Municipality Credit Iceland

Translation of Financial Statements 2014

These financial statements are translated from the original which is in Icelandic. Should there be discrepancies between the two versions, the Icelandic version will take priority over the translated version.

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Municipality Credit Iceland Plc.
Identity number 580407-1100
Borgartun 30, P.O. Box 8100
128 Reykjavik

Report of the Board of Directors and the Managing Director

Municipality Credit Iceland Plc. (MCI) is a statutory limited liability company owned by the Icelandic municipalities. MCI is a financial institution, and operates pursuant to Act no. 1450/2006 on the incorporation of Municipality Credit Iceland as a statutory limited liability company; Act No. 161/2002 on Financial undertakings; cf. The Companies Act No. 2/1995 and is supervised by the Icelandic Financial Supervisor. MCI´s main function is to secure favorable funding to the municipalities and related organisations and enterprises. MCI is by law only allowed to fund municipal projects that are of general economic interest. MCI had three employees at year end, the same as in the year before.

Operating results and financial position

The profit for the year amounted to ISK 247 million, as compared to ISK 715 million the previous year.

Total assets at year-end amounted to ISK 76,782 million, as compared to ISK 77,095 million the previous year. Total outstanding loans amounted to ISK 71,347 at the end of the year as compared to 69,316 the previous year. Shareholder equity amounted to ISK 15,666 million as compared to ISK 15,777 million at year-end 2013 which is a decrease of 0.7% during the year. The CAD ratio, based on Basel II, was 68% at year end and increased from 67% at year end 2013.

MCI is owned by the 74 municipalities in Iceland. Reykjavik city holds 17.5% share and is the only shareholder with a total share above 10%. The ten largest shareholders hold in total 56% of the company´s shares. A detailed shareholder list can be found in note 28. In April 2014, MCI paid out ISK 358 million in dividend to its shareholders which was equivalent to 50% of MCI´s profit in 2013. The board of MCI proposes that dividend will not be paid out because of year 2014. Any further changes in equity can be found in the financial statement.

MCI´s Governance

MCI´s board of directors aim to maintain good corporate governance and to follow "Management governance directions for public companies" published in 2012 by Iceland chamber of commerce, Nasdaq OMX Iceland and SA-Confederation of Icelandic employers. In March 2013 The Center of Corporate Governance provided MCI with a certification as Exemplary company in corporate governance. This certification was updated in March 2015. Further information can be found in the Annual Report.

Statement

The financial statements for the year ending 31 December 2014 have been, to the best knowledge of the board of directors, prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and additional Icelandic disclosure requirements in Act No. 3/2006. According to our best knowledge it is our opinion that the financial statements give a true and fair view of the financial performance of MCI for the financial year 2014, its assets, liabilities and financial position for the year 2014.

The Board of Directors of Municipality Credit Iceland and the Managing Director hereby confirm the financial statements for the year 2014 with their signatures.

Reykjavík, 24. March 2015

Magnús B. Jónsson
Chairman

Svanfríður Inga Jónasdóttir | Kristinn Jónasson

Elliði Vignisson | Helga Benediktsdóttir

Óttar Guðjónsson
Managing director

Independent Auditor's Report

To the Board of Directors and Shareholders of Municipality Credit Iceland Plc.

We have audited the accompanying financial statements of Municipality Credit Iceland Plc., which comprise the statement of financial position as at December 31, 2014, the income statement and 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 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 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the 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 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.

Opinon

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

Report on the Board of Directors report

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

Reykjavík, 24. March 2015

KPMG ehf.

Income Statement and Statement of Comprehensive Income

January 1st through December 31st 2014

	Notes	2014	2013
Interest income and CPI linked revenue		3.738.806.214	4.954.311.206
Interest expenses and CPI linked expenses		(2.871.936.394)	(3.907.101.818)
Net interest income	5	866.869.820	1.047.209.388
Net gain on fin. assets designated at FV through P&L	6	13.201.445	5.983.595
Net foreign exchange (loss) gain	7	1.983.800	(87.335.871)
Other operating income		15.185.245	(81.352.276)
Net operating income		882.055.065	965.857.112
Salaries and related expenses	8	69.248.131	61.393.367
Cost of bond issuance	9	41.854.307	42.649.817
The Debtors' Ombudsman	10	0	(18.513.309)
FSA's annual fee and monitoring fee		6.467.000	6.635.952
Other operating expenses	11	52.231.226	57.880.028
Depreciation	17	1.195.628	1.195.628
Operating expenses		170.996.292	151.241.483
Provision due to loan in foreign currency	18	463.690.088	99.528.700
Profit for the year and comprehensive income		247.368.685	715.086.929

Earnings per share

	Notes	2014	2013
Basic and diluted earnings per share	12	0,05	0,14

Statement of financial position

	Notes	2014	2013
Assets			
Cash and balances with Central bank	13	4.255.950.383	4.392.652.302
Amounts due from credit institutions	14	50.549.537	3.224.378.218
Loans and receivables	15	71.347.411.516	69.316.203.659
Fin. assets designated at fair value through profit or loss	16	1.079.913.877	111.866.373
Property, plant and equipment	17	46.629.468	47.825.096
Other assets		1.725.706	1.952.831
Total assets		76.782.180.487	77.094.878.479
Liabilities			
Debt securities in issue	20	52.833.058.917	52.225.181.655
Other borrowed funds	21	7.232.018.018	8.672.250.305
Short term borrowings	22	510.735.547	355.854.859
Debt to municipalities and subsidaries	18	473.731.179	0
Pension obligations	23	59.332.922	56.535.169
Other liabilities	24	6.844.517	7.965.789
Total liabilities		61.115.721.100	61.317.787.777
Equity			
Share capital		5.000.000.000	5.000.000.000
Statutory reserve		1.250.000.000	1.250.000.000
Retained earnings		9.416.459.387	9.527.090.702
Total equity	25	15.666.459.387	15.777.090.702
Total liabilities and equity		76.782.180.487	77.094.878.479

Statement of Changes in Equity

	Share capital	Statutory reserve	Retained earnings	Total equity
Changes in equity 2013				
Equity as at 1.1.2013	5.000.000.000	1.250.000.000	9.220.003.773	15.470.003.773
Dividend paid out to shareholders			(408.000.000)	(408.000.000)
Profit for the year and comprehensive income			715.086.929	715.086.929
Equity as at 31.12.2013	5.000.000.000	1.250.000.000	9.527.090.702	15.777.090.702
Changes in equity 2014				
Equity at 1.1.2014	5.000.000.000	1.250.000.000	9.527.090.702	15.777.090.702
Dividend paid out to shareholders			(358.000.000)	(358.000.000)
Profit for the year and comprehensive income			247.368.685	247.368.685
Equity as at 31.12.2014	5.000.000.000	1.250.000.000	9.416.459.387	15.666.459.387

Statement of Cash Flows

	Notes	2014	2013
Cash flows from operating activities			
Profit for the year and comprehensive income		247.368.685	715.086.929
Items not affecting cash:			
Net interest income deducted		(866.869.820)	(1.047.209.388)
CPI linked and currency movements and accrued interests		(83.500.561)	167.774.751
Pension obligations, decrease (increase)	23	2.797.753	3.673.900
Depreciation	17	1.195.628	1.195.629
Provision due to loan in foreign currency	18	473.731.179	99.528.700
		(472.645.821)	(775.036.408)
Changes in operating assets			
Loans provided to customers		(8.501.325.673)	(14.066.367.878)
Loans collected from customers		7.076.818.593	6.400.418.848
Financial assets designated at FV through P&L, increase		(954.846.059)	(5.983.595)
Short term loans provided to customers, decrease		0	30.000.000
Short term loans borrowings, (decrease) / increase		154.290.300	(3.672.010)
Other assets, (increase) / decrease		227.125	(1.276.753)
Other liabilities, (decrease) / increase		(1.121.272)	3.391.012
Interest received		3.057.631.426	2.930.300.407
Interest paid		(2.195.647.509)	(2.081.287.894)
		(1.363.973.069)	(6.794.477.863)
Net cash from operating activities		(1.589.250.205)	(6.854.427.342)
Cash flows from financing activities			
Borrowings		3.915.187.592	10.222.606.808
Borrowings repaid		(5.280.269.031)	(4.855.676.439)
Dividend to shareholders		(358.000.000)	(408.000.000)
		(1.723.081.439)	4.958.930.369
Net decrease in cash and cash equivalents		(3.312.331.644)	(1.895.496.973)
Currency effects on cash and cash equivalents		1.801.045	(2.228.250)
Cash and cash equivalents at the beginning of year		7.617.030.519	
Cash and cash equivalents at end of year		4.306.499.920	(1.897.725.223)
Cash and cash equivalents, split			
Cash and balances with Central bank		4.255.950.383	4.392.652.302
Amounts due from credit institutions		50.549.537	3.224.378.218
		4.306.499.920	7.617.030.520

Notes

1. General information

Municipality Credit Iceland Plc. (MCI) is a statutory limited liability company owned by the Icelandic municipalities. MCI is a financial institution, and operates pursuant to Act No. 161/2002 on Financial undertakings; cf. The Companies Act No. 2/1995 and is supervised by the Icelandic Financial Supervisor. MCI´s main function is to secure favorable funding or guarantees to the municipalities and related organisations and enterprises. MCI is by law only allowed to fund municipal projects that are of general economic interest.

MCI is incorporated and domiciled in Iceland. The address of its registered office is: Borgartún 30, Reykjavík. MCI has issued bonds which are listed at the OMX Nordic Exchange and MCI has market maker agreements in place for a part of them. The Financial statements were approved for issue by the Board of Directors of Municipality Credit Iceland on 24 March 2015.

2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all years, unless otherwise stated.

2.1 Statement stating that International Accounting standards have been applied

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

2.2 Basis for the financial statements

The financial statements are prepared on the historical cost basis, except for short-term securities which are measured at fair value.

2.3 New accounting standards and changes in current standards

A few new accounting standards became effective at the beginning of the year 2014. Those standards are not seen as having considerable impact on MCI´s financial statements. Some of the new standards and the amended ones which have been confirmed by the European Union will take effect as of 1st of January 2015 or later and have not been implemented in preparing these financial statements. The assumption is that those new standards and the changes in current standars will not have considerable impact on MCI´s financial statements when they will take effect.

2.4 Estimates and judgements

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the company's accounting policies. See further explanation in Note 3.

2.5 Foreign currency transactions

(a) Functional and presentation currency
All amounts are presented in Krona unless otherwise indicated.

(b) Transactions and balances
Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Currency exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

2.6 Segment reporting

Due to the nature of the MCI´s business its operation has not been split into different segments.

2.7 Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except for those classified at fair value through profit or loss, are recognised within the income statement using the effective interest method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, MCI estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and payments paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

2.8 Derivatives

Derivatives are initially recognised at fair value on the date which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate.

The most reliable estimate of fair value of a derivative is the transaction price, i.e. the fair value of the consideration paid or received except when the price of the derivative is based on a price of a similar transactions with similar financial instruments in a comparable market. The fair value can also be determined from valuation techniques.

Certain derivatives can be embedded in other financial instruments, and are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not designated at fair value through profit or loss. These embedded derivatives are measured at fair value with the changes in fair value recognised in the income statement. At year end MCI did not own or have any outstanding derivatives.

2.9 Financial instruments

MCI classifies its financial assets in the following categories: Financial assets designated at fair value through profit and loss and loans and receivables. The classifications are determined at initial recognition.

(a) Financial assets designated at fair value through profit or loss

Financial assets are designated at fair value through profit or loss when:

- Financial assets are managed and evaluated on a fair value basis in accordance with the MCI's documented risk management or investment strategy.

Financial assets designated at fair value through profit or loss are initially recognised and subsequently measured at fair value in the balance sheet with fair value changes recognised in the income statement. After initial recognition as financial asset designated at fair value through profit or loss a resclassification is prohibited.

(b) Loans and receivables

Loans and receivables are financial instruments with fixed or determinable payments which are not quoted in an active market. Loans and receivables are recognised when cash is advanced to borrowers and MCI does not intend to sell the asset immediately or in the near term.

Loans and receivables are recognised using the effective interest method. Accrued interests are recognised as part of loans and receivables.

2.9 Financial instruments, cont.

(c) Netting

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

(d) Borrowing

Borrowings are recognised initially at fair value net of transaction costs incurred. Borrowings are subsequently stated at amortised cost using the effective interest method.

(e) Cash and cash equivalents

Cash and cash equivalents in the statement of cash flows consist of deposits with the central bank and amounts due from credit institutions.

2.10 Impairment on loans and receivables

At the end of each financial period, MCI estimates whether there is objective evidence of a financial asset or group of financial assets being impaired. According to Act No. 150/2006 on MCI, MCI can only lend to Icelandic municipalities, their organisations and enterprises for projects which are of general public interest. The condition for the extension of credit to municipality-owned enterprises and institutions is that such enterprises and institutions must be wholly owned by municipalities or jointly owned by municipalities and the State Treasury, with both acting as guarantors to the MCI for the loans.

According to paragraph 2 of article 68 of Act No. 138/2011 (Local Government Act), municipalities may put up their revenues as security for loans they receive from MCI and for guarantees they grant. MCI's objective is to demand such pledge as security for the loans.

MCI has not had any impairment losses on loans since its inception in 1967 and therefore does not have an impairment allowance account.

2.11 Property, plant and equipment

Property, plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to other operating expenses during the financial period in which they are incurred.

Depreciation of properties is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, which is 50 years.

The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. Assets that are subject to depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are recognised in other operating expenses in the income statement.

2.12 Post-employment obligations

MCI and other jointly administrated institutions are subject to pension obligations related to their employees, that have and do participate in the B-department of the State Employees' Pension Fund. MCI's obligation is calculated at the end of the year and recorded as liability in the balance sheet in accordance with Actuary´s calculations. Those calculations are the same as for the B-department of the State Employees´ Pension Fund, with a 2,0% interest rate and same expected lifetime as for 2007-2011. The benchmark of 65 years is used in order to calculate the post-employment liability.

2.13 Share Capital

In December, 2006 the Icelandic Parliament, Althingi, approved a new Act No. 150/2006 on the incorporation of Municipality Credit Iceland as a statutory limited liability company. On the initial shareholders´ meeting of MCI it was decided that the nominal value os share capital was to be ISK 5,000 million. The shareholders of MCI are all municipalities in Iceland, which are defined in Act No. 150/2006.

2.14 Taxes

According to Act No. 90/2003 on Income tax, MCI is exempted from paying income tax.

According to Act No. 94/1996 on Capital tax, MCI is exempted from paying capital tax.

According to Act No. 161/2002 on Financial institutions, MCI is exempted from stamp duty.

According to Act No. 155/2010 on specific tax on financial institutions, MCI is exempted from any tax payments under those laws.

3. Critical accounting estimates and judgements

Assets and liabilities are based on management´s judgement. Such estimates and judgements are continually evaluated and are based on factors such as expectations of future events that are believed to be reasonable under given circumstances. Determination of fair value changes is an example of that.

4. Financial risk management

Through MCI's activities it is exposed to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management to some degree of risk or combination of risks. Effective risk management includes analysis of main risk factors, risk measurement, processes to limit risk and continous supervision. MCI´s aim is therefore to identify MCI´s main risk factors, implement processes to monitor them, assess them regularly, maintain supervision and rules in order to make sure that the company will surpass any potential macroeconomic scenarios.

The Board of Directors determines MCI's risk management policy and is responsible towards the owners for it´s uphold. The Managing Director is responsible to the Board of Directors and proposes new policies and if appropriate, risk limits and is responsible for the monitoring of the major risk factors. MCI has been granted an exemption from operating an internal auditing department in accordance with guidelines from the Financial Services Authority No. 2/2011. The guidelines spell out how an internal audit shall be conducted and that the main role of an internal audit is to oversee the operations to ensure that rules are being followed in accordance with the boards decisions. MCI´s board contracts the annual internal audit of MCI in accordance with the Financial Services Authority´s rules. The internal audit has been conducted by Deloitte ehf. since 2005.

MCI is an intermediary for the Icelandic municipalities and their organisations and enterprises to the domestic and foreign financial markets. The main objective is to secure funding on favourable terms. Credit risk is the greatest single risk faced by the company, however liquidity risk, counterparty risk and operational risk are also important to MCI. Market risk is kept at it´s minimum even though it is present in terms of interest and currency risk.

4.1 Credit risk

Exposure to credit risk arises from MCI´s loans to Icelandic municipalities and the State Treasury. MCI solely grants loans to municipalities, their organisations and enterprises. The condition for the provision of credit to municipality-owned enterprises and organisations is that such enterprises and organisations must be wholly owned by municipalities or jointly owned by municipalities and the State Treasury, with both acting as guarantors to the Company for respective loans.

4.1 Credit risk, cont.

There are now 74 municipalities in Iceland, their number has decreased over the last years which has led to a stronger financial position towards MCI. At year-end MCI had loans outstanding to 59 municipalities. The Local Government Act gives a solid legal framework for the municipalities to operate under. The Icelandic municipalities can technically not become bankrupt but it is stated in the Local Government Act that the State will interefere if financial difficulties will arise within a municipality according to chapter VII in the previous mentiond Act.
The municipalities have been reliable borrowers and there has not been a loan loss since MCI commenced operations in 1967. MCI does therefore not make provisions for loan losses in its books.

According to the Local Government Act No. 138/2011, municipalities may pledge their revenues as security for loans granted by MCI and for guarantees it provides, but for no other loans or guarantees. When granting loans it is the policy of MCI that such security should be provided for by the municipality in question. At year end, 99.95% of MCI´s loans to municipalities and companies owned by them had such a pledge.

When loan applications are reviewed, the borrower has to fulfill all of the legal requirements for receiving a loan as well as the project being of general economic interest. A thorough valuation of the financial position and development of the borrowers and their guarantors is performed. All loan applications are introduced to the board of directors, either for their approval or as an introduction.

At year end MCI had 2 borrowers which were defined as large exposures. Large exposures are defined as exposures that exceed 10% of MCI´s equity according to rule nr. 625/2013 by the FSA. Ten of the largest borrowers are liable for 63% of the total loans. According to law on financial institutions nr.161/2002, no single exposure may exceed 25% of MCI´s equity.

4.1.1 Contractual risk

MCI is owned by the Icelandic municipalities and only lends to municipalities and companies owned by municipalities or municipalities and the State. According to the Local Government Act No. 138/2011, municipalities may pledge their revenues as security for loans and guarantess borrowed from MCI and MCI has the policy to take such a pledge for granted loans. Therefore MCI´s contractual commitments are guaranteed by municipalities and the risk is therefore limited to bankruptcy of a municpality or if they will seek moratorium or composition.
Counterparty risk excluding the credit risk is limited to the State Treasury and entities with guarantees from the State Treasury as well as domestic financial institutions which have a license from the Financial Services Authority. Risk related to a foreign financial institution shall be approved by the board of directors.

4.1.2 Counterparty risk

The managing director is responsible for MCI´s counterparty risk monitoring. Exposure to counterparty risk is regularly reviewed and managed through analysis and evaluation of loans and defaults. MCI did not apply its pledge in 2014 but it has been done once, in 2010.

The following table shows MCI´s maximum Counterparty Risk at year end 2014 and 2013.

	Maximum exposure	
	2014	**2013**
Counterparty risk position due to balance sheet assets in ISK million:		
Cash and balances with Central bank	4.256	4.393
Amounts due from credit institutions	51	3.224
Loans to municipalities and their companies	71.347	69.316
Financial assets designated at fair value through profit or loss	1.080	112
Other assets	2	2
Total counterparty risk	76.736	77.047

4.2 Liquidity and Funding Risk

Liquidity risk is the risk that MCI will encounter difficulty in meeting contractual payment obligations associated with its financial liabilities. MCI formulates liquidity management policies regarding its liquidity position and funding, to maintain the flexibility needed. The principal rule is to finish the funding process of a loan before granting a loan commitment. Part of the equity resources is managed short term to ensure a constant access to liquid capital and to maintain flexibility.
MCI monitors maturities on the financial instruments in order to secure that it can pay all liabilities on due dates. MCI always has to have enough liquidity to be able to meet predictable and unpredictable obligations. The following tables present the future cash flow in line with contractual repayments.

Balance 31.12.2014 in ISK million	**0-1 months**	**1 to 3 months**	**3 to 12 months**	**1 to 5 years**	**Over 5 years**	**Total**
Financial assets						
Cash and deposits	4.306	0	0	0	0	4.306
Financial assets at fair value	319	0	733	53	0	1.105
Loans	122	3.004	6.536	33.899	44.966	88.527
Total financial assets	4.747	3.004	7.269	33.952	44.966	93.938
Financial liabilities						
Bonds and debt instruments	532	2.838	4.558	27.057	39.429	74.414
Total financial liabilities	532	2.838	4.558	27.057	39.429	74.414
Net, assets - liabilities	4.215	166	2.711	6.895	5.537	19.524

Balance 31.12.2013 in ISK million	**0-1 months**	**1 to 3 months**	**3 to 12 months**	**1 to 5 years**	**Over 5 years**	**Total**
Financial assets						
Cash and deposits	7.617	0	0	0	0	7.617
Financial assets at fair value	112	0	0	0	0	112
Loans	77	2.870	6.145	32.648	44.684	86.424
Total financial assets	7.806	2.870	6.145	32.648	44.684	94.153
Financial liabilities						
Bonds and debt instruments	374	2.751	4.327	26.922	41.419	75.793
Total financial liabilities	374	2.751	4.327	26.922	41.419	75.793
Net, assets - liabilities	7.432	119	1.818	5.726	3.265	18.360

4.3 Interest rate risk

MCI´s aim with regards to interest rate riskis to balance the repayment profile of both assets and liabilities as well as to balance the fixed and variable interest rates. In general, loans are provided on the same terms as their financing with regards to life time of the loan, repayment profile, interest rates, interest periods as well as refixing interest premium. Part of the loans are funded with MCI´s equity with variable interest rates which the company can amend unilaterally.

Financial assets and liabilities, classified by interest repricing time, in ISK million as at 31.12.2014.

Financial assets	**0-1 years**	**1-5 years**	**5-10 years**	**Over 10 y.**	**Total**
ISK - CPI linked	6.534	21.759	22.720	10.926	61.939
ISK - non indexed	7.675	50	0	0	7.725
EUR	6.209	0	0	0	6.209
USD	636	0	0	0	636
JPY	109	0	0	0	109
CHF	101	0	0	0	101
GBP	15	0	0	0	15
Total financial assets	21.279	21.809	22.720	10.926	76.734
Financial liabilities					
ISK - CPI linked	4.953	17.622	20.395	10.339	53.309
ISK - non indexed	511	0	0	0	511
EUR	6.189	0	0	0	6.189
USD	568	0	0	0	568
Total financial liabilities	12.220	17.622	20.395	10.339	60.576
Net assets - liabilities	9.059	4.187	2.325	587	16.158

Financial assets and liabilities, classified by interest repricing time, in ISK million as at 31.12.2013.

Financial assets	**0-1 years**	**1-5 years**	**5-10 years**	**Over 10 y.**	**Total**
ISK - CPI linked	6.129	20.167	22.609	10.951	59.856
ISK - non indexed	8.775	0	0	0	8.775
EUR	7.482	0	0	0	7.482
USD	678	0	0	0	678
JPY	131	0	0	0	131
CHF	107	0	0	0	107
GBP	16	0	0	0	16
Total financial assets	23.318	20.167	22.609	10.951	77.045
Financial liabilities					
ISK - CPI linked	4.613	16.335	20.699	11.206	52.853
ISK - non indexed	356	0	0	0	356
EUR	7.432	0	0	0	7.432
USD	612	0	0	0	612
Total financial liabilities	13.013	16.335	20.699	11.206	61.253
Net assets - liabilities	10.305	3.832	1.910	(255)	15.792

4.3 Interest rate risk, cont.

Interest sensitivity

Interest sensitivity analysis with the assumption of average lifetime shows that 1 percentage interest increase would increase net interest revenue by ISK 39 million or 0,3% of MCI´s equity as compared to ISK 45 million and 0,3% of MCI´s equity as of year end 2013. The table below shows the effects of interest rate increase split down to asset and liability groups according to repricing time in ISK million.

	Parallel upwards shift on interest curve (bps)	2014	2013
		Profit (loss)	
ISK - CPI linked	100	57	101
ISK - non indexed	100	(17)	(55)
Foreign currencies	100	(1)	(1)
Total		**39**	**45**

Inflation risk

At year end 2014, MCI´s CPI linked assets exceeded CPI linked liabilities by 8,630 millions as compared to 7,003 million the year before. It has the effect that if the consumer price index increases by 1% then MCI's profit would increase by ISK 86 million and 1% decrease would reduce the profit by ISK 86 million.

CPI link effects	**2014**	**2013**
CPI linked assets	61.939	59.856
CPI linked liabilities	53.309	52.853
Net CPI linked position	**8.630**	**7.003**

4.4 Currency risk

MCI´s policy is to be in compliance with Central Banks rules and to eliminate currency risk by minimizing the mismatch between financial assets and financial liabilities denominated in foreign currencies.

Currency sensitiviy analysis

A sensitivity analsysis on MCI´s currency position reveals that 10% weakening of the Icelandic krona will increase MCI's profit and equity by ISK 32 million which represents 0.2% of equity. The table below illustrates the sensitivy analysis whereby MCI´s currency position is split down to each currency and shows the effect on profit and equity if the Icelandic krona would weaken by 10% with respect to foreign currencies.

Currency sensitivity analysis in ISK million	**Currencies strengthening/ weakening towards the ISK**	**2014**	**2013**
		Profit (loss)	
EUR	(10%)	2	7
USD	(10%)	7	5
JPY	(10%)	11	13
CHF	(10%)	10	11
GBP	(10%)	2	1
Total		**32**	**37**

The following table lists the exchange rates employed in calculations applicable to this annual statement.

	31.12.2014	**31.12.2013**	**Change %**
EUR/ISK	154,70	158,94	(2,7%)
USD/ISK	127,20	115,30	10,3%
JPY/ISK	1,0652	1,0987	(3,0%)
CHF/ISK	128,65	129,55	(0,7%)
GBP/ISK	198,14	190,67	3,9%

4.4 Currency risk, cont.

Financial assets and liabilities in ISK million as at 31.12.2014

	EUR	USD	JPY	Other currencies	Total
Financial assets					
Cash and deposits	29	0	0	0	29
Loans	6.180	636	109	116	7.041
Total financial assets	6.209	636	109	116	7.070
Financial liabilities					
Borrowed funds	6.189	568	0	0	6.757
Total financial liabilities	6.189	568	0	0	6.757
Net, assets-liabilities	20	68	109	116	313

Financial assets and liabilities in ISK million as at 31.12.2013

	EUR	USD	JPY	Other currencies	Total
Financial assets					
Cash and deposits	87	0	0	0	87
Loans	7.395	678	131	123	8.327
Total financial assets	7.482	678	131	123	8.414
Financial liabilities					
Borrowed funds	7.432	612	0	0	8.044
Total financial liabilities	7.432	612	0	0	8.044
Net, assets-liabilities	50	66	131	123	370

4.5 Operational risk

Regarding operational risk, MCI aims to have written and clear policies for all major business processes and standardise it´s loan agreements. It has also been a policy to outsource administrative services in order to minimise risk by distributing operations. As the operation of MCI can be characterised as relatively simple with the clients both being homogeneous and limited, the operational risk is limited.

4.5.1 Employee risk

MCI has three employees, Managing director, Credit manager and Treasury manager. In addition to that the company has outsourced various administrative services to The Association of Local Authorities in Iceland which has worked well and will be continued.

4.5.2 Legal risk

MCI operates pursuant to Act no. 150/2006 on the incorporation of Municipality Credit Iceland as a statutory limited liability company, Act no.161/2002 on financial undertakings and the companies Act no. 2/1995. MCI can not take responsibility on changes in law, court rulings or government decisions.

From July 1st 2001 MCI has provided loans in foreign currency to municipalities and their companies for a total amount of ISK 15,376, based on the initial value of the loans translated into ISK. MCI´s board has repeatedly revised MCI´s loan portfolio in foreign currency with respect to rulings where loans in foreign currency have been judged as illegal, (i.e. illegal loan in Icelandic krona linked to foreign currencies) and it is, and has been, the board´s opinion that MCI´s loans in foreign currency are not in contradiction to Act. No 38/2001 on interest and indexation.

On October 2nd 2014 the Supreme Court confirmed the ruling of Reykjavik District Court in the case of the municipality of Skagafjörður against MCI. The ruling stated that the relevant loan was a loan in ISK illegally linked to foreign currencies and in accordance with that MCI was made to adjust the loan in dispute accordingly. The ruling stated that on March 16th 2012 the outstanding loan amounted to ISK 103.8 million. In line with the ruling of Reykjavik District Court a provision against the loan in the amount of ISK 99.5 million was made in the financial statement for the year ended 2013. The final write off at year end 2014 attributable to this loan amounted to ISK 89 million.

On March 12th 2015 the Reykjavik District Court ruled in the case of Slökkvilið Höfuðborgarsvæðisins (The Capitols fire brigade) against MCI. The ruling stated that the relevant loan was a loan in ISK illegally linked to foreign currencies and in accordance with that MCI was made to adjust the loan in dispute accordingly. In accordance with the ruling MCI has to repay ISK 370.4 million as well as legal costs and penalty rates from December 31st 2012. Due to this ruling a charge has been made in the financial statement for this year in the amount of ISK 473.7 million. The board has not made a decision on whether or not to appeal the ruling to the Supreme Court.

These two above mentioned loans are the only two loans in MCI´s loan portfolio where neither a certain nominal amount nor the ratio in foreign currency is specified in the main body of the loan agreement. In MCI´s opinion the grounds for the rulings in these two cases do not apply to other loans in MCI´s loan portfolio as they are specific in the before mentioned ways, but the two of them also differ in some important aspects.

MCI is currently dealing with two other court cases disputing the legality of foreign loans. On June 23rd 2014 Reykjavik District Court ruled a loan to Fjardabyggd as being a legal loan in foreign currency. That ruling has been appealed to the Supreme Court by Fjarðabyggð. Hitaveita Egilsstada and Fella has also subpoenaed MCI regarding a foreign currency loan and that case was filed at Reykjavik District Court on January 8th 2015.

4.6 Equity management

The aim with equity management is that MCI has always enough equity to counterbalance against MCI´s underlying risk factors.

MCI´s equity consists of share capital, statutory reserve and retained earnings (Tier 1).

The minimum capital requirement according to paragraph 84 in Act no. 161/2002 is 8% of risk weighted assets. The requirements are based on the European legal framework for capital requirements (CRD) implementing the Basel framework. The regulatory minimum capital requirement under Pillar I of the Basel framework is 8% of risk-weighted assets (RWA) for credit risk, market risk and operational risk. MCI applies the standardised approach when it comes to calculating credit risk and market risk, but basic indicator approach when it comes to operational risk.

In conformity with Pillar II of the Basel framework, the Bank annually assesses its own capital needs through the Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP results are subsequently reviewed by the Financial Supervisory Authority (FME) in the Supervisory Review and Evaluation Process (SREP). The company´s equity assessment, with the ICAAP analysis, is a key element in MCI's equity and risk management.

FME conducted a SREP assessment on MCI´s ICAAP report in 2014. The outcome of the assessment was introduced to MCI and the analysis confirms that MCI´s equity is well above the standard set by MCI as well as the standards set by FME.

Notes

5. Net interest income

	2014	2013
Interest income and CPI linked revenue		
Loans	3.363.663.577	4.450.812.082
Cash and short term funds	375.142.637	503.499.124
	3.738.806.214	4.954.311.206
Interest expense and CPI linked expenses		
Debt securities in issue and other borrowed funds	2.871.936.394	3.907.101.818
Net interest income	866.869.820	1.047.209.388

6. Net gain on financial assets designated at fair value through profit or loss

	2014	2013
Money market securities	13.201.445	5.983.595

7. Net foreign exchange gains

	2014	2013
Loans	(140.107.077)	(751.196.769)
Borrowings	143.891.922	661.632.648
Amounts due from credit institutions	(1.801.045)	2.228.250
	1.983.800	(87.335.871)

8. Salaries and salary related expenses

At the end of 2014 there were three employees working for MCI same as during 2013. MCI has entered into a service agreement with the Icelandic Association of Local Authorities regarding the purchase of administrative services and such expense is recorded under the other operational expenses item. All board members receive 8% pension fund remuneration and the Managing director 12%.

	2014	2013
Salaries	54.501.261	47.528.752
Paid pension contribution	5.645.038	5.366.589
Calculated pensions costs related to pension obligations	3.700.509	3.878.534
Related expenses	5.401.323	4.619.492
	69.248.131	61.393.367
Óttar Guðjónsson, Managing director	19.374.101	18.878.685
Board of directors:		
Magnús B. Jónsson, chairman of the board	1.580.262	1.435.302
Kristinn Jónasson, vice chairman of the board	1.053.510	963.533
Svanfríður Inga Jónasdóttir, chairman	1.053.510	943.533
Elliði Vignisson, chairman	1.053.510	943.533
Helga Benediktsdóttir, chairman	1.053.510	922.444
Hilmar Sigurðsson, substitute chairman	84.354	60.541
	5.878.656	5.268.886

9. Bond issuance costs

	2014	2013
Market makers	35.500.000	35.500.001
Bond issuance fees	1.535.475	3.237.029
Annual fees related to bond issuance	4.818.832	3.912.787
	41.854.307	42.649.817

10. The Debtors' Ombudsman

MCI received invoices from The Debtor´s Ombudsman where they were charging MCI for a part of its cost of operations in 2010 and 2011. That charge was based on Act no. 100/2010. MCI protested against this charge and appealed the case to court of law, where MCI asked for a repayment. On May 14th MCI and the government signed an agreement whereby the government accepted that the charged cost was in fact a service fee in which MCI should not participate. As a consequence MCI got repaid the full cost along with associated interest and legal costs. The Icelandic parliament passed a specific law in 2011, Act. no.166/2011, regarding which entities should bear cost of the Debtor´s Ombudsman operation whereby MCI was specifically exempted from any part of that cost.

11. Other operating expenses

	2014	2013
Contract with the Icelandic Association of Local Authorities	15.895.608	15.169.668
Housing expenses	6.638.965	10.688.677
Computer and software	5.598.548	9.569.579
Auditor´s fees	5.807.942	8.250.892
Professional fees	11.698.657	6.727.051
Travelling expenses	2.306.585	3.087.867
Office equipment	962.110	1.218.394
Other operating expenses	3.322.811	3.167.900
	52.231.226	57.880.028

12. Earnings per share

	2014	2013
Profit for the year	247.368.685	715.086.929
Weighted average number of ordinary shares in issue	5.000.000.000	5.000.000.000
Earnings per share	0,05	0,14

13. Cash and balances with the Central bank

	2014	2013
Deposits with the Central bank, non mandatory	238.292.605	277.721.302
Term deposits with the Central bank	4.017.657.778	0
Deposit certificates with the Central bank	0	4.114.931.000
	4.255.950.383	4.392.652.302

Cash and balances with the Central bank as well as amounts due from credit institutions constitute cash and cash equivalents at year end as stated in the statement of Cash Flows, amounted to ISK 4,306 million as compared to ISK 7,617 at year end 2013.

14. Amounts due from credit institutions

	2014	2013
Bank accounts	50.549.537	96.533.983
Money market deposits	0	3.127.844.235
	50.549.537	3.224.378.218

14. Loans and receivables

	2014	2013
CPI linked loans	61.939.139.295	59.855.815.810
Foreign currency loans	7.039.209.267	8.326.913.560
Non - CPI linked loans	2.369.062.954	1.133.474.289
	71.347.411.516	69.316.203.659

16. Financial assets designated at fair value

	2014	2013
Bonds and debt instruments	761.117.420	0
Money market funds	318.796.457	111.866.373
	1.079.913.877	111.866.373

MCI has two claims outstanding against Winding-Up committes of bankrupt financial institutions as described below:

MCI´s gross claim on Glitnir bank amounted to ISK 6,723 million. There is a disagreement between MCI and Glitnir bank on how to calculate the claim and how to net different contracts between the parties. This disagreement resolved in Glitnir bank´s Winding-Up Board appealing the case to the Reykjavik District Court in May 2013. A ruling can be expected in 2015, after report submission and data collection is completed. The claim against Glitnir bank was written down to 0 in MCI´s annual statement for 2008 and is still 0, which is appropriate considering the fact that the dispute is being resolved by Court of law. MCI wrote down ISK 1,472 million due to these contracts at year end 2008.

MCI took provision against a bond, issued by SPRON, of the amount of 113 million in 2009. A claim of ISK 144 million was lodged against SPRON´s Winding-Up Board on January 21st 2010. According to SPRON´s claim list, dated on the 10th of March 2010, a confirmed claim was 135 million. SPRON´s receivership estimates below 5% recovery.

17. Property, plant and equipment

	2014	2013
Net book amount at the beginning of year	47.825.096	49.020.724
Depreciation during the year	(1.195.628)	(1.195.628)
Net book amount at year end	46.629.468	47.825.096
Net book amount is specified as:		
Historical cost	59.781.372	59.781.372
Accumulated depreciation	(13.151.904)	(11.956.276)
Net book amount	46.629.468	47.825.096

Real estate evaluation at year end 2014 amounted to ISK 65.0 million and assessed value for fire insurance amounted to ISK 75.9 million. At year end 2013 the real estate evaluations amounted to 49.3 million and assessed value for fire insurance amounted to 76.8 million.

18. Provision due to loan in foreign currency

On October 2nd 2014 the Supreme Court confirmed the ruling of Reykjavik District Court in the case of the municipality of Skagafjörður against MCI. The ruling stated that the relevant loan was a loan in ISK illegally linked to foreign currencies and in accordance with that MCI was made to adjust the loan in dispute accordingly. The ruling stated that on March 16th 2012 the outstanding loan amounted to ISK 103.8 million. In line with the ruling of Reykjavik District Court a provision against the loan in the amount of ISK 99.5 million was made in the financial statement for the year ended 2013. The final write off at year end 2014 attributable to this loan amounted to ISK 89 million.

On March 12th 2015 the Reykjavik District Court ruled in the case of Slökkvilið Höfuðborgarsvæðisins (The Capitols fire brigade) against MCI. The ruling stated that the relevant loan was a loan in ISK illegally linked to foreign currencies and in accordance with that MCI was made to adjust the loan in dispute accordingly. In accordance with the ruling MCI has to repay ISK 370.4 million as well as legal costs and penalty rates from December 31st 2012. Due to this ruling a charge has been made in the financial statement for this year in the amount of ISK 473.7 million. The board has not made a decision on whether or not to appeal the ruling to the Supreme Court.

19. Classification and measurement of financial assets and liabilities

According to IAS39 "Financial Instruments: Recognition and Measurement", financial assets and financial liabilities must be classified into specific categories which then determines the subsequent measurement of the instrument.

Each category´s basis of subsequent measurement is specified below:

- Loans and receivables, at amortized cost;
- Financial assets designated as at fair value through profit or loss, measured at fair value;
- Other liabilities, at amortized cost.

The following table shows the classification of financial assets and financial liabilities according to IAS39 and their fair values as at 31 december 2014:

	Loans and receivables	Designated as at fair value	Liabilities at amortized cost	Total carrying amount	Fair value
Assets					
Cash and balances with Central Bank	4.255.950.383	-	-	4.255.950.383	4.255.950.383
Loans to credit institutions	50.549.537	-	-	50.549.537	50.549.537
Loans and receivables	71.347.411.516	-	-	71.347.411.516	73.356.977.175
Marketable securities	-	1.079.913.877	-	1.079.913.877	1.079.913.877
Total assets	75.653.911.436	1.079.913.877	0	76.733.825.313	78.743.390.972
Liabilities					
Bonds and debt instruments	-	-	60.575.812.482	60.575.812.482	62.831.837.519
Total liabilities	0	0	60.575.812.482	60.575.812.482	62.831.837.519

The following table shows the classification of financial assets and financial liabilities according to IAS39 and their fair values as at 31 december 2013:

	Loans and receivables	Designated as at fair value	Liabilities at amortized cost	Total carrying amount	Fair value
Assets					
Cash and balances with Central Bank	4.392.652.302	-	-	4.392.652.302	4.392.652.302
Loans to credit institutions	3.224.378.218	-	-	3.224.378.218	3.224.378.218
Loans and receivables	69.316.203.659	-	-	69.316.203.659	71.737.298.000
Marketable securities	-	111.866.373	-	111.866.373	111.866.373
Total assets	76.933.234.179	111.866.373	0	77.045.100.552	79.466.194.893
Liabilities					
Bonds and debt instruments	-	-	61.253.286.819	61.253.286.819	63.228.040.118
Total liabilities	0	0	61.253.286.819	61.253.286.819	63.228.040.118

The fair value of MCI´s bonds is based on their trading price at year end.

The loan portfolios fair value is measured by calculating the present value using the funds bonds in addition to a 20bp spread. The 20bp spread is a combination of 15bp to cover direct bond issuance and market making costs as well as 5bp towards the funds running costs.

19. Classification and measurement of financial assets and liabilities (continued)

Municipality Credit uses a valuation hierarchy for disclosure of inputs to valuation used to measure fair value. Fair value measurements of financial instruments are made on the basis of the following hierarchy:

Level 1: Quoted prices are used for assets and liabilities traded in active markets.
issuanc
Level 2: Valuation technique based on observable inputs. The most recent transaction prices in combination with generally accepted valuation methods are used to measure fair value of shares. However, the yield of actively traded bonds with the same duration is used as a benchmark for the valuation of bonds.

Level 3: Valuation technique based on significant non-observable inputs. It covers all instruments for which the valuation technique includes inputs based on unobservable data and the unobservable inputs have significant effect on the instrument's valuation.

The following table shows the Level in the heirarchy into which the fair value of financial assets and liabilities, carried at fair value in the balance sheet, are categorised as at 31 december 2014:

	Level 1	Level 2	Level 3	Total
Assets				
Bonds and debt instruments	1.079.913.877	-	-	1.079.913.877
Total	1.079.913.877	0	0	1.079.913.877

Contract with the Icelandic Association of Local Authorities

	Level 1	Level 2	Level 3	Total
Assets				
Bonds and debt instruments	111.866.373	-	-	111.866.373
Total	111.866.373	0	0	111.866.373

The following table shows the Level in the heirarchy into which the fair value of financial assets and liabilities, not carried at fair value in the balance sheet, are categorised as at 31 december 2014:

	Level 1	Level 2	Level 3	Total
Assets				
Cash and balances with Central Bank	-	4.255.950.383	-	4.255.950.383
Loans to credit institutions	-	50.549.537	-	50.549.537
Loans and receivables	-	71.347.411.516	-	71.347.411.516
Total	0	75.653.911.436	0	75.653.911.436
Liabilities				
Bonds and debt instruments	60.575.812.482	-	-	60.575.812.482
Total	60.575.812.482	0	0	60.575.812.482

The following table shows the Level in the heirarchy into which the fair value of financial assets and liabilities, not carried at fair value in the balance sheet, are categorised as at 31 december 2013:

	Level 1	Level 2	Level 3	Total
Assets				
Cash and balances with Central Bank	-	4.392.652.302	-	4.392.652.302
Loans to credit institutions	-	3.224.378.218	-	3.224.378.218
Loans and receivables	-	69.316.203.659	-	69.316.203.659
Total	0	76.933.234.179	0	76.933.234.179
Liabilities				
Bonds and debt instruments	61.253.286.819	-	-	61.253.286.819
Total	61.253.286.819	0	-	61.253.286.819

20. Debt securities in issue

	Weighted average interest rate*			
	2014	2013	2014	2013
LSS '03, notes due 2018	5,17%	5,17%	435.734.534	554.290.946
LSS '04, notes due 2019	4,08%	4,08%	1.039.406.971	1.233.932.563
LSS '05-2, notes due 2022	4,30%	4,30%	4.945.434.825	5.489.750.481
LSS 150224, notes due 2024	4,66%	4,73%	27.911.722.982	28.549.782.529
LSS 150434, notes due 2034	3,59%	3,72%	15.997.942.607	13.792.572.177
LSS '08 1, notes due 2034	5,29%	5,29%	2.502.816.998	2.604.852.959
Debt securities in issue total			52.833.058.917	52.225.181.655

* Weighted average interest rate is calculated in accordance with the effective interest rate method.

21. Other long term borrowings

	Interest rate			
	2014	2013	2014	2013
EUR loans (EURIBOR + margin)	0,22%	0,22%	6.188.542.507	7.431.906.196
USD loans (LIBOR + margin)	0,17%	0,17%	567.694.048	612.478.522
ISK loans (CPI linked)	6,09%	6,09%	475.781.463	627.865.587
Other long term borrowings total			7.232.018.018	8.672.250.305

22. Short term borrowings

	Interest rate			
	2014	2013	2014	2013
ISK loans, non-CPI linked	4,88%	5,25%	510.735.547	355.854.859

23. Post-employment obligations

MCI and other jointly administrated institutions are subject to pension obligations related to their employees, that have and do participate in the B-department of the State Employees' Pension Fund. The calculations of an actuary has been calculated for the pension obligations and recorded as liability in the balance sheet based on a 2,0% interest rate and life expectancy rate according to 2007-2011 values. The benchmark of 65 years is used when it comes to calculating the post-employment obligations.

Post-employment obligations are specified as:	2014	2013
Pension liability as at 1.1.2014	56.535.170	52.861.269
Paid during the year	(902.757)	(624.358)
Increase during the year	3.700.509	4.298.259
Pension obligation, total	59.332.922	56.535.170

24. Other liabilities

	2014	2013
Creditors	4.268.400	5.427.980
Unpaid salary related expenses	2.576.117	2.537.809
	6.844.517	7.965.789

25. Equity

The minimum capital requirement according to paragraph 84 in Act no. 161/2002 is 8% of risk weighted assets. The requirements are based on the European legal framework for capital requirements (CRD) implementing the Basel framework. The regulatory minimum capital requirement under Pillar I of the Basel framework is 8% of risk-weighted assets (RWA) for credit risk, market risk and operational risk. MCI applies the standardised approach when it comes to calculating credit risk and market risk, but basic indicator approach when it comes to operational risk.

At the end of the year the total share capital was ISK 5.000 million. One vote is entitled to each nominal ISK.

The capital adequacy ratio is determined as follows:

	2014	2013
Equity		
Share Capital	5.000.000.000	5.000.000.000
Statutory reserve	1.250.000.000	1.250.000.000
Retained earnings	9.416.459.387	9.527.090.702
Equity in total	15.666.459.387	15.777.090.702
Risk base		
Credit risk	21.046.242.468	21.355.364.361
Market risk	313.000.000	369.429.000
Contract with the Icelandic Association of Local Authorities	1.757.885.258	1.893.052.318
Risk base in total	23.117.127.725	23.617.845.679
Capital adequacy ratio		
Capital adequacy ratio	68%	67%

In conformity with Pillar II of the Basel framework, the Bank annually assesses its own capital needs through the Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP results are subsequently reviewed by the Financial Supervisory Authority (FME) in the Supervisory Review and Evaluation Process (SREP). The company´s equity assessment, with the ICAAP analysis, is a key element in MCI's equity and risk management.

FME conducted a SREP assessment on MCI´s ICAAP report in 2014. The outcome of the assessment was introduced to MCI and the analysis confirms that MCI´s equity is well above the standard set by MCI as well as the standards set by FME.

26. Related party disclosures

Related parties are defined as municipalities and companies, owned by them, which are related to members and reserve members of MCI´s board of directors as well as municipalities and related companies who are among the 10 largest shareholders of MCI. This definition is based on IAS 24. Information regarding related parties are as follows:

	2014	2013
Balance at the beginning of year........	43.176.107.268	34.636.543.873
New loans to related parties........	4.018.485.086	10.116.589.996
Loan repayments from related parties........	(4.109.580.771)	(3.958.415.745)
Other changes........	126.787.704	2.381.389.144
Balance at year end........	43.211.799.287	43.176.107.268
Interest income........	1.673.837.663	1.487.582.552
Interest expense........	13.633.336	16.489.562

Information about directors´salary, see note 8.
Expenses paid to the Icelandic Association of Local Authorities, see note 11.
Debt to related parties at year end 2014, see note18.
Transactions with related parties are all in the normal course of MCI´s activities.

27. Outstanding loans

The table below shows the outstanding loans for each municipality borrower, amounting to a total of ISK 62.368 million. In addition to that MCI has granted loans to companies held 100% by the municipalities totalling ISK 8.979 million.

Municipality	Amount Mill. ISK	Habitants 31.12.'14
Kópavogsbær	9.834	33.205
Hafnarfjarðarkaupstaður	6.489	27.875
Sveitarfélagið Árborg	4.582	8.052
Mosfellsbær	3.571	9.300
Fjarðabyggð	3.460	4.747
Fljótsdalshérað	3.301	3.454
Ísafjarðarbær	2.778	3.629
Garðabær	2.371	14.453
Sveitarfélagið Skagafjörður	2.313	3.910
Akureyrarkaupstaður	2.076	18.191
Sandgerðisbær	1.737	1.580
Borgarbyggð	1.652	3.539
Akraneskaupstaður	1.530	6.767
Reykjanesbær	1.494	14.924
Sveitarfélagið Ölfus	1.294	1.885
Stykkishólmsbær	1.017	1.107
Hveragerðisbær	906	2.384
Grímsnes- og Grafningshre	850	431
Norðurþing	823	2.806
Bolungarvíkurkaupstaður	791	923
Grundarfjarðarbær	758	900
Vesturbyggð	747	1.002
Snæfellsbær	655	1.679
Reykjavíkurborg	636	121.822
Blönduósbær	602	861
Rangárþing ytra	581	1.548
Bláskógabyggð	496	961
Dalvíkurbyggð	483	1.861
Seyðisfjarðarkaupstaður	472	653
Hrunamannahreppur	443	794

Municipality	Amount Mill. ISK	Habitants 31.12.'14
Sveitarfélagið Vogar	400	1.102
Þingeyjarsveit	371	920
Rangárþing eystra	318	1.749
Djúpavogshreppur	279	422
Dalabyggð	240	680
Mýrdalshreppur	225	480
Fjallabyggð	223	2.037
Skaftárhreppur	191	460
Langanesbyggð	175	513
Sveitarfélagið Hornafjörður	164	2.150
Breiðdalshreppur	155	186
Hörgársveit	149	567
Eyjafjarðarsveit	116	1032
Vopnafjarðarhreppur	106	674
Seltjarnarneskaupstaður	76	4411
Tálknafjarðarhreppur	74	305
Húnavatnshreppur	71	414
Kjósarhreppur	49	216
Reykhólahreppur	41	268
Skútustaðahreppur	33	395
Grýtubakkahreppur	32	364
Hvalfjarðarsveit	31	635
Skagabyggð	25	99
Súðavíkurhreppur	21	204
Strandabyggð	19	473
Flóahreppur	17	616
Kaldrananeshreppur	13	112
Skeiða- og Gnúpverjahreppur	8	518
Tjörneshreppur	6	59

MCI has received permission in writing from its borrowers whereby they approve of the publication of their total borrowings from MCI. This is done in order to be able to publish the information in financial statements and investor reports where total loans are split down by municipalities and companies owned by them. This permission was sought in accordance with article 60 of Act no. 161/2002 on financial institutions.

28. List of shareholders

MCI is owned by all 74 municipalities in Iceland. Reykjavik is the only shareholder with a share above 10%, holding 17.5% of MCI´s shares. The ten biggest shareholders together own 56% of MCI´s shares. Below is a table presenting all MCI´s shareholders and their respective share.

Municipality	Shares in %	Municipality	Shares in %
Akrahreppur	0,08%	Kópavogsbær	5,52%
Akraneskaupstaður	2,41%	Langanesbyggð	0,54%
Akureyrarkaupstaður	5,49%	Mosfellsbær	1,49%
Árneshreppur	0,04%	Mýrdalshreppur	0,37%
Ásahreppur	0,04%	Norðurþing	2,22%
Bláskógabyggð	0,63%	Rangárþing eystra	1,67%
Blönduósbær	1,47%	Rangárþing ytra	1,72%
Bolungarvíkurkaupstaður	0,83%	Reykhólahreppur	0,30%
Borgarbyggð	1,78%	Reykjanesbær	3,03%
Borgarfjarðarhreppur	0,09%	Reykjavíkurborg	17,47%
Breiðdalshreppur	0,35%	Sandgerðisbær	0,63%
Dalabyggð	0,61%	Seltjarnarneskaupstaður	1,16%
Dalvíkurbyggð	1,35%	Seyðisfjarðarkaupstaður	0,98%
Djúpavogshreppur	0,33%	Skaftárhreppur	0,38%
Eyja- og Miklaholtshreppur	0,05%	Skagabyggð	0,03%
Eyjafjarðarsveit	0,37%	Skeiða- og Gnúpverjahreppur	0,37%
Fjallabyggð	2,39%	Skorradalshreppur	0,02%
Fjarðabyggð	3,00%	Skútustaðahreppur	0,21%
Fljótsdalshérað	1,59%	Snæfellsbær	1,77%
Fljótsdalshreppur	0,03%	Strandabyggð	0,45%
Flóahreppur	0,25%	Stykkishólmsbær	1,85%
Garðabær	3,76%	Súðavíkurhreppur	0,30%
Grindavíkurbær	1,09%	Svalbarðarstandarhreppur	0,18%
Grímsnes- og Grafningshreppur	0,22%	Svalbarðshreppur	0,08%
Grundarfjarðarbær	0,60%	Sveitarfélagið Árborg	3,05%
Grýtubakkahreppur	0,13%	Sveitarfélagið Garður	0,46%
Hafnarfjarðarkaupstaður	4,25%	Sveitarfélagið Hornafjörður	1,35%
Helgafellssveit	0,02%	Sveitarfélagið Skagafjörður	2,34%
Hrunamannahreppur	0,24%	Sveitarfélagið Skagaströnd	0,29%
Húnavatnshreppur	0,15%	Sveitarfélagið Vogar	0,42%
Húnaþing vestra	0,89%	Sveitarfélagið Ölfus	0,86%
Hvalfjarðarsveit	0,22%	Tálknafjarðarhreppur	0,20%
Hveragerðisbær	0,96%	Tjörneshreppur	0,02%
Hörgársveit	0,17%	Vestmannaeyjabær	5,81%
Ísafjarðarbær	4,15%	Vesturbyggð	1,32%
Kaldrananeshreppur	0,06%	Vopnafjarðarhreppur	0,68%
Kjósárhreppur	0,08%	Þingeyjarsveit	0,34%