%
Other	384,726	(3,111)	381,615	1.7%
Total	22,577,554	(290,415)	22,287,138	100.0%

31.12.2013	**Claim value**	**Impairment allowance**	**Carrying amount**	**%**
Services	8,747,858	(101,165)	8,646,693	31.7%
Individuals	8,182,202	(138,555)	8,043,647	29.5%
Holding companies	3,173,116	(23,805)	3,149,312	11.6%
Retail	2,852,387	(45,351)	2,807,036	10.3%
Financial institutions	1,789,616	(12,770)	1,776,846	6.5%
Real estate, construction and industry	1,491,881	(11,566)	1,480,314	5.4%
Other	1,509,953	(171,681)	1,338,272	4.9%
Total	27,747,012	(504,893)	27,242,120	100.0%

b. By seniority

The following definitions are used when ranking its loan portfolio by seniority:

- Senior I
  Loans in this category have first priority claims on the borrower's assets, are secured with collateral which can be marked to market and have asset coverage exceeding 100%.
- Senior II
  Loans in this category have sufficient coverage and liquid collateral, but the collateral can in some cases not be marked to market, e.g. unlisted shares.
- Junior
  Junior loans have second lien claims on the borrower’s assets or lower levels of collateral coverage.
- Mezzanine
  Mezzanine loans are loans which are unsecured and subordinated to all of the borrower’s other liabilities.

The breakdown of loans by categories is as follows:

	Senior I	**Senior II**	**Junior**	**Mezzanine**	**31.12.2014**
Neither past due nor individually impaired	7,158,273	9,499,752	2,944,486	1,628,183	21,230,694
Past due but not individually impaired	506,982	316,168	110,868	79,111	1,013,129
Individually impaired	1,634	6,950	27,131	7,601	43,315
Total	7,666,889	9,822,870	3,082,485	1,714,895	22,287,138

	Senior I	**Senior II**	**Junior**	**Mezzanine**	**31.12.2013**
Neither past due nor individually impaired	8,575,784	11,185,373	2,276,808	2,004,268	24,042,232
Past due but not individually impaired	792,015	1,091,016	784,035	433,651	3,100,718
Individually impaired		25,233	4,557	69,380	99,170
Total	9,367,799	12,301,622	3,065,399	2,507,299	27,242,120

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

45. Collateral and other credit enhancements

a. Valuation

The Group applies the same valuation methods to collateral held as other comparable assets held by the Group. The methods used for financial assets are outlined in note 59. For other types of assets the Group uses third party valuation where possible. Haircuts are then applied to account for liquidity and other factors which may affect the collateral value of the asset or other credit enhancement.

b. Loans to customers

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2014
Financial institutions	1	309,110					309,111
Corporate customers	720,827	52,435	2,801,236	9,191,701	327,599	2,299,054	15,392,852
Individuals	23,197	8,219	3,016	4,635,572	47,900	90,461	4,808,366
Other	509	54,187	2,004				56,700
Total	744,533	423,952	2,806,256	13,827,274	375,499	2,389,515	20,567,029

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2013
Public entities		151,192			2,140		153,332
Financial institutions	54	1,577,681					1,577,735
Corporate customers	397,118	519,112	1,718,758	8,636,933	1,982,214	2,577,223	15,831,358
Individuals	11,937	19,262	43,712	3,853,277	2,625,773	94,162	6,648,122
Other					2,701		2,701
Total	409,109	2,267,247	1,762,470	12,490,210	4,612,827	2,671,385	24,213,248

Amounts have been adjusted to exclude collateral in excess of claim value, i.e. overcollateralization. Other collateral includes financial claims, inventories, receivables and letters of credit and guarantees.

c. Derivatives

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2014
Financial institutions	349,070	13,484	1,260,637				1,623,190
Corporate customers	307,432	39,852	58,395				405,679
Individuals	1,281	3,478	87,779				92,539
Total	657,783	56,814	1,406,811	0	0	0	2,121,409

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2013
Financial institutions	590,517	134,764	392,803				1,118,084
Corporate customers	403,161	75,363	320,013				798,537
Individuals	90,035	89,459	80,018				259,512
Total	1,083,713	299,586	792,834	0	0	0	2,176,133

Amounts have been adjusted to exclude collateral in excess of claim value, i.e. overcollateralization.

46. Foreclosed assets

Should a borrower default on their obligations the Group may initiate foreclosure of pledged assets. In certain circumstances the Group may bid for the foreclosed assets to protect its interests. Should the Group be the highest bidder it is Group policy to classify such assets as held for sale and dispose of them as soon as possible. The value of foreclosed assets is specified as follows:

	2014	2013
Buildings and land	38,630	0
Other fixed assets, primarily vehicles	0	3,682
Total	38,630	3,682

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

47. Loan-to-value

a. General

The loan-to-value ratio (LTV) is the ratio of the gross amount of the loan to the value of the collateral, if any. The general creditworthiness of a customer is viewed as the most reliable indicator of credit quality of a loan. Valuation of collateral held against loans is therefore not updated unless the creditworthiness of a borrower deteriorates.

b. Breakdown

The breakdown of loans to customers by LTV is specified as follows:

	31.12.2014	%	31.12.2013	%
Less than 50%	5,101,171	22.9%	5,403,697	19.8%
51-70%	8,837,367	39.7%	8,653,589	31.8%
71-90%	4,109,840	18.4%	6,119,251	22.5%
91-100%	1,548,464	6.9%	3,123,000	11.5%
More than 100%	1,122,592	5.0%	1,200,876	4.4%
No collateral	1,567,704	7.0%	2,741,707	10.1%
Total	22,287,138	100.0%	27,242,120	100.0%

48. Large exposures

In accordance with the Financial Supervisory Authority's regulation no. 625/2013 on financial institutions' large exposures, total exposure towards a customer is classified as a large exposure if it exceeds 10% of the Bank's capital base (see note 38). According to the regulation a single exposure, net of risk adjusted mitigation, cannot exceed 25% of the capital base.

		31.12.2014		31.12.2013
Large exposures before risk adjusted mitigation	**Number**	**Amount**	**Number**	**Amount**
10-20% of capital base	12	7,985,737	11	6,984,780
20-25% of capital base	0	0	2	1,941,754
Exceeding 25% of capital base	0	0	0	0
Total	12	7,985,737	13	8,926,534
Thereof nostro accounts with foreign banks with S&P rating of A- or higher	3	1,987,230	3	2,681,805
Large exposures net of risk adjusted mitigation	8	4,948,076	11	7,282,675

Large exposures net of risk adjusted mitigation take into account the effects of collateral held by the Bank, and other credit enhancements, in accordance with the Financial Supervisory Authority's regulation no . 625/2013.

49. Liquidity risk

a. Definition

Liquidity risk is the risk that the Group will encounter difficulty in meeting contractual payment obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. This risk mainly arises from mismatches in the timing of cash flows. The Group has internal rules that require certain matching of the maturities of assets and liabilities. Furthermore, to ensure the sufficiency of funds, the Group has lines of credit, overdraft facilities and highly liquid securities such as treasury bills and treasury bonds.

b. Management

Liquidity is managed by treasury and monitored by risk management. Liquidity position is reported to the ALCO committee. The Central Bank of Iceland sets minimum requirements for coverage ratio between cash flows of assets and liabilities (LCR) and stable funding in foreign currencies (NSFR). The minimum 30 day LCR was 70% in 2014 (100% for non-ISK assets) will be 80% for 2015. The minimum NSFR was 80% in 2014 and will be increased to 90% in 2016.

The Group was in compliance with internal and external liquidity requirements throughout the years 2014 and 2013.

c. Maturity analysis of financial assets and financial liabilities

Maturity analysis of financial assets and financial liabilities is based on contractual maturity and takes into account both on-balance sheet and off-balance sheet items. Amounts are based on undiscounted cash flows, including both principal and interest cash flows. If an amount receivable or payable is not fixed, e.g. for inflation indexed assets and liabilities, the maturity analysis uses estimates based on current conditions.

When the timing of a cash flow is not fixed, e.g. for demand deposits, the analysis assumes the earliest possible payment of amounts due and the latest possible payment of amounts receivable, which is the worst case scenario from the Group's perspective.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

49. Liquidity risk (cont.)

31.12.2014

Financial assets - contractual maturity	**On demand**	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**No stated maturity**	**Total**	**Carrying amount**
Cash and cash equivalents	3,750,397	9,220,022					12,970,418	12,970,418
Receivables from Central Bank		98,832					98,832	98,832
Fixed income securities		217,735	620,720	1,583,713	2,570,451	29,655	5,022,274	4,196,330
Shares and other variable income securities						790,723	790,723	790,723
Securities used for hedging		6,856,641					6,856,641	6,856,641
Loans to customers	578,819	5,609,256	5,097,777	9,435,183	8,013,669		28,734,704	22,287,138
Other assets	51,561	511,527	130,774				693,863	693,863
Financial assets excluding derivatives	4,380,777	22,514,013	5,849,271	11,018,895	10,584,120	820,378	55,167,455	47,893,946
Derivatives		199,158		11,969			211,127	233,685
Total	4,380,777	22,713,171	5,849,271	11,030,864	10,584,120	820,378	55,378,582	48,127,631

Financial liabilities - contractual maturity	**On demand**	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**No stated maturity**	**Total**	**Carrying amount**
Deposits from customers	20,282,912	2,437,239	1,145,948	3,246,384	97,113		27,209,596	26,764,581
Deposits from credit institutions	2,711,342						2,711,342	2,711,342
Borrowings	2,784	9,039,523	883,210				9,925,516	9,854,731
Short positions used for trading	2,988,252						2,988,252	2,988,256
Short positions used for hedging	249,158						249,158	249,158
Other liabilities	299,259	479,618	175,394	53,725			1,007,996	1,007,996
Loan commitments	2,870,010						2,870,010	
Financial guarantee contracts	344,622						344,622	
Financial liabilities excluding derivatives	29,748,338	11,956,380	2,204,552	3,300,108	97,113	0	47,306,492	43,576,063
Derivatives		161,990	10,324				172,314	154,196
Total	29,748,338	12,118,370	2,214,876	3,300,108	97,113	0	47,478,806	43,730,259

	On demand	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**No stated maturity**	**Total**	**Carrying amount**
Financial assets - contractual maturity	4,380,777	22,713,171	5,849,271	11,030,864	10,584,120	820,378	55,378,582	48,127,631
Financial liabilities - contractual maturity	(29,748,338)	(12,118,370)	(2,214,876)	(3,300,108)	(97,113)		(47,478,806)	(43,730,259)
Net financial assets (liabilities)	(25,367,561)	10,594,800	3,634,395	7,730,756	10,487,007	820,378	7,899,776	4,397,371

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

49. Liquidity risk (cont.)

31.12.2013

Financial assets - contractual maturity	**On demand**	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**No stated maturity**	**Total**	**Carrying amount**
Cash and cash equivalents	8,156,001	8,999,063	640,929				17,795,993	17,795,993
Receivables from Central Bank		4,510,503					4,510,503	4,510,503
Fixed income securities		1,097,000	985,625	1,230,196	2,320,895	14,468	5,648,183	4,284,835
Shares and other variable income securities						953,747	953,747	953,747
Securities used for hedging		2,853,297					2,853,297	2,853,272
Loans to customers	1,555,011	6,882,759	5,221,822	8,812,266	5,671,189		28,143,046	27,242,120
Other assets	27,840	68,586	242,977				339,403	339,403
Financial assets excluding derivatives	9,738,852	24,411,206	7,091,353	10,042,462	7,992,083	968,215	60,244,171	57,979,872
Derivatives	442	309,543	187,895	29,023			526,903	504,341
Total	9,739,294	24,720,750	7,279,248	10,071,484	7,992,083	968,215	60,771,074	58,484,213

Financial liabilities - contractual maturity	**On demand**	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**No stated maturity**	**Total**	**Carrying amount**
Deposits from customers	26,474,219	3,946,844	1,759,947	3,153,336	364,003		35,698,349	35,229,708
Deposits from credit institutions	2,346,121						2,346,121	2,346,121
Borrowings		8,631,262					8,631,262	8,327,416
Short positions used for trading	6,273,089						6,273,089	4,492,682
Short positions used for hedging	3,175,178						3,175,178	3,174,046
Other liabilities	401,986	1,092,108	149,815	53,725			1,697,634	1,697,634
Loan commitments	3,234,058						3,234,058	
Financial guarantee contracts	542,453						542,453	
Financial liabilities excluding derivatives	42,447,105	13,670,214	1,909,762	3,207,061	364,003	0	61,598,145	55,267,607
Derivatives	1,724	197,124					198,848	184,109
Total	42,448,829	13,867,338	1,909,762	3,207,061	364,003	0	61,796,994	55,451,716

	On demand	**Up to 3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**No stated maturity**	**Total**	**Carrying amount**
Financial assets - contractual maturity	9,739,294	24,720,750	7,279,248	10,071,484	7,992,083	968,215	60,771,074	58,484,213
Financial liabilities - contractual maturity	(42,448,829)	(13,867,338)	(1,909,762)	(3,207,061)	(364,003)		(61,796,994)	(55,451,716)
Net financial assets (liabilities)	(32,709,535)	10,853,411	5,369,486	6,864,423	7,628,080	968,215	(1,025,920)	3,032,497

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

49. Liquidity risk (cont.)

d. Liquid assets

A large portion of the Group's financial liabilities has contractual maturity of less than 3 months. To offset risks inherent in this situation the Group invests primarily in highly liquid assets that can be converted to cash through repurchase agreements or outright sales. This is not adequately reflected by the contractual maturity of financial assets.

The Group defines two levels of liquid assets:

- Level I
  Level I includes cash and cash equivalents and listed securities which are eligible for repurchase agreements with the Central Bank of Iceland. Such assets can be converted to cash within two business days.
- Level II
  Level II includes listed securities which are not eligible for repurchase agreements with the Central Bank of Iceland but are actively traded. Such securities can be converted to cash within 5 business days.

Level I	**31.12.2014**	**31.12.2013**
Cash and cash equivalents	12,970,418	17,795,993
Securities eligible for repurchase agreements with the Central Bank	6,312,945	3,318,641
Level II		
Actively traded listed securities	4,806,010	3,837,507
Total	24,089,373	24,952,141

50. Market risk

a. Definition

Market risk constitutes risk due to changes in the market prices of financial instruments and comprises interest rate risk, currency risk and other price risk.

b. Management

The Group has a strict policy on controlling market risk and to keep the exposure within set limits. The risk management unit monitors market risk limits on a daily basis and reports regularly to the ALCO committee and to the CEO.

51. Interest rate risk

a. Definition

The Group's exposure to interest rate risk is twofold. On one hand, the Group has a proprietary portfolio of bonds, where market rates affect prices and any fluctuations are recognised in the income statement. On the other hand, the Group has mismatch in assets and liabilities with fixed interest terms. These include loans and swap contracts for securities on the asset side and borrowings and deposits on the liability side. This mismatch does not create an immediate effect on the income statement but nevertheless affects the Group's economic value.

Proprietary positions which are subject to interest rate risk fall under the scope of the Group's market risk management.

b. Management

The Group takes measures to minimise interest rate risk by matching the interest rate profile and duration of assets with the Group’s liabilities as well as using derivative and non-derivative financial instruments to manage effectively the risk of an adverse impact on the Group’s earnings.

52. Interest rate risk associated with trading portfolios

a. Breakdown

The breakdown of financial assets and liabilities in trading portfolios by the earlier of interest repricing time or maturity is specified as follows:

	Up to 1 month	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**31.12.2014**
Fixed income securities		118,896	435,123	977,050	2,665,261	4,196,330
Short positions - fixed income securities			(1,046,034)	(927,852)	(966,072)	(2,939,958)
Net imbalance	0	118,896	(610,911)	49,198	1,699,188	1,256,371

	Up to 1 month	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**31.12.2013**
Fixed income securities	50		1,654,298	1,408,501	1,221,987	4,284,835
Short positions - fixed income securities		(1,931,140)		(874,544)	(1,625,715)	(4,431,398)
Net imbalance	50	(1,931,140)	1,654,298	533,957	(403,728)	(146,563)

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

52. Interest rate risk associated with trading portfolios (cont.)

b. Sensitivity analysis

The Group performs monthly sensitivity analysis on financial assets and liabilities in trading portfolios that are subject to interest rate risk. The sensitivity analysis assumes a shift in the yield curves for all currencies. A parallel shift in yield curves would have the following impact on the Group's pre-tax profit and equity, assuming all other risk factors remain constant:

	Shift in basis points	Downward	31.12.2014 Upward	Downward	31.12.2013 Upward
Indexed	50	38,541	(38,541)	15,465	(15,465)
Non-indexed	100	(22,830)	22,830	(21,001)	21,001
Total		15,710	(15,710)	(5,536)	5,536

53. Interest rate risk associated with non-trading portfolios

a. Breakdown

The breakdown of financial assets and liabilities in non-trading portfolios by the earlier of interest repricing time or maturity is specified as follows:

31.12.2014

Financial assets	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and cash equivalents	10,733,984	2,236,434				12,970,418
Receivables from Central Bank	98,832					98,832
Loans to customers	11,813,845	8,133,183	1,317,469	791,214	231,427	22,287,138
Financial assets excluding derivatives	22,646,661	10,369,617	1,317,469	791,214	231,427	35,356,388
Effect of derivatives	9,904,103	273,363		539,441		10,716,906
Total	32,550,764	10,642,979	1,317,469	1,330,655	231,427	46,073,295

Financial liabilities	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Deposits from customers	26,640,567	2,545	5,875		115,594	26,764,581
Deposits from credit institutions	2,711,342					2,711,342
Borrowings	4,289,789	4,701,770	863,173			9,854,731
Financial liabilities excluding derivatives	33,641,697	4,704,315	869,048	0	115,594	39,330,653
Effect of derivatives	9,855,079	280,578		504,914		10,640,571
Total	43,496,776	4,984,893	869,048	504,914	115,594	49,971,224
Total interest repricing gap	(10,946,012)	5,658,086	448,421	825,741	115,833	(3,897,930)

31.12.2013

Financial assets	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and cash equivalents	16,141,453	547,014	1,107,526			17,795,993
Receivables from Central Bank	4,196,330					4,196,330
Loans to customers	16,104,568	8,072,589	1,054,369	1,728,509	282,085	27,242,120
Financial assets excluding derivatives	36,442,351	8,619,602	2,161,895	1,728,509	282,085	49,234,442
Effect of derivatives	3,500,595	248,521		2,746,970		6,496,087
Total	39,942,946	8,868,124	2,161,895	4,475,480	282,085	55,730,529

Financial liabilities	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Deposits from customers	34,945,172	23,939	144,954	115,643		35,229,708
Deposits from credit institutions	2,346,121					2,346,121
Borrowings	4,685,067	3,642,349				8,327,416
Financial liabilities excluding derivatives	41,976,360	3,666,288	144,954	115,643	0	45,903,245
Effect of derivatives	6,263,282	239,698				6,502,980
Total	48,239,642	3,905,986	144,954	115,643	0	52,406,226
Total interest repricing gap	(8,296,696)	4,962,138	2,016,940	4,359,836	282,085	3,324,304

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

53. Interest rate risk associated with non-trading portfolios (cont.)

b. Sensitivity analysis

The Group performs monthly sensitivity analysis on financial assets and liabilities in non-trading portfolios subject to interest rate risk. The sensitivity analysis assumes a shift in the yield curves for all currencies. A parallel shift in yield curves would have the following impact on the Group's pre-tax profit and equity, assuming all other risk factors remain constant:

	Shift in		31.12.2014		31.12.2013
Currency	**basis points**	**Downward**	**Upward**	**Downward**	**Upward**
ISK, indexed	50	23,332	(23,332)	35,625	(35,625)
ISK, non-indexed	100	12,559	(12,559)	37,133	(37,133)
Other currencies	20	178	(178)	1,209	(1,209)
Total		36,069	(36,069)	73,967	(73,967)

54. Exposure towards changes in the CPI

a. Definition

Exposure towards changes in CPI is the risk that fluctuations in the Icelandic Consumer Price Index (CPI) will affect the balance and cash flow of indexed financial instruments.

The Group is exposed to Icelandic inflation since CPI indexed liabilities exceed CPI indexed assets. All indexed assets and liabilities are valued according to the CPI measure at any given time and changes in CPI are recognised in the income statement as interest.

b. Management

The Group controls its indexation risk through derivatives contracts and sales and purchases of indexed bonds, mostly government bonds, and thus keeps its inflationary position within the limits set by the ALCO committee.

c. Balance of CPI linked assets and liabilities

The net balance of CPI linked assets and liabilities is specified as follows:

	31.12.2014	**31.12.2013**
Assets	8,353,457	8,897,489
Liabilities	(5,545,008)	(6,170,250)
Total	2,808,449	2,727,239

55. Currency risk

a. Definition

Currency risk arises when financial instruments are not denominated in the functional currency of the respective Group entity and can affect both the Group's income statement and statement of financial position. A part of the Group's financial assets and liabilities is denominated in foreign currencies.

b. Management

Currency positions are monitored by risk management and reported to the ALCO committee. Any mismatch between assets and liabilities in each currency is monitored closely and managed within limits.

The Group is subject to limits set by the Central Bank of Iceland regarding the maximum open currency position. At 31 December 2014 and 31 December 2013 the Group's position in foreign currencies was within those limits.

c. Exchange rates

The following exchange rates have been used by the Group in the preparation of these financial statements:

	Closing 31.12.2014	**Average 2014**	**Closing 31.12.2013**	**Average 2013**
EUR/ISK	154.3	154.8	158.5	162.4
USD/ISK	126.9	116.8	115.0	122.3
ISK trade index	194.8	195.1	198.1	206.9

Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

55. Currency risk (cont.)

d. Breakdown of financial assets and financial liabilities denominated in foreign currencies

31.12.2014

Financial assets	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Cash and cash equivalents	1,614,337	1,286,923	330,286	226,143	334,126	3,791,814
Fixed income securities				84,637		84,637
Shares and other variable income securities	220	62,583		0	28,909	91,712
Securities used for hedging		391		0		391
Loans to customers	665,865	150,887			21,383	838,135
Other assets		1		1	59,964	59,965
Financial assets excluding derivatives	2,280,422	1,500,784	330,286	310,781	444,383	4,866,656
Derivatives		2,967				2,967
Total	2,280,422	1,503,751	330,286	310,781	444,383	4,869,622

Financial liabilities	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Deposits from customers	2,327,604	1,096,531	341,028	246,917	139,397	4,151,477
Short positions used for trading		126				126
Short positions used for hedging		391				391
Other liabilities					17,649	17,649
Financial liabilities excluding derivatives	2,327,604	1,097,048	341,028	246,917	157,046	4,169,643
Derivatives						0
Total	2,327,604	1,097,048	341,028	246,917	157,046	4,169,643

Net currency position	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Net on-balance sheet position	(47,182)	406,703	(10,742)	63,864	287,337	699,979
Financial guarantee contracts	(206,105)	(83,949)			(10,568)	(300,622)
Total	(253,287)	322,754	(10,742)	63,864	276,769	399,358

31.12.2013

Financial assets	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Cash and cash equivalents	1,075,562	723,636	900,597	107,703	320,827	3,128,324
Fixed income securities	1,109,257	919,053		94,027	14,468	2,136,805
Shares and other variable income securities	847	78,272	61,188	0	17,580	157,886
Securities used for hedging	67,152	95,533		0		162,685
Loans to customers	690,747	214,015			49,722	954,484
Other assets		67,596			290,717	358,313
Financial assets excluding derivatives	2,943,565	2,098,104	961,784	201,730	693,313	6,898,497
Derivatives	62,375	2,475				64,850
Total	3,005,940	2,100,579	961,784	201,730	693,313	6,963,347

Financial liabilities	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Deposits from customers	2,803,783	1,682,091	914,866	208,391	275,158	5,884,290
Short positions used for trading		185		48		233
Financial liabilities excluding derivatives	2,803,783	1,682,276	914,866	208,438	275,158	5,884,522
Derivatives	47,550	334,047			51,834	433,432
Total	2,851,333	2,016,323	914,866	208,438	326,993	6,317,954

Net currency position	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Net on-balance sheet position	154,607	84,256	46,918	(6,708)	366,321	645,393
Financial guarantee contracts	(34,078)	(83,136)			(50,033)	(167,247)
Total	120,530	1,120	46,918	(6,708)	316,287	478,146

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

55. Currency risk (cont.)

e. Sensitivity to currency risk

Given the net currency position, a 10% change in the value of the ISK would, with other things constant, result in the following changes to the Group's pre-tax profit.

	31.12.2014		31.12.2013	
Assets and liabilities denominated in foreign currencies	**-10%**	**+10%**	**-10%**	**+10%**
EUR	(25,329)	25,329	12,053	(12,053)
USD	32,275	(32,275)	112	(112)
GBP	(1,074)	1,074	4,692	(4,692)
NOK	6,386	(6,386)	(671)	671
Other currencies	27,677	(27,677)	31,629	(31,629)
Total	39,936	(39,936)	47,815	(47,815)

The effect on equity would be the same, net of income tax.

56. Other price risk

Other price risk arises from changes in the market prices of equity securities in the Group's portfolio. The Group invests primarily in equity securities listed on regulated markets, but has also invested in unlisted equities. A breakdown of shares and other variable income securities is provided in note 15. The Group's risk is the general risk involved in investing in equity securities. Efforts are made to reduce this risk through active risk management.

			31.12.2014			31.12.2013
	Average	**Max**	**Carrying amount**	**Average**	**Max**	**Carrying amount**
Listed shares	259,833	500,651	338,712	278,700	524,633	400,662
Listed unit shares	222	237	220	208	231	221
Unlisted shares	304,154	365,127	291,500	244,189	587,835	182,379
Unlisted unit shares	195,926	374,099	160,292	892,923	1,314,089	370,485
Total			790,723			953,747

The Group is also exposed to changes in the market prices of equity options as specified in note 19 and equities included in short positions used for trading as specified in note 32.

57. Operational risk

a. Definition

Operational risk is the risk of financial losses resulting from the failure or inadequacy of internal processes or systems, from employee error or from external events. Operational risk includes legal risk, but excludes reputational risks. It is therefore inherent in all areas of business activities.

b. Management

Operational risk can be reduced through staff training, process re-design and enhancement of the control environment. The risk management unit monitors operational risk by tracking loss events, quality deficiencies, potential risk indicators and other early-warning signals. The unit takes an active role in internal control and quality management.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Financial assets and liabilities

58. Accounting classification of financial assets and liabilities

The accounting classification of financial assets and liabilities is specified as follows:

31.12.2014 **Financial assets**	**Held for trading**	**Designated at fair value**	**Available for sale**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Cash and cash equivalents				12,970,418		12,970,418
Receivables from Central Bank				98,832		98,832
Fixed income securities	3,927,365	268,965				4,196,330
Shares and other variable income securities	543,674	247,049				790,723
Securities used for hedging		6,856,641				6,856,641
Loans to customers				22,287,138		22,287,138
Derivatives	233,685					233,685
Other assets				693,863		693,863
Total	4,704,724	7,372,655	0	36,050,251	0	48,127,631

Financial liabilities	**Held for trading**	**Designated at fair value**	**Available for sale**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Deposits from customers					26,764,581	26,764,581
Deposits from credit institutions					2,711,342	2,711,342
Borrowings					9,854,731	9,854,731
Short positions used for trading	2,988,256					2,988,256
Short positions used for hedging	249,158					249,158
Derivatives	154,196					154,196
Other liabilities					1,007,996	1,007,996
Total	3,391,609	0	0	0	40,338,650	43,730,259

31.12.2013 **Financial assets**	**Held for trading**	**Designated at fair value**	**Available for sale**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Cash and cash equivalents				17,795,993		17,795,993
Receivables from Central Bank				4,510,503		4,510,503
Fixed income securities	2,416,145	197,537	1,671,154			4,284,835
Shares and other variable income securities	692,893	260,854				953,747
Securities used for hedging		2,853,272				2,853,272
Loans to customers				27,242,120		27,242,120
Derivatives	504,341					504,341
Other assets				339,403		339,403
Total	3,613,378	3,311,663	1,671,154	49,888,018	0	58,484,213

Financial liabilities	**Held for trading**	**Designated at fair value**	**Available for sale**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Deposits from customers					35,229,708	35,229,708
Deposits from credit institutions					2,346,121	2,346,121
Borrowings					8,327,416	8,327,416
Short positions used for trading	4,492,682					4,492,682
Short positions used for hedging	3,174,046					3,174,046
Derivatives	184,109					184,109
Other liabilities					1,697,634	1,697,634
Total	7,850,836	0	0	0	47,600,880	55,451,716

The book value of financial assets and liabilities not carried at fair value is considered a reasonable approximation of their fair value, as discussed in note 60. Their fair value is therefore not shown separately.

Notes to the Consolidated Financial Statements

59. Financial assets and liabilities measured at fair value

a. Fair value hierarchy

The fair value of financial assets and liabilities that are traded in active markets are based on quoted market prices. For other financial instruments the Bank determines fair value using various valuation techniques. IFRS 13 specifies a fair value hierarchy based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources whereas unobservable inputs reflect the Bank's market assumptions. These two types of inputs result in the following fair value hierarchy:

- Level 1
  Inputs are quoted market prices (unadjusted) in active markets for identical instruments.

- Level 2
  Inputs are not quoted market prices but are observable either directly, i.e. as prices, or indirectly, i.e. derived from prices. This category includes financial instruments valued using quoted prices in active markets for similar instruments, quoted prices for similar or identical instruments in markets that are considered less than active and other instruments which are valued using techniques which rely primarily on inputs that are directly or indirectly observable from market data.

- Level 3
  Inputs are not observable or unobservable inputs have a significant effect on the valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments are required to reflect the differences between the instruments.

b. Valuation process

The Bank's ALCO committee is responsible for fair value measurements of financial assets and liabilities classified as level 2 or level 3 instruments. The valuation is carried out by personnel from Risk and Treasury and is revised at least quarterly, or when there are indications of significant changes in the underlying inputs.

c. Valuation techniques

The Group uses widely recognized valuation techniques, including net present value and discounted cash flow models, comparison with similar instruments for which market observable prices exist, Black-Scholes and other valuation models.

Valuation techniques include recent arm's length transactions between knowledgeable, willing parties, if available, reference to the current fair value of other instruments that are substantially the same, the discounted cash flow analysis and option pricing models. Valuation techniques incorporate all factors that market participants would consider in setting a price and are consistent with accepted methodologies for pricing financial instruments. Periodically, the Group calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument, without modification or repackaging, or based on any available observable market data.

For more complex instruments, the Group uses proprietary models, which usually are developed from recognised valuation models. Some or all of the inputs into these models may not be market observable, and are derived from market prices or rates or are estimated based on assumptions. When entering into a transaction, the financial instrument is recognised initially at the transaction price, which is the best indicator of fair value, although the value obtained from the valuation model may differ from the transaction price. This initial difference, usually an increase in fair value, indicated by valuation techniques is recognised in income depending upon the individual facts and circumstances of each transaction and no later than when the market data becomes observable.

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

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

59. Financial assets and liabilities measured at fair value (cont.)

d. Fair value hierarchy classification

The fair value of financial assets and liabilities measured at fair value in the statement of financial position is classified into the fair value hierarchy as follows:

31.12.2014

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Fixed income securities	3,927,365			3,927,365
Shares and other variable income securities	543,674			543,674
Derivatives		233,685		233,685
Designated at fair value				
Fixed income securities		29,655	239,310	268,965
Shares and other variable income securities		19,697	227,352	247,049
Securities used for hedging	6,856,641			6,856,641
Total	11,327,680	283,037	466,662	12,077,379

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Short positions used for trading	2,988,249	7		2,988,256
Short positions used for hedging	249,158			249,158
Derivatives		154,196		154,196
Total	3,237,406	154,203	0	3,391,609

There were no transfers between levels during the year.

31.12.2013

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Fixed income securities	2,416,145			2,416,145
Shares and other variable income securities	692,893			692,893
Derivatives		504,341		504,341
Designated at fair value				
Fixed income securities			197,537	197,537
Shares and other variable income securities		3,260	257,594	260,854
Securities used for hedging	2,853,272			2,853,272
Available for sale				
Fixed income securities	1,671,154			1,671,154
Total	7,633,463	507,600	455,131	8,596,195

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Short positions used for trading	4,492,675	6		4,492,682
Short positions used for hedging	3,174,046			3,174,046
Derivatives		184,109		184,109
Total	7,666,721	184,115	0	7,850,836

Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

59. Financial assets and liabilities measured at fair value (cont.)

e. Reconciliation of changes in Level 3 fair value measurements

31.12.2014	Fixed income securities	Shares and other var. income securities	Total
Balance as at 1 January 2014	197,537	257,594	455,131
Total gains and losses in profit or loss	52,597	(9,718)	42,878
Purchases		1,521	1,521
Settlements	(10,823)	(22,045)	(32,868)
Balance as at 31 December 2014	239,310	227,352	466,662

31.12.2013	Fixed income securities	Shares and other var. income securities	Total
Balance as at 1 January 2013	197,455	217,005	414,459
Total gains and losses in profit or loss	39,867	(16,765)	23,102
Purchases	61,851	1,665	63,516
Settlements	(101,635)		(101,635)
Sales		(27,500)	(27,500)
Transfers into Level 3		83,190	83,190
Balance as at 31 December 2013	197,537	257,594	455,131

f. Change in unrealised gains or losses related to Level 3 financial assets held at year-end

Net financial income - 2014	Fixed income securities	Shares and other var. income securities	Total
Financial assets designated at fair value through profit and loss	52,647	(9,718)	42,928
Total	52,647	(9,718)	42,928

Net financial income - 2013	Fixed income securities	Shares and other var. income securities	Total
Financial assets designated at fair value through profit and loss	34,087	(6,140)	27,947
Total	34,087	(6,140)	27,947

g. Fair value measurements for Level 3 financial assets

Level 3 assets consist primarily of highly illiquid, unlisted bonds, shares and share certificates. Each asset is evaluated separately but assets within an asset group share a valuation method. The following valuation methods are in use in 2014:

Asset class	Method	Significant unobservable input	Range	Book value 31.12.2014
Unlisted bonds (performing)	Expected recovery	Value of assets	83-100%	239,310
Unlisted shares	P/B multiplier	Equity	1.07-1.17	164,769
Unlisted unit shares	Investment multiplier	Original investment	0.51	62,583
Total				466,662

Asset class	Method	Significant unobservable input	Range	Book value 31.12.2013
Unlisted bonds (performing)	Expected recovery	Value of assets	53-100%	197,487
Unlisted shares	P/B multiplier	Equity	1.01-1.13	180,778
Unlisted unit shares	Investment multiplier	Original investment	0.70	76,817
Other assets (distressed/non-performing)	Fixed, nominal value			50
Total				455,131

Given the methods used, the possible range of the significant unobservable inputs is wide. When determining the values used the Group considers the financial strength of the entity in question, recent trades if any and multipliers for comparable instruments.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

59. Financial assets and liabilities measured at fair value (cont.)

h. The effect of unobservable inputs in Level 3 fair value measurements

The Group believes its estimates represent appropriate approximations of fair value and that the use of different valuation methodologies and reasonable changes in assumptions or unobservable inputs would not significantly change the estimates.

A 10% change in the estimates would have the following effect on profit before taxes:

	+10%	-10%
Fixed income securities	23,931	(23,931)
Shares and other variable income securities	22,735	(22,735)
Total	46,666	(46,666)

60. Financial assets and liabilities not measured at fair value

Financial assets and liabilities not measured at fair value have either a short time to maturity or settlement, variable interest rates or other attributes which result in the carrying amount being a reasonable approximation of their fair value.

a. Fair value hierarchy classification

The carrying amount of financial assets and liabilities not measured at fair value in the statement of financial position is classified into a fair value hierarchy as follows:

31.12.2014

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Fair value**
Cash and cash equivalents		12,970,418		12,970,418
Receivables from Central Bank		98,832		98,832
Loans to customers		22,135,062	152,077	22,287,138
Other assets		684,010	9,853	693,863
Total	0	35,888,321	161,930	36,050,251

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Fair value**
Deposits from customers		26,764,581		26,764,581
Deposits from credit institutions		2,711,342		2,711,342
Borrowings		9,854,731		9,854,731
Other liabilities		1,007,996		1,007,996
Total	0	40,338,650	0	40,338,650

31.12.2013

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Fair value**
Cash and cash equivalents		17,795,993		17,795,993
Receivables from Central Bank		4,510,503		4,510,503
Loans to customers		26,848,644	393,476	27,242,120
Other assets		311,022	28,381	339,403
Total	0	49,466,161	421,857	49,888,018

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Fair value**
Deposits from customers		35,229,708		35,229,708
Deposits from credit institutions		2,346,121		2,346,121
Borrowings		8,327,416		8,327,416
Other liabilities		1,697,634		1,697,634
Total	0	47,600,880	0	47,600,880

b. Determination of fair value

Cash and cash equivalents includes several components as detailed in note 13. Cash equivalent assets are either balances available on-demand or on very short notice, or other assets easily converted to cash. Loans to customers are substantially all either short-term or have variable interest rates. Other financial assets consist primarily of short-term receivables. The carrying amount of these assets is therefore a reasonable approximation of their fair value.

Deposits, deposits from credit institutions and borrowings are typically either short-term or have variable interest rates. Other liabilities consist primarily of accounts payables, withholding taxes and other short-term payables. The carrying amount of these liabilities is therefore considered a reasonable approximation of their fair value.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Segment information

61. Geographical information

Net operating income is based on the customer's country of domicile and assets are based on the geographical location of the assets.

Net operating income	2014	2013
Iceland	3,398,901	3,539,553
Other regions	48,680	8,935
Eliminations	(119,323)	56,066
Total	3,328,258	3,604,554

Total assets	31.12.2014	31.12.2013
Iceland	50,099,773	60,689,382
Other regions	108,206	425,115
Eliminations	(863,653)	(605,636)
Total	49,344,327	60,508,862

62. Business segments

Segment reporting is based on the same principles and structure as internal reporting to senior management and the board of directors. Segment performance is evaluated on earnings before tax.

Assets and liabilities which support revenue generation are allocated to business segments. All equity is allocated to Treasury and all funding flows through Treasury. The segments pay and receive interest from Treasury to reflect the allocation of capital and funding costs, with inter segment pricing being determined on an arm's length basis. Administrative expenses of support functions are allocated to business segments based on the underlying cost drivers.

A substantial change in the definition of reportable segments took effect on 1 January 2014. The change was introduced to support organizational changes and a renewed focus on core competencies and involved the introduction of two new segments, Banking and Markets, which replaced two segments which were phased out, Investment Banking and Retail Banking. The change also involved the transfer of certain products and revenue streams between segments. As a result no comparative information is available.

The Bank initiated the sale of the majority of its equipment financing assets in January 2014. The sale was completed in June 2014 and the remaining assets were transferred to the Banking unit. Asset financing does therefore no longer represent a reportable segment.

a. Reportable segments
The Group defines three reportable segments which reflect the reporting structure of the Bank.

- Asset Management
  Products and services offered include asset management, both domestic and foreign assets, private banking, and private pension plans.
- Banking
  Banking offers various forms of savings (e.g. checking accounts, savings accounts and money market deposits) and lending (e.g. overdrafts, mortgages, inventory financing, project financing and credit cards) and payment services, with a special focus on institutional investors, financial institution, SME's and professionals. Banking also provides treasury services to the Bank.
- Markets
  Markets offers securities and foreign currency brokerage, derivatives brokerage, forward contracts, market making activities and merger and acquisition advisory services to clients, which include institutional investors, corporates and high net worth individuals. Markets also manage proprietary trading on behalf of the Bank.

Information about other divisions of the Bank, e.g. non-revenue generating divisions, various non-core subsidiaries of the Bank, non-current assets classified as held for sale, and certain non-core assets acquired from EA fjárfestingarfélag hf. in 2011, primarily unlisted securities and non-performing loans, is presented under the heading Other operations.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

62. Business segments (cont.)

b. Business segment balance sheet

31.12.2014	**Asset Management**	**Banking**	**Markets**	**Other Operations**	**Elimination entries**	**Total**
Segment assets 31.12.2014	150,625	76,965,970	15,131,712	1,743,965	(44,647,946)	49,344,327
Segment liabilities 31.12.2014	150,625	71,369,464	15,131,712	1,743,965	(44,647,946)	43,747,821
Segment equity 31.12.2014	0	5,596,506	0	0	0	5,596,506

31.12.2013	**Asset Management**	**Banking**	**Markets**	**Other Operations**	**Elimination entries**	**Total**
Segment assets 31.12.2013	130,492	94,437,261	16,029,729	5,966,472	(56,055,092)	60,508,862
Segment liabilities 31.12.2013	130,492	89,400,494	16,029,729	5,966,472	(56,055,092)	55,472,095
Segment equity 31.12.2013	0	5,036,767	0	0	0	5,036,767

Elimination entries arise primarily from internal funding, as all funding flows through Treasury which is a part of the Banking segment.

c. Business segments results

2014	**Asset Management**	**Banking**	**Markets**	**Other Operations**	**Elimination entries**	**Total**
Interest income	0	2,381,302	326,504	230,312	(39,227)	2,898,891
Interest expense	(21)	(1,607,993)	(29)	(28,053)	39,227	(1,596,870)
Net interest income	(21)	773,308	326,476	202,259	0	1,302,021
Net fee and commission income	296,753	285,396	816,760	357,479	(26,663)	1,729,725
Net financial income	(170)	44,235	(53,437)	189,684	0	180,312
Share in profit of associates, net of income tax	47,153	0	0	67,934	(92,660)	22,427
Other operating income	0	2,268	2,588	88,918	(0)	93,773
Net operating income from external customers	343,715	1,105,207	1,092,386	906,274	(119,323)	3,328,258
Net operating income from internal customers	3,986	405,616	(197,509)	(212,093)	0	0
Net operating income	347,700	1,510,823	894,877	694,181	(119,323)	3,328,258
Administrative expenses	(428,345)	(1,199,256)	(885,706)	(584,261)	26,663	(3,070,905)
Impairment of loans and receivables	0	(28,542)	0	39,233	0	10,692
Profit from assets held for sale	0	0	0	14,531	0	14,531
Profit (loss) before taxes	(80,644)	283,026	9,171	163,684	(92,660)	282,576

Internal reporting is based on the results of the Bank, which accounts for around 90% of the net operating income of the Group, and do not take into account the effects of consolidation. As a result, elimination entries are needed to reconcile internal reporting with consolidated results. Elimination entries arise primarily from interest calculated on internal balances, share in the results of subsidiaries and fees charged for services the parent provides to subsidiaries.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Other information

63. Related parties

a. Definition of related parties

The Group has a related party relationship with the board members of the Bank, the CEO of the Bank and key employees (together referred to as management), associates as disclosed in note 21, shareholders with significant influence over the Bank (defined as holding 10% or greater of the shares in the Bank as disclosed in note 69), close family members of individuals identified as related parties and entities under the control or joint control of related parties.

b. Arm's length

Transactions with related parties are carried out at arm's length and subject to an annual review by the Bank's internal auditor.

c. Effects on statement of financial position

31.12.2014	Loans & receivables	Deposits & payables
Management	8,821	123,420
Associates	0	194,319
Shareholders	0	0
Total	8,821	317,739

31.12.2013	Loans & receivables	Deposits & payables
Management	10,784	188,940
Associates	2,307	314,172
Shareholders	0	0
Total	13,091	503,112

d. Off-balance sheet obligations

There were no off-balance sheet obligations with related parties during year.

e. Effects on income statement

2014	Interest income	Interest expense	Impairment expense	Fees received	Fees paid
Management	54	6,491	0	27	31,666
Associates	0	7,981	0	0	231
Shareholders	0	0	0	0	0
Total	54	14,472	0	27	31,897

2013	Interest income	Interest expense	Impairment expense	Fees received	Fees paid
Management	1,942	13,934	0	2,633	30,426
Associates	7,376	6,246	0	299	5,649
Shareholders	0	0	(8,440)	0	0
Total	9,318	20,180	(8,440)	2,932	36,075

Further information about salaries and benefits paid to the Board of Directors, the CEO and Managing Directors is provided in note 10.

64. Remuneration policy

The Board of Directors has adopted a remuneration policy at the proposal of the Remuneration Committee. The policy was approved by the Bank's Annual General Meeting in April 2012.

The remuneration policy conforms to Article 57 of Act No. 161/2002 on Financial Undertakings, Act No. 2/1995 on Public Limited Companies and the Icelandic FSA's directive No. 700/2011 on Incentive Schemes. The policy covers three remuneration components, base pay, performance based incentive scheme and other benefits, including pension fund contributions. A more detailed description of the policy can be found on the Bank's website, www.mp.is.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

65. Incentive scheme

The Board of Directors has approved a performance based incentive scheme at the proposal of the Remuneration Committee. The scheme forms a part of the remuneration policy adopted by the Bank.

a. Description

The incentive scheme conforms to the Icelandic FSA's directive No. 700/2011 on Incentive Schemes. Payments according to the scheme are based on key performance indicators (KPIs) that reflect the goals of the Bank, the division and the employee. The basis for performance based pay reflects sound risk management and does not induce excessive risk taking. Performance based pay to individual employees does not exceed 25% of their annual base salary, and payment of 40-60% of the performance based pay is deferred for three years. Performance based pay can be in the form of cash payments or share options. Share based payments are discussed in note 66.

b. Performance based payments

		2014		2013
	Cash	**Options**	**Cash**	**Options**
Non-deferred	0	0	1,951	0
Deferred	0	2,126	1,500	2,126
Total	0	2,126	3,451	2,126

c. On-balance sheet deferred performance based payments

	31.12.2014	**31.12.2013**
Deferred cash payments	40,585	71,962
Total	40,585	71,962

66. Share-based payments

The remuneration policy approved by the Board of Directors of the Bank includes a share-based incentive scheme. At the Bank's Annual General Meeting in April 2012 the Board of Directors was authorised to increase the share capital of the Bank by up to ISK 1 billion in stages to fulfil any obligations arising from the scheme. In December 2014 the limit was reduced to ISK 333 million.

a. Description

In 2012 the Bank established a share based incentive scheme that grants key personnel options to purchase shares in the Bank at a fixed price. The options are equity-settled, have a term of five years and will vest in three tranches with vesting dates 36, 48 and 60 months from the grant date. The grant is subject to the participant's continued employment by the company, and various other conditions satisfying the requirements of the Icelandic FSA. A more detailed description of the scheme can be found on the Bank's website, www.mp.is.

As at 31 December 2014, the Bank had enrolled 8 employees in the share-based incentive scheme, with a total number of options granted equalling 25 million shares in the bank. No options had vested as at 31 December 2014.

b. Grant date fair value

The grant date fair value of the options granted through the scheme was as follows:

	2014	**2013**
Grant date fair value (ISK per share)	-	0.08-0.17

The grant date fair value of the options is calculated using the Black-Scholes method for European style options pricing. The following inputs were used in the valuation of the options:

	2014	**2013**
Exercise price (ISK per share)	-	5.75
Risk free interest rate	-	5.5%-6.0%
Expected volatility	-	1.0%-1.1%
Option life (years)	-	3-5

No options were granted in 2014.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

67. Operating lease commitments

The Group leases under operating leases office premises for its operations in Reykjavik. The typical lease period is 3-5 years with a renewal option. In some leases the rent is based on the Icelandic Consumer Price Index and changes accordingly. Future non-cancellable minimum operating lease payments are specified as follows:

	31.12.2014	31.12.2013
Up to 1 year	61,124	81,422
1-5 years	32,539	144,361
Total	93,663	225,783

68. Pledged assets

The Group has pledged assets, in the ordinary course of banking business, to the Central Bank of Iceland in the amount of ISK 3.0 billion as at 31 December 2014 (2013: 3.0 billion) to secure settlement in the Icelandic clearing systems. Further pledges have been placed in the ordinary course of banking business for netting and set-off arrangements in the total amount of ISK 4.0 billion as at 31 December 2014 (2013: 14.2 billion).

69. Shareholders of the Bank

Ownership in the Bank is specified as follows:

		31.12.2014	31.12.2013	
Shareholder	**Country**	**%**	**%**	**Beneficial owners**
Straumur fjárfestingabanki hf.	Iceland	19.54%	-	Ármann Ármannsson (16%)
Títan B ehf.	Iceland	9.91%	9.91%	Skúli Mogensen (100%)
Lífeyrissjóður verslunarmanna	Iceland	9.74%	9.74%	
Mízar ehf.	Iceland	9.40%	9.40%	Guðmundur Steinar Jónsson (100%)
Fagfjárfestasjóðurinn Norðurljós	Iceland	8.20%	8.20%	Júpíter rekstrarfélag hf., as managing company
Tryggingamiðstöðin hf.	Iceland	5.12%	5.12%	
Eignasafn Seðlabanka Íslands ehf.	Iceland	4.36%	-	Central Bank of Iceland
Klakki ehf.	Iceland	4.27%	4.27%	Arion banki hf. (34%), Kaupþing hf. (19%)
MP Canada Iceland Ventures Inc	Canada	3.42%	3.42%	Robert Reich (100%)
Alkor ehf.	Iceland	2.76%	2.76%	Berglind Björk Jónsdóttir (100%)
Arkur ehf.	Iceland	2.56%	2.56%	Steinunn Jónsdóttir (100%)
ET sjón ehf.	Iceland	2.56%	2.56%	Eiríkur Ingvar Þorgeirsson (100%)
P 126 ehf.	Iceland	1.71%	1.71%	Charamino Holdings Limited (100%)
Stekkur fjárfestingarfélag ehf.	Iceland	1.71%	1.71%	Kristinn Aðalsteinsson (100%)
Linley Limited	UK	-	9.54%	The Rowland Purpose Trust 2001
Manastur Holding B.V.	Netherlands	-	9.99%	Joseph Lewis (100%)
Drómi hf.	Iceland	-	4.36%	Sparisjóður Reykjavíkur og nágrennis hf. (99%)
Others, each less than 1%		14.68%	14.68%	2014: 35, 2013: 34
		99.93%	99.93%	
Treasury shares		0.07%	0.07%	
Issued share capital		100.00%	100.00%	

Beneficial owners are defined as owners holding a share of 10% or greater, directly or indirectly. The information presented is based on publicly available information and the Bank is in some cases unable to verify its accuracy.

70. Other matters

The Bank has sold the majority of the assets of its equipment financing business, which operated under the brand name Lykill. The assets transferred consisted primarily of equipment financing contracts with individuals and accounted for approximately 7% of the Bank's total assets at the date of closing. The sale did not have a significant impact on the Bank's income statement.

71. Events after the reporting date

In February 2015 the Bank disclosed its intentions to commence a formal merger process with Straumur fjárfestingabanki hf. based on heads of terms mutually agreed by the two banks. This merger, which is expected to be completed later in the year 2015, will substantially increase the Bank's presence in asset management and investment banking as well as strengthening its capabilities to service its banking clients.

Notes to the Consolidated Financial Statements

Significant accounting policies

72. Basis of consolidation

The accounting policies set out below have been applied consistently to all periods presented in these Consolidated Financial Statements, and have been applied consistently by Group entities.

a. Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Group reassesses its relationship with an entity when there is a change in one or more of the elements of control.

The Group uses the acquisition method to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value, at the date of exchange, of the assets given, liabilities incurred or assumed and equity instruments issued. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest.

The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recognised as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised immediately in the income statement.

b. Non-controlling interest

Non-controlling interest represent the portion of profit or loss and equity not owned, directly or indirectly, by the Bank. Non-controlling interest is presented separately in the income statement and is included in equity in the statement of financial position, separately from equity attributable to owners of the Bank.

The Group chooses on an acquisition-by-acquisition basis whether to measure non-controlling interest in an acquiree at fair value or according to the proportion of non-controlling interests in the acquiree's net assets. Changes in the Bank's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions. In such circumstances the carrying amounts of the controlling and non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interest is adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Bank.

c. Fiduciary services

The Group provides custody services, fund management and discretionary and advisory investment management services which require the Group to make decisions on the handling, acquisition or disposal of financial instruments on behalf of its clients.

The financial statements of managed funds and investment portfolios managed by the Group on behalf of customers are not included in the financial statements, as they do not constitute assets or liabilities of the Group.

d. Transactions eliminated on consolidation

Intra-bank balances, income and expenses, and unrealised gains and losses arising from intra-bank transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates are eliminated against the investment to the extent of the Group's interest in the associate. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

73. Foreign currency

a. Foreign currency transactions

Transactions in foreign currencies are translated into the functional currency of the respective Group's entity using the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to the functional currency using the exchange rate at the reporting date. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the exchange rate at the date the fair value was determined.

Foreign currency differences are posted a separate line item under net financial income as disclosed in notes 5 and 84.

b. Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into the functional currency at spot exchange rate current at the reporting date. The income and expenses of foreign operations are translated into the functional currency at the spot exchange rates at the dates of the transactions.

Translation differences on foreign operations are presented as a separate category in the statement of changes in equity.

Notes to the Consolidated Financial Statements

74. Recognition and derecognition of financial assets and liabilities

a. Recognition

Loans to customers and deposits are recognised on the date that they are originated. All other financial assets and liabilities are initially recognised on the trade date, which is the date when the Group becomes a party to the contractual provisions of the instrument.

b. Derecognition

A financial asset is derecognised when the contractual rights to the cash flows from the asset expire, or when the Group enters into a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

Financial liabilities are derecognised when the obligation of the Group is discharged, cancelled or expires.

75. Offsetting

Financial assets and liabilities are offset, and the net amount reported in the statement of financial position, when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis for gains and losses arising from a group of similar transactions, such as in the Group's trading activity, or other circumstances permitted by International Financial Reporting Standards.

76. Amortised cost measurement of financial assets and liabilities

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

77. Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, and initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment, when a payment under the guarantee has become probable. Financial guarantees are included within other liabilities.

78. Financial instruments - accounting classification

Upon initial recognition, financial assets and liabilities are classified into one of the categories below. This classification determines amongst other things initial measurement, subsequent accounting and handling of interest revenue and expenses. International Financial Reporting Standards restrict the reclassification of financial instruments after initial recognition.

a. Held for trading

A financial instrument is classified as held for trading if it is purchased or incurred with the intention to resell and repurchase within a short period of time, or if it is a part of a group of defined financial instruments managed on a portfolio basis and historical data shows recent pattern of short-term profit taking or it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

Financial assets held for trading include fixed income securities, shares and other variable income securities and derivatives. Financial liabilities held for trading include derivatives and short positions, i.e. commitments to deliver financial assets that the Bank has borrowed and sold to a third party.

Financial instruments held for trading are initially recognised at fair value, with transactions costs recognised in profit or loss. They are subsequently measured at fair value in the statement of financial position. Interest income and expense from derivatives is recognised in net interest income but all other interest income and expense, and all changes in fair value, are recognised as financial income.

b. Designated at fair value

A financial instrument is designated at fair value through profit and loss when it is a part of a portfolio of financial instruments that are managed on the basis of fair value and information provided to management is based on fair value.

Financial assets designated at fair value include fixed income securities, shares and other variable income securities and securities used for hedging.

Financial instruments designated at fair value are initially recognised at fair value, with transactions costs recognised in profit or loss. They are subsequently measured at fair value in the statement of financial position. Interest income and expense, and all changes in fair value, are recognised as financial income.

Notes to the Consolidated Financial Statements

78. Financial instruments - accounting classification cont.

c. Available for sale
Non-derivative assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold indefinitely, but not necessarily to maturity, are classified as available for sale.

Financial assets classified as available for sale consist of fixed income securities.

Financial instruments classified as available for sale are initially recognised at fair value. They are subsequently measured at fair value in the statement of financial position, with interest income recognised in net interest income using the effective interest method. The difference between fair value and amortised cost is recognised in comprehensive income until the financial instrument is sold or reaches maturity, whereupon the cumulative gains or losses previously recognised in other comprehensive income are reclassified to financial income.

d. Loans and receivables
Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market are classified as loans and receivables.

Financial assets classified as loans and receivables include cash and cash equivalents, loans to customers and receivables.

Financial assets classified as loans and receivables are initially recognised at fair value, which is typically equal to cost, i.e. cash advanced plus any transaction costs. They are subsequently measured at amortised cost using the effective interest method. Accrued interest, in the case of interest bearing assets, is included in the carrying amount. Interest income is recognised in net interest income.

e. Other at amortised cost
Non-derivative financial liabilities with fixed or determinable payments that are not quoted in an active market are classified as other at amortised cost.

Financial liabilities classified as other at amortised cost include deposits, borrowings and payables.

Financial liabilities classified as other at amortised cost are initially recognised at fair value, which is typically equal to cost, i.e. cash advanced less any transaction costs. They are subsequently measured at amortised cost using the effective interest method. Accrued interest, in the case of interest bearing liabilities is included in the carrying amount. Interest expense is recognised in net interest income.

79. Determination of fair value

The determination of fair value of financial assets and financial liabilities that are quoted in an active market is based on quoted prices. A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. For all other financial instruments fair value is determined by using valuation techniques, see in notes 59 - 60.

80. Impairment

a. General principle
The carrying amount of the Group's non-financial assets and financial assets not at fair value through profit and loss is reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment is recognised in the income statement whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

b. Reversal of impairment
If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is recognised as reduction of cost in the income statement. An impairment loss recognised for goodwill is not reversed in a subsequent period.

c. Calculation of recoverable amount
The recoverable amount of the Group's investments in financial assets carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate.

The recoverable amount of other assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Notes to the Consolidated Financial Statements

81. Impairment of loans

a. Indications of impairment

Objective evidence of impairment includes information about one or more of the following:

- Indications of significant financial difficulties of the borrower, including financial restructuring and refinancing concessions that a lender would not otherwise consider
- A breach of contract, such as a default on instalments or on interest or principal payments
- An observable decrease in the estimated future cash flows from a group of loans due to adverse changes in the economic conditions of a sector or region in which the borrower operates, even if the decrease cannot yet be identified with the individual financial assets in the group
- The disappearance of an active market for an asset held as collateral

Impairment losses expected as a result of events taking place after the reporting date, no matter how likely, are not recognised.

b. Calculation of impairment losses

Impairment loss is calculated by comparing the carrying amount of individual loans with the present value of their expected future cash flows, discounted at their original effective interest rate. In the case of loans at variable interest rates, the discount rate used is their current effective interest rate.

c. Individually assessed loans

Impairment losses on individually assessed loans are determined by an evaluation of the exposures on a case-by-case basis. This procedure is applied to all loans that are considered individually significant. In making the assessment, the following factors are considered:

- The Group's aggregate exposure towards the customer
- The amount and timing of expected receipts and recoveries
- The likely recovery upon liquidation or bankruptcy
- Complexity and uncertainty related to ranking of creditor claims and legal standing
- The realisable value of securities or other credit mitigants and the likelihood of successful repossession
- The likely deduction of any costs involved in recovery of amounts outstanding

d. Collectively assessed loans

Impairment losses on collectively assessed loans are determined by an evaluation of the exposures on a group of loans with similar risk characteristics. This procedure is applied to all loans that are not considered individually significant, or have been individually assessed but showed no indications of impairment. This loss covers loans that are impaired at the reporting date but which will not be individually identified as such until some time in the future.

The collective impairment loss is determined after taking into account the following:

- Historical loss experience in portfolios of similar risk characteristics, for example, by industry sector, loan grade or product
- The estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an allowance against the loss on an individual loan
- Management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience

Estimates of changes in future cash flows for groups of assets are consistent with changes in observable data from period to period, for example changes in property prices, payment status, or other factors indicative of changes in the probability of losses on the group and their magnitude. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to minimise any differences between loss estimates and actual losses.

e. Loan write-offs

The carrying amount of impaired loans is reduced through the use of an allowance account. Loans are written off, partially or in full, when there is no realistic prospect of recovery.

f. Forbearance

The Group may modify the contractual terms of a loan for a variety of reasons. Changes in terms are subject to the same policies and limits as new loans and are evaluated on a case by case basis. If the change is triggered by the borrower's inability to meet the terms and conditions of the loan (a forbearance activity), the loan is first evaluated for indications of impairment. If there is evidence of impairment the loan is subject to specific impairment and classified as such. If there is no identified need for specific impairment the loan is considered performing.

Notes to the Consolidated Financial Statements

82. Interest income and expense

Interest income and expense are recognised in the income statement using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash flows to the carrying amount of the financial asset or liability, over the expected life of the financial instrument. Estimated future cash flows take into account all contractual terms of the financial instruments but not future credit losses.

Interest income and expense presented in the income statement includes interest on:
- financial assets classified as loans and receivables
- financial assets classified as available for sale
- financial liabilities carried at amortised cost
- derivatives

Further information about the accounting classification of financial assets and liabilities is provided in notes 58 and 78.

83. Fee and commission income and expense

The Group earns income from providing various services to its customers. This includes fees for managing assets on behalf of customers, commissions received for equity and bond transactions and fees and commissions for various other financial services.

Fee and commission income and expense comprises the following:
- Fee and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate
- Other fee and commission income is recognised in the income statement as the services are provided
- Fee and commission expense relates mainly to transaction fees, which are expensed as the services are received

84. Net financial income

Net financial income comprises the following:
- Realised and unrealised gains or losses from price changes of fixed income securities carried at fair value
- Realised and unrealised gains or losses from price changes of variable income securities
- Interest income from fixed income securities carried at fair value through profit or loss
- Dividends, excluding dividends from associates
- Fair value changes in derivatives
- Foreign exchange difference

85. Dividend income

Dividend income is recognised when the right to receive income is established. Usually this is the ex-dividend date for equity securities. Dividends, other than those from associates, are presented as a component of net financial income.

86. Administrative expenses

Administrative expenses comprise expenses other than interest expenses, fee and commission expenses and expenses related to fair value changes. A breakdown of administrative expenses is provided in note 7.

87. Employee benefits

a. Short-term employee benefits
Short-term employee benefits obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

b. Defined contribution plans
Obligations for contributions to defined contribution plans are expensed in profit or loss as the related service is provided. The Group has no further obligations once those contributions have been paid.

c. Shared-based payments
The grant date fair value of equity settled share-based payment awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market performance conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that meet the related service and non-market performance conditions at the vesting date.

Notes to the Consolidated Financial Statements

88. Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, except to the extent that it relates to items recognised directly in other comprehensive income or equity, in which case it is recognised there.

Current tax liabilities include the estimated tax payable next year on current year's profit according to the tax rates prevailing at reporting date, in addition to corrections on tax from previous years.

The deferred income tax asset and/or liability has been calculated and recognised in the statement of financial position. The calculation is based on the difference between assets and liabilities as presented in the tax return on one hand, and in the consolidated financial statements on the other, taking into consideration tax losses carried forward. This difference is due to the fact that the tax assessment is based on premises that differ from those governing the financial statements, mostly due to temporary differences arising from the recognition of revenue and expense in the tax returns and in the financial statements.

Deferred tax assets and tax liabilities are offset in the statement of financial position when there is a legal right to settle on a net basis and they are levied by the same taxing authority on the same entity or on different entities subject to joint taxation.

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

89. Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, balances held with central banks and other financial institutions, and highly liquid financial assets with original maturities of three months or less from the acquisition date that are subject to and insignificant risk of changes in their fair value, and are used by the Group in the management of its short-term commitments.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

90. Receivables from Central Bank

Receivables from Central Bank of Iceland represent short-term claims on the Central Bank of Iceland resulting from reverse repurchase agreements.

91. Fixed income securities

Fixed income securities are initially measured at fair value and subsequently accounted for depending on their classification as discussed in note 78.

92. Shares and other variable income securities

Shares and other variable income securities consist of equity investments and unit shares in mutual funds. Shares and other variable income securities are initially measured at fair value and subsequently accounted for depending on their classification as discussed in note 78.

93. Securities used for hedging

Securities used for hedging consist of non-derivative financial assets that are used to hedge the Group's risk exposure arising from derivative contracts with customers. Securities used for hedging are designated at fair value as discussed in note 78.

94. Loans to customers

Loans are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and include loans provided by the Group to its customers, participation in loans from other lenders and purchased loans that are not quoted in an active market and which the Group has no intention of selling immediately or in the near future.

Loans are initially recognised at fair value, which is the cash advanced, plus any transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the loans and advances. The carrying amount of impaired loans is reduced through the use of an allowance account.

When the Group purchases a financial asset and simultaneously enters into an agreement to resell the asset, or a substantially similar asset, at a fixed price at a future date (“reverse repo” or “stock borrowing”), the arrangement is accounted for as a loan and the underlying asset is not recognised in the Group’s statement of financial position.

Notes to the Consolidated Financial Statements

95. Derivatives

A derivative is a financial instrument or another contract that falls under the scope of IAS 39 and has the following three characteristics:

- Its value changes due to changes in an underlying variable, such as bond price, share price, security or price index (including CPI), foreign currency exchange rate or interest rate
- The contract requires no initial investment or an initial investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors
- Settlement takes place at a future date

The Group uses derivatives for trading purposes and to hedge its exposure to market price risk, foreign exchange risk and inflation and interest risk arising from operating, financing and investing activities. The Group does not apply hedge accounting.

Derivative assets and liabilities are initially recognised and subsequently measured at fair value in the statement of financial position. Derivatives with positive fair values are classified as financial assets and derivatives with negative fair values as financial liabilities. Revenue from derivatives is split into interest income and net income from financial instruments at fair value and presented in the corresponding line items in the income statement.

96. Intangible assets

a. Asset categories

The Group groups intangible assets into three categories:

- Software
  Software comprise acquired software licences and external costs associated with the development of bespoke applications.
- Goodwill
  Goodwill arises in business combinations. It is recognised as of the acquisition date and measured as the aggregate of (a) the fair value of the consideration transferred, (b) the recognised amount of any non-controlling interest in the acquiree, and (c) the fair value of any previously held equity interest in the acquiree, less the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as at the acquisition date. The consideration transferred includes the fair value of assets transferred, liabilities incurred and equity interests issued by the Group. In addition, consideration transferred includes the fair value of any contingent consideration. Following initial recognition, goodwill is recognised at cost less any accumulated impairment losses.
- Other intangible assets
  Other intangible assets comprise licences and acquired trademarks used in the operation of the Group.

The Group has not defined any internally generated intangible assets.

b. Initial recognition

Intangible assets are initially recognised at cost.

c. Subsequent measurement

The Group uses the cost model for measurement after recognition and intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Intangible assets are reviewed for indications of impairment or changes in estimated future economic benefits at each reporting date. If such indications exist, the assets are analysed to assess whether their carrying amount is fully recoverable. An impairment loss is recognised in accordance with the accounting policy for non-financial assets described in note 81.

d. Amortisation

Intangible assets with finite useful life are amortised using the straight-line method over their estimated useful economic life, with the amortisation recognised in the income statement. The estimated useful life of intangible assets is as follows:

Software	5-10 years
Other intangible assets with finite useful life	10 years

Depreciation of property and equipment and amortisation of intangible assets are presented together as a separate line item in administrative expenses as disclosed in note 7. Further breakdown is provided in notes 24-25.

MP banki hf. Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

97. Property and equipment

a. Asset categories
The Group groups tangible assets into two categories:

- Real estate, which includes office and residential buildings, land and building rights
- Other property and equipment, which includes automobiles, furniture and fixtures, computers and other office equipment

b. Initial recognition
Property and equipment is initially recognised at cost, which includes direct expenses related to the purchase.

c. Subsequent measurement
The Group uses the cost model for the measurement after recognition and property and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses. Property and equipment is reviewed for indications of impairment or changes in estimated future economic benefits at each reporting date. If such indications exist, the assets are analysed to assess whether their carrying amount is fully recoverable. An impairment loss is recognized in accordance with the accounting policy for non-financial assets described in note 81.

d. Subsequent cost
The Group recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. The decision, if subsequent costs are added to the acquisition cost of property and equipment, is based on whether an identified component, or part of such component, has been replaced or not, or if the nature of the subsequent cost means a contribution of a new component. All other costs are expensed in the income statement when incurred.

e. Depreciation
Depreciation is recognised in the income statement on a straight-line basis over the estimated useful lives of each component of an item of property and equipment. The estimated useful lives are as follows:

Real estate	15-50 years
Other property and equipment	3-5 years

Where parts of an item of property and equipment have different useful lives, those components are accounted for separately.

Depreciation of property and equipment and amortisation of intangible assets are presented together as a separate line item in administrative expenses as disclosed in note 7. Further breakdown is provided in notes 24-25.

98. Investments in associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence generally exists when the Group holds between 20% and 50% of the voting power, including potential voting rights, if any. Investments in associates are initially recognised at cost.

The Group's share of the total recognised gains and losses of associates is included in the financial statements of the Group on an equity accounted basis, from the date the significant influence commences until the date it ceases.

If the Group's share of loss exceeds its interest in an associate, the Group's carrying amount is reduced to zero and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the Group resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

99. Other assets

Other assets are measured at amortised cost.

100. Assets classified as held for sale

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets are remeasured in accordance with the Group's accounting policies. Thereafter the assets are measured at the lower of their carrying amount and fair value less cost to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

Notes to the Consolidated Financial Statements

101. Deposits from customers

Deposits consist of time deposits and demand deposits. Money market deposits are included in borrowings. Deposits are recognised at amortised cost, including accrued interest.

102. Borrowings

Borrowings are initially recognised at fair value less attributable transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in their carrying amount.

When the Group sells a financial asset and simultaneously enters into an agreement to repurchase the asset, or a substantially similar asset, at a fixed price at a future date (“repo” or “stock lending”), the arrangement is accounted for as a borrowing and the underlying asset continues to be recognised in the Group’s statement of financial position.

103. Short positions used for trading

Short positions are carried at fair value with all fair value changes recognised in the income statement under net financial income.

104. Short positions used for hedging

Short positions used for hedging consist of non-derivative financial liabilities that are used to hedge the Group's risk exposure arising from derivative contracts with customers.

105. Other liabilities

Other liabilities are measured at amortised cost.

106. Share capital

a. Treasury shares
Acquired own shares and other equity instruments (treasury shares) are deducted from equity. No gain or loss is recognised in income statement on the purchase, sale, issue or cancellation of treasury shares. Consideration paid or received is recognised directly in equity. Incremental transaction costs of treasury share transactions are accounted for as a deduction from equity, net of any related income tax benefit.

b. Share premium
Share premium represents excess of payment above nominal value (ISK 1 per share) that shareholders have paid for shares sold by the Group.

c. Dividends on share capital
Dividends on share capital are deducted from equity in the period in which they are approved by the Group's shareholders meetings.

107. Nature and purpose of equity reserves

a. Option reserve
The option reserve represents the cumulative charge to the income statement for options to purchase shares in the Bank granted under the Bank's Remuneration policy, which is discussed in notes 64-66.

b. Warrants reserve
The warrants reserve represents the consideration received for outstanding warrants, as disclosed in note 37.

c. Deficit reduction reserve
The deficit reduction reserve was created as a part of a share capital reduction approved by the Bank's Annual General Meeting in April 2014, as discussed in note 35. The reserve has no specified purpose and can only be used with the approval of a shareholders' meeting.

d. Equity instrument reserve
The equity instrument reserve represents the consideration received for financial instruments issued by the Bank, which meet the definition of an equity instrument.

Notes to the Consolidated Financial Statements

107. Nature and purpose of equity reserves cont.

e. Translation reserve
The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations, until the operations are sold, dissolved or abandoned.

f. Fair value reserve
The fair value reserve comprises the cumulative net change in the fair value of available for sale financial assets, until the assets are derecognised or impaired.

g. Accumulated deficit - retained earnings
Accumulated deficit (Retained earnings if positive) consists of undistributed profits and losses accumulated, less transfers to other reserves.

108. New standards and interpretations

A number of new standards, amendments to standards and interpretations were not yet effective for the year ended 31 December 2014 and have not been applied in the preparation of these financial statements. Early adoption of new standards and amendments is not planned and the effects of adoption are generally not known.

IFRS 9 Financial Instruments, which will become effective for annual reporting periods beginning on or after 1 January 2018, includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets. Given the nature of the Group's operations, adoption of IFRS 9 is expected to have a pervasive impact on the Group's financial statements.

a. New standards, amendments and interpretations which became effective for the financial year starting 1 January 2014
Several new standards and interpretations relevant to the Group became effective during the financial year, the most significant of which are IFRS 10 Consolidate Financial Statements and IFRS 12 Disclosure of Interests in Other Entities. These standards include a revised definition of control and introduce new disclosure requirements. The adoption of IFRS 10 and IFRS 12 did not have a material effect on the financial statements.

b. New standards, amendments and interpretations which become effective for the financial year starting 1 January 2015
No new standards, amendments or implementations with significant relevance to the Group will become effective during the next financial year.

109. Use of estimates and judgements

In the process of applying the Group's accounting policies, management makes use of judgements and estimates which are based on various assumptions. These judgements and estimates can affect the reported amounts of assets and liabilities, income and expense.

Assumptions and estimates are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances, and are reviewed on an on-going basis. The estimates form the basis for judgements about the carrying value of assets and liabilities that are not readily available from other sources and actual results may differ. Judgement may also be required in circumstances not involving estimates, e.g. when determining the substance of a particular transaction, contract or relationship.

The areas where the use of judgements and estimates has the most significant effect on the amounts recognised in the statement of financial position or the income statement are disclosed in this note.

a. Fair value of financial instruments
The fair value of financial instruments that are not quoted in active markets is determined using valuation techniques which are reviewed regularly as discussed in note 59.

b. Impairment of financial assets
As outlined in notes 80-81, the use of estimates and judgement is an important component of the calculation of impairment losses. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. Unforeseen events could, however, result in further impairment losses which would have a material effect on the income statement and statement of financial position.

c. Deferred tax asset
Judgement is required to determine the extent to which deferred tax assets are recognised in the statement of financial position, based on the likely timing and level of future taxable profits.