Consolidated Financial Statements
31 December 2012

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Endorsement and Statement
by the Board of Directors and the CEO

The Consolidated Financial Statements of MP Bank hf. for the year 2012 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, and additional Icelandic disclosure requirements. The Consolidated Financial Statements comprise MP Bank hf. and its subsidiaries.

According to the Consolidated Income Statement, profit in 2012 amounted to ISK 251 million. According to the Consolidated Statement of Financial Position, the Bank's equity at the end of the year 2012 amounted to ISK 5,250 million. As at 31 December 2012, the Bank's total assets amounted to ISK 69,393 million. The Tier 1 capital ratio of the Bank was 10.8% but the minimum requirement by law is 8.0%.

The Bank's issued share capital amounted to ISK 5,554 million as at 31 December 2012 (2011: ISK 5,554 million). The Bank held treasury shares with a nominal value of ISK 4 million (2011: ISK 4 million).

At a Shareholders Meeting in November 2012, the Board of Directors was authorized to increase its share capital by up to ISK 2 billion at nominal value through a subscription for new shares. The new shares shall be issued at the price range from 1 to 1.2 ISK per each share.

The Bank had 49 shareholders at year-end (2011: 49). One shareholder held more than 10% of shares in the Bank, Títan B ehf. with 17.3%.

The Bank had no operations at the start of 2011. On 1 April 2011 the Bank signed a contract acquiring the Icelandic and Lithuanian assets and operations of EA Fjárfestingarfélag hf. (formerly MP Bank hf.) and resumed commercial banking activities on 12 April 2011. Comparative information in the Income Statement and Statement of Cash Flows, and accompanying notes, is therefore not fully comparable.

The Bank's Board of Directors propose that no dividend will be paid in the year 2013 on 2012 operations.

Corporate Governance

The Board of Directors emphasizes good corporate governance and following accepted guidelines on corporate governance. The Board has laid down comprehensive rules, *The Rules of Procedures for the Board of MP Bank*, 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 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.

Statement by the Board of Directors and the CEO

To the best of our knowledge the Consolidated Financial Statements of MP Bank hf. for the year 2012 comply with International Financial Reporting Standards as adopted by the EU, and give a true and fair view of the Bank's assets, liabilities and financial position as at 31 December 2012 and the financial performance of the Bank and changes of cash flows for the year 2012.

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 Bank's operations and its position and describes the principal risks and uncertainties faced by the Bank.

The Board of Directors and the CEO of the Bank have today discussed the Consolidated Financial Statements for the year 2012 and confirm them by the means of their signatures.

Reykjavík, 21 March 2013.

Board of Directors

Þorsteinn Pálsson

Hanna Katrín Friðriksson

CEO

Independent Auditor's Report

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

We have audited the accompanying consolidated financial statements of MP Bank hf. and its subsidiaries, which comprise the consolidated statement of financial position as at December 31, 2012, 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.

Management's Responsibility for the Financial Statements

Management is 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 management determines 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 judgment, including the assessment of the risks of material misstatement of the 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 principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the 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 Bank hf. as at December 31, 2012, 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 106, Paragraph 1, Item 5 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 financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the Financial Statements.

Reykjavík, 21 March 2013.

KPMG ehf.

MP Bank hf. Amounts are in ISK thousands

Consolidated Income Statement
For the year 2012

	Notes	2012	2011
Interest income		3,495,332	1,440,943
Interest expense		(1,779,213)	(982,218)
Net interest income	39	1,716,119	458,725
Fee and commission income	40	1,505,321	847,051
Fee and commission expense		(110,263)	(71,004)
Net fee and commission income		1,395,058	776,047
Net financial income	41-42	637,035	492,714
Share in profit of associates, net of income tax	57	217,482	66,128
Other operating income		28,873	36,365
Other operating income		883,390	595,207
Net operating income		3,994,567	1,829,979
Administrative expenses	43-46	(3,128,166)	(2,126,991)
Impairment of loans and receivables	55	(670,962)	(244,210)
Loss from assets held for sale	14, 63	(10,989)	0
Profit (loss) before taxes		184,451	(541,221)
Income tax	47	148,413	115,602
Special tax on financial institutions	48	(81,516)	(57,930)
Profit (loss) for the year		251,348	(483,549)

	Notes	2012	2011
Attributable to the shareholders of MP Bank hf.		255,500	(486,005)
Attributable to non-controlling interest	56	(4,153)	2,456
Profit (loss) for the year		251,348	(483,549)

The notes on pages 8 to 46 are an integral part of these Consolidated Financial Statements.

Amounts are in ISK thousands

Consolidated Statement of Comprehensive Income

For the year 2012

	Notes	2012	2011
Profit (loss) for the year		251,348	(483,549)
Fair value changes in securities classified as available for sale		(121,707)	141,775
Exchange difference on translation of foreign operations		2,549	(8,478)
Other comprehensive income, net of tax		(119,158)	133,297
Total comprehensive income (loss) for the year		132,189	(350,252)

	Notes	2012	2011
Attributable to the shareholders of MP Bank hf.		136,342	(352,708)
Attributable to non-controlling interest		(4,153)	2,456
Total comprehensive income (loss) for the year		132,189	(350,252)

The notes on pages 8 to 46 are an integral part of these Consolidated Financial Statements.

MP Bank hf. Amounts are in ISK thousands

Consolidated Statement of Financial Position

As at 31 December 2012

Assets	Notes	2012	2011
Cash and cash equivalents	50	20,289,559	11,545,143
Receivables from Central Bank of Iceland		3,287,741	0
Fixed income securities	51	5,221,038	13,678,864
Shares and other variable income securities	52	1,243,133	1,068,531
Securities used for hedging	53	6,807,792	7,694,837
Loans to customers	54-55	27,789,290	13,294,303
Derivatives	28	312,795	199,571
Investment in associates	57	560,825	405,272
Intangible assets	58-59	1,103,829	1,123,857
Property and equipment	60	738,099	328,599
Deferred tax asset	61	292,288	107,872
Other assets	62	646,485	662,246
Assets classified as held for sale	14, 63	1,100,000	0
Total assets		69,392,873	50,109,096

Liabilities	Notes	2012	2011
Deposits	64	42,402,442	34,594,083
Borrowings	65	6,575,208	2,051,155
Short positions used for trading	66	5,961,847	4,838,963
Short positions used for hedging	67	2,024,604	1,274,229
Derivatives	28	221,518	101,498
Current tax liabilities		3,180	32,704
Deferred tax liabilities		180	303
Other liabilities	68	6,159,274	2,147,207
Liabilities associated with assets classified as held for sale	14, 63	795,000	0
Total liabilities		64,143,251	45,040,142

Equity	Notes	2012	2011
Share capital	69	5,550,000	5,550,000
Share premium		7,500	7,500
Option reserve	94	518	0
Other reserves		41,890	(8,478)
Accumulated deficit		(346,283)	(480,076)
Total equity attributable to the shareholders of MP Bank hf.		5,253,625	5,068,945
Non-controlling interest		(4,003)	9
Total equity		5,249,622	5,068,954
Total liabilities and equity		69,392,873	50,109,096

The notes on pages 8 to 46 are an integral part of these Consolidated Financial Statements.

MP Bank hf. Amounts are in ISK thousands

Consolidated Statement of Changes in Equity

For the year 2012

1 January 2012 to 31 December 2012	Notes	Share capital	Share premium	Share options reserve	Other reserves	Accumulated deficit	Total shareholders' equity	Non-controlling interest	Total equity
Equity as at 1 January 2012		5,550,000	7,500		(8,478)	(480,076)	5,068,945	9	5,068,954
Total comprehensive income for the year					2,549	133,793	136,342	(4,153)	132,189
Share-based payment transactions	94			518			518		518
Acquisition of non-controlling interest	56						0	141	141
Equity instrument related to the acquisition of ALFA verðbréf hf.	56				47,819		47,819		47,819
Equity at 31 December 2012		5,550,000	7,500	518	41,890	(346,283)	5,253,625	(4,003)	5,249,622

1 January 2011 to 31 December 2011	Notes	Share capital	Share premium	Share options reserve	Other reserves	Accumulated deficit	Total shareholders' equity	Non-controlling interest	Total equity
Equity as at 1 January 2011		100,000	330,000			(410,847)	19,153		19,153
Total comprehensive income for the year					(8,478)	(344,230)	(352,708)	2,456	(350,252)
New share capital sold		5,450,000	7,500				5,457,500		5,457,500
Expenses incurred in relation to share capital increase						(55,000)	(55,000)		(55,000)
Share premium offset against accumulated deficit			(330,000)			330,000	0		0
Acquisition of non-controlling interest	56						0	(2,447)	(2,447)
Equity at 31 December 2011		5,550,000	7,500	0	(8,478)	(480,076)	5,068,945	9	5,068,954

The notes on pages 8 to 46 are an integral part of these Consolidated Financial Statements.

MP Bank hf. Amounts are in ISK thousands

Consolidated Statement of Cash Flows
For the year 2012

Cash flows from operating activities	Notes	2012	2011
Profit (loss) for the year		251,348	(483,549)
Adjustments for:			
Indexation and exchange rate difference		244,918	491,489
Share in profit of associates, net of income tax	57	(217,482)	(66,128)
Depreciation and amortisation	58-60	119,125	111,673
Impairment of loans and receivables	55	670,962	244,210
Deferred income tax, change	61	(184,540)	(107,784)
Other adjustments		23,431	0
		907,761	189,911
Changes in:			
Loans		(14,989,996)	(4,756,632)
Deposits		7,283,641	1,360,123
Financial assets		5,647,597	(1,850,123)
Financial liabilities		2,041,097	(1,358,814)
Income tax paid		(31,093)	(27,519)
Operating assets and liabilities		4,029,397	(3,307,727)
Net cash from (to) operating activities		4,888,404	(9,750,781)

Cash flows from investing activities	Notes	2012	2011
Associated companies	57	42,607	38,408
Acquisition of intangible assets	58	(32,229)	(301,966)
Acquisition of property and equipment	60	(504,680)	(51,212)
Proceeds from the sale of property and equipment	60	34,167	138,405
Investment in assets classified as held for sale	14, 63	(305,000)	0
Net cash to investing activities		(765,135)	(176,365)

Cash flows from financing activities	Notes	2012	2011
Borrowings		24,911,000	17,802,155
Repayment of borrowings		(20,386,947)	(15,751,000)
New share capital		0	5,402,500
Net cash from financing activities		4,524,053	7,453,655

	Notes	2012	2011
Cash and cash equivalents at the beginning of the year	50	11,545,143	0
Net increase (decrease) in cash and cash equivalents		8,647,322	(2,473,491)
Cash acquired through business combinations		0	13,961,738
Effects of exchange rate fluctuations on cash held		97,093	56,897
Cash and cash equivalents at the end of the year	50	20,289,559	11,545,143

The notes on pages 8 to 46 are an integral part of these Consolidated Financial Statements.

Notes

General information

1. Reporting entity

MP Bank hf. 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 2012 comprise MP Bank hf. (the Parent) and its subsidiaries (together referred to as the Bank). The Bank is primarily involved in investment, corporate and retail banking, and in providing asset management services.

The Bank has established a new business unit providing asset financing services in the form of loans and leases. The unit operates under the brand name Lykill and opened for business on 23 March 2012.

The Consolidated Financial Statements were approved and authorised for issue by the Board of Directors and CEO on 21 March 2013.

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 financial instruments at fair value through profit or loss, available for sale financial assets and short positions which are measured at fair value as outlined in notes 84.

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 Bank's ability to continue as a going concern and it is satisfied that the Bank 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 38.

f. Comparative information
The Bank had no operations at the start of 2011. On 1 April 2011 the Bank signed a contract acquiring the Icelandic and Lithuanian assets and operations of EA Fjárfestingarfélag hf. (formerly MP Bank hf.) and resumed commercial banking activities on 12 April 2011. Comparative information in the Income Statement and Statement of Cash Flows, and accompanying notes, is therefore not fully comparable.

Notes - continued

Significant accounting policies

3. 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 Bank entities.

a. Subsidiaries
Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control usually exists when the Bank holds more than 50% of the voting power of the subsidiary. In assessing control, potential voting rights that are presently exercisable or convertible, if any, are taken into account. The financial statements of subsidiaries are included in the financial statements of the Bank from the date that control commences until the date that control ceases.

The Bank uses the purchase 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 Bank'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 Bank 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 Bank provides custody services, fund management and discretionary and advisory investment management services which require the Bank 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 Bank on behalf of customers, are not included in the financial statements of the Bank, as they do not constitute assets or liabilities of the Bank.

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 Bank'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.

4. Associates

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

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

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

Notes - continued

5. Foreign currency

a. Foreign currency transactions

Transactions in foreign currencies are translated into the functional currency of the respective Bank'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.

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.

6. Recognition and derecognition of financial assets and liabilities

a. Recognition

Loans, deposits, debt securities issued and subordinated liabilities 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 Bank 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 Bank 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 Bank is recognised as a separate asset or liability.

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

7. Offsetting

Financial assets and liabilities are offset, and the net amount reported in the statement of fiancial 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 Bank's trading activity, or other circumstances permitted by International Financial Reporting Standards.

8. 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.

9. Financial guarantees

Financial guarantees are contracts that require the Bank 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.

Notes - continued

10. 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, repurchase, repay or collect 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.

Financial assets held for trading include fixed income securities, shares and other variable income securities and derivatives. Financial liabilities 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. They are subsequently measured at fair value in the statement of financial position, with transactions costs recognised in profit or loss. 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 and shares and other variable income securities. Financial liabilities consist primarily of short positions, i.e. commitments to deliver financial assets that the Bank has borrowed and sold to a third party.

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

c. Available for sale
Non-derivative assets with fixed or determinable payments and fixed maturity that the Bank 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 primarily 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. Held to maturity
Non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to marturity are classified as held to maturity.

Financial assets classified as held to maturity consist primarily of fixed income securities.

Financial assets classified as held to maturity are initially recognised at cost. They are subsequently measured at amortised cost using the effective interest method, with interest income recognised in net interest income.

A sale or reclassification of a more than insignificant amount of held to maturity investments would result in the reclassification of all held to maturity investments as available for sale, and would prevent the Bank from classifying investment securities as held to maturity for the current and the following two financial years.

e. 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.

f. 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.

Notes - continued

11. 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 is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis. For all other financial instruments fair value is determined by using valuation techniques.

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 Bank 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 Bank 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.

12. Impairment

a. General principle

The carrying amount of the Bank'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 Bank'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.

13. 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 installments 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.

Notes - continued

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 Bank'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 reposession
- 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.

14. 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 Bank'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.

15. 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 Bank. According to Icelandic Companies Act, 25% of the nominal value of share capital must be held in reserve which can not be paid out as dividend to shareholders.

c. Dividends on share capital

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

Notes - continued

16. 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 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 held to maturity
- 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 10 and 84.

17. Fee and commission income and expense

The Bank 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 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

18. 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
- Dividends, excluding dividends from associates
- Fair value changes in derivatives
- Foreign exchange difference

19. 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 component of net financial income.

20. 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 43.

21. 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 Bank 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
Contractual payments to contribution pension plans are recognised as an expense in profit or loss when they are due. The Bank has no further obligations once those contributions have been paid.

c. Shared-based payments
The grant date fair value of 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 nonmarket performance conditions at the vesting date.

Notes - continued

22. 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.

23. Cash and cash equivalents

Cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, including cash in hand, balances with banks, unrestricted balances with Central Bank and other short-term highly liquid investments with original maturities of three months or less.

24. Fixed income securities

Fixed income securities are initially measured at fair value and subsequently accounted for depending on their classification as discussed in note 10.

25. 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 10.

26. Securities used for hedging

Securities used for hedging consist of non-derivative financial assets that are used to hedge the Bank's risk exposure arising from derivative contracts with customers. Securities used for hedging are designated at fair value as discussed in note 10.

27. 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 Bank to its customers, participation in loans from other lenders and purchased loans that are not quoted in an active market and which the Bank 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 Bank 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 Bank’s statement of financial position.

Notes - continued

28. 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
- Settlement takes place at a future date

The Bank 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 Bank 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 deratives with negative fair values as financial liabilities. Revenue from derviatives 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.

29. Intangible assets

a. Asset categories
The Bank 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 and equals the difference between the purchase price and share in the net assets of the acquired company. Net assets include book equity and the revaluation of assets and liabilites, if relevant, and the value of off-balance sheet assets and liabilities. Following initial recognition, goodwill is recognised at cost less impairment.
- Other intangible assets
  Other intangible assets comprise licences and acquired trademarks used in the operation of the Bank.

b. Initial recognition
Intangible assets are initally recognised at cost.

c. Subsequent measurement
The Bank uses the cost model for measurement after recognition and intangible assets are carried at cost less accumulated amortisation and impairment. 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 if the carrying amount exceeds the recoverable amount.

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

Notes - continued

30. Property and equipment

a. Asset categories
The Bank groups intangible assets into two categories:

- Real estate
  Real estate comprise office buildings.
- Other property and equipment
  Other property and equipment comprise 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 Bank uses the cost model for the measurement after recognition and property and equipment is carried at cost less accumulated depreciation and impairment. 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 if the carrying amount exceeds the recoverable amount.

d. Subsequent cost
The Bank 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 Bank 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.

31. Other assets

Other assets are measured at cost.

32. Deposits

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

33. 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 Bank 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 Bank’s statement of financial position.

34. 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.

35. Short positions used for hedging

Short positions used for hedging consist of non-derivative financial liabilities that are used to hedge the Bank's risk exposure arising from derivative contracts with customers. Short positions used for hedging are designated at fair value as discussed in note 10.

Notes - continued

36. Other liabilities

Other liabilities are measured at cost.

37. New standards and interpretations

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2012 and have not been applied in preparing these financial statements. Those which may be relevant to the Bank are IFRS 9 Financial Instruments, IFRS 13 Fair Value Measurement and amendments to IFRS 7 and IAS 32 on offsetting financial assets and financial liabilities. Early adoption of the standards is not planned and the effects of the adoption have not been estimated.

38. Use of estimates and judgements

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

a. Impairment losses
As outlined in notes 12 and 13, 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.

b. Deferred tax asset
The value of a deferred tax asset is estimated by management, based on projections about future profits and the extent to which the tax asset will be realised.

c. 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 by qualified independent personnel. All models that are used must be approved and calibrated to ensure that outputs reflect actual data.

MP Bank hf. Amounts are in ISK thousands

Notes - continued

Income statement

39. Net interest income

Interest income is specified as follows:

	2012	2011
Cash and cash equivalents	988,318	419,537
Derivatives	165,695	221,475
Loans to customers	1,803,778	448,913
Other interest income	537,541	351,018
Total	3,495,332	1,440,943

Interest expense is specified as follows:

	2012	2011
Deposits	1,452,621	956,155
Borrowings	282,279	4,431
Other interest expense	44,313	21,632
Total	1,779,213	982,218

Other interest income includes interest income from securities classified as held to maturity and available for sale.

40. Fee and commission income

Fee and commission income is specified as follows:

	2012	2011
Banking	391,914	145,714
Capital Markets	458,049	253,696
Asset Management	361,943	357,239
Other	293,415	90,401
Total	1,505,321	847,051

41. Net financial income

Net financial income is specified as follows:

	2012	2011
Fixed income	423,409	318,347
Equities	(7,572)	99,301
Foreign exchange	68,168	101,081
Fair value adjustments	153,030	(26,016)
Total	637,035	492,714

42. Foreign currency exchange difference

Foreign currency exchange difference is specified as follows:

	2012	2011
Gain (loss) on financial instruments at fair value through profit and loss	27,486	(27,628)
Gain on other financial instruments	40,683	128,709
Total	68,168	101,081
Change in the ISK trade index during the year	+7.1%	+4.4%

Note 79 provides information about the development of foreign exchange rates against the Icelandic krona.

Notes - continued

43. Administrative expenses

Administrative expenses are specified as follows:

	2012	2011
Salaries and related expenses	1,668,078	989,124
Other operating expenses	1,230,621	947,908
Depositors' and Investors' Guarantee Fund contributions	110,342	96,748
Depreciation and amortisation	119,125	93,210
Total	3,128,166	2,126,991

44. Salaries and related expenses

Salaries and related expenses are specified as follows:

	2012	2011
Salaries	1,195,574	788,049
Performance based payments excluding share based payments	100,897	12,074
Share-based payment expenses	518	0
Pension fund contributions	163,538	94,058
Tax on financial activity	72,848	0
Other salary related expenses	134,703	94,944
Total	1,668,078	989,124
Average number of full time employees during the year	117	116
Total number of full time employees at year-end	125	105

According to Act No. 165/2011, passed in 2011, banks and other financial institutions providing VAT exempt services, must pay a calculated tax based on salary payments, called tax on financial activity. The current tax rate is 5.45% (2011: 0.0%) but the rate will increase to 6.75% in 2013.

45. Employment terms of the board of directors and management

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

	Salaries	Number of shares	2012 Options	Salaries	Number of shares	2011 Options
Sigurður Atli Jónsson, CEO	35,861	25,000	25,000	11,582	25,000	0
Gunnar Karl Guðmundsson, former CEO	0	0	0	28,787	0	0
Þorsteinn Pálsson, Chairman of the Board	6,000	0	0	4,500	0	0
Skúli Mogensen, Deputy Chairman of the Board	3,000	960,600	0	2,250	960,600	0
Hanna Katrín Friðriksson, Board member	3,000	0	0	2,610	0	0
Mario Espinosa, Board member	3,000	0	0	2,250	0	0
Vilmundur Jósefsson, Board member	3,000	20,000	0	2,490	20,000	0
Inga Björg Hjaltadóttir, alternate Board member	2,250	0	0	0	0	0
Michael Crossley Wright, alternate Board member	2,250	0	0	0	0	0
Baldur Oddur Baldursson, former Board member	0	0	0	550	0	0
Managing Directors (2012: 7, 2011: 6)	168,421	0	120,000	75,429	0	0
Total	226,782	1,005,600	145,000	130,448	1,005,600	0

Contributions to pension funds and other benefits for the Board of Directors, the CEO and Managing Directors amounted to ISK 35.6 million in 2012 and ISK 15.0 million in 2011. The Bank resumed commercial banking operations on 12 April 2011 and as a result comparative information is not fully comparable.

Figures for shares and share options are in thousands and include shares held by companies owned by or under the control of the respective parties as at 31 December 2012 and 31 December 2011.

The Bank has defined two Managing Directors as Key Employees, 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 benfits, including pension fund contributions. Further information about the remuneration policy is provided in notes 92-94.

MP Bank hf. Amounts are in ISK thousands

Notes - continued

46. Auditor's fees

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

	2012	2011
Audit of annual accounts	23,075	18,569
Review of interim accounts	6,979	4,467
Other audit related services	5,339	2,380
Total	35,392	25,416
Thereof to the auditors of the parent company	32,083	19,964

47. Income tax

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

	2012	2011
Current income tax	3,180	32,704
Deferred tax income	145,233	82,898
Total	148,413	115,602

Reconciliation of effective tax rate:

		2012		2011
Profit (loss) before income tax		102,935		(599,151)
Income tax using the domestic corporation tax rate	20.0%	(20,587)	20.0%	119,830
Non-deductible expenses	17.2%	(17,725)	(6.6%)	(39,268)
Non-taxable income	(130.6%)	134,446	0.0%	0
Recognition of previously unrecognised tax losses	0.0%	0	4.0%	23,906
Other changes	(50.8%)	52,279	1.9%	11,134
Effective income tax	(144.2%)	148,413	19.3%	115,602

Profit before taxes amounts to ISK 184.5 million. Income tax amounts to ISK -148.4 million, resulting in an effective tax rate of -144.2%. This is substantially different from the Icelandic corporate tax rate of 20% due to an adjustment to the Bank's Deferred tax asset as at 31 December 2011.

48. 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. The tax rate is set at 0.041%. This tax is not a deductible expense for income tax purposes. A temporary amendment to the act passed in 2011 increases the tax rate by 0.0875% for taxes payable in 2012 and 2013.

	2012	2011
Special tax on financial institutions	81,516	57,930

49. Quarterly statements (unaudited)

	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011
Net interest income	412,708	452,363	473,752	377,297	322,952
Net fee and commission income	412,335	359,619	291,742	331,362	562,841
Net financial income	159,203	154,237	241,483	82,111	254,888
Share in profit of associates, net of income tax	0	0	164,267	53,215	78,803
Other operating income	21,867	14,252	18,200	(25,446)	16,733
Net operating income	1,006,113	980,472	1,189,444	818,538	1,236,216
Administrative expenses	(889,563)	(684,369)	(821,334)	(732,899)	(865,729)
Impairment of loans and receivables	(390,817)	(26,376)	(217,268)	(36,501)	(64,710)
Loss from assets held for sale	(10,989)	0	0	0	0
(Loss) profit before taxes	(285,256)	269,728	150,842	49,137	305,778
Income tax	180,431	6,623	(29,545)	(9,096)	(61,913)
Special tax on financial institutions	(16,208)	(22,473)	(24,835)	(18,000)	(20,725)
(Loss) profit for the period	(121,033)	253,878	96,462	22,041	223,140

MP Bank hf. Amounts are in ISK thousands

Notes - continued

Statement of Financial Position

50. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	2012	2011
Cash	106,824	123,762
Balances with banks	9,313,187	4,661,380
Certificates of deposits issued by Central Bank of Iceland	10,869,548	6,760,002
Total	20,289,559	11,545,143

51. Fixed income securities

Fixed income securities are specified as follows:

	2012	2011
Government bonds	3,131,968	13,136,745
Treasury bills	115,972	0
Listed bonds	1,775,643	338,975
Unlisted bonds	197,455	203,144
Total	5,221,038	13,678,864

52. Shares and other variable income securities

Shares and other variable income securities are specified as follows:

	2012	2011
Listed shares	349,076	86,938
Listed unit shares	199	152
Unlisted shares	129,836	175,254
Unlisted unit shares	764,022	806,188
Total	1,243,133	1,068,531

53. Securities used for hedging

Securities used for hedging are specified as follows:

	2012	2011
Government bonds	2,614,941	6,813,795
Listed bonds	784,324	153,924
Listed shares	3,408,527	727,118
Total	6,807,792	7,694,837

54. Loans to customers

Loans to customers are specified as follows:

	2012	2011
Loans to customers, gross amount	28,619,840	13,502,700
Specific allowance for impairment losses	(661,360)	(152,467)
Collective allowance for impairment losses	(169,190)	(55,929)
Total	27,789,290	13,294,303

MP Bank hf. Amounts are in ISK thousands

Notes - continued

55. Allowance for impairment losses

Change in allowance for impairment losses is specified as follows:

2012	**Specific**	**Collective**	**Total**
Balance as at 1 January 2012	187,629	55,819	243,448
Charge to the income statement for the year	557,591	113,371	670,962
Write-offs	(53,631)	0	(53,631)
Balance as at 31 December 2012	691,588	169,190	860,779

2011	**Specific**	**Collective**	**Total**
Balance as at 1 January 2011	0	0	0
Charge to the income statement for the year	188,391	55,819	244,210
Write-offs	(752)	0	(752)
Translation difference	(9)	0	(9)
Balance as at 31 December 2011	187,629	55,819	243,448

The impairment allowance is deducted from the following items in the statement of financial position:

	2012	**2011**
Loans to customers	830,550	208,397
Other assets	30,228	35,051
Total	860,779	243,448

Specific impairment charges in 2012 is largly related to a single loan and a contingent claim on the borrower, granted in relation to the restructuring of the bank in April 2011.

56. Group entities

The Bank holds 12 subsidiaries at year-end (2011: 8) all of which are included in the Consolidated Financial Statements. They are specified as follows:

	Domicile	**Share 2012**	**Share 2011**
Axia Asset Management UAB	Lithuania	100%	100%
FÍ Fasteignafélag GP ehf. (formerly Fasteignasjóður Íslands GP ehf.)	Iceland	70%	-
Heildun UAB	Lithuania	100%	100%
Horn Florida Ltd.	UK	100%	100%
Júpíter rekstrarfélag hf.	Iceland	100%	100%
LV31 ehf.	Iceland	100%	-
Lykillán ehf.	Iceland	100%	-
M-Investments ehf.	Iceland	100%	100%
M8 ehf.	Iceland	100%	-
Mánatún GP ehf.	Iceland	100%	-
Mánatún slhf.	Iceland	100%	-
MP Pension Funds Baltic UAB	Lithuania	100%	100%

The merger of the Bank with ALFA verðbréf hf., a subsidiary of the Bank in 2011, was completed in Q1 2012. The merger had an immaterial effect on the income statement or statement of financial position.

The Bank initiated a voluntary winding down of KFP ehf. The process was completed in Q4 and had an immaterial effect on the income statement and statement of financial position.

The Bank established four new direct subsidiaries in 2012, LV31 ehf., Lykillán ehf., M8 ehf. and Mánatún GP ehf. The consideration transferred was immaterial in all cases. The Bank established two indirect subsidiaries in 2012, FÍ Fasteignafélag GP ehf. and Mánatún slhf. The Bank's share in Mánatún slhf. was classified as asset held for sale, as discussed in note 63.

MP Bank hf. Amounts are in ISK thousands

Notes - continued

57. Investment in associates

a. Information about associated companies at year-end:

2012	Domicile	Assets	Liabilities	Results	Share	Share in results	Book value
GAM Management hf.	Iceland	487,653	89,034	177,517	26.8%	67,402	178,017
Londonderry Associates LLC	USA	194,174	0	0	38.0%	0	73,786
Teris	Iceland	623,171	32,373	63,151	50.2%	150,080	309,021
Total						217,482	560,825

2011	Domicile	Assets	Liabilities	Results	Share	Share in results	Book value
GAM Management hf.	Iceland	281,071	63,070	112,238	36.8%	41,528	176,528
Júpíter rekstrarfélag hf.	Iceland	0	0	0	0.0%	38,409	0
Londonderry Associates LLC	USA	183,692	0	0	38.0%	0	69,803
Teris	Iceland	921,521	365,200	(161,675)	28.6%	(13,809)	158,941
Total						66,128	405,272

Information about associates is based on unaudited accounts.

The Bank sold a 9.99% share in GAM Management hf. during the year. The sale had an immaterial effect on the income statement and statement of financial position.

Júpíter rekstrarfélag hf. was an associated company from July 2011 through November 2011. In December 2011 the Bank acquired all outstanding shares in the company and subsequently it was reclassified as a subsidiary.

Teris has sold all material assets and operations to Reiknistofa Bankanna hf., and is in the process of winding down its operations. This process is expected to be completed in 2013.

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

	2012	2011
Balance at the beginning of the year	405,272	170,955
Acquisition of shares in associates	534	201,683
Disposal of shares in associates	(65,913)	0
Reclassification	0	(38,409)
Share in profit of associates, net of income tax	217,482	66,128
Translation difference	3,449	4,915
Total	560,825	405,272

58. Intangible assets

Intangible assets are specified as follows:

2012	Software	Goodwill	Other	Total
Balance as at 1 January 2012	181,588	599,930	342,339	1,123,857
Acquisitions	32,229	0	0	32,229
Amortisation	(33,843)	0	(18,415)	(52,258)
Translation difference	1	0	0	1
Balance as at 31 December 2012	179,975	599,930	323,924	1,103,829

2011	Software	Goodwill	Other	Total
Balance as at 1 January 2011	0	0	0	0
Acquisitions	237,362	599,930	356,150	1,193,443
Impairment	(27,302)	0	0	(27,302)
Amortisation	(28,592)	0	(13,811)	(42,403)
Translation difference	120	0	0	120
Balance as at 31 December 2011	181,588	599,930	342,339	1,123,857

MP Bank hf. Amounts are in ISK thousands

Notes - continued

59. Impairment testing

Assets with indefinite useful life, such as goodwill, are not amortised but are subject to annual inpairment testing as described in note 29. The assets were acquired in business combinations in 2011. Purchase price allocation was completed in Q4 2011 at which time the fair value of the assets was determined. Impairment testing was performed in 2012.

The recoverable amount of cash-generating units was based on their value in use. Value in use was determined by discounting the future cash flows generated from the continuing use of the units. Cash flows were projected based on a 3 year financial plan and extrapolated for determining the residual value using a constant long-term nominal growth rate.

	2012	2011
Discount rate	13.8%	-
Long-term nominal growth rate	3.0%	-

As a result of this analysis no impairment was recognised for any of the cash-generating units of the Bank.

a. Assets with indefinite useful life

	2012	2011
Goodwill	599,930	599,930
Other intangible assets	172,000	172,000
Total	771,930	771,930

b. Allocation of assets to cash-generating units

	2012	2011
Asset Managment	186,821	-
Investment Banking	55,540	-
Retail Banking	268,849	-
Other Operations	260,720	-
Unallocated	0	771,930
Total	771,930	771,930

c. Sensitivity analysis

The key assumptions described above may change as economic and market conditions change. The Bank estimates that reasonably possible changes in these assumptions are not expected to cause the recoverable amount of any cash-generating units to decline below the carrying amount.

60. Property and equipment

Property and equipment is specified as follows:

2012	**Real estate**	**Other**	**Total**
Balance as at 1 January 2012	199,553	129,047	328,599
Additions	460,400	44,281	504,681
Disposals	(31,153)	(15,600)	(46,753)
Depreciation	(20,674)	(33,607)	(54,281)
Translation difference	5,797	56	5,853
Balance as at 31 December 2012	613,923	124,176	738,099

2011	**Real estate**	**Other**	**Total**
Balance as at 1 January 2011	0	0	0
Additions	348,441	160,134	508,575
Disposals	(129,375)	(9,030)	(138,405)
Impairment	0	(408)	(408)
Depreciation	(19,833)	(21,727)	(41,559)
Translation difference	320	77	397
Balance as at 31 December 2011	199,553	129,047	328,599

Real estate is specified as follows:	**Official value**	**Insurance value**	**Book value**
Office buildings in Reykjavik, Iceland	270,500	290,850	527,394
Office buildings in Vilnius, Lithuania	-	-	86,528
Balance as at 31 December 2012			613,923

MP Bank hf. Amounts are in ISK thousands

Notes - continued

61. Deferred tax assets/liabilities

Change in deferred tax is specified as follows:

	2012	2011
Balance at the beginning of the year	107,569	0
Calculated income tax	148,413	115,602
Current income tax payable	(3,180)	(32,704)
Income tax recognized in other comprehensive income and equity	30,427	21,694
Other changes	8,880	2,977
Net	292,108	107,569

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

	2012	2011
Property and equipment	23,079	(3,056)
Intangible assets	(7,725)	709
Assets and liabilities denominated in foreign currencies	(8,203)	(5,710)
Other items	2,372	(5,250)
Tax losses	282,585	120,876
Total	292,108	107,569

62. Other assets

Other assets consist of accounts receivables and prepayments.

63. Assets classified as held for sale

The Bank has designated its holdings in Mánatún slhf. as assets classified as held for sale. The Board of Directors of Mánatún slhf., a subsidiary of Mánatún GP ehf., approved a share capital increase in January 2013 and the newly issued capital has already been subscribed reducing the Bank's share to 65.4%. It is the Bank's intention to further reduce it's shareholding in the company during the year 2013.

64. Deposits

Deposits are specified as follows:

	2012	2011
Demand deposits	36,212,486	27,799,381
Time deposits	6,189,956	6,794,702
Total	42,402,442	34,594,083

65. Borrowings

Borrowings are specified as follows:

	2012	2011
Repo transactions and overnight borrowings from the Central Bank of Iceland	147,682	0
Money market deposits	6,427,526	2,049,678
Other borrowings	0	1,477
Total	6,575,208	2,051,155

66. Short positions used for trading

Short positions used for trading are specified as follows:

	2012	2011
Government bonds	5,947,104	4,769,566
Listed bonds	14,435	68,954
Listed shares	300	443
Unlisted shares	7	0
Total	5,961,847	4,838,963

MP Bank hf. Amounts are in ISK thousands

Notes - continued

67. Short positions used for hedging

Short positions used for hedging are specified as follows:

	2012	2011
Government bonds	2,024,604	1,274,229
Total	2,024,604	1,274,229

68. Other liabilities

Other liabilities are specified as follows:

	2012	2011
Payment and settlement services	3,515,054	0
Unsettled securities transactions	1,220,677	720,821
Accounts payable	138,765	410,745
Withholding taxes	544,386	405,635
Other liabilities	740,391	610,006
Total	6,159,274	2,147,207

In 2012 the Bank entered into agreements with 10 savings banks whereby the Bank will handle all foreign exchange payments and settlements for the savings banks.

69. Equity

a. Share capital

	2012	2011
Share capital according to the Parent's Articles of Association	5,554,000	5,554,000
Nominal amount of treasury shares	4,000	4,000

b. Capital adequacy ratio (CAD)

Equity at the end of the year was ISK 5,250 million (2011: 5,069 million), equivalent to 7.6% (2011: 10.1%) of total assets according to the statement of financial position. The capital adequacy ratio of the Bank, calculated in accordance with Article 84 of Act No. 161/2002 on Financial Undertakings, was 10.8% (2011: 19.2%). The minimum according to the Act is 8.0%. The ratio is calculated as follows:

Tier 1 capital	2012	2011
Total equity	5,249,622	5,068,954
Goodwill and intangibles	(1,103,829)	(942,269)
Shares in financial institutions	(178,017)	(176,528)
Subordinated fixed income securities	(96,156)	(99,615)
Deferred tax asset	(292,288)	(107,872)
Total	3,579,332	3,742,670

Capital requirements	2012	2011
Credit risk	1,993,050	1,016,740
Market risk	220,044	270,827
Operational risk	436,841	271,890
Total	2,649,934	1,559,457

Surplus capital	929,398	2,183,213
Capital adequacy ratio (CAD)	10.8%	19.2%

c. 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.

The Icelandic Financial Supervisory Authority 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.

Notes - continued

Risk management

70. Risk management framework

a. Board of Directors

The Bank's Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. For the parent company the Board of Directors set the risk appetite. Risk management policies are reviewed regularly to reflect changes in market conditions and the Bank's activities. The Bank, 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, Remunation Committee and Audit committee. The Audit Committee oversees how management monitors compliance with the Bank's risk managment 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 Bank 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 risk management is to identify, quantify, control and report on the risks that the Bank is exposed to in its daily activities. The unit also participates in drafting the overall risk policy of the Bank 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 Bank's risk policy and the obligations of risk management and credit control. The division reports regularly on the Bank'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 Bank 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 opinon on the Bank'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.

71. Hedging

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

Notes - continued

72. Credit risk - overview

a. Definition

One of the Bank’s primary sources of risk is counterparty credit risk. If one or more counterparties, typically borrowers, fail to meet their financial obligations towards the Bank, the Bank has to recognise losses due to these defaults.

b. Management

The risk management and credit control unit is responsible for managing and reporting on credit risk. The Bank 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 Bank uses different methods to reduce credit risk by obtaining collateral from customers where appropriate. Such collateral gives the Bank right to the collateralised assets for current and future obligations incurred by the customer.

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

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

e. Credit rating, control and provisioning

The risk management and credit control 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 Bank 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 Bank's history of defaulted loans. Risk management and credit control suggest a provisioning percentage for the portfolio, based on the expected loss assessment. Risk management and credit control 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 Bank’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 and credit control to monitor that these limits are not being violated and to report discrepancies to the credit committee.

g. Derivatives

The Bank offers derivative contracts in the form of swap contracts on listed, highly liquid securities. On the day when the contract is entered into, the Bank purchases the underlying security and hedges its exposure to price changes. Collateral is in the form of cash or listed, highly liquid securities. The Bank's 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.

h. Securities used for hedging

The Bank 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 Bank hf. Amounts are in ISK thousands

Notes - continued

73. 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:

	2012	2011
Cash and cash equivalents	20,289,559	11,545,143
Receivables from Central Bank of Iceland	3,287,741	0
Fixed income securities	5,221,038	13,678,864
Shares and other variable income securities	674,379	583,654
Securities used for hedging	3,399,265	6,967,719
Loans to customers	27,789,290	13,294,303
Derivatives	312,795	199,571
Other assets	646,485	662,246
	61,620,552	46,931,500
Loan commitments	3,319,497	6,046,285
Financial guarantee contracts	1,318,623	159,648
Total	66,258,671	53,137,433

74. Financial assets not measured at fair value - credit risk

Financial assets not measured at fair value, but exposed to credit risk, are specified as follows:

2012	Neither past due nor individually impaired	Past due but not individually impaired	Individually impaired	Claim value	Less specific impairment allowance	Less collective impairment allowance	Net carrying amount
Cash and cash equivalents	20,289,559			20,289,559			20,289,559
Receivables from Central Bank of Iceland	3,287,741			3,287,741			3,287,741
Loans to customers	25,665,673	2,208,921	745,246	28,619,840	(661,360)	(169,190)	27,789,290
Other assets	647,134		29,578	676,713	(23,251)	(6,977)	646,485
Total	49,890,108	2,208,921	774,825	52,873,853	(684,611)	(176,167)	52,013,075

2011	Neither past due nor individually impaired	Past due but not individually impaired	Individually impaired	Claim value	Less specific impairment allowance	Less collective impairment allowance	Net carrying amount
Cash and cash equivalents	11,545,143			11,545,143			11,545,143
Fixed income securities	9,245,989			9,245,989			9,245,989
Loans to customers	12,689,381	494,883	318,436	13,502,700	(152,467)	(55,929)	13,294,303
Other assets	667,718		29,578	697,297	(30,051)	(5,000)	662,246
Total	34,148,231	494,883	348,015	34,991,129	(182,519)	(60,929)	34,747,681

Past due but not impaired financial assets are those assets where contractual payments are more than 30 days past due but the Bank 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.

MP Bank hf. Amounts are in ISK thousands

Notes - continued

75. Breakdown of loans

a. By segments

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

	2012	%	2011	%
Services	9,989,440	35.9%	4,964,494	37.3%
Individuals	6,587,114	23.7%	2,577,154	19.4%
Holding companies	3,908,775	14.1%	3,013,221	22.7%
Retail	3,545,082	12.8%	1,268,888	9.5%
Real estate, construction and industry	2,229,210	8.0%	1,172,253	8.8%
Other	1,529,669	5.5%	298,293	2.2%
Total	27,789,290	100.0%	13,294,303	100.0%

b. By seniority

The Bank's loan portfolio mainly consists of Senior I loans which 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% and Senior II loans which have sufficient coverage and liquid collateral but in some cases collateral such as unlisted shares and other collateral which cannot be marked to market. The loan portfolio contains less than 30% of either junior loans which have second lien claims on the borrower's assets or mezzanine loans where the loan is unsecured and subordinated to all of the borrower's liabilities.

76. Foreclosed assets

The Bank's policy is to sell foreclosed assets as soon as possible. The Bank did not hold or take possession of collateral held as security in 2012 or 2011.

77. Large exposures

In accordance with the Financial Supervisory Authority's regulation no. 216/2007 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 69). According to the regulation a single exposure, net of collateralised assets, cannot exceed 25% of the capital base.

		2012		2011
Large exposures net of collateralised assets	**Number**	**Amount**	**Number**	**Amount**
10-20% of capital base	6	2,805,348	3	1,627,123
20-25% of capital base	1	789,711	0	0
Exceeding 25% of capital base	0	0	0	0
Total	7	3,595,059	3	1,627,123

MP Bank hf. Amounts are in ISK thousands

Notes - continued

78. Liquidity risk

a. Definition

Liquidity risk is the risk that the Bank 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 Bank has internal rules that require certain matching of the maturities of assets and liabilities. Furthermore, to ensure the sufficiency of funds, the Bank 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 comittee. The Bank is subject to the Central Bank's of Iceland requirements about minimum coverage ratio between cash flows of assets and liabilities. The Bank was in compliance with external liquidity requirements throughout the period.

c. Breakdown of financial assets and financial liabilities by maturity

The table below shows the contractual maturity of financial assets and liabilities, for both on-balance sheet and off-balance sheet items. The analysis is based on contractual maturities of undiscounted cash flows. The table does not take future interest payments into account and therefore doesn't fully reflect future cash flows.

Furthermore, since the table is based on contractual maturities it doesn't reflect the liquid nature of market securities which can be converted to cash through repo transactions. Such securities amounted to ISK 1.6 billion at the reporting date and could be converted to cash within two days.

2012

Financial assets	**up to 1 months**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**No stated maturity**	**Total**
Cash and cash equivalents	20,289,559						20,289,559
Receivables from Central Bank of Iceland	3,287,741						3,287,741
Fixed income securities			1,524,833	1,487,426	2,186,165	22,613	5,221,038
Shares and other variable income securities						1,243,133	1,243,133
Securities used for hedging				578,424	2,820,841	3,408,527	6,807,792
Loans to customers	8,024,844	2,236,860	3,619,728	9,414,416	4,493,443		27,789,290
Other assets	152,487	269,762	60,746			163,489	646,485
Financial assets excluding derivatives	31,754,631	2,506,622	5,205,307	11,480,265	9,500,450	4,837,763	65,285,037
Derivatives	165,120	27,040		120,635			312,795
Total	31,919,751	2,533,662	5,205,307	11,600,901	9,500,450	4,837,763	65,597,833

Financial liabilities	**up to 1 months**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**No stated maturity**	**Total**
Deposits	36,576,205	1,639,500	1,319,134	2,795,405	72,198		42,402,442
Borrowings	3,407,555	3,167,653					6,575,208
Short positions used for trading			4,230,821	1,192,308	538,410	307	5,961,847
Short positions used for hedging			528,853	686,856	808,895		2,024,604
Other liabilities	5,906,543	29,374	120,078	91,801		11,477	6,159,274
Financial liabilities excluding derivatives	45,890,303	4,836,527	6,198,886	4,766,371	1,419,503	11,784	63,123,374
Derivatives	213,717	7,801			0		221,518
Total	46,104,020	4,844,327	6,198,886	4,766,371	1,419,503	11,784	63,344,891

	up to 1 months	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**No stated maturity**	**Total**
Financial assets	31,919,751	2,533,662	5,205,307	11,600,901	9,500,450	4,837,763	65,597,833
Financial liabilities	(46,104,020)	(4,844,327)	(6,198,886)	(4,766,371)	(1,419,503)	(11,784)	(63,344,891)
Loan commitments	(342,884)	(549,536)	(1,483,495)	(930,060)	(13,522)		(3,319,497)
Financial guarantee contracts	(207,762)	(650,733)	(305,515)	(128,441)	(26,172)		(1,318,623)
Net financial assets (liabilities)	(14,734,916)	(3,510,935)	(2,782,589)	5,776,030	8,041,253	4,825,978	(2,385,178)

MP Bank hf. Amounts are in ISK thousands

Notes - continued

2011

Financial assets	**up to 1 months**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**No stated maturity**	**Total**
Cash and cash equivalents	11,545,143						11,545,143
Fixed income securities	306,685	102,861	53	513,267	12,755,288	711	13,678,864
Shares and other variable income securities						1,068,531	1,068,531
Securities used for hedging				269,794	6,656,888	768,155	7,694,837
Loans to customers	6,498,349	840,026	1,675,572	3,041,527	1,238,829		13,294,303
Other assets	411,816	26,845	20,320			203,264	662,246
Financial assets excluding derivatives	18,761,994	969,731	1,695,945	3,824,587	20,651,005	2,040,661	47,943,925
Derivatives	101,183	10,686	87,702				199,571
Total	18,863,177	980,417	1,783,648	3,824,587	20,651,005	2,040,661	48,143,496

Financial liabilities	**up to 1 months**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**No stated maturity**	**Total**
Deposits	28,043,037	2,870	4,626,824	1,868,469	52,883		34,594,083
Borrowings	2,051,155						2,051,155
Short positions used for trading			3,801,395	530,866	506,261	442	4,838,963
Short positions used for hedging			458,543	815,686			1,274,229
Other liabilities	1,721,122	226,766	199,318				2,147,207
Financial liabilities excluding derivatives	31,815,314	229,636	9,086,080	3,215,021	559,144	442	44,905,637
Derivatives	94,465	7,033					101,498
Total	31,909,779	236,669	9,086,080	3,215,021	559,144	442	45,007,135

	up to 1 months	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**No stated maturity**	**Total**
Financial assets	18,863,177	980,417	1,783,648	3,824,587	20,651,005	2,040,661	48,143,496
Financial liabilities	(31,909,779)	(236,669)	(9,086,080)	(3,215,021)	(559,144)	(442)	(45,007,135)
Loan commitments	(699,346)		(4,442,079)	(669,036)	(235,824)		(6,046,285)
Financial guarantee contracts	(25,154)	(78,785)	(36,989)	(15,551)	(3,169)		(159,648)
Net financial assets (liabilities)	(13,771,102)	664,962	(11,781,500)	(75,021)	19,852,869	2,040,220	(3,069,572)

MP Bank hf. Amounts are in ISK thousands

Notes - continued

79. Currency risk

a. Definition

Currency risk arises when financial instruments are not denominated in the functional currency of the respective Bank entity and can affect both the Bank's income statement and statement of financial position. A part of the Bank'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 Bank is subject to limits set by the Central Bank of Iceland regarding the maximum open currency position. At 31 December 2012 and 31 December 2011 the Bank's position in foreign currencies was within those limits.

c. Exchange rates

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

	2012	2011	Average 2012	Average 2011
EUR/ISK	169.8	158.8	160.6	161.5
LTL/ISK	49.2	46.0	47.0	46.8
NOK/ISK	23.0	20.4	21.5	20.7
USD/ISK	128.7	122.7	125.0	116.0
ISK trade index	219.4	204.9	209.1	204.5

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

2012

Financial assets	EUR	LTL	NOK	USD	Other currencies	Total
Cash and cash equivalents	2,446,953	124,385	138,941	464,712	529,814	3,704,804
Fixed income securities		22,613	115,977			138,590
Shares and other variable income securities	840			88,141	42,765	131,745
Securities used for hedging	91,315		905	1,604		93,824
Loans to customers	1,044,610		60,172	288,119	22,773	1,415,673
Other assets		252,775		73,786		326,561
Financial assets excluding derivatives	3,583,718	399,774	315,995	916,361	595,351	5,811,198
Derivatives	43,038		1,199	7,320		51,557
Total	3,626,756	399,774	317,194	923,681	595,351	5,862,755

Financial liabilities	EUR	LTL	NOK	USD	Other currencies	Total
Deposits	3,552,260		218,615	1,172,418	469,342	5,412,635
Short positions used for trading			61	246		307
Financial liabilities excluding derivatives	3,552,260	0	218,676	1,172,664	469,342	5,412,942
Derivatives	133,293				105,028	238,321
Total	3,685,553	0	218,676	1,172,664	574,371	5,651,263

Net currency position	EUR	LTL	NOK	USD	Other currencies	Total
Financial assets	3,626,756	399,774	317,194	923,681	595,351	5,862,755
Financial liabilities	(3,685,553)		(218,676)	(1,172,664)	(574,371)	(5,651,263)
Net off-balance sheet position	(256,816)			(59,408)	(98,488)	(414,711)
Total	(315,613)	399,774	98,518	(308,391)	(77,507)	(203,219)

MP Bank hf. Amounts are in ISK thousands

Notes - continued

2011

Financial assets	**EUR**	**LTL**	**NOK**	**USD**	**Other currencies**	**Total**
Cash and cash equivalents	514,552	13,538	93,804	625,072	206,039	1,453,006
Fixed income securities	320,486	711	102,861			424,058
Shares and other variable income securities	715	2		66,282	89,172	156,171
Securities used for hedging	107,635		1,053	2,637		111,325
Loans to customers	638,725	343,534		882,338	217,970	2,082,567
Financial assets excluding derivatives	1,582,113	357,786	197,718	1,576,328	513,181	4,227,126
Derivatives	51,407		4,448	934,025		989,880
Total	1,633,520	357,786	202,166	2,510,353	513,181	5,217,005

Financial liabilities	**EUR**	**LTL**	**NOK**	**USD**	**Other currencies**	**Total**
Deposits	1,986,875		194,448	1,715,391	135,883	4,032,596
Short positions used for trading	6		128	307		442
Financial liabilities excluding derivatives	1,986,881	0	194,576	1,715,698	135,883	4,033,037
Derivatives	317,680			306,775	159,021	783,476
Total	2,304,561	0	194,576	2,022,473	294,904	4,816,513

Net currency position	**EUR**	**LTL**	**NOK**	**USD**	**Other currencies**	**Total**
Financial assets	1,633,520	357,786	202,166	2,510,353	513,181	5,217,005
Financial liabilities	(2,304,561)		(194,576)	(2,022,473)	(294,904)	(4,816,513)
Net off-balance sheet position						0
Total	(671,041)	357,786	7,589	487,880	218,277	400,492

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 Bank's pre-tax profit.

		2012		**2011**
Assets and liabilities denominated in	**-10%**	**+10%**	**-10%**	**+10%**
EUR	(31,561)	31,561	(67,104)	67,104
LTL	39,977	(39,977)	35,779	(35,779)
NOK	9,852	(9,852)	759	(759)
USD	(30,839)	30,839	48,788	(48,788)
Other currencies	(7,751)	7,751	21,828	(21,828)
Total	(20,322)	20,322	40,049	(40,049)

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

MP Bank hf. Amounts are in ISK thousands

Notes - continued

80. Interest rate risk

a. Definition

The Bank's exposure to interest rate risk is twofold. On one hand, the Bank 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 Bank has mismatch in assets and liabilities with fixed interest terms in the banking book. The banking book generally pertains to the Bank's 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 Bank's economic value.

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

b. Management

The Bank takes measures to minimise interest rate risk in the banking book by matching the interest rate profile and duration of assets with the Bank’s liabilities. This is obtained in part by matching the currency and duration of the funding of the Bank with its assets, as well as using derivative and non-derivative financial instruments to manage effectively the risk of an adverse impact on the Bank’s earnings.

c. Breakdown of financial assets and financial liabilities by currency and interest repricing time

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

2012

Financial assets	ISK	EUR	DKK	NOK	USD	Other currencies	Total
0-1 year	51,271,685	1,619,966	22,760	63,565	664,871		53,642,846
1-2 years	3,170						3,170
2-3 years	2,890,227						2,890,227
3-4 years	219,435						219,435
Over 4 years	1,426,617						1,426,617
Total	55,811,134	1,619,966	22,760	63,565	664,871	0	58,182,295

Financial liabilities	ISK	EUR	DKK	NOK	USD	Other currencies	Total
0-1 year	52,317,820	3,652,047	233,899	216,992	1,162,765	333,109	57,916,632
Total	52,317,820	3,652,047	233,899	216,992	1,162,765	333,109	57,916,632

Net imbalance	ISK	EUR	DKK	NOK	USD	Other currencies	Total
0-1 year	(1,046,135)	(2,032,081)	(211,139)	(153,428)	(497,894)	(333,109)	(4,273,786)
1-2 years	3,170						3,170
2-3 years	2,890,227						2,890,227
3-4 years	219,435						219,435
Over 4 years	1,426,617						1,426,617
Total	3,493,314	(2,032,081)	(211,139)	(153,428)	(497,894)	(333,109)	265,663

MP Bank hf. Amounts are in ISK thousands

Notes - continued

2011

Financial assets

	ISK	EUR	DKK	NOK	USD	Other currencies	Total
0-1 year	28,689,045	444,586		3,753	7,999		29,145,383
1-2 years	1,750				636,619		638,369
2-3 years	2,000,000						2,000,000
3-4 years	4,400						4,400
Over 4 years	10,034,515						10,034,515
Total	40,729,711	444,586	0	3,753	644,618	0	41,822,668

Financial liabilities

	ISK	EUR	DKK	NOK	USD	Other currencies	Total
0-1 year	36,942,807	1,979,494	14,922	194,400	1,708,091	120,748	40,960,463
Total	36,942,807	1,979,494	14,922	194,400	1,708,091	120,748	40,960,463

Net imbalance

	ISK	EUR	DKK	NOK	USD	Other currencies	Total
0-1 year	(8,253,762)	(1,534,908)	(14,922)	(190,647)	(1,700,093)	(120,748)	(11,815,079)
1-2 years	1,750				636,619		638,369
2-3 years	2,000,000						2,000,000
3-4 years	4,400						4,400
Over 4 years	10,034,515						10,034,515
Total	3,786,904	(1,534,908)	(14,922)	(190,647)	(1,063,473)	(120,748)	862,205

d. Sensitivity analysis for non-trading portfolios

The Bank performs monthly sensitivity analysis on non-trading portfolios. 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 Bank's pre-tax profit and equity, assuming all other risk factors remain constant.

	Shift in		2012		2011
Currency	**basis points**	**Downward**	**Upward**	**Downward**	**Upward**
ISK, indexed	50	(86,850)	86,850	(66,924)	66,924
ISK, non-indexed	100	(40,610)	40,610	(481,800)	481,800
Other currencies	20	(224)	224	(7,800)	7,800
Total		(127,684)	127,684	(556,524)	556,524

81. 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 Bank is exposed to Icelandic inflation since CPI indexed assets exceed CPI indexed liabilities. 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 Bank 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:

Net inflation exposure	**2012**	**2011**
Assets	10,063,006	6,249,421
Liabilities	(5,834,415)	(7,061,369)
Total	4,228,591	(811,948)

MP Bank hf. Amounts are in ISK thousands

Notes - continued

82. Market risk

a. Definition

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

b. Management

The Bank 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.

c. Market price risk

Market price risk arises from changes in the market values of securities in the Bank's portfolio, the size of which varies greatly. The Bank invests primarily in securities listed on regulated markets, but has also invested in unlisted equities and bonds. The Bank's risk is the general risk involved in investing in securities. Efforts are made to reduce this risk through active risk management.

d. Interest rate risk

The breakdown of interest rate risk associated with proprietary position is specified as follows:

2012

Financial assets	**Less than 1 year**	**1-3 years**	**3-5 years**	**5-7 years**	**More than 7 years**	**Total**
Fixed income securities in ISK	1,408,856	538,709	948,718	1,710,844	470,184	5,077,311
Fixed income securities in foreign currencies	115,977					115,977
Total	1,524,833	538,709	948,718	1,710,844	470,184	5,193,288

Financial liabilities	**Less than 1 year**	**1-3 years**	**3-5 years**	**5-7 years**	**More than 7 years**	**Total**
Fixed income securities in ISK	4,230,821	538,531	653,777	14,439	527,192	5,964,761
Total	4,230,821	538,531	653,777	14,439	527,192	5,964,761

Net imbalance	**Less than 1 year**	**1-3 years**	**3-5 years**	**5-7 years**	**More than 7 years**	**Total**
Fixed income securities in ISK	(2,821,965)	178	294,940	1,696,405	(57,008)	(887,450)
Fixed income securities in foreign currencies	115,977					115,977
Total	(2,705,988)	178	294,940	1,696,405	(57,008)	(771,473)

2011

Financial assets	**Less than 1 year**	**1-3 years**	**3-5 years**	**5-7 years**	**More than 7 years**	**Total**
Fixed income securities in ISK	274,325	593,554	513,114	12,189,920	749,184	14,320,097
Fixed income securities in foreign currencies	102,861					102,861
Total	377,185	593,554	513,114	12,189,920	749,184	14,422,958

Financial liabilities	**Less than 1 year**	**1-3 years**	**3-5 years**	**5-7 years**	**More than 7 years**	**Total**
Fixed income securities in ISK	4,076,847	1,090,510	33,757	280,119	437,246	5,918,479
Fixed income securities in foreign currencies						0
Total	4,076,847	1,090,510	33,757	280,119	437,246	5,918,479

Net imbalance	**Less than 1 year**	**1-3 years**	**3-5 years**	**5-7 years**	**More than 7 years**	**Total**
Fixed income securities in ISK	(3,802,522)	(496,956)	479,357	11,909,802	311,938	8,401,618
Fixed income securities in foreign currencies	102,861					102,861
Total	(3,699,662)	(496,956)	479,357	11,909,802	311,938	8,504,479

83. Operational risk

a. Definition

The risk involved in the Bank's operations is primarily linked to the risks inherent in each type of security in which the Bank invests, although there are several other factors which can also affect its operations and performance, such as incorrect analysis of investment options, employee negligence, violations of rules, problems with information systems and loss of key personnel. The Bank's reputation may be damaged, either for the above reasons or as a result of other factors which are difficult to control.

b. Management

Operational risk can be reduced through staff training, process re-design and enhancement of the control environment. The risk management and credit control 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 Bank hf. Amounts are in ISK thousands

Notes - continued

Financial assets and liabilities

84. Accounting classification of financial assets and liabilities

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

2012 **Financial assets**	**Held for trading**	**Designated at fair value**	**Available for sale**	**Held to maturity**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Cash and cash equivalents					20,289,559		20,289,559
Receivables from Central Bank of Iceland					3,287,741		3,287,741
Fixed income securities	3,187,811	197,455	1,835,772				5,221,038
Shares and other variable income securities	1,026,128	217,005					1,243,133
Securities used for hedging		6,807,792					6,807,792
Loans to customers					27,789,290		27,789,290
Derivatives	312,795						312,795
Other assets					646,485		646,485
Total	4,526,734	7,222,251	1,835,772	0	52,013,075	0	65,597,833

Financial liabilities	**Held for trading**	**Designated at fair value**	**Available for sale**	**Held to maturity**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Deposits						42,402,442	42,402,442
Borrowings						6,575,208	6,575,208
Short positions used for trading	5,961,847						5,961,847
Short positions used for hedging		2,024,604					2,024,604
Derivatives	221,518						221,518
Other liabilities						6,159,274	6,159,274
Total	6,183,364	2,024,604	0	0	0	55,136,923	63,344,891

2011 **Financial assets**	**Held for trading**	**Designated at fair value**	**Available for sale**	**Held to maturity**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Cash and cash equivalents					11,545,143		11,545,143
Fixed income securities	1,418,908	203,144	2,810,823	9,245,989			13,678,864
Shares and other variable income securities	844,084	224,447					1,068,531
Securities used for hedging		7,694,837					7,694,837
Loans to customers					13,294,303		13,294,303
Derivatives	199,571						199,571
Other assets					662,246		662,246
Total	2,462,563	8,122,428	2,810,823	9,245,989	25,501,692	0	48,143,496

Financial liabilities	**Held for trading**	**Designated at fair value**	**Available for sale**	**Held to maturity**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Deposits						34,594,083	34,594,083
Borrowings						2,051,155	2,051,155
Short positions used for trading	4,838,963						4,838,963
Short positions used for hedging		1,274,229					1,274,229
Derivatives	101,498						101,498
Other liabilities						2,147,207	2,147,207
Total	4,940,461	1,274,229	0	0	0	38,792,445	45,007,135

85. Reclassification of assets previously designated as held to maturity

The Bank has sold during the year 2012 certain securities that were classified as held-to-maturity as at 31 December 2011. Due to this tainting, the entire hold-to-maturiry portfolio was subsequently reclassified as available for sale. Furthermore the Bank's use of the hold-to-maturity classification is restricted during the years 2012, 2013 and 2014.

MP Bank hf. Amounts are in ISK thousands

Notes - continued

86. Financial assets and liabilities measured at fair value

a. Fair value hierarchy

IFRS 7 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; unobservable inputs reflect the Bank's market assumptions. These two types of inputs result in the following fair value hierarchy:

- Level 1
  Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example Nasdaq OMX, London Stock Exchange, Frankfurt Stock Exchange, New York Stock Exchange) and exchanges traded derivatives like futures (for example Nasdaq, S&P 500).
- Level 2
  Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes the majority of the OTC derivative contracts, traded loans and issued structured debt. The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg and Reuters.
- Level 3
  Inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable inputs

Fair value measurements requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible.

b. 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 fair value hierarchy as follows:

2012

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Fixed income securities	3,187,811			3,187,811
Shares and other variable income securities	1,023,655	2,473		1,026,128
Derivatives		312,795		312,795
Designated at fair value				
Fixed income securities			197,455	197,455
Shares and other variable income securities	(29,250)		246,255	217,005
Securities used for hedging	6,807,792			6,807,792
Available for sale				
Fixed income securities	1,835,772			1,835,772
Total	12,825,781	315,268	443,709	13,584,758

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Short positions used for trading	5,961,839	7		5,961,847
Derivatives		221,518		221,518
Designated at fair value				
Short positions used for hedging	2,024,604			2,024,604
Total	7,986,443	221,525	0	8,207,968

MP Bank hf. Amounts are in ISK thousands

Notes - continued

2011

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Fixed income securities	1,418,908			1,418,908
Shares and other variable income securities	807,507	36,578		844,084
Derivatives		199,571		199,571
Designated at fair value				
Fixed income securities			203,144	203,144
Shares and other variable income securities			224,447	224,447
Securities used for hedging	7,694,837			7,694,837
Available for sale				
Fixed income securities	2,810,823			2,810,823
Total	12,732,074	236,149	427,591	13,395,815

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Short positions used for trading	4,838,963			4,838,963
Derivatives		101,498		101,498
Designated at fair value				
Short positions used for hedging	1,274,229			1,274,229
Total	6,113,192	101,498	0	6,214,690

87. Financial assets and liabilities not measured at fair value

The fair value of financial assets and liabilities not measured at fair value in the statement of financial position is specified as follows:

2012

Financial assets	**Carrying amount**	**Fair value**	**Unrealized gain**
Cash and cash equivalents	20,289,559	20,289,559	0
Receivables from Central Bank of Iceland	3,287,741	3,287,741	0
Loans to customers	27,789,290	27,789,290	0
Other assets	646,485	646,485	0
Total	52,013,075	52,013,075	0

Financial liabilities	**Carrying amount**	**Fair value**	**Unrealized gain**
Deposits	42,402,442	42,402,442	0
Borrowings	6,575,208	6,575,208	0
Other liabilities	6,159,274	6,159,274	0
Total	55,136,923	55,136,923	0

2011

Financial assets	**Carrying amount**	**Fair value**	**Unrealized gain**
Cash and cash equivalents	11,545,143	11,545,143	0
Fixed income securities	9,245,989	9,740,512	494,523
Loans to customers	13,294,303	13,294,303	0
Other assets	662,246	662,246	0
Total	34,747,681	35,242,204	494,523

Financial liabilities	**Carrying amount**	**Fair value**	**Unrealized gain**
Deposits	34,594,083	34,594,083	0
Borrowings	2,051,155	2,051,155	0
Other liabilities	2,147,207	2,147,207	0
Total	38,792,445	38,792,445	0

MP Bank hf. Amounts are in ISK thousands

Notes - continued

Segment information

88. Segment analysis

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. 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. Operating segments
The Bank defines four reportable segments.

- **Asset Management** manages assets on behalf of its clients, who consist primarily of institutional investors and high net worth individuals, and offers a variety of products and services to meet their diverse needs.
- **Investment Banking** is divided into Corporate Finance, Capital Markets, Credit, Proprietary Trading and Treasury and serves institutional and private investors and corporate clients. Services provided to external customers include M&A advisory services, securities and FX brokerage, specialized lending and market making activities.
- **Retail Banking** provides selected banking services with a special focus on SME's and professionals.
- **Asset Financing** provides equipment financing to individuals and corporate clients.

Other divisions, subsidiaries and certain legacy assets form a fifth reporting segment, **Other Operations**.

c. Reportable segments results

2012	Asset Management	Investment Banking	Retail Banking	Other Operations	Elimination entries	Total
Net interest income	33,355	887,930	778,611	16,224	0	1,716,119
Net fee and commission income	195,741	747,399	258,782	212,068	(18,932)	1,395,058
Net financial income	113	478,735	14,851	172,585	(29,250)	637,035
Share in profit of associates, net of income tax	0	0	0	74,565	142,917	217,482
Other operating income	0	1,605	12	27,256	0	28,873
Net operating income	229,208	2,115,670	1,052,256	502,698	94,735	3,994,567
Administrative expenses	(163,800)	(710,441)	(624,535)	(1,645,623)	16,233	(3,128,166)
Allocated cost	(84,378)	(511,590)	(451,465)	1,047,433	0	0
Impairment of loans and receivables	0	(38,216)	(104,059)	(283,903)	(244,784)	(670,962)
Profit (loss) before taxes	(18,970)	855,423	(127,802)	(379,395)	(144,804)	184,451

	Asset Management	Investment Banking	Retail Banking	Other Operations	Elimination entries	Total
Net operating income from external customers	119,505	3,100,360	64,539	615,428		3,899,832
Net operating income from internal customers	109,703	(984,690)	987,717	(112,730)	94,735	94,735
Net operating income	229,208	2,115,670	1,052,256	502,698	94,735	3,994,567

The Bank reported internally as a single business segment in 2011 and no comparative information is available.

d. Business segment balance sheet

2012	Asset Management	Investment Banking	Retail Banking	Other Operations	Elimination entries	Total
Segment assets 31.12.2012	0	71,288,957	56,131,633	5,062,212	(63,089,929)	69,392,873
Segment liabilities 31.12.2012	0	66,039,334	56,131,633	5,062,212	(63,089,929)	64,143,251
Segment equity 31.12.2012	0	5,249,622	0	0	0	5,249,622

The Bank reported internally as a single business segment in 2011 and no comparative information is available.

MP Bank hf. Amounts are in ISK thousands

Notes - continued

89. 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.

2012	Net operating income	Total assets
Iceland	3,795,220	70,971,872
Lithuania	83,549	400,051
Other regions and eliminations	115,797	(1,979,050)
Total	3,994,567	69,392,873

2011	Net operating income	Total assets
Iceland	1,647,229	50,508,489
Lithuania	58,132	882,979
Other regions and eliminations	124,618	(1,282,372)
Total	1,829,979	50,109,096

MP Bank hf. Amounts are in ISK thousands

Notes - continued

Other information

90. Off-balance sheet obligations

a. Lease agreements
The Bank has entered into lease agreements for the office premises in Ármúli 13a and Höfðatún 2 in Reykjavík. Monthly lease payments amount to ISK 4.6 million and the agreements expire in 2015.

91. Related parties

a. Definition of related parties
The Bank has a related party relationship with its subsidiaries as disclosed in note 56, associates as disclosed in note 57, large shareholders, board members, CEO and key employees (together referred to as management), close family members of these parties and companies where related parties are large shareholders.

b. Arm's length
All transactions with related parties are carried out at arm's length and subject to an annual review by the Bank's internal and external auditors.

c. Effects on statement of financial position

2012	Receivables	Payables	Loans	Deposits
Board members	16,818	9,650	47,529	393,706
Management	1,602	0	22,154	13,889
Subsidiaries	485,876	0	896,170	186,638
Associates	757	138	79,825	39,022
Total	505,053	9,788	1,045,677	633,256

2011	Receivables	Payables	Loans	Deposits
Board members	0	2,401	0	28,313
Management	0	0	0	13,544
Subsidiaries	6,601	0	551,525	98,930
Associates	8,359	16,859	0	105,099
Total	14,960	19,260	551,525	245,886

d. Off-balance sheet obligations
As at 31 December 2012 and 31 December 2011 there were no off-balance sheet obligations with related parties.

e. Effects on income statement

2012	Interest income	Interest expense	Impairment expense	Fee received	Fees paid
Board members	3,543	5,755	8,440	26,520	73,425
Management	1,686	694	0	5	6,718
Subsidiaries	56,055	9,332	0	18,932	0
Associates	6,343	1,951	0	624	74,031
Total	67,627	17,733	8,440	46,081	154,175

2011	Interest income	Interest expense	Impairment expense	Fee received	Fees paid
Board members	968	1,416	0	9,030	55,000
Management	0	677	0	0	0
Subsidiaries	20,757	4,947	0	15,097	0
Associates	0	5,255	0	14,921	102,073
Total	21,725	12,294	0	39,048	157,073

Further information about salaries and benefits paid to the Board of Directors, the CEO and Managing Directors is provided in note 45.

MP Bank hf. Amounts are in ISK thousands

Notes - continued

92. 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 benfits, including pension fund contributions. A more detailed description of the policy can be found on the Bank's website, www.mp.is.

93. 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 94.

b. Performance based payments

		2012		2011
	Cash	**Options**	**Cash**	**Options**
Non-deferred	28,935	0	12,074	0
Deferred	71,962	13,628	0	0
Total	100,897	13,628	12,074	0

c. On-balance sheet deferred performance based payments

	2012	**2011**
Deferred cash payments	71,962	0
Total	71,962	0

94. 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 authorized to increase the share capital of the Bank by up to ISK 275 million in stages to fulfill any obligations arising from the scheme.

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 2012, the Bank had enrolled 11 employees in the share-based incentive scheme, with a total number of options granted equalling 195 million shares in the bank. No options had vested as at 31 December 2012.

b. Grant date fair value

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

	2012	**2011**
Grant date fair value (ISK per share)	0.01-0.13	-

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:

	2012	**2011**
Exercise price (ISK per share)	1.15	-
Risk free interest rate	6.0%-6.7%	-
Expected volatility	2.7%	-
Option life (years)	2-4	-

Notes - continued

95. Supreme Court ruling no. 600/2011 on interest rate calculations on loans linked to foreign currencies

In February 2012 the Supreme Court of Iceland passed ruling no. 600/2011 in a case involving a dispute about interest rate calculations on a loan the court had previously ruled was currency indexed and as such in violation of Icelandic law. The ruling, and other rulings in comparable cases, will have no material effect on the financial statements of the Bank.

96. Pledged assets

The Bank 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 2012 (2011: 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 9.5 billion as at 31 December 2012 (2011: 8.6 billion).