Íslandsbanki

Consolidated Financial Statements 2019

Contents

Highlights

Our profile

A leader in financial services in Iceland, Íslandsbanki is a universal bank with total assets of ISK 1,199bn, a total capital ratio of 22.4% and a 25-40% market share across all domestic business segments at year-end 2019.

Íslandsbanki's purpose is to move Iceland forward by empowering our customers to succeed. Driven by the vision to be #1 for service, Íslandsbanki's relationship banking business model is propelled by three business divisions that manage and build relationships with the Bank's customers.

Íslandsbanki has developed a wide range of online services such as the Íslandsbanki and Kass apps, enabling customers to do their banking anywhere and anytime. At the same time, the Bank continues to operate the most efficient branch network in Iceland through its strategically located 14 branches.

Íslandsbanki has a BBB+/A-2 rating from S&P Global Ratings.

Our bank

14 branches

749 Number of FTEs at Íslandsbanki at year-end

New unified banking app

Market share*

32% individuals

35% SMEs

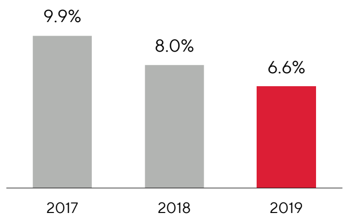
34% large companies

Credit rating

S&P Global Ratings

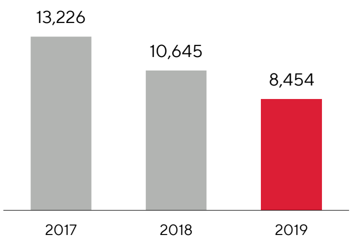
BBB+/A-2
Negative outlook

ROE reg. operations CET1 16%**

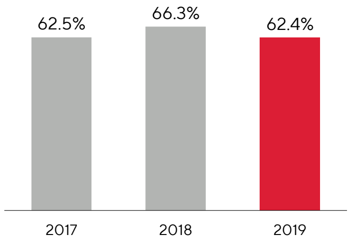


Profit after tax

(ISKm)

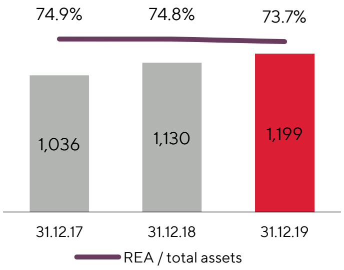


Cost / income ratio



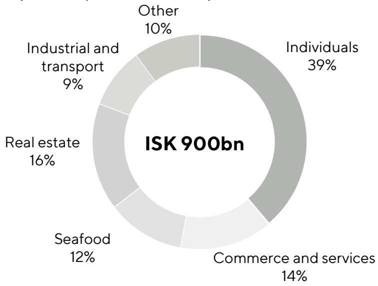
Total assets

(ISKbn)



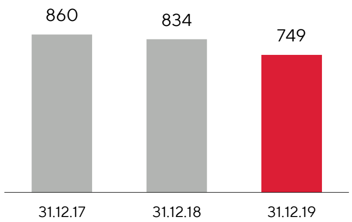
Loans to customers

(Sector split as of 31.12.19)



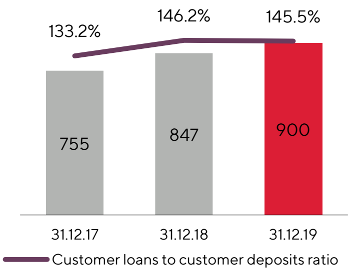
Number of FTEs at Íslandsbanki

(Excluding seasonal employees)

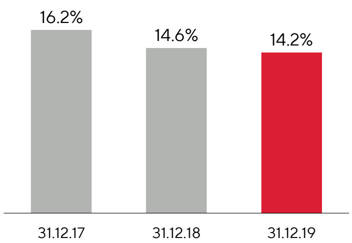


Loans to customers

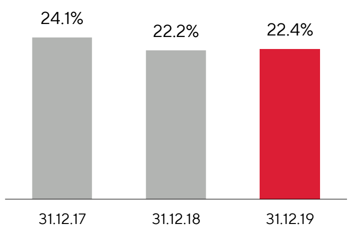
(ISKbn)



Leverage ratio



Total capital ratio



The information above has not been audited by the Bank's auditor.
*Based on Gallup survey regarding primary bank.
**Return from regular operations and corresponding ratios on normalized CET1 of 16%, adjusted for risk free interest on excess capital.

Directors' Report

The audited consolidated financial statements of Íslandsbanki hf. (“the Bank” or “Íslandsbanki”) for the year 2019 comprise the financial statements of Íslandsbanki hf. and its subsidiaries, together referred to as "the Group".

Operations in 2019

Íslandsbanki is a universal bank offering comprehensive financial services to households, corporations, and institutional investors in Iceland. The Group is one of Iceland's largest banking and financial services groups, with a strong domestic market share. The vision is to make Íslandsbanki #1 for service.

The profit from the Group's operations for the reporting period amounted to ISK 8,454 million, which corresponds to 4.8% return on equity. The Board of Directors proposes that ISK 4.2 billion will be paid in dividends to shareholders, which is in line with the Bank’s policy of paying dividends of 40-50% of profit of the year. The Board may convene a special shareholders' meeting later in the year to propose payment of additional dividends if the Bank's accumulated capital reserves are considered to exceed its long-term capital requirements. In 2019, the Bank paid ISK 5.3 billion in dividends to the Bank's shareholders, amounting to 50% of the Bank’s profit of the year in 2018. At the end of the reporting period, the Group employed 984 full-time members of staff, including 749 within the Bank itself, 60% female and 40% male.

Net interest income increased by 5.4% between years, broadly in line with growth in the loan book. Net fee and commission income increased by 9.3%, as modest growth in the Bank was supported by strong growth in the Bank’s three main subsidiaries. Other net operating income was ISK 1.5 billion, where negative net financial income was offset by one-off items in other operating income. The one-off items were a settlement of the Bank’s claim deriving from the acquisition of Byr savings bank in 2011 and a reversal of previously expensed contribution to the Depositors' and Investors' Guarantee Fund relating to past changes in the legislation on deposit insurance. Administrative expenses were up by 1.7% between years. Salary costs were up by 5.0% due to general wage increases and substantial redundancy payments, offset by reduction in the number of FTE's in the Bank where the number of year-end employees reduced by 10.2% between years. Net impairments were negative by ISK 3.7 billion, going from a net reversal of ISK 1.6bn in 2018 to a net charge in 2019, adversely affected by adjustments made to take into account the increased downside risk in the macroeconomic outlook and increased impairments against a few single-name exposures.

The balance sheet of the Group grew by 6.1% between years on the back of a 6.3% growth in loans to customers, with the largest increase in Personal banking. Loan book growth was especially strong in the first half of the year and slowed somewhat down in the second half and especially in the fourth quarter. The ratio of non-performing loans rose from 1.7% to 3.0% during the year due to a less favourable economic environment, with economic growth close to zero percent due to a drop in tourism.

Deposits from customers increased by 6.8% in 2019, driven by an increase in deposits from individuals and institutional investors. The Bank issued its first senior unsecured bond in the domestic market in 2019 and the issuance was well received by investors in Iceland and will serve as a good benchmark for other banks and corporate issuers. The Bank continued to have good access to international capital markets and fulfilled its funding plans across markets. In the second quarter the Bank issued a Tier 2 bond in the Nordic market and continues to be well supported by investors in that region. In January the Bank terminated its credit rating contract with Fitch ratings and was the decision driven primarily from a cost perspective. The Bank's ratings were affirmed by S&P (BBB+), however S&P placed all the Icelandic banks on negative outlook, mainly due to weaker earnings and competition from the pension funds in the mortgage market.

The Group's total equity amounted to ISK 180.1 billion and total assets were ISK 1,199.5 billion at the end of the reporting period and the Group's total capital ratio was 22.4%. At the end of September, the Group was presented with the results of the annual SREP process conducted by the Icelandic Financial Supervisory Authority. The results included the updated capital requirement for the Group. The total regulatory capital requirement is now 18.8% of the risk exposure amount and did not change from the last SREP process. The composition of the requirement did however change, as a 50 basis point increase in the counter-cyclical buffer was offset by a reduction in the pillar 2 charge. The countercyclical buffer will increase by further 25 basis points, from 1.75% to 2.00%, as of February 2020, which will then bring the total regulatory capital requirement up to 19.0%. The Bank’s capital target entails a management buffer of 0.5-2.0% on top of the SREP requirement and from February 2020 onwards the capital target will therefore be 19.5-21.0%. The Bank's liquidity position remains strong and well above regulatory requirements.

The Bank engaged BCG Nordics to help to formulate a new strategy for the Bank and the outcome was presented to the Bank's employees at a strategic summit at the end of March. The strategy work was based on extensive research, industry insights and benchmarks, identifying the competitive advantages and future strategic positioning in a changing environment. The outcome of the work was an articulation of the Bank's purpose, values and vision along with a list of strategic initiatives to be implemented in the next five years. The purpose of “Moving Iceland forward through empowering our customers to succeed” was defined through input from workshops with all employees. It articulates a more active role of the Bank in a shaping and progressing society. The purpose is further supported by three values that will serve as a guiding principle for employees in all their efforts: 'Passion, Professionalism, and Collaboration'.

To live the purpose and values, Íslandsbanki continues to be guided by the vision to be '#1 for service', placing the customer at the centre of gravity for value creation. The Bank will put a strong emphasis on technology to facilitate innovation and development of simple, efficient solutions for its customers. Going forward, the Bank will be reinforcing its commitment to corporate social responsibility (CSR) by integrating social and environmental impact as a driver of strategy and value creation within the Bank. As such, the Bank's CSR work will be centred around four of the United Nations’ seventeen Sustainable Development Goals (SDGs): #4 Quality education; #5 Gender equality; #9 Industry, innovation and infrastructure; and #13 Climate action. As a result of the BCG work, the Bank has also focused on improving its pricing models and finding efficiency gains, for example with the implementation of robotics.

Directors' Report

Outlook

Following a long period of robust growth, the Icelandic economy faced headwinds in 2019 as a major airline went bankrupt and the number of tourists visiting the country declined by 14% year-on-year. However, the tourist sector, as well as the wider economy, seems to be weathering this setback relatively well so far. The improvement in the balance sheets of both the private and public sector over the past decade are a major factor in increasing economic resilience to adverse developments such as those Iceland has faced recently.

The Bank's Chief economist expects GDP growth to resume in 2020, following broadly unchanged GDP in 2019, measuring 1.4% this year and rising to 2.3% in 2021. After a year of contraction, investment is assumed to return to growth as business sentiment recovers and the public sector steps up infrastructure investments. Buoyed by a sound financial position and ongoing real wage growth, households are expected to continue increasing private consumption, albeit at a more modest pace than in recent years. Inflation has subsided to the Central Bank's target after a short-lived inflation spike and the outlook is for moderate inflation in coming quarters, which will increase the leeway for counter-cyclical economic policy. The Icelandic króna has remained relatively stable following a 10% depreciation in the latter half of 2018 and there are numerous indications that the current exchange rate will help facilitate a continuation of the historically long period of current account surplus Iceland has enjoyed in recent years.

The Bank aims to reach a return of equity of 8-10%. To achieve that goal, the Bank will strive to continue to grow revenue on average in line with GDP, while growing the cost base at a slower pace with strict cost control and efficiency gains, lowering the cost-income ratio below our target of 55%. The Bank’s capital position remains strong and well above the regulatory requirements, supporting dividend payments in line with the target of 40-50% payout ratio.

Risk management

The Bank is exposed to various risks. The management of these risks is an integral part of the Bank's operations and the Bank has focused on building up a responsible internal risk culture among the Bank's employees. The ultimate responsibility for ensuring an adequate risk management framework lies with the Board of Directors. The Board defines and communicates the acceptable level of risk through the Bank's risk management policies and the CEO is responsible for ensuring that risks are managed within those limits.

The Board hereby declares that Íslandsbanki has overall satisfactory risk management in relation to the Bank’s profile and strategy.

The Bank's risk management framework and policies are discussed under Notes 45-63 to the consolidated financial statements and in the unaudited Pillar 3 Report.

Ownership

The Bank is wholly owned by the Icelandic Government and there were no changes in the ownership during the course of 2019. The shares are administered by the Icelandic State Financial Investments (ISFI) in accordance with Act no. 88/2009 on Icelandic State Financial Investments.

The Icelandic Government published in July 2017 a general ownership policy for financial institutions with regards to ownership stakes administered with the Icelandic State Financial Investments (ISFI). In December 2018 the Bank signed an agreement with ISFI on general and specific goals for the operations, in line with article 2.3 in the policy.

Corporate governance

The Board of Directors of Íslandsbanki is committed to excellence in its governance framework so that it complies with the best corporate governance practices in the financial market at all times.

Íslandsbanki was first recognised as “Exemplary in Corporate Governance” in March 2014 by the Center of Corporate Governance at the Institute for Business Research, University of Iceland. The recognition was awarded following a comprehensive review of the practices of the Board, Board subcommittees and management. The recognition has been renewed annually since.

The Board of Directors comprises seven non-executive directors and two alternates. The Board undertakes the Bank's affairs and is responsible for setting the Bank's general strategy as well as instructing the CEO on its further implementation and execution. The Board has a supervisory role overseeing that the Bank's organisation and activities are at all times in accordance with relevant laws, regulations and good business practices. Furthermore, the Board shall monitor the execution of its policies, the sound control of accounting and financial management, and ensure that group internal audit, compliance, risk management and internal controls are effective at all times.

Candidates for board membership are nominated through a selection process administered by the Icelandic State Financial Investments in accordance with Article 7 of the ISFI Act no. 88/2009. At the Bank's Annual General Meeting in March the Board of Directors was elected for the Bank. The Articles of Association of the Bank provide that the ratio of each gender on the Board of Directors shall not be lower than 40%, currently the Board consists of seven members, three female and four male. The Board has approved a policy on the suitability of the Board of Directors, the CEO and key function holders. The policy states, among other things, that the composition of the Board shall at any time be diverse, with regard to educational and professional background, gender and age.

Directors' Report

The Board appoints subcommittees, each one comprising Board members and operating under the terms of a mandate letter from the Board as well as the Rules of Procedure of the Board. The mandate letters of Board subcommittees are available on the Bank's website.

The CEO is responsible for the day-to-day operations of the Bank and that the Bank's business is, at all times, in accordance with the Bank's Articles of Association, policies of the Board and the relevant law. The CEO engages the Bank's Compliance Officer and appoints members of the Executive Committee and other Senior Management Committees.

The Executive Committee, comprising seven members, including the CEO, is composed of three women and four men. The role of the Executive Committee is to maintain an overall view of the Bank's operations and to coordinate key aspects of its activities that are not supervised by other senior management committees. The CEO ensures that the Board is regularly provided with accurate information on the Bank's finances, development and operations.

The Bank's Finance division is responsible for the preparation of the Group's consolidated financial statements which are prepared in accordance with the International Financial Reporting Standards (IFRS). The Board's Audit Committee gives its opinion on annual and interim consolidated financial statements before their submission for Board approval and endorsement. Management reporting is generally presented to the Board 10 times a year. The external auditors review the second quarter interim consolidated financial statements and audit annual consolidated financial statements.

The regulatory framework for corporate governance practices within Íslandsbanki consists of the law applicable to its operations, including those imposed by the FME, Central Bank of Iceland and Nasdaq Iceland. The applicable laws include, inter alia, the Act on Financial Undertakings no. 161/2002, the Act on Securities Transactions no. 108/2007, the Act on Public Limited Companies no. 2/1995 and the Act on Competition no. 44/2005, available on the Icelandic legislature's website (www.althingi.is).

The Board of Directors follows the Corporate Governance Guidelines (5th ed.) issued by the Iceland Chamber of Commerce, Nasdaq Iceland and SA-Business Iceland, available on www.corporategovernance.is (hereinafter the Guidelines). The Bank's practices are compliant with the guidelines except for Article 1.5.

Article 1.5 of the Guidelines provides that the shareholders' meeting shall appoint members to a nomination committee or decide how they should be appointed. The Bank's shareholders, as well as the Board, have not deemed it necessary to appoint a nomination committee at this time given the ownership of the Bank. Candidates for board membership are nominated by the Icelandic Government, sole owner of the Bank, through a selection process administered by ISFI in accordance with article 7 of the ISFI Act.

A more detailed description of Íslandsbanki's governance framework and associated practices can be found in the Bank's Corporate Governance Statement enclosed in an unaudited Appendix to the consolidated financial statements and on the Bank's website, www.islandsbanki.is.

Sustainability

Íslandsbanki's Sustainability Policy was approved by its board in late 2019. The Policy aims at making the Bank a model of exemplary operations in the Icelandic business community, based on internationally recognised environmental, social, and governance (ESG) criteria. The ESG criteria are a set of references used by investors to evaluate investments based on responsible investment methodology.
The Bank aims to be a leader in the area of sustainable development and a catalyst for positive social action, moving Iceland forward by empowering its customers to succeed. To this end, the Bank intends to initiate broad collaboration on responsible business practices that both contribute to sustainable development in the Icelandic economy and support the Government's Climate Action Plan, while also supporting the UN SDGs.

Alongside its vision of being a leader in service to customers, the Bank will focus on integrating sustainability considerations into its activities, in addition to its profit objectives. The Bank will take account of ESG criteria in its risk management and will explore opportunities to take advantage of green investment opportunities. Íslandsbanki aims to increase the general public's financial knowledge and interest in the subject and, to this end, it offers interesting and accessible seminars on finance and economics.

Íslandsbanki's Sustainability Policy creates a comprehensive framework for its activities in the area of environmental affairs, respect for human rights, responsible lending, investments, purchasing, and grants, as well as integrating with and supporting the Bank's other policies. Íslandsbanki sets quantifiable ESG targets in its operations and discloses its performance relative to targets in a separate report issued concurrent with the Bank's annual financial statements.

As a signatory to the UN Global compact Íslandsbanki is committed to aligning its operations and strategies with 10 principles covering human rights, labour, the environment and anti-corruption. The Bank has in place a Code of Conduct and a Conflict of Interest Policy in order to ensure creditability in business transacted by the Bank and its clients and employees' impartiality in handling and processing individual cases.

The Bank's sustainability and ESG factors are further described in the unaudited annual and sustainability report.

Directors' Report

Statement by the Board of Directors and the CEO

The audited consolidated financial statements for the year ended 31 December 2019 have been prepared on a going concern basis in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union; the Act on Annual Accounts, no. 3/2006; the Act on Financial Undertakings, no. 161/2002; and rules on accounting for credit institutions, where applicable, to the extent that they are not inconsistent with the requirements of the IFRS as adopted by the EU.

To the best of our knowledge, these consolidated financial statements provide a true and fair view of the Group's operating profits and cash flows in 2019 and its financial position as of 31 December 2019. Furthermore in our opinion the financial statements and the Director's report give fair view of the main operational developments and achievements and describe the principal risks and uncertainties that the Group faces in its operations.

The Board of Directors and the CEO have today discussed and approved the 2019 Consolidated Financial Statements of Íslandsbanki.

Kópavogur, 12 February 2020

Board of Directors:

Friðrik Sophusson, Chairman
Tómas Már Sigurðsson, Vice-Chairman
Anna Þórðardóttir
Auður Finnbogadóttir
Árni Stefánsson
Hallgrímur Snorrason
Heiðrún Jónsdóttir

Chief Executive Officer:

Birna Einarsdóttir

Building a better working world

Independent Auditor's Report

To the Board of Directors and shareholders of Íslandsbanki hf.

Opinion

We have audited the consolidated financial statements of Íslandsbanki hf. and its subsidiaries (the Group) which comprise the consolidated statement of financial position as at 31 December 2019 and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flow for the year then ended and a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2019, and its consolidated financial performance and its consolidated cash flows for the year then ended, in accordance with the International Financial Reporting Standards, as adopted by the European Union and additional requirements in the Icelandic Act on Annual Accounts, Act on Financial Undertakings and rules on accounting for credit institutions, where applicable.

Basis for Opinion

We conducted our audit in accordance with the International Standards on Auditing (ISAs). Our responsibilities are further described in the Auditor's Responsibilities for the Audit of the financial statements section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in Iceland, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key Audit Matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Why significant	How our audit addressed the Key Audit Matter
Provision for credit impairment	

As described in Notes 2 and 66.3, the provision for credit impairment is determined in accordance with International Financial Reporting Standard 9, Financial Instruments (IFRS 9).
 	
The provision for credit impairment is dependent on the estimation and judgement of management. Loans to customers represent ISK 899,632 million or 75% of total assets at 31 December 2019 against which impairment allowances of ISK 10,298 million have been recorded.
 	
Key areas of judgement include:
‣ the interpretation of the requirements to determine impairment under application of IFRS 9, which is reflected in the Group's expected credit loss model;
‣ the identification of loans with significant deterioration in credit quality;
‣ assumptions used in the expected credit loss model such as the financial condition of the counterparty, expected future cash flows and forward-looking macroeconomic factors as disclosed in Notes 2 and 66.3.
 	
The determination of the provision for credit impairment is based on estimates and judgement by management. Due to the use of judgement and estimates and the relative size of loans to customers on the balance sheet, we consider the provision for credit impairment a Key Audit Matter.
	Our procedures focused on the following to respond to the Key Audit Matter, among others:
	
	‣ Assessing the Group's expected credit loss model, focusing on the following areas:
	  ‣ alignment of the expected credit loss model and its underlying methodology with the requirements of IFRS 9; and
	  ‣ approach to the incorporation of forward-looking macroeconomic factors.
	‣ Testing the effectiveness of relevant controls relating, among others, to the:
	  ‣ data used to determine the provision for credit impairment, including transactional data captured at loan origination and ongoing internal credit quality assessment;
	  ‣ expected credit loss model, including model build and approval, ongoing monitoring/validation, model governance and mathematical accuracy;
	  ‣ registration and valuation of collateral used in the calculation of expected credit loss;
	‣ Examination of a sample of loans and procedures to evaluate the:
	  ‣ timely identification of loans with significant deterioration in credit quality; and
	  ‣ expected loss calculation by re-performing and assessing the reasonableness of the ECL model calculations.
	In addition, we assessed the adequacy of the disclosures in the consolidated financial statements.

Why significant	How our audit addressed the Key Audit Matter
Reliability of information from IT systems	
The Group is highly dependent on IT systems due to the significant number of transactions that are processed daily and the complexity of the various systems used by the Group. In the process of preparing the consolidated financial statements the Group uses information from many systems and is dependent on the accuracy and completeness of information drawn from the systems. Because of the above we consider the accuracy and completeness of information generated by the IT systems a Key Audit Matter.	Our procedures focused on the following, among other, to respond t the Key Audit Matter: We selected the systems most important for the preparation of the consolidated financial statements. For those, the following procedures among others, were performed: ▸ Inspection of the appropriateness of employees' access. ▸ Recalculation of interest income and expense calculations in the systems for selected dates during the year. ▸ Comparison of information from the systems with external data sources, such as currency exchange rates and consumer price index. ▸ Comparison of information from different systems within the group for consistency. ▸ Recalculation of reports generated by the systems. ▸ Testing of IT application controls For a material outsourced system, we relied on an ISAE 3402 report provided by the service provider.

We have fulfilled our responsibilities described in the ''Auditor´s responsibilities for the audit of the consolidated financial statements'' section, including in relation to the Key Audit Matters above. Accordingly, our audit included the design and performance of procedures to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters above, provide the basis for our audit opinion on the consolidated financial statements.

Other information

This document also contains other information than the consolidated financial statements and our auditor's report thereon. The other information are: The unaudited highlights, Directors´ Report, unaudited quarterly statements in note 9 and unaudited Íslandsbanki ´s Corporate Governance Statement 2019 in appendix. Management and Board of Directors are responsible for the other information.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon except for confirmation regarding Directors´ Report as stated below.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether it is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we, based on the work we have performed concerning this other information, conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of CEO and Board of Directors for the consolidated financial statements

The Chief Executive Officer (CEO) and Board of Directors are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards, as adopted by the European Union and additional requirements in the Icelandic Act on Annual Accounts, Act on Financial Undertakings and rules on accounting for credit institutions, where applicable.

The CEO and Board of Directors are responsible for such internal control that management determines is necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

The Board of Directors is responsible for overseeing the Group's consolidated financial reporting process.

Auditor's Responsibilities for the Audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (ISAs) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with the International Standards on Auditing (ISAs), we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the Key Audit Matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on the Board of Directors Report

Pursuant to the legal requirements of Article 104, Paragraph 2 of the Icelandic Financial Statement Act no. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the consolidated financial statements includes all information required by the Icelandic Financial Statement Act.

Reykjavík, 12 February 2020

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Margrét Pétursdóttir
State Authorised Public Accountant

Ernst & Young ehf.
Borgartúni 30
105 Reykjavík

Consolidated Income Statement

	Notes	2019	2018
Interest income*		62,846	61,675
Interest expense		(29,170)	(29,738)
Net interest income	10	33,676	31,937
Fee and commission income		21,026	19,853
Fee and commission expense		(7,667)	(7,626)
Net fee and commission income	11	13,359	12,227
Net financial expense	12	(817)	(962)
Net foreign exchange gain	13	143	1
Other operating income	14	2,134	1,784
Other net operating income		1,460	823
Total operating income		48,495	44,987
Salaries and related expenses	15	(16,279)	(15,500)
Other operating expenses	16	(11,828)	(12,150)
Contribution to the Depositors' and Investors' Guarantee Fund		(936)	(1,173)
Bank tax	66.22	(3,528)	(3,281)
Total operating expenses		(32,571)	(32,104)
Profit before net impairment on financial assets		15,924	12,883
Net impairment on financial assets	18	(3,663)	1,584
Profit before tax		12,261	14,467
Income tax expense	19	(3,682)	(4,734)
Profit for the year from continuing operations		8,579	9,733
Discontinued operations, net of income tax	20	(125)	912
Profit for the year		8,454	10,645

*Of which interest income amounting to ISK 60,123 million (2018: ISK 59,741 million) is calculated using the effective interest method.

	Notes	2019	2018
Profit attributable to:			
Shareholders of Íslandsbanki hf.		8,809	11,036
Non-controlling interests		(355)	(391)
Profit for the year		8,454	10,645
Earnings per share from continuing operations			
Basic and diluted earnings per share attributable to the shareholders of Íslandsbanki hf.	21	0.89	1.01

The notes on pages 16 to 84 are an integral part of these consolidated financial statements.

Íslandsbanki hf. Consolidated Financial Statements 2019 10 Amounts are in ISK million

Consolidated Statement of Comprehensive Income

	2019	2018
Profit for the year	8,454	10,645
Items that will not be reclassified to profit or loss		
Changes in fair value of financial assets, net of tax	1,272	610
Changes in fair value of financial liabilities, net of tax	(677)	1,120
Other comprehensive income for the year, net of tax	595	1,730
Total comprehensive income for the year	9,049	12,375
Total comprehensive income attributable to:		
Shareholders of Íslandsbanki hf.	8,939	12,542
Non-controlling interests	110	(167)
Total comprehensive income for the year	9,049	12,375

The notes on pages 16 to 84 are an integral part of these consolidated financial statements.

Íslandsbanki hf. Consolidated Financial Statements 2019 11 Amounts are in ISK million

Consolidated Statement of Financial Position

	Notes	31.12.2019	31.12.2018
Assets			
Cash and balances with Central Bank	22	146,638	135,056
Loans to credit institutions	23	54,376	41,577
Bonds and debt instruments	5	52,870	69,415
Derivatives	24	5,621	4,550
Loans to customers	25	899,632	846,599
Shares and equity instruments	5	18,426	13,074
Investments in associates	27	746	682
Property and equipment	29	9,168	5,271
Intangible assets	30	4,330	5,002
Other assets	31	7,683	9,177
Total Assets		1,199,490	1,130,403
Liabilities			
Deposits from Central Bank and credit institutions	32	30,925	15,619
Deposits from customers	33	618,313	578,959
Derivative instruments and short positions	24	6,219	5,521
Debt issued and other borrowed funds	35	306,381	300,976
Subordinated loans	36	22,674	16,216
Tax liabilities	38	7,853	7,150
Other liabilities	39	27,063	29,649
Total Liabilities		1,019,428	954,090
Equity			
Share capital		10,000	10,000
Share premium		55,000	55,000
Reserves		7,065	6,499
Retained earnings		105,569	102,496
Total Shareholders' Equity		177,634	173,995
Non-controlling interests		2,428	2,318
Total Equity		180,062	176,313
Total Liabilities and Equity		1,199,490	1,130,403

The notes on pages 16 to 84 are an integral part of these consolidated financial statements.

Íslandsbanki hf. Consolidated Financial Statements 2019 12 Amounts are in ISK million

Consolidated Statement of Changes in Equity

	Share capital	Share premium	Statutory reserve	Restricted reserves	Fair value reserve	Liability credit reserve	Retained earnings	Total shareholders' equity	Non-controlling interests	Total equity
Equity as at 1.1.2019	10,000	55,000	2,500	3,750	625	(376)	102,496	173,995	2,318	176,313
Profit (loss) for the year							8,809	8,809	(355)	8,454
Dividends paid							(5,300)	(5,300)		(5,300)
Net change in fair value of financial assets					807			807	465	1,272
Net change in fair value of financial liabilities						(16)	(661)	(677)		(677)
Restricted due to capitalised development costs				(551)			551	-		-
Restricted due to fair value changes				308			(308)	-		-
Restricted due to subsidiaries and associates				18			(18)	-		-
Equity as at 31.12.2019	10,000	55,000	2,500	3,525	1,432	(392)	105,569	177,634	2,428	180,062
Equity as at 1.1.2018	10,000	55,000	2,500	3,440	239	(1,486)	104,760	174,453	2,485	176,938
Profit (loss) for the year							11,036	11,036	(391)	10,645
Dividends paid							(13,000)	(13,000)		(13,000)
Net change in fair value of financial assets					386			386	224	610
Net change in fair value of financial liabilities						1,110	10	1,120		1,120
Restricted due to capitalised development costs				458			(458)	-		-
Restricted due to fair value changes				123			(123)	-		-
Restricted due to subsidiaries and associates				(271)			271	-		-
Equity as at 31.12.2018	10,000	55,000	2,500	3,750	625	(376)	102,496	173,995	2,318	176,313

Authorised share capital of the Bank is 10,000 million ordinary shares of ISK 1 each. At 31.12.2019 paid up share capital totalled ISK 65,000 million which is the total stated share capital of the Bank. The Bank has one class of ordinary shares which carry no right to fixed income. The Annual General Meeting ("AGM") for the operating year 2018 was held on 21 March 2019. At the AGM shareholders approved the Board's proposal to pay dividends to shareholders amounting to ISK 5,300 million which is equivalent to ISK 0.53 per share (2018: ISK 1.30 per share). The dividends were paid on 27 March 2019.

The notes on pages 16 to 84 are an integral part of these consolidated financial statements.

Íslandsbanki hf. Consolidated Financial Statements 2019 13 Amounts are in ISK million

Consolidated Statement of Cash Flows

	Notes	2019	2018
Profit for the year		8,454	10,645
Non-cash items included in profit for the year*		24,324	16,061
Changes in operating assets and liabilities*		(7,998)	(120,407)
Dividends received		46	55
Income tax and bank tax paid		(6,493)	(7,873)
Net cash provided by (used in) operating activities		18,333	(101,519)
Net investment in subsidiaries and associated companies		-	4,764
Proceeds from sales of property and equipment		21	15
Purchase of property and equipment		(327)	(611)
Purchase of intangible assets		(246)	(877)
Net cash (used in) provided by investing activities		(552)	3,291
Proceeds from borrowings		112,105	115,661
Repayment of borrowings		(114,708)	(48,475)
Repayment of lease liabilities		(378)	-
Dividends paid		(5,300)	(13,000)
Net cash (used in) provided by financing activities		(8,281)	54,186
Net increase (decrease) in cash and cash equivalents		9,500	(44,042)
Effects of foreign exchange rate changes		(222)	(193)
Cash and cash equivalents at the beginning of the year		143,203	187,438
Cash and cash equivalents at year-end		152,481	143,203

	Notes	2019	2018
Reconciliation of cash and cash equivalents			
Cash on hand	22	4,403	3,095
Cash balances with Central Bank	22	142,235	131,961
Bank accounts	23	21,122	25,259
Mandatory reserve and special restricted balances with Central Bank	22	(15,279)	(17,112)
Cash and cash equivalents at year-end		152,481	143,203

*For further breakdown see the following page.

The Group has prepared its consolidated statement of cash flows using the indirect method. The statement is based on the net profit after tax for the year and shows the cash flows from operating, investing and financing activities and the increase or decrease in cash and cash equivalents during the year.

Interest received in 2019 amounted to ISK 60,624 million (2018: ISK 58,354 million) and interest paid in 2019 amounted to ISK 22,736 million (2018: ISK 24,386 million). Interest paid is defined as having been paid when it has been deposited into the customer account and is available for the customer's disposal.

The notes on pages 16 to 84 are an integral part of these consolidated financial statements.

Íslandsbanki hf. Consolidated Financial Statements 2019 14 Amounts are in ISK million

Consolidated Statement of Cash Flows

	2019	2018
Depreciation, amortisation and write-offs	1,960	1,312
Share of profit of associates	(64)	(29)
Accrued interest and fair value changes on debt issued and subordinated loans	11,450	10,436
Net impairment on financial assets	3,568	(1,634)
Foreign exchange gain	(143)	(1)
Net loss (gain) from sales of subsidiaries, property and equipment	17	(1,557)
Unrealised fair value loss recognised in profit or loss	192	406
Discontinued operations, net of income tax	125	(912)
Bank tax	3,528	3,281
Income tax	3,682	4,734
Other changes	9	25
Non-cash items included in profit for the year	24,324	16,061

	2019	2018
Mandatory reserve and special restricted balances with Central Bank	1,833	454
Loans to credit institutions	(15,268)	767
Bonds and debt instruments	17,254	(38,740)
Loans to customers	(52,638)	(82,808)
Shares and equity instruments	(3,953)	(2,411)
Other assets	1,653	3,455
Deposits from Central Bank and credit institutions	15,232	4,116
Deposits from customers	37,678	4,307
Derivative instruments and short positions	(2,944)	(2,761)
Other liabilities	(6,845)	(6,786)
Changes in operating assets and liabilities	(7,998)	(120,407)

Non-cash transactions 2019
During the year the Bank repurchased own debt securities amounting to ISK 4,319 million by issuing new debt.

The Group recognised right-of-use assets amounting to ISK 4,505 million and the same amount in lease liabilities following the adoption of IFRS 16 - Leases (see Note 3).

Non-cash transactions 2018
During the year the Bank repurchased own debt securities amounting to ISK 184 million by issuing new debt.

The notes on pages 16 to 84 are an integral part of these consolidated financial statements.

Íslandsbanki hf. Consolidated Financial Statements 2019 15 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Notes to the Consolidated Financial Statements

1. Corporate information

Íslandsbanki hf., the parent company, was incorporated on 8 October 2008 and is a limited liability company domiciled in Iceland. The address of its registered office is Hagasmári 3, 201 Kópavogur, Iceland.

The consolidated financial statements for the year ended 31 December 2019 ("the consolidated financial statements") comprise the financial statements of Íslandsbanki hf. ("the Bank" or "Íslandsbanki") and its subsidiaries together referred to as "the Group".

At the end of 2019 the Bank was wholly owned by the Icelandic Government. The shares are administered by the Icelandic State Financial Investments in accordance with Act no. 88/2009 on Icelandic State Financial Investments.

The Group provides a wide range of financial services such as retail banking, corporate banking, investment banking, wealth management and asset financing. The Group operates mainly in the Icelandic market.

The consolidated financial statements were approved and authorised for issue by the Board of Directors and the CEO of Íslandsbanki hf. on 12 February 2020.

2. Basis of preparation

The consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union and additional requirements in the Act on Annual Accounts no. 3/2006, the Act on Financial Undertakings no. 161/2002 and rules on accounting for credit institutions.

The consolidated financial statements are presented in Icelandic króna (ISK), which is the functional currency of Íslandsbanki hf. All amounts presented in ISK have been rounded to the nearest million, except when otherwise indicated. At year-end 2019 the exchange rate of the ISK against the USD was 121.10 and 135.83 for the EUR (year-end 2018: USD 116.33 and EUR 133.23).

The Group's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future. Therefore, the consolidated financial statements have been prepared on a going concern basis.

Significant accounting estimates and judgements

The preparation of the consolidated financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses recognised. Actual results may differ from those estimates.

Estimates and underlying assumptions are regularly review and revised by management as deemed necessary. Changes in accounting estimates are recognised when they occur.

Impairment of financial assets

The main assumptions used for calculating the allowance for credit losses that are subject to significant judgement include the following:

• Probability of default (PD), loss given default (LGD) and exposure at default (EAD)

• Macroeconomic variables for multiple scenarios build on available information

• Assessment of significant increase in credit risk

The probability of default (PD), exposure at default (EAD), and loss given default (LGD) inputs used to estimate expected credit losses are modelled based on variables that are most closely related with credit losses in the relevant portfolio. This includes macroeconomic variables, demographic variables, variables related to past payment history among other variables. These variables are sourced both internally and externally. Significant judgements required for measuring expected credit loss (ECL) include the following:

- Determining criteria for assessing what constitutes a significant increase in credit risk
- Establishing the forward-looking scenarios and their relative weightings
- Choosing appropriate models and assumptions for the measurement of ECL

The allowance for credit losses is further discussed in Notes 25-26, in Notes 48-50 on risk management and in Note 66.3.

Fair value of financial instruments

The fair value of financial instruments where an active market or quoted prices are not available are decided upon by using estimation procedures. Financial instruments measured at fair value are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. Level 3 financial assets are measured at fair value using valuation techniques based on significant unobservable inputs. The valuation of Level 3 financial assets is subjective as the assumptions on which the valuation is based on are not easily observable and subject to management's assessment. The valuation techniques are discussed in Notes 6-7 and in Note 66.3.

Notes to the Consolidated Financial Statements

2. Cont'd

Intangible assets

Intangible assets, except for goodwill, are amortised over four to ten years. Intangible assets are reviewed at each reporting date to determine whether there is any indication of impairment. The value in use method is used by the Group to determine the recoverable amount of intangible assets. The following relevant criteria are considered when assessing whether indications of impairment exists:

- A decline in the asset´s market value
- Plans to restructure or liquidate the asset
- The asset generates less income than anticipated

Intangible assets are further discussed in Note 30 and in Note 66.9.

3. Changes to accounting policies

The Group adopted a new IFRS standard, IFRS 16 – Leases, which replaced IAS 17, IFRIC 4, SIC 15 and SIC 27 as of 1 January 2019. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for most leases under a single on-balance sheet model. As a result of the adoption of IFRS 16, the Group has changed its accounting policy for lease contracts (see Note 66.10).

A number of amendments to IFRS standards were effective from 1 January 2019 but they did not have a material impact on the Group's consolidated financial statements.

Impact of adoption of IFRS 16

The Group applied IFRS 16 using the modified retrospective approach and therefore the comparative information has not been restated.

The Group's lease liabilities and right-of-use assets at transition were mostly derived from CPI-linked lease commitments for offices, branches and storage but a small minority stems from lease commitments for land. At transition, ISK 4,505 million were recognised as lease liabilities and the same amount as right-of-use assets. Lease liabilities were measured at the present value of the remaining lease payments, discounted with each entity's incremental borrowing rate as at 1 January 2019. The weighted average rate applied by the Group was 2.14% for CPI-linked leases.

At transition to IFRS 16 the Group elected to apply the practical expedient to apply the standard only to contracts previously identified as leases under IAS 17. The Group used the following practical expedients; not to recognise right-of-use assets and liabilities for leases with less than 12 months of lease term and for leases of low-value assets; exclude initial direct costs from measuring right-of-use assets at the date of initial application, and using hindsight when determining the lease term if the contract contains options to extend or terminate the lease.

Reconciliation between IAS 17 lease commitments and IFRS 16 lease liabilities as at 1 January 2019

Operating lease commitments at 31 December 2018 as disclosed in the Group's consolidated financial statements	5,143
Effects of discounting operating lease commitments using the incremental borrowing rate	(593)
Recognition exemption for short-term and low-value asset leases	(61)
Addition for lease commitments for land	16
Lease liabilities recognised as at 1 January 2019	4,505

Lessor accounting under IFRS 16 is substantially unchanged from IAS 17. Lessors will continue to classify leases as either operating or finance leases using similar principles as in IAS 17. Therefore, IFRS 16 did not have an impact on leases where the Group is the lessor.

Changes to IFRS standards issued but not effective at the reporting date

A new IFRS standard and number of amendments to standards have been issued but are not yet effective. The Group did not early adopt any of them and intends to adopt them when they become effective. Changes that are likely to affect the Group's future financial reporting are described below, no significant impact is expected.

Interest Rate Benchmark Reform

The Group adopted amendments to IFRS 9 – Financial Instruments, IAS 39 – Financial Instruments: Recognition and Measurement, and IFRS 7 – Financial Instruments: Disclosures, as of 1 January 2020. The amendments modify certain hedge accounting requirements, relating to the method that is used to assess the effectiveness of the hedging relationship, to provide relief from potential effect of uncertainty caused by the Interest Rate Benchmark Reform, prior to the transition to alternative interest rates.

The amendments will not have a significant impact on the Group's consolidated financial statements.

3. Cont'd

To manage the transition to alternative interest rates the Bank has set up a working group responsible for the overall transition. A comprehensive review of legacy contracts has been carried out by the Legal department and new contract language been introduced to accommodate the benchmark reform. The work on systems and processes, along with education and communication to major stakeholders, is ongoing. It is expected that financial effects of the transition will be minimal to the Group. The Bank is continually monitoring developments in the benchmark reform work in jurisdictions affected and will adjust its implementation accordingly, should the need arise.

4. Operating segments

Segment information is presented in accordance with the Group's management and internal reporting structure. The Bank has three main business segments: Personal Banking, Business Banking and Corporate & Investment Banking. Operating segments pay and receive interest to and from Treasury to reflect the allocation of capital, funding costs and the relevant risk premium. The accounting policies for the reportable segments are in line with the Group's accounting policies. The Group operates mainly in the Icelandic market.

Capital allocation to the business units is 16% of the risk exposure amount (REA) which corresponds to the Bank's CET1 target from the risk appetite statement. Income tax with breakdown for each segment is according to the current tax rate. Bank tax and contribution to the Icelandic Depositors' and Investors' Guarantee Fund are shown separately and allocated across segments. The allocation of the bank tax is based on the expected long-term ratio, as stated in law, or 0.145%.

The Group comprises the following operating segments:

Personal Banking

Personal Banking provides comprehensive financial services to individuals, such as lending, savings and payments. Íslandsbanki's customers are increasingly taking care of their day-to-day banking via digital solutions such as apps, the online bank and the secure web chat. Customers can also visit the Bank's efficient branch network for comprehensive consultancy services.

Business Banking

Business Banking provides wide-ranging financial services to small- and medium-sized enterprises. Business Banking is organised around the branches where it can service its customers close to their own business. In addition, Business Banking operates Ergo, the asset based financing unit of the Bank.

Corporate & Investment Banking

Corporate & Investment Banking provides universal banking services to large companies, municipalities, institutional investors and affluent individuals. Services include customised products and services to customers including lending and advisory, risk management, brokerage and private banking services. The division is sector-focused, building and maintaining relationships with key customer segments within Iceland. Outside of Iceland, Íslandsbanki has a special focus on the North Atlantic seafood industry, leveraging its expertise in the domestic market and global contacts.

Treasury and Proprietary Trading

Treasury is responsible for funding the Bank's operations and for managing the internal pricing framework. It is also responsible for the Bank's balance sheet management and for relations with investors, financial institutions, stock exchanges and rating agencies. Equity that is not allocated to business units sits within Treasury. Proprietary Trading includes equity and debt investments in the trading book and banking book.

Cost centres

Cost centres comprise the CEO's office (Human Resources, Marketing & Communications, Strategy, and Legal), Finance excluding Treasury and Proprietary Trading, IT, Risk Management and Compliance. Group Internal Audit is included in cost centres, however, it is independent from the Bank and the Chief Audit Executive reports directly to the Bank's Board of Directors.

Subsidiaries, eliminations and adjustments

Subsidiaries include Borgun hf., Íslandssjóðir hf., Allianz Ísland hf. and other less significant subsidiaries (see Note 28).

Following is an overview showing the Group's performance with a breakdown by operating segments. A change from previous years is that almost all operational results from cost centres have been allocated to the Bank's operating segments. Comparative amounts have not been restated.

Notes to the Consolidated Financial Statements

4. Cont'd

2019	Personal Banking	Business Banking	Corporate & Investment Banking	Treasury & Proprietary Trading	Cost centres	The Bank total	Subsidiaries, eliminations & adjustments	The Group total
Net interest income	10,578	10,812	8,397	3,169	(251)	32,705	971	33,676
Net fee and commission income	4,504	1,716	3,530	(236)	7	9,521	3,838	13,359
Other net operating income	77	25	564	(848)	2,197	2,015	(555)	1,460
Total operating income	15,159	12,553	12,491	2,085	1,953	44,241	4,254	48,495
Salaries and related expenses	(2,791)	(1,993)	(1,720)	(253)	(6,516)	(13,273)	(3,006)	(16,279)
Other operating expenses	(2,131)	(1,184)	(660)	(257)	(5,725)	(9,957)	(1,871)	(11,828)
Contribution to the Depositors' and Investors' Guarantee Fund	(530)	(314)	(89)	(3)	-	(936)	-	(936)
Bank tax	(483)	(339)	(486)	(2,205)	(15)	(3,528)	-	(3,528)
Net impairment on financial assets	(547)	(1,098)	(1,043)	(791)	-	(3,479)	(184)	(3,663)
Cost allocation	(5,606)	(3,381)	(3,421)	278	12,130	-	-	-
Profit (loss) before tax	3,071	4,244	5,072	(1,146)	1,827	13,068	(807)	12,261
Income tax expense	(924)	(1,192)	(1,445)	318	(478)	(3,721)	39	(3,682)
Profit (loss) for the year from continuing operations	2,147	3,052	3,627	(828)	1,349	9,347	(768)	8,579
Net segment revenue from external customers	18,137	14,492	19,191	(9,708)	2,129	44,241	4,254	48,495
Net segment revenue from other segments	(2,978)	(1,939)	(6,700)	11,793	(176)	-	-	-
Fee and commission income	6,224	1,724	3,574	124	8	11,654	9,372	21,026
Depreciation, amortisation and write-offs	(215)	(112)	(21)	-	(1,367)	(1,715)	(245)	(1,960)
At 31 December 2019								
Loans to customers	329,265	230,842	334,788	2	-	894,897	4,735	899,632
Other assets	3,553	3,085	347	267,384	10,648	285,017	14,841	299,858
Total segment assets	332,818	233,927	335,135	267,386	10,648	1,179,914	19,576	1,199,490
Deposits from customers	290,894	167,623	113,455	49,517	-	621,489	(3,176)	618,313
Other liabilities	1,497	1,822	2,553	374,459	6,209	386,540	14,575	401,115
Total segment liabilities	292,391	169,445	116,008	423,976	6,209	1,008,029	11,399	1,019,428
Allocated equity	29,981	38,924	58,953	42,882	1,145	171,885	8,177	180,062
Risk exposure amount	194,601	247,565	367,456	48,063	6,968	864,653	19,897	884,550

The individual segment balance sheet positions are with external customers, and exclude internal transactions thus explaining the differences in total assets and total liabilities and equity.

Íslandsbanki hf. Consolidated Financial Statements 2019 20 Amounts are in ISK million

4. Cont'd

2018	Personal Banking	Business Banking	Corporate & Investment Banking	Treasury & Proprietary Trading	Cost centres	The Bank total	Subsidiaries, eliminations & adjustments	The Group total
Net interest income	9,946	9,788	7,676	3,649	(218)	30,841	1,096	31,937
Net fee and commission income	4,564	1,477	3,321	(109)	12	9,265	2,962	12,227
Other net operating income	1	41	353	1,070	282	1,747	(924)	823
Total operating income	14,511	11,306	11,350	4,610	76	41,853	3,134	44,987
Salaries and related expenses	(2,585)	(2,069)	(1,641)	(258)	(6,185)	(12,738)	(2,762)	(15,500)
Other operating expenses	(2,466)	(1,062)	(680)	(494)	(5,646)	(10,348)	(1,802)	(12,150)
Contribution to the Depositors' and Investors' Guarantee Fund	(669)	(395)	(109)	-	-	(1,173)	-	(1,173)
Bank tax	(434)	(327)	(470)	(2,041)	(9)	(3,281)	-	(3,281)
Net impairment on financial assets	579	955	164	(37)	-	1,661	(77)	1,584
Cost allocation	(5,134)	(2,813)	(2,660)	423	10,184	-	-	-
Profit (loss) before tax	3,802	5,595	5,954	2,203	(1,580)	15,974	(1,507)	14,467
Income tax expense	(989)	(1,455)	(1,548)	(1,280)	411	(4,861)	127	(4,734)
Profit (loss) for the year from continuing operations	2,813	4,140	4,406	923	(1,169)	11,113	(1,380)	9,733
Net segment revenue from external customers	14,958	14,996	17,337	(5,733)	295	41,853	3,134	44,987
Net segment revenue from other segments	(447)	(3,690)	(5,987)	10,343	(219)	-	-	-
Fee and commission income	5,990	1,612	3,420	133	12	11,167	8,686	19,853
Depreciation, amortisation and write-offs	(275)	(142)	(26)	(38)	(688)	(1,169)	(143)	(1,312)
At 31 December 2018								
Loans to customers	299,429	219,608	322,974	904	-	842,915	3,684	846,599
Other assets	1,332	3,151	316	252,085	8,056	264,940	18,864	283,804
Total segment assets	300,761	222,759	323,290	252,989	8,056	1,107,855	22,548	1,130,403
Deposits from customers	275,265	164,738	101,417	42,566	-	583,986	(5,027)	578,959
Other liabilities	1,453	2,811	3,199	345,375	2,317	355,155	19,976	375,131
Total segment liabilities	276,718	167,549	104,616	387,941	2,317	939,141	14,949	954,090
Allocated equity	24,582	37,304	57,200	48,982	646	168,714	7,599	176,313
Risk exposure amount	164,795	239,073	360,923	61,986	3,316	830,093	15,856	845,949

Íslandsbanki hf. Consolidated Financial Statements 2019 21 Amounts are in ISK million

Notes to the Consolidated Financial Statements

4. Cont'd

Subsidiaries, eliminations & adjustments

2019

	Borgun hf.*	Íslands-sjóðir hf.	Allianz Ísland hf.	Other subsidiaries	Eliminations & adjustments	Total
Net interest income	872	28	26	36	9	971
Net fee and commission income	1,716	1,089	1,069	(30)	(6)	3,838
Other net operating income	15	156	(1)	(5)	(720)	(555)
Total operating income	2,603	1,273	1,094	1	(717)	4,254
Salaries and related expenses	(2,260)	(558)	(188)	-	-	(3,006)
Other operating expenses	(1,359)	(181)	(471)	(2)	142	(1,871)
Net impairment on financial assets	(184)	-	-	-	-	(184)
(Loss) profit before tax	(1,200)	534	435	(1)	(575)	(807)
Income tax expense	228	(107)	(87)	-	5	39
(Loss) profit for the year from cont. operations	(972)	427	348	(1)	(570)	(768)
Net segment revenue from external customers	3,329	1,475	1,080	(16)	(1,614)	4,254
Net segment revenue from other segments	(726)	(202)	14	17	897	-
Fee and commission income	9,889	1,520	1,069	-	(3,106)	9,372
Depreciation, amortisation and write-offs	(235)	-	(3)	-	(7)	(245)
At 31 December 2019						
Total assets	22,362	2,726	1,201	6,467	(13,180)	19,576
Total liabilities	15,753	302	412	2	(5,070)	11,399
Total equity	6,609	2,424	789	6,465	(8,110)	8,177

*The Bank's shares in Borgun have been in a divestment process since January 2019. The Bank is in discussions with prospective buyers, however, there is still uncertainty as to whether the sale will occur and therefore the Bank has not reclassified the shares in Borgun as assets held for sale.

2018

	Borgun hf.	Íslands-sjóðir hf.	Allianz Ísland hf.	Other subsidiaries	Eliminations & adjustments	Total
Net interest income	1,021	28	19	15	13	1,096
Net fee and commission income	1,104	1,028	950	(31)	(89)	2,962
Other net operating income	3	21	13	519	(1,480)	(924)
Total operating income	2,128	1,077	983	503	(1,556)	3,134
Salaries and related expenses	(2,072)	(529)	(157)	-	(4)	(2,762)
Other operating expenses	(1,323)	(200)	(432)	(3)	156	(1,802)
Net impairment on financial assets	(76)	-	-	-	(1)	(77)
(Loss) profit before tax	(1,343)	348	394	499	(1,405)	(1,507)
Income tax expense	274	(74)	(79)	(1)	7	127
(Loss) profit for the year from cont. operations	(1,069)	274	315	498	(1,398)	(1,380)
Net segment revenue from external customers	2,813	1,217	939	1,125	(2,960)	3,134
Net segment revenue from other segments	(685)	(140)	44	(622)	1,403	-
Fee and commission income	9,331	1,421	950	-	(3,016)	8,686
Depreciation, amortisation and write-offs	(141)	-	(3)	-	1	(143)
At 31 December 2018						
Total assets	28,498	2,466	1,043	9,352	(18,811)	22,548
Total liabilities	22,154	196	231	1,860	(9,492)	14,949
Total equity	6,344	2,270	812	7,492	(9,319)	7,599

Íslandsbanki hf. Consolidated Financial Statements 2019 22 Amounts are in ISK million

5. Classification of financial assets and financial liabilities

At 31 December 2019	Mandatorily at FVTPL	Held for hedging	Designated as at FVTPL	Fair value through OCI	Amortised cost	Carrying amount
Cash and balances with Central Bank	-	-	-	-	146,638	146,638
Loans to credit institutions	-	-	-	-	54,376	54,376
Listed bonds and debt instruments	33,302	-	-	-	-	33,302
Listed bonds and debt instruments used for economic hedging	18,220	-	-	-	-	18,220
Unlisted bonds and debt instruments	1,348	-	-	-	-	1,348
Derivatives	4,700	921	-	-	-	5,621
Loans to customers	-	-	-	-	899,632	899,632
Listed shares and equity instruments	3,779	-	-	-	-	3,779
Listed shares and equity instruments used for economic hedging	8,681	-	-	-	-	8,681
Unlisted shares and equity instruments	2,851	-	-	3,115	-	5,966
Other financial assets	-	-	-	-	5,757	5,757
Total financial assets	72,881	921	-	3,115	1,106,403	1,183,320
Deposits from Central Bank and credit institutions	-	-	-	-	30,925	30,925
Deposits from customers	-	-	-	-	618,313	618,313
Derivative instruments and short positions	6,219	-	-	-	-	6,219
Debt issued and other borrowed funds	-	41,816	49,352	-	215,213	306,381
Subordinated loans	-	-	-	-	22,674	22,674
Other financial liabilities	-	-	-	-	24,772	24,772
Total financial liabilities	6,219	41,816	49,352	-	911,897	1,009,284

At 31 December 2018	Mandatorily at FVTPL	Held for hedging	Designated as at FVTPL	Fair value through OCI	Amortised cost	Carrying amount
Cash and balances with Central Bank	-	-	-	-	135,056	135,056
Loans to credit institutions	-	-	-	-	41,577	41,577
Listed bonds and debt instruments	45,496	-	-	-	-	45,496
Listed bonds and debt instruments used for economic hedging	22,405	-	-	-	-	22,405
Unlisted bonds and debt instruments	1,514	-	-	-	-	1,514
Derivatives	3,923	627	-	-	-	4,550
Loans to customers	-	-	-	-	846,599	846,599
Listed shares and equity instruments	2,928	-	-	-	-	2,928
Listed shares and equity instruments used for economic hedging	5,458	-	-	-	-	5,458
Unlisted shares and equity instruments	2,846	-	-	1,842	-	4,688
Other financial assets	-	-	-	-	7,511	7,511
Total financial assets	84,570	627	-	1,842	1,030,743	1,117,782
Deposits from Central Bank and credit institutions	-	-	-	-	15,619	15,619
Deposits from customers	-	-	-	-	578,959	578,959
Derivative instruments and short positions	5,521	-	-	-	-	5,521
Debt issued and other borrowed funds	-	40,714	68,154	-	192,108	300,976
Subordinated loans	-	-	-	-	16,216	16,216
Other financial liabilities	-	-	-	-	27,186	27,186
Total financial liabilities	5,521	40,714	68,154	-	830,088	944,477

Íslandsbanki hf. Consolidated Financial Statements 2019 23 Amounts are in ISK million

Notes to the Consolidated Financial Statements

6. Fair value information for financial instruments

Financial instruments carried at fair value

The fair value of a financial instrument is the transaction price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Where a market price is not readily available, the Group applies valuation techniques based on estimates and assumptions that are consistent with that which market participants would use in setting a price for the financial instrument.

The table below shows financial instruments carried at fair value at 31 December 2019 categorised into three levels of fair value hierarchy that reflect the type of inputs used in making the fair value measurements. The different levels have been defined as follows:

Level 1: Inputs that are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Group can access at the measurement date.

Level 2: Valuation techniques based on observable inputs other than the quoted prices included in Level 1, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Valuation techniques based on significant unobservable inputs, e.g. internal assumptions.

At 31 December 2019	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	51,522	-	1,348	52,870
Derivatives	-	5,621	-	5,621
Shares and equity instruments	12,383	27	6,016	18,426
Total financial assets	63,905	5,648	7,364	76,917
Short positions	814	-	-	814
Derivative instruments	-	5,405	-	5,405
Debt issued and other borrowed funds designated as at FVTPL	49,352	-	-	49,352
Total financial liabilities	50,166	5,405	-	55,571

At 31 December 2018	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	67,901	-	1,514	69,415
Derivatives	-	4,550	-	4,550
Shares and equity instruments	8,344	42	4,688	13,074
Total financial assets	76,245	4,592	6,202	87,039
Derivative instruments	-	5,521	-	5,521
Debt issued and other borrowed funds designated as at FVTPL	68,154	-	-	68,154
Total financial liabilities	68,154	5,521	-	73,675

Changes in Level 3 assets measured at fair value	Bonds and debt instruments	Shares and equity instruments
Fair value at 1 January 2019	1,514	4,688
Purchases	7	338
Sales and instalments	(537)	(52)
Net gain (loss) on financial instruments recognised in profit or loss	306	(118)
Net gain on financial instruments recognised in other comprehensive income	-	1,272
Other changes	58	(112)
Fair value at 31 December 2019	1,348	6,016

Íslandsbanki hf. Consolidated Financial Statements 2019 24 Amounts are in ISK million

6. Cont'd

	Bonds and debt instruments	Shares and equity instruments
Fair value at 1 January 2018	1,828	3,373
Purchases	8	790
Net loss on financial instruments recognised in profit or loss	(249)	(135)
Net gain on financial instruments recognised in other comprehensive income	-	610
Transfers from Level 1 or 2	-	50
Other changes	(73)	-
Fair value at 31 December 2018	1,514	4,688

At the end of each reporting period the Group determines whether transfers have occured between levels in the hierarchy, by reassessing categorisation based on the lowest level input that is significant to the fair value measurement as a whole. No transfers between levels took place in 2019.

Valuation process

The responsibility for the valuation of the fair value of financial instruments lies with the relevant business units. Each quarter, the business units present a valuation report to the Investment Committee for approval. The report and its assumptions are reviewed by Risk Management.

Valuation techniques

Where applicable, fair values are determined using quoted prices in active markets for identical assets and liabilities. In other cases, where there is no active market, the fair value is estimated using valuation techniques such as net present value and discounted cash flow models; comparison with similar instruments for which observable market data exists; net asset value (NAV) for investment fund units or expected recovery for distressed bonds. These valuation techniques are based on various assumptions and inputs such as risk-free rate, expected revenue growth and credit and liquidity spreads. In some cases, where significant inputs into these models are not observable, expert judgement and estimation for these inputs are required.

Level 1: Fair value established from quoted market prices.

Assets at this level are financial assets and financial liabilities containing actively traded bonds and equities that are listed either domestically or abroad.

Level 2: Fair value established using valuation techniques with observable market information.

Assets at this level are assets and liabilities containing domestic bonds, equities as well as derivatives. For interest rate derivatives contracts such as interest rate swaps (IRS) and cross-currency interest rate swaps (CIRS) the Group calculates the net present value of estimated future cash flows based on yield curves with key inputs such as interest swap rates and forward-rate agreements (FRAs) rates. Foreign-currency forwards and foreign-currency swaps are valued using the FX spot rate adjusted for forward pricing points that can be obtained from market sources. These products are classified as Level 2. Bond forwards and equity forwards are also classified as Level 2 as they are valued using standard models with key inputs observed from stock prices, estimated dividend rates and funding rates.

Level 3: Fair value established using valuation techniques using significant unobservable market information.

Assets at this level contain primarily unlisted and illiquid equities and bonds. Unlisted equities and bonds are initially recorded at their transaction price but are revalued each quarter based on the models as described above.

At 31 December 2019 the Group's Level 3 equities amounted to ISK 6,016 million:

-These include shares in seven professional investment funds and investment companies investing in unlisted equities and specialised investments in Iceland totalling ISK 1,722 million. The Group receives information from fund managers which use valuation models for the valuation of these equities.

-The Group holds Series C preferred shares in Visa Inc., amounting to ISK 3,115 million, which are subject to selling restrictions for a period of up to 9 years and under certain conditions may have to be recalled. The fair value of the preferred shares is closely linked to the market value of Visa Inc. at NYSE stock exchange, written down by 24% due to uncertainty of the final number of shares and marketability.

-Other Level 3 equities amounting to ISK 1,179 million.

At 31 December 2019 the Group's Level 3 bonds amounted to ISK 1,348 million:

-The majority of the amount in Level 3 bonds is estimated by discounting cash flow where the yield is the contractual currency's base rate with a premium that is decided by expert judgement on projected risk and financing cost.

Sensitivity analysis for Level 3 assets

The valuations of Level 3 assets are in general uncertain and subject to various factors. The favourable and unfavourable scenarios can be considered as being likely movements in valuation within a year. The very favourable and very unfavourable scenarios are considered less likely, but not impossible and are not worst-case scenarios for some of the assets.

Íslandsbanki hf. Consolidated Financial Statements 2019 25 Amounts are in ISK million

Notes to the Consolidated Financial Statements

6. Cont'd

The table below shows how profit (loss) and total comprehensive income would have been affected if one or more of the inputs for fair value measurement in Level 3 were changed.

Effect on profit or (loss):	Carrying amount	Very favourable	Favourable	Unfavourable	Very unfavour-able
Level 3 Bonds and debt instruments	1,348	330	257	(296)	(1,348)
Level 3 Shares and equity instruments	2,901	2,399	645	(762)	(1,614)
Effect on comprehensive income:					
Level 3 Shares in Visa Inc.	3,115	1,246	623	(623)	(1,246)

7. Financial instruments not carried at fair value

Assets

The fair value of “Loans to customers” may differ from their net carrying amount because the interest rates they carry may not reflect the interest rates that similar new loans would carry. The fair value is estimated by subtracting from or adding to the net carrying amount of the loans the discounted interest rate difference calculated from the reporting date until the next interest reset or maturity, whichever comes first. Since the interest rate difference is estimated using internal models these assets are classified as Level 3.

For “Cash and balances with Central Bank”, “Loans to credit institutions” and “Other financial assets” the fair value is adequately approximated by the carrying amount as they are short-term in nature. They are thus classified as Level 2.

Liabilities

The fair value of a financial liability with a demand feature, such as a demand deposit, is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. Most deposits are on demand or carry floating interest rates and as such their carrying amount is considered a good approximation of their fair value. The fair value for longer term fixed rate deposits is calculated with a duration approach, using the difference in each liability's current interest rate from the rate that a similar deposit would carry today. All deposits are classified as Level 2 based on the use of observable market interest rates to estimate the fair value.

Observed market value is used for the fair value of "Debt issued and other borrowed funds" where it is available. Issued bonds and bills with quoted market prices are classified as Level 1. If there is no quoted market price the fair value of the debt is valued in the same manner as deposits if it carries a fixed rate. If the debt carries a floating rate its fair value is estimated by comparing the margin with the Group's current funding premium on similar debt. These liabilities are classified as Level 2. The funding premium is based on the interest margin in the Group's issued papers including covered bonds, commercial papers as well as foreign currency denominated bonds.

Other financial liabilities mainly include unsettled securities transactions, payments due to leasing contracts and liabilities to retailers for credit card provisions and they are classified as Level 2 since their value is not observable from active market prices. Due to the short-term nature of these liabilities their carrying amount is considered a good approximation of their fair value.

The following table shows the fair value measurement and classification of the Group's assets and liabilities not carried at fair value. The different levels are defined in Note 6.

At 31 December 2019	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Cash and balances with Central Bank	-	146,638	-	146,638	146,638
Loans to credit institutions	-	54,376	-	54,376	54,376
Loans to customers	-	-	902,053	902,053	899,632
Other financial assets	-	5,757	-	5,757	5,757
Total financial assets	-	206,771	902,053	1,108,824	1,106,403
Deposits from Central Bank and credit institutions	-	31,027	-	31,027	30,925
Deposits from customers	-	618,592	-	618,592	618,313
Debt issued and other borrowed funds	165,044	100,334	-	265,378	257,029
Subordinated loans	22,626	-	-	22,626	22,674
Other financial liabilities	-	24,772	-	24,772	24,772
Total financial liabilities	187,670	774,725	-	962,395	953,713

Íslandsbanki hf. Consolidated Financial Statements 2019 26 Amounts are in ISK million

Notes to the Consolidated Financial Statements

7. Cont'd

At 31 December 2018	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Cash and balances with Central Bank	-	135,056	-	135,056	135,056
Loans to credit institutions	-	41,577	-	41,577	41,577
Loans to customers	-	-	848,751	848,751	846,599
Other financial assets	-	7,511	-	7,511	7,511
Total financial assets	-	184,144	848,751	1,032,895	1,030,743
Deposits from Central Bank and credit institutions	-	15,633	-	15,633	15,619
Deposits from customers	-	579,232	-	579,232	578,959
Debt issued and other borrowed funds	151,767	84,476	-	236,243	232,822
Subordinated loans	16,167	-	-	16,167	16,216
Other financial liabilities	-	27,186	-	27,186	27,186
Total financial liabilities	167,934	706,527	-	874,461	870,802

8. Offsetting financial assets and financial liabilities

The tables below show reconciliation to the net amounts of financial assets and financial liabilities, which are subject to offsetting, enforceable master netting agreements and similar agreements.

	Financial assets subject to netting arrangements			Amounts not set off but subject to master netting arrangements and similar agreements					
At 31 December 2019	Financial assets before netting	Netting with financial liabilities	Net financial assets	Financial liabilities	Cash collateral received	Financial instruments collateral received	Net amount after consideration of potential effect of netting arrangements	Assets outside the scope of offsetting disclosure requirements	Total financial assets recognised in the balance sheet
Reverse repurchase agreements	1,114	-	1,114	-	-	-	1,114	-	1,114
Derivatives	5,621	-	5,621	(1,374)	(3,146)	(88)	1,013	-	5,621
Total assets	6,735	-	6,735	(1,374)	(3,146)	(88)	2,127	-	6,735
At 31 December 2018									
Reverse repurchase agreements	153	-	153	-	-	-	153	-	153
Derivatives	4,550	-	4,550	(1,655)	(1,383)	(698)	814	-	4,550
Total assets	4,703	-	4,703	(1,655)	(1,383)	(698)	967	-	4,703

	Financial liabilities subject to netting arrangements			Amounts not set off but subject to master netting arrangements and similar agreements					
At 31 December 2019	Financial liabilities before netting	Netting with financial assets	Net financial liabilities	Financial assets	Cash collateral pledged	Financial instruments collateral pledged	Net amount after consideration of potential effect of netting arrangements	Liabilities outside the scope of offsetting disclosure requirements	Total financial liabilities recognised in the balance sheet
Derivative instruments and short positions	6,219	-	6,219	(1,374)	(1,139)	-	3,706	-	6,219
At 31 December 2018									
Derivative instruments and short positions	5,521	-	5,521	(1,655)	(85)	-	3,781	-	5,521

Íslandsbanki hf. Consolidated Financial Statements 2019 27 Amounts are in ISK million

Notes to the Consolidated Financial Statements

9. Quarterly statements (unaudited)

2019	Q4	Q3	Q2	Q1	Total
Net interest income	8,486	8,412	8,626	8,152	33,676
Net fee and commission income	3,646	3,090	3,406	3,217	13,359
Net financial (expense) income	(840)	(598)	173	448	(817)
Net foreign exchange gain (loss)	97	147	(71)	(30)	143
Other operating income	917	44	29	1,144	2,134
Salaries and related expenses	(4,196)	(3,720)	(4,312)	(4,051)	(16,279)
Other operating expenses	(3,130)	(2,698)	(2,961)	(3,039)	(11,828)
Contribution to the Depositors' and Investors' Guarantee Fund	(216)	(210)	(198)	(312)	(936)
Bank tax	(814)	(900)	(934)	(880)	(3,528)
Net impairment on financial assets	(1,585)	(230)	(929)	(919)	(3,663)
Profit before tax	2,365	3,337	2,829	3,730	12,261
Income tax expense	(611)	(1,292)	(626)	(1,153)	(3,682)
Profit for the period from continuing operations	1,754	2,045	2,203	2,577	8,579
Discontinued operations, net of income tax	(95)	41	(83)	12	(125)
Profit for the period	1,659	2,086	2,120	2,589	8,454

2018	Q4	Q3	Q2	Q1	Total
Net interest income	8,294	8,301	7,602	7,740	31,937
Net fee and commission income	3,478	2,939	3,032	2,778	12,227
Net financial (expense) income	(637)	(420)	378	(283)	(962)
Net foreign exchange gain (loss)	76	(8)	(57)	(10)	1
Other operating income	120	64	1,587	13	1,784
Salaries and related expenses	(4,047)	(3,501)	(4,026)	(3,926)	(15,500)
Other operating expenses	(3,418)	(2,962)	(2,846)	(2,924)	(12,150)
Contribution to the Depositors' and Investors' Guarantee Fund	(299)	(295)	(287)	(292)	(1,173)
Bank tax	(740)	(944)	(812)	(785)	(3,281)
Net impairment on financial assets	(297)	(53)	1,846	88	1,584
Profit before tax	2,530	3,121	6,417	2,399	14,467
Income tax expense	(1,118)	(1,136)	(1,465)	(1,015)	(4,734)
Profit for the period from continuing operations	1,412	1,985	4,952	1,384	9,733
Discontinued operations, net of income tax	(8)	126	81	713	912
Profit for the period	1,404	2,111	5,033	2,097	10,645

Íslandsbanki hf. Consolidated Financial Statements 2019 28 Amounts are in ISK million

Notes to the Consolidated Financial Statements

10. Net interest income

	2019	2018
Cash and balances with Central Bank	4,755	7,279
Loans at amortised cost	55,368	52,462
Financial assets mandatorily at fair value through profit or loss	2,630	1,825
Other assets	93	109
Total interest income	62,846	61,675
Deposits from Central Bank and credit institutions	(625)	(409)
Deposits from customers	(15,241)	(16,539)
Debt issued and other borrowed funds at fair value through profit or loss	(734)	(963)
Debt issued and other borrowed funds at amortised cost	(9,823)	(9,035)
Subordinated loans	(501)	(198)
Other interest expense*	(2,246)	(2,594)
Total interest expense	(29,170)	(29,738)
Net interest income	33,676	31,937

*Thereof is lease liabilities' interest expense amounting to ISK 94 million.

Net interest margin on total assets 2.8% (2018: 2.9%).

11. Net fee and commission income

	2019	2018
Asset management	2,225	2,116
Investment banking and brokerage	2,430	2,303
Payment processing	12,783	12,065
Loans and guarantees	1,510	1,467
Other fee and commission income	2,078	1,902
Total fee and commission income	21,026	19,853
Brokerage	(337)	(300)
Clearing and settlement	(7,293)	(7,302)
Other fee and commission expense	(37)	(24)
Total fee and commission expense	(7,667)	(7,626)
Net fee and commission income	13,359	12,227

Fee and commission income by segment is disclosed in Note 4.

12. Net financial expense

	2019	2018
Net loss on financial assets and liabilities mandatorily at FVTPL	(419)	(720)
Net loss on financial liabilities designated as at FVTPL	(399)	(240)
Net gain (loss) on fair value hedges	1	(2)
Net financial expense	(817)	(962)

Íslandsbanki hf. Consolidated Financial Statements 2019 29 Amounts are in ISK million

12. Cont'd

	2019	2018
Shares and related derivatives	(572)	(576)
Dividend income	32	38
Bonds and related derivatives	144	(197)
Other derivatives	(23)	15
Net loss on financial assets and liabilities mandatorily at FVTPL	(419)	(720)
Debt issued and other borrowed funds designated as at FVTPL	(399)	(240)
Net loss on financial liabilities designated as at FVTPL	(399)	(240)
Clean fair value gain on interest rate swaps designated as hedging instruments	285	486
Fair value loss on bonds issued by the Group attributable to interest rate risk	(284)	(488)
Net gain (loss) on fair value hedges	1	(2)

13. Net foreign exchange gain

	2019	2018
Cash and balances with Central Bank	(222)	(193)
Financial assets mandatorily at fair value through profit or loss	(1,781)	2,281
Loans at amortised cost	5,686	17,120
Other assets	138	305
Net foreign exchange gain for assets	3,821	19,513
Deposits	(1,749)	(7,938)
Debt issued and other borrowed funds designated as at FVTPL	(1,667)	(3,868)
Debt issued and other borrowed funds at amortised cost	(384)	(6,567)
Subordinated loans	233	(884)
Other liabilities	(111)	(255)
Net foreign exchange loss for liabilities	(3,678)	(19,512)
Net foreign exchange gain	143	1

14. Other operating income

	2019	2018
Share of profit of associates, net of income tax	64	29
Net (loss) gain from sale of subsidiaries	(16)	1,526
Legal dispute settlement*	1,103	-
Legal fees	93	83
Rental income	38	37
Depositor's and Investor's Guarantee Fund reversed contribution**	847	-
Other net operating income	5	109
Other operating income	2,134	1,784

*In February 2019 Íslandsbanki and Old Byr reached an agreement on the settlement of the dispute deriving from the acquisition of Byr savings bank in 2011.

**The Bank had recognised a liability of ISK 847 million against the Depositors' and Investors' Guarantee Fund (the Fund) for the year 2010 in accordance with the Act on Depositor's and Investor's Guarantee Fund at the time. The Icelandic Parliament has since discussed a bill on a new Depositors' and Investors' Guarantee Fund, without reaching a conclusion on the matter. An amendment to the Act regarding contributions to the Fund was made in 2011 and Icelandic banks have made quarterly payments to a separate division within the Fund since then. The Bank is of the opinion that it is not obliged to pay the expensed contribution from 2010 and therefore the Bank has reversed the previously expensed contribution.

Íslandsbanki hf. Consolidated Financial Statements 2019 30 Amounts are in ISK million

15. Personnel and salaries

	2019	2018
Salaries	12,565	11,923
Contributions to pension funds	1,849	1,767
Social security charges and financial activities tax*	1,711	1,723
Other salary-related expenses	154	95
Capitalisation of internal staff costs in software development	-	(8)
Salaries and related expenses	16,279	15,500

*Financial activities tax calculated on salaries is 5.5% (2018: 5.5%).

	2019		2018	
	The Bank	The Group	The Bank	The Group
Average number of employees	842	1,079	873	1,076
Positions at year-end	749	984	834	1,075

Total amount of compensation to the Board of Directors, the CEO and Executive Board are specified as follows:

	2019	2018
Friðrik Sophusson, Chairman of the Board	11.3	11.3
Tómas Már Sigurðsson, Vice-Chairman of the Board	6.6	-
Anna Þórðardóttir, member of the Board	7.9	7.8
Auður Finnbogadóttir, member of the Board	7.6	7.5
Árni Stefánsson, member of the Board	7.8	7.5
Hallgrímur Snorrason, member of the Board	7.6	7.5
Heiðrún Jónsdóttir, member of the Board	7.9	7.7
Helga Valfells, former Vice-Chairman of the Board	2.3	9.0
Alternate board members	1.3	0.4
Total salaries	60.3	58.7

Contribution to pension funds for the Board of Directors amounted to ISK 7.1 million in 2019 (2018: ISK 7.2 million).

	2019		2018	
	Total salaries	Contri-butions to pension funds	Total salaries	Contri-butions to pension funds
Birna Einarsdóttir, CEO	50.9	11.9	63.5	14.0
Ásmundur Tryggvason, Managing Director of Corporate & Investment Banking	39.5	5.6	-	-
Guðmundur Kristinn Birgisson, Chief Risk Officer	36.1	5.1	8.0	1.1
Jón Guðni Ómarsson, Chief Financial Officer	41.5	6.1	41.0	6.0
Riaan Dreyer, Director of Information Technology	13.6	2.0	-	-
Sigríður Hrefna Hrafnkelsdóttir, Managing Director of Personal Banking	37.8	5.3	36.0	5.0
Una Steinsdóttir, Managing Director of Business Banking	42.6	6.1	41.9	6.0
Sigríður Olgeirsdóttir, former Director of Information Technology	22.8	3.3	41.5	5.9
Sverrir Örn Þorvaldsson, former Chief Risk Officer	-	-	39.8	6.0
Vilhelm Þorsteinsson, former Managing Director of Corporate & Investment Banking	3.3	0.5	42.1	6.0
Total	288.1	45.9	313.8	50.0

The amounts in the table above comprise salaries for the managing directors for their executive board responsibilities. Included in total salaries are non-monetary benefits such as the use of cars owned by the Group.

As of 1 January 2017, the Bank has not had an active remuneration policy in place as stated in the Bank's compensation policy. Included in total salaries are paid performance-based salaries, which were earned in 2015, and paid by the Bank in 2019. For the Bank's CEO those amounted to ISK 4.1 million (2018: ISK 3.9 million) and for the managing directors the payments amounted to ISK 10.7 million (2018: ISK 12.5 million). The final payment for unpaid performance-based salaries at year-end, based on salaries for 2016, will be paid in April 2020.

There were no share based payments in the years 2019 and 2018.

Íslandsbanki hf. Consolidated Financial Statements 2019 31 Amounts are in ISK million

Notes to the Consolidated Financial Statements

16. Other operating expenses

	2019	2018
Professional services	2,051	2,385
Software and IT expenses	4,616	4,568
Real estate and office equipment	1,188	1,796
Depreciation, amortisation and write-offs	1,960	1,312
Other administrative expenses	2,013	2,089
Other operating expenses	11,828	12,150

17. Auditors' fees

	2019	2018
Audit of the annual accounts	125	117
Review of interim accounts	23	24
Other services	5	15
Auditors' fees	153	156

18. Net impairment on financial assets

	2019	2018
Expected credit loss, on-balance sheet items*	(3,524)	529
Expected credit loss, off-balance sheet items	(52)	38
Changes in provision due to court rulings	(87)	1,017
Net impairment on financial assets	(3,663)	1,584

*The main reasons for the additional expected credit loss allowance are: increased loan impairments for a few customers (ISK 1,178 million), due to a less favourable economic environment (ISK 992 million), and an unfavourable ruling in a court case (ISK 787 million).

19. Income tax expense

Recognised income tax is based on applicable tax laws. The income tax rate for legal entities in 2019 is 20% (2018: 20%). Special financial activities tax is calculated as 6% of taxable profits exceeding ISK 1 billion in accordance with the Act on Financial Activities Tax no. 165/2011. The effective income tax rate in the Group's income statement for the year 2019 is 30.1% (2018: 32.7%).

	2019	2018
Current tax expense excluding discontinued operations	2,610	3,205
Special financial activities tax	642	860
Difference in prior year's calculated income tax	(6)	196
Changes in deferred tax assets and deferred tax liabilities	436	473
Income tax recognised in the income statement	3,682	4,734
Income tax recognised in other comprehensive income	(233)	(884)

Íslandsbanki hf. Consolidated Financial Statements 2019 32 Amounts are in ISK million

Notes to the Consolidated Financial Statements

19. Cont'd

	2019		2018	
Profit before tax	12,261		14,467	
20% income tax calculated on the profit of the year	2,452	20.0%	2,893	20.0%
Special financial activities tax	642	5.2%	860	5.9%
(Income) expenses not subject to tax	(140)	(1.1%)	217	1.5%
Non-deductible expenses	708	5.8%	657	4.5%
Other differences	20	0.2%	107	0.8%
Effective income tax expense	3,682	30.1%	4,734	32.7%

The Bank is taxed jointly with its subsidiary Íslandssjóðir hf.

20. Discontinued operations, net of income tax

	2019	2018
Net (loss) profit from foreclosed assets	(199)	58
Net profit from disposal groups held for sale	74	854
Discontinued operations, net of income tax	(125)	912

21. Earnings per share

	Discontinued operations			
	Excluded		Included	
	2019	2018	2019	2018
Profit attributable to shareholders of the Bank	8,934	10,124	8,809	11,036
Weighted average number of outstanding shares	10,000	10,000	10,000	10,000
Basic earnings per share	0.89	1.01	0.88	1.10

The Group's basic and diluted earnings per share are equal as the Group has not issued any options, warrants, convertibles, or other financial instruments that dilute earnings per share (2018: none).

22. Cash and balances with Central Bank

	31.12.2019	31.12.2018
Cash on hand	4,403	3,095
Balances with Central Bank	126,956	114,849
Balances with Central Bank subject to special restrictions*	1,679	3,049
Included in cash and cash equivalents	133,038	120,993
Mandatory reserve deposits with Central Bank	13,600	14,063
Cash and balances with Central Bank	146,638	135,056

*Balances as defined in Act no. 37/2016 on the treatment of króna-denominated assets subject to special restrictions and rules no. 490/2016 on special reserve requirements for new foreign currency inflows.

Íslandsbanki hf. Consolidated Financial Statements 2019 33 Amounts are in ISK million

Notes to the Consolidated Financial Statements

23. Loans to credit institutions

	31.12.2019	31.12.2018
Money market loans	33,254	16,314
Bank accounts	21,122	25,259
Other loans	-	4
Loans to credit institutions	54,376	41,577

24. Derivative instruments and short positions

At 31 December 2019	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	1,254	114,393	3,575	96,212
Cross-currency interest rate swaps	3,015	91,950	880	13,073
Equity forwards	141	4,664	298	4,001
Foreign exchange forwards	212	5,460	321	10,217
Foreign exchange swaps	867	30,990	298	24,928
Bond forwards	132	12,756	33	6,219
Derivatives	5,621	260,213	5,405	154,650
Short positions in listed bonds	-	-	814	734
Total	5,621	260,213	6,219	155,384

At 31 December 2018	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	1,037	102,429	3,422	134,010
Cross-currency interest rate swaps	1,821	69,691	1,184	28,309
Equity forwards	419	4,596	78	1,195
Foreign exchange forwards	359	9,242	196	3,869
Foreign exchange swaps	875	35,726	440	13,373
Bond forwards	39	3,511	201	19,993
Derivatives	4,550	225,195	5,521	200,749

The Group uses derivatives to hedge currency exposure, interest rate risk in the banking book as well as inflation risk. The Group carries relatively low indirect exposure due to margin trading with clients and the Group holds collaterals for possible losses. Other derivatives in the Group held for trading or for other purposes are insignificant.

Short positions are in Icelandic Government bonds and bonds issued by institutions with government guarantees. As a primary dealer the Group has access to securities lending facilities provided by the Central Bank and the Housing Financing Fund. Majority of the securities lending facilities have a maturity of less than a year.

The Group applies hedge accounting only with respect to certain EUR denominated interest rate swaps, whereby the Group pays floating rate interest and receives fixed rate interest. The interest rate swaps are hedging the exposure of changes in the fair value of certain fixed-rate EUR denominated bonds (see Note 35) arising from changes in interest rates. The Group applies fair value hedge accounting to the hedging relationships. At year-end 2019 the total fair value of the interest rate swaps was positive and amounted to ISK 921 million (2018: ISK 627 million) and their total notional amount was ISK 40,749 million (2018: ISK 39,696).

Íslandsbanki hf. Consolidated Financial Statements 2019 34 Amounts are in ISK million

25. Loans to customers

At 31 December 2019	Gross carrying amount			Expected credit loss			Net carrying
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	amount
Individuals	338,335	4,119	9,362	(1,319)	(168)	(1,148)	349,181
Commerce and services	115,679	6,999	6,515	(739)	(194)	(1,772)	126,488
Construction	39,248	849	4,924	(310)	(53)	(238)	44,420
Energy	7,913	-	-	(26)	-	-	7,887
Financial services	2,315	-	-	-	-	-	2,315
Industrial and transportation	77,492	3,338	3,503	(278)	(221)	(1,546)	82,288
Investment companies	19,542	4,369	265	(260)	(216)	(110)	23,590
Public sector and non-profit organisations	12,279	44	15	(23)	(2)	(1)	12,312
Real estate	140,604	3,831	2,345	(542)	(89)	(590)	145,559
Seafood	105,411	249	385	(148)	(10)	(295)	105,592
Loans to customers	858,818	23,798	27,314	(3,645)	(953)	(5,700)	899,632

At 31 December 2018							
Individuals	308,870	5,901	6,860	(1,130)	(256)	(855)	319,390
Commerce and services	118,563	4,981	3,358	(643)	(179)	(1,838)	124,242
Construction	25,958	3,301	298	(196)	(247)	(19)	29,095
Energy	6,145	740	-	(20)	(7)	-	6,858
Financial services	1,708	-	-	(4)	-	-	1,704
Industrial and transportation	74,338	2,625	3,800	(398)	(53)	(488)	79,824
Investment companies	18,709	5,128	398	(217)	(103)	(116)	23,799
Public sector and non-profit organisations	12,054	22	30	(18)	-	(1)	12,087
Real estate	139,073	2,588	2,087	(528)	(154)	(181)	142,885
Seafood	103,014	3,616	479	(123)	(80)	(191)	106,715
Loans to customers	808,432	28,902	17,310	(3,277)	(1,079)	(3,689)	846,599

Íslandsbanki hf. Consolidated Financial Statements 2019 35 Amounts are in ISK million

26. Expected credit loss

Loans to customers

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2019	3,277	1,079	3,689	8,045
Transfer to Stage 1	1,725	(1,343)	(382)	-
Transfer to Stage 2	(1,336)	1,687	(351)	-
Transfer to Stage 3	(178)	(720)	898	-
Net remeasurement of loss allowance	(1,216)	145	2,727	1,656
New financial assets originated or purchased	1,803	278	353	2,434
Derecognitions and maturities	(430)	(169)	(188)	(787)
Write-offs	-	(4)	(1,616)	(1,620)
Recoveries of amounts previously written off	-	-	249	249
Foreign exchange	-	-	10	10
Unwinding of interests	-	-	311	311
At 31 December 2019	3,645	953	5,700	10,298
At 1 January 2018	2,701	1,244	9,151	13,096
Transfer to Stage 1	2,652	(1,733)	(919)	-
Transfer to Stage 2	(1,053)	2,317	(1,264)	-
Transfer to Stage 3	(99)	(1,167)	1,266	-
Net remeasurement of loss allowance	(2,073)	126	(429)	(2,376)
New financial assets originated or purchased	1,474	478	711	2,663
Derecognitions and maturities	(323)	(185)	(618)	(1,126)
Write-offs	(2)	(1)	(5,254)	(5,257)
Recoveries of amounts previously written off	-	-	416	416
Foreign exchange	-	-	87	87
Unwinding of interests	-	-	542	542
At 31 December 2018	3,277	1,079	3,689	8,045

Total expected credit loss

	Stage 1	Stage 2	Stage 3	Total
Cash and balances with Central Bank	4	-	-	4
Loans to credit institutions	67	-	-	67
Loans to customers	3,645	953	5,700	10,298
Other financial assets	9	3	86	98
Off-balance sheet loan commitments and financial guarantees*	403	55	231	689
At 31 December 2019	4,128	1,011	6,017	11,156
Cash and balances with Central Bank	48	-	-	48
Loans to credit institutions	62	-	-	62
Loans to customers	3,277	1,079	3,689	8,045
Other financial assets	5	3	83	91
Off-balance sheet loan commitments and financial guarantees*	410	142	84	636
At 31 December 2018	3,802	1,224	3,856	8,882

*For further breakdown see Note 39.

Íslandsbanki hf. Consolidated Financial Statements 2019 36 Amounts are in ISK million

Notes to the Consolidated Financial Statements

27. Investments in associates

		31.12.2019	31.12.2018
Auðkenni hf., an information security company, Borgartún 31, 105 Reykjavík	Iceland	23.8%	23.8%
JCC ehf., a cash centre service company, Borgartún 19, 105 Reykjavík	Iceland	33.3%	33.3%
Reiknistofa bankanna hf., an IT service centre company, Katrínartún 2, 105 Reykjavík	Iceland	30.8%	30.8%

	2019	2018
Investments in associates at the beginning of the year	682	704
Additions during the year	-	86
Sales of shares in associates	-	(39)
Transfer from associates to subsidiaries	-	(80)
Share of gain of associates	64	29
Dividends paid	-	(18)
Investments in associates	746	682

Summarised financial information in respect of the Group's associates is set out below:	2019	2018
Revenue	6,259	5,487
Profit	281	171
Assets	5,445	5,291
Liabilities	(2,832)	(2,932)
Net assets	2,613	2,359
Group's share of net assets of associates	746	682

28. Investments in subsidiaries

		31.12.2019	31.12.2018
Borgun hf., a payment acquirer and issuing processor, Ármúli 30, 108 Reykjavík	Iceland	63.5%	63.5%
B-Payment Group Szolgáltató Zrt., a payment processing company, H-1132 Budapest	Hungary	100%	100%
Íslandssjóðir hf., an investment fund management company, Hagasmári 3, 201 Kópavogur	Iceland	100%	100%
Hringur-eignarhaldsfélag ehf., a holding company, Dalshraun 3, 220 Hafnarfjörður	Iceland	100%	100%
Allianz Ísland hf., an insurance agent, Dalshraun 3, 220 Hafnarfjörður	Iceland	100%	100%

In addition Íslandsbanki has control over nine other non-significant subsidiaries.

Borgun hf. is the only subsidiary of Íslandsbanki that has a material non-controlling interest, 2019: 36.5% (2018: 36.5%). The following table summarises key information relevant to Borgun hf. The amounts shown are before inter-company eliminations.

	2019	2018
Loans at amortised cost	7,780	7,425
Other assets	14,582	21,073
Liabilities	15,753	22,154
Net assets	6,609	6,344
Carrying amount of non-controlling interests	2,412	2,318
Revenue	10,807	10,383
Loss for the year	(972)	(1,069)
Other comprehensive income for the year, net of tax	1,272	610
Total comprehensive income	300	(459)
Profit (loss) allocated to non-controlling interests	110	(167)
Net cash used in operating activities	(1,679)	(4,500)
Net cash provided by investing activities	75	371
Net cash (used in) provided by financing activities	(405)	19
Net decrease in cash and cash equivalents	(2,009)	(4,110)

Íslandsbanki hf. Consolidated Financial Statements 2019 37 Amounts are in ISK million

Notes to the Consolidated Financial Statements

29. Property and equipment

At 31 December 2019	Land and buildings	Right-of-use assets: Land, buildings & vehicles	Fixtures, equipment & vehicles	Total
Balance at the beginning of the year	4,054	-	3,984	8,038
Impact of adopting IFRS 16, see Note 3	-	4,505	-	4,505
Additions during the year	56	3	271	330
Disposals and write-offs during the year	(14)	-	(187)	(201)
Remeasurement	-	126	-	126
Historical cost	4,096	4,634	4,068	12,798
Balance at the beginning of the year	(1,402)	-	(1,365)	(2,767)
Depreciation during the year	(47)	(420)	(574)	(1,041)
Disposals and write-offs during the year	2	-	176	178
Accumulated depreciation	(1,447)	(420)	(1,763)	(3,630)
Carrying amount	2,649	4,214	2,305	9,168
Annual deprecion rates	0-2%	3-33%	8-35%	
Official real estate value of land and buildings				2,240
Insurance value of buildings				3,545
Insurance value of fixtures, equipment and vehicles				3,429

At 31 December 2018	Land and buildings	Fixtures, equipment & vehicles	Total
Balance at the beginning of the year	5,722	4,683	10,405
Additions during the year	15	829	844
Disposals and write-offs during the year	(1,683)	(1,528)	(3,211)
Historical cost	4,054	3,984	8,038
Balance at the beginning of the year	(1,330)	(1,947)	(3,277)
Depreciation during the year	(72)	(496)	(568)
Disposals and write-offs during the year	-	1,078	1,078
Accumulated depreciation	(1,402)	(1,365)	(2,767)
Carrying amount	2,652	2,619	5,271
Annual deprecion rates	0-2%	8-33%	
Official real estate value of buildings and land			3,747
Insurance value of buildings			4,889
Insurance value of fixtures, equipment and vehicles			3,500

Íslandsbanki hf. Consolidated Financial Statements 2019 38 Amounts are in ISK million

30. Intangible assets

At 31 December 2019	Purchased software	Developed software	Goodwill	Total
Balance at the beginning of the year	1,639	3,644	248	5,531
Additions during the year and internal development	169	7	70	246
Write-offs during the year	(26)	(268)	-	(294)
Historical cost	1,782	3,383	318	5,483
Balance at the beginning of the year	(222)	(307)	-	(529)
Amortisation during the year	(313)	(318)	-	(631)
Write-offs during the year	7	-	-	7
Accumulated amortisation	(528)	(625)	-	(1,153)
Carrying amount	1,254	2,758	318	4,330
Amortisation rates	10-25%	10-25%	-	

At 31 December 2018	Purchased software	Developed software	Goodwill	Total
Balance at the beginning of the year	1,381	3,090	-	4,471
Additions during the year and internal development	479	555	248	1,282
Write-offs during the year	(221)	(1)	-	(222)
Historical cost	1,639	3,644	248	5,531
Balance at the beginning of the year	(39)	(201)	-	(240)
Amortisation during the year	(345)	(106)	-	(451)
Write-offs during the year	162	-	-	162
Accumulated amortisation	(222)	(307)	-	(529)
Carrying amount	1,417	3,337	248	5,002
Amortisation rates	10-25%	10-25%	-	

31. Other assets

	31.12.2019	31.12.2018
Receivables	4,810	5,793
Unsettled securities transactions	279	1,033
Accruals	253	289
Prepaid expenses	468	395
Deferred tax assets	476	215
Other assets	322	222
Non-current assets and disposal groups held for sale	1,075	1,230
Other assets	7,683	9,177

Íslandsbanki hf. Consolidated Financial Statements 2019 39 Amounts are in ISK million

Notes to the Consolidated Financial Statements

31. Cont'd

Non-current assets and disposal groups held for sale	31.12.2019	31.12.2018
Repossessed collateral:		
Land and buildings	739	995
Industrial equipment and vehicles	44	17
Assets of disposal groups classified as held for sale	292	218
Total	1,075	1,230

At year-end 2019 the Group classified the assets and liabilities of Miðengi ehf. (100%) as assets and liabilities of disposal groups held for sale.

32. Deposits from Central Bank and credit institutions

	31.12.2019	31.12.2018
Deposits from credit institutions	30,808	15,527
Repurchase agreements with Central Bank	117	92
Deposits from Central Bank and credit institutions	30,925	15,619

33. Deposits from customers

	31.12.2019	31.12.2018
Demand deposits and deposits with maturity up to 3 months	530,960	499,170
Term deposits with maturity of more than 3 months	87,353	79,789
Deposits from customers	618,313	578,959

Deposits from customers specified by owners	31.12.2019		31.12.2018	
	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	12,553	2%	9,331	2%
Municipalities	5,619	1%	5,574	1%
Companies	299,204	48%	278,209	48%
Individuals	300,937	49%	285,845	49%
Deposits from customers	618,313	100%	578,959	100%

34. Pledged assets

	31.12.2019	31.12.2018
Financial assets pledged as collateral against liabilities	205,773	190,471
Financial assets pledged as collateral in foreign banks	402	1,105
Financial assets pledged as collateral in repurchase agreements	1,114	153
Pledged assets against liabilities	207,289	191,729

The Group has pledged assets against the issuance of covered bonds under Icelandic law, which are pledged on a pool of consumer mortgage loans.

The Group has also pledged cash in foreign banks and financial institutions, mainly as collateral for trades under ISDA agreements to hedge market risk.

Íslandsbanki hf. Consolidated Financial Statements 2019 40 Amounts are in ISK million

35. Debt issued and other borrowed funds

	Issued	Maturity		Interest	31.12.2019	31.12.2018
Covered bonds in ISK*	2014-2017	2019	At maturity	Fixed rates	-	9,866
Covered bonds in ISK	2019	2021	At maturity	Fixed rates	3,918	-
Covered bonds in ISK	2015-2019	2023	At maturity	Fixed rates	20,170	10,890
Covered bonds in ISK - CPI-linked*	2012-2014	2019	At maturity	Fixed rates	-	8,937
Covered bonds in ISK - CPI-linked	2014-2015	2020	At maturity	Fixed rates	4,359	4,248
Covered bonds in ISK - CPI-linked	2015-2017	2022	At maturity	Fixed rates	18,512	18,009
Covered bonds in ISK - CPI-linked	2012-2018	2024	At maturity	Fixed rates	35,752	35,009
Covered bonds in ISK - CPI-linked	2015-2018	2026	At maturity	Fixed rates	27,661	26,992
Covered bonds in ISK - CPI-linked	2019	2028	At maturity	Fixed rates	14,228	-
Covered bonds in ISK - CPI-linked	2017-2018	2030	At maturity	Fixed rates	25,463	24,862
Covered bonds					150,063	138,813
Senior unsecured bonds in SEK	2015	2019	At maturity	Fixed rates	-	7,844
Senior unsecured bonds in EUR	2017	2019	At maturity	Fixed rates	-	4,398
Senior unsecured bonds in SEK	2018	2019	At maturity	Fixed rates	-	1,302
Senior unsecured bonds in EUR**	2016	2020	At maturity	Fixed rates	7,782	68,154
Senior unsecured bonds in SEK*	2018	2020	At maturity	Fixed rates	-	3,259
Senior unsecured bonds in SEK	2019	2020	At maturity	Floating rates	4,557	-
Senior unsecured bonds in SEK	2018	2021	At maturity	Fixed rates	1,308	1,311
Senior unsecured bonds in SEK	2018-2019	2021	At maturity	Floating rates	18,913	15,053
Senior unsecured bonds in EUR	2019	2021	At maturity	Floating rates	1,559	-
Senior unsecured bonds in SEK	2018	2022	At maturity	Floating rates	12,990	12,995
Senior unsecured bonds in EUR**	2019	2022	At maturity	Fixed rates	41,570	-
Senior unsecured bonds in NOK	2019	2022	At maturity	Floating rates	13,856	-
Senior unsecured bonds in EUR***	2018	2024	At maturity	Fixed rates	41,816	40,714
Senior unsecured bonds in NOK	2019	2024	At maturity	Fixed rates	5,709	-
Senior unsecured bonds in ISK	2019	2024	Monthly	Floating rates	3,553	-
Bonds issued					153,613	155,030
Bills issued					2,705	6,729
Other debt securities					-	404
Other borrowed funds					2,705	7,133
Debt issued and other borrowed funds					306,381	300,976

*The Bank repurchased own bonds during the year amounting to ISK 7,614 million.

**These bond issuances are classified as being designated as at fair value through profit or loss. At 31 December 2019 the total carrying amount of the bonds amounted to ISK 49,352 million and included in the amount are fair value changes amounting to ISK 863 million. The carrying amount of the bond at 31 December 2019 was ISK 367 million higher than the contractual amount due at maturity. Íslandsbanki repurchased part of the bond issuance maturing in 2020 during the year, amounting to ISK 62,227 million.

***The Group applies hedge accounting to this bond issuance and uses certain EUR denominated interest rate swaps as hedging instruments (see Note 24). The interest rate swaps are hedging the exposure of the Group's changes in the fair value of this fixed-rate EUR denominated bond arising from changes in interest rates. The Group applies fair value hedge accounting to the hedging relationships. At 31 December 2019 the total carrying amount of the bond issuance amounted to ISK 41,816 million and included in the amount are fair value changes amounting to ISK 771 million.

The Bank has issued additional covered bonds to hold for the purpose of securities lending with regards to market making agreements. These covered bond amounts are not included in the total.

Íslandsbanki hf. Consolidated Financial Statements 2019 41 Amounts are in ISK million

36. Subordinated loans

	Issued	Maturity		Interest	31.12.2019	31.12.2018
Loans which qualify as Tier 2 capital:						
Subordinated loans in SEK	2017	2027	At maturity	Floating, STIBOR + 2.0%	9,714	9,724
Subordinated loans in SEK	2018	2028	At maturity	Floating, STIBOR + 2.5%	6,485	6,492
Subordinated loans in SEK	2019	2029	At maturity	Floating, STIBOR + 3.9%	6,475	-
Subordinated loans					22,674	16,216

37. Changes in liabilities arising from financing activities

			Non-cash changes			
	1.1.2019	Cash flows	Interest expense	Foreign exchange	Fair value changes	31.12.2019
Covered bonds in ISK	20,756	2,060	1,272	-	-	24,088
Covered bonds in ISK - CPI-linked	118,057	1,263	6,655	-	-	125,975
Senior unsecured bonds in ISK	-	3,528	25	-	-	3,553
Senior unsecured bonds FX	46,162	12,139	1,016	(425)	-	58,892
Senior unsecured bonds FX at fair value	68,154	(22,509)	734	1,667	1,306	49,352
Senior unsecured bonds used for hedging	40,714	(465)	497	786	284	41,816
Other borrowed funds	7,133	(4,809)	358	23	-	2,705
Subordinated loans	16,216	6,190	501	(233)	-	22,674
Total	317,192	(2,603)	11,058	1,818	1,590	329,055

					Non-cash changes			
	31.12.2017	Reclassi-fication & remeasure	1.1.2018	Cash flows	Interest expense	Foreign exchange	Fair value changes	31.12.2018
Covered bonds in ISK	17,589	-	17,589	2,055	1,112	-	-	20,756
Covered bonds in ISK - CPI-linked	91,351	-	91,351	20,134	6,572	-	-	118,057
Senior unsecured bonds FX	37,182	(19,003)	18,179	23,275	531	4,177	-	46,162
Senior unsecured bonds FX at fair value	-	84,563	84,563	(20,083)	963	3,868	(1,157)	68,154
Senior unsecured bonds used for hedging ..	63,652	(63,652)	-	37,406	430	2,390	488	40,714
Other borrowed funds	7,974	-	7,974	(1,231)	390	-	-	7,133
Subordinated loans	9,505	-	9,505	5,629	198	884	-	16,216
Total	227,253	1,908	229,161	67,185	10,196	11,319	(669)	317,192

Íslandsbanki hf. Consolidated Financial Statements 2019 42 Amounts are in ISK million

38. Tax assets and tax liabilities

	31.12.2019		31.12.2018	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	6,670	-	6,472
Deferred tax	476	1,183	215	678
Tax in the balance sheet	476	7,853	215	7,150

Changes in the deferred tax assets and the tax liabilities were as follows:

	Assets	Liabilities
Deferred tax assets and tax liabilities 1.1.2018	4	88
Calculated income tax for 2018	211	3,888
Income tax payable in 2019	-	(3,214)
Income tax recognised in other comprehensive income	-	(94)
Prior year's income tax adjustment	-	10
Deferred tax assets and tax liabilities 31.12.2018	215	678
Calculated income tax for 2019	256	3,223
Income tax payable in 2020	-	(2,535)
Income tax recognised in other comprehensive income	9	(183)
Prior year's income tax adjustment	(4)	-
Deferred tax assets and tax liabilities 31.12.2019	476	1,183

Movements in temporary differences during the year were as follows:

				Balance at 31 December		
2019	Net balance at 1 January	Recognised in profit or (loss)	Recognised in equity	Net	Deferred tax assets	Deferred tax liabilities
Property and equipment	(249)	(848)	-	(1,097)	-	(1,097)
Intangible assets	(527)	16	-	(511)	-	(511)
Assets and liabilities denominated in foreign currency	(264)	(12)	-	(276)	-	(276)
Deferred foreign exchange difference	(213)	(213)	-	(426)	-	(426)
Derivatives	194	(236)	-	(42)	-	(42)
Lease liabilities	-	851	-	851	851	-
Debt issued and other borrowed funds	329	(253)	192	268	268	-
Other items	(2)	32	-	30	30	-
Tax loss carry forwards	269	227	-	496	496	-
	(463)	(436)	192	(707)	1,645	(2,352)
Set-off of deferred tax assets together with liabilities of the same taxable entities					(1,169)	1,169
Tax assets (liabilities)	(463)	(436)	192	(707)	476	(1,183)

Íslandsbanki hf. Consolidated Financial Statements 2019 43 Amounts are in ISK million

38. Cont'd

2018	Net balance at 1 January	Recognised in profit or (loss)	Recognised in equity	Balance at 31 December Net	Deferred tax assets	Deferred tax liabilities
Property and equipment	(79)	(170)	-	(249)	-	(249)
Intangible assets	(395)	(132)	-	(527)	-	(527)
Assets and liabilities denominated in foreign currency	(186)	(78)	-	(264)	-	(264)
Deferred foreign exchange difference	(202)	(11)	-	(213)	-	(213)
Derivatives	465	(271)	-	194	194	-
Debt issued and other borrowed funds	314	(79)	94	329	329	-
Other items	(1)	(1)	-	(2)	-	(2)
Tax loss carry forwards	-	269	-	269	269	-
	(84)	(473)	94	(463)	792	(1,255)
Set-off of deferred tax assets together with liabilities of the same taxable entities					(577)	577
Tax assets (liabilities)	(84)	(473)	94	(463)	215	(678)

39. Other liabilities

	31.12.2019	31.12.2018
Accruals	3,217	3,906
Liabilities to retailers for credit cards	14,765	20,722
Lease liabilities	4,256	-
Provision for effects of court rulings	75	-
Expected credit loss for off-balance sheet loan commitments and financial guarantees	689	636
Withholding tax	1,559	1,733
Unsettled securities transactions	515	612
Deferred income	229	193
Sundry liabilities	1,758	1,841
Non-current liabilities and disposal groups held for sale	-	6
Other liabilities	27,063	29,649

Expected credit loss for off-balance sheet loan commitments and financial guarantees

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2019	410	142	84	636
Transfer to Stage 1	152	(81)	(71)	-
Transfer to Stage 2	(20)	39	(19)	-
Transfer to Stage 3	(9)	(18)	27	-
Net remeasurement of loss allowance	(455)	(27)	131	(351)
New loan commitments and financial guarantees	447	20	119	586
Derecognitions and maturities	(122)	(20)	(40)	(182)
At 31 December 2019	403	55	231	689
At 1 January 2018	467	101	106	674
Transfer to Stage 1	595	(545)	(50)	-
Transfer to Stage 2	(58)	67	(9)	-
Transfer to Stage 3	(6)	(69)	75	-
Net remeasurement of loss allowance	(828)	481	(132)	(479)
New loan commitments and financial guarantees	521	130	132	783
Derecognitions and maturities	(281)	(23)	(38)	(342)
At 31 December 2018	410	142	84	636

Íslandsbanki hf. Consolidated Financial Statements 2019 44 Amounts are in ISK million

40. Custody assets

	31.12.2019	31.12.2018
Custody assets - not managed by the Group	2,898,686	2,167,946

41. Leases

The Group as a lessee

The Group adopted a new IFRS standard, IFRS 16 - Leases as of 1 January 2019 (see Note 3). As a result of the adoption the Group changed its accounting policy for leases (see Note 66.10).

The Group's significant leases are leases for offices, branches and storage but the Group also leases land and vehicles. Most leases are CPI-linked real estate leases with duration of 5-10 years with extension options. Lease commitments are recognised on-balance sheet except for short-term leases and leases of low-value assets. Total expense for leases of low-value assets and short-term leases amounted to ISK 21 million during the year 2019.

Total cash outflow for leases amounted to ISK 493 million (2018: ISK 492 million).

Right-of-use assets are presented in the line item “Property and equipment” (see Note 29). Lease liabilities are presented in the line item “Other liabilities” (see Note 39).

At 31 December 2018 the future non-cancellable minimum operating lease payments where the Group was a lessee was:

	31.12.2018
Due within 1 year	470
Due in 1-5 years	1,831
Due in more than 5 years	2,842
Operating lease commitments	5,143

The Group as a lessor

Net investment in finance lease receivables

	31.12.2019	31.12.2018
Due within 1 year	17,559	18,524
Due in 1-5 years	30,960	30,195
Due in more than 5 years	3,538	3,011
Total gross investment in the lease	52,057	51,730
Due within 1 year	15,303	16,069
Due in 1-5 years	27,628	26,730
Due in more than 5 years	2,692	2,317
Total present value of lease payments*	45,623	45,116
Unearned interest income	6,434	6,614

*The Group presents finance lease receivables in the line item “Loans to customers”.

Expected credit loss allowance	202	193
Interest income from finance lease receivables during the year	3,165	3,166

Íslandsbanki hf. Consolidated Financial Statements 2019 45 Amounts are in ISK million

42. Related party

Íslandsbanki is wholly owned by the Icelandic Government. The shares are administered by the Icelandic State Financial Investments (ISFI). As a result, the Icelandic Government and the Icelandic State Financial Investments are defined as related parties. The Group has applied the partial exemption for government-related entities, as described in IAS 24, and does not disclose those transactions in the related party note.

The Board of Directors and key management personnel of the Bank, ISFI and subsidiaries of the Bank, close family members of individuals referred to herein and legal entities controlled by them, are defined as related parties.

The Group's associates are also defined as related parties.

The Group's products and services are offered to the Icelandic Government and government-related entities in competition with other vendors and under generally accepted commercial terms. In a similar manner the Group entities purchase products and services from government-related entities under generally accepted commercial terms. Transactions with related parties were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third party counterparties.

Cash and balances with the Central Bank are disclosed under Note 22 and Deposits from the Central Bank are disclosed under Note 32.

All loans to employees are provided on general business terms of the Group and the balances do not reflect collaterals held by the Group.

At 31 December 2019	Assets	Liabilities	Net balance	Commitments, guarantees & overdrafts
Board of Directors, key management personnel and other related parties	324	392	(68)	51
Associated companies	16	830	(814)	213
Balances with related parties	340	1,222	(882)	264

2019	Interest income	Interest expense	Other income	Other expense
Board of Directors, key management personnel and other related parties	25	7	1	-
Associated companies	7	17	3	1,620
Transactions with related parties	32	24	4	1,620

At 31 December 2018	Assets	Liabilities	Net balance	Commitments, guarantees & overdrafts
Shareholders with control over the Group	-	105	(105)	-
Board of Directors, key management personnel and other related parties	220	493	(273)	82
Associated companies	198	469	(271)	210
Balances with related parties	418	1,067	(649)	292

2018	Interest income	Interest expense	Other income	Other expense
Shareholders with control over the Group	-	2	-	-
Board of Directors, key management personnel and other related parties	16	10	2	-
Associated companies	15	10	2	1,937
Transactions with related parties	31	22	4	1,937

At year-end 2019 ISK 2 million were recognised as Stage 1 expected credit loss against balances outstanding with related parties (2018: ISK 2 million). No share option programmes were operated during the reporting period. For related party remuneration see Note 15.

Íslandsbanki hf. Consolidated Financial Statements 2019 46 Amounts are in ISK million

Notes to the Consolidated Financial Statements

43. Contingencies

Contingent liabilities

Borgun hf.

Borgun hf., a subsidiary of Íslandsbanki, is a payment acquirer and issuing processor. Landsbankinn hf. sold its 31.2% stake in Borgun in late 2014. Landsbankinn claims that Borgun's management did not disclose all available information that might have affected the value of Borgun during the sales process, namely the worth of its stake in Visa Europe which was sold to Visa International shortly after the Borgun sale. In order to reclaim the alleged loss, Landsbankinn filed a lawsuit against Borgun hf. and others on 12 January 2017, claiming the right to damages for having been deprived of the true value of the stake involved in the sale. Landsbankinn does not quantify the claim, but its estimate of the lost profit from having sold its shares in Borgun is approximately ISK 1,930 million. Seeing that the conclusion of the case is uncertain and the financial effect cannot be estimated the Group has not recognised a provision in relation to this matter. Court appointed surveyors presented their assessment in November 2019. A reassessment has been demanded. It is uncertain when a ruling is to be expected.

44. Events after the reporting period

No events have arisen after the reporting period that require amendments or additional disclosures in the consolidated financial statements for the year ended 31 December 2019.

45. Risk management

Risk governance

The Group is exposed to various risk factors and managing these risks is an integral part of its operations. The Bank emphasises sound governance principles. The risk management and internal control framework of the Group is based on a three lines of defence model, as referred to in the European Banking Authority Guidelines on Internal Governance, and aims for informed decision-making and strong risk awareness. The framework is intended to ensure effective and efficient operations, adequate control of risks, prudent conduct of business, reliability of financial and non-financial information reported internally and externally, and compliance with laws, regulations, supervisory requirements and the Group’s internal rules.

The first line of defence consists of the Bank's business and support units; the second line of defence comprises the Bank's internal control units, risk management and compliance; and the third line of defence is Internal Audit which gives the Board an independent assessment of the quality of corporate governance, risk management and internal controls.

The Group's management body has a dual structure. The Board of Directors of the Bank has a supervising role in setting and monitoring the execution of set policies, the sound control of accounting and financial management and ensuring that group internal audit, compliance and risk management are effective. The Chief Executive Officer (CEO), the Chief Risk Officer (CRO), other members of the senior management and the senior management committees are responsible for implementing risk management practises and internal monitoring in accordance with Board authorisation.

The ultimate responsibility for ensuring an adequate risk management and internal control framework at the Group lies with the Board of Directors. The Board defines and communicates the risk governance framework and the acceptable level of risk through risk management policies and the Risk Appetite Statement. To assist the Board in fulfilling its oversight responsibilities, the Board has appointed three board subcommittees.

The CEO is responsible for the day-to-day operations of the Bank, pursuant to set policies and resolutions of the Board. Moreover, it is the task of the CEO to ensure that the Group's operations are consistent with applicable legislation and the Group's Articles of Association which includes maintaining adequate and effective risk management and internal control functions. The CEO appoints the Chief Risk Officer, the Compliance Officer as well as other members of the Executive Board. The CEO also engages the members of the senior management committees.

The CRO heads the risk management function and is responsible for defining the daily tasks of the department and to assess the adequacy of its professional skills. In addition, the CRO is responsible for monitoring the risk management framework at the Group and for verifying that the Bank has the right resources and an appropriate organisation to manage its risks efficiently.

The CRO is selected and appointed by the CEO, subject to Board confirmation. The CRO reports directly to the Board and the Board Risk Committee on the overall risk profile of the Group and cannot be removed without the Board's prior approval.

45. Cont'd

The CRO is independent from the business units, is a member of the Executive Board and reports directly to the CEO. The CRO provides an independent view on the Group's exposure to risk. The CRO has the right but not the responsibility to veto certain risk-taking decisions of the senior management committees if an internal control unit considers the proposal inconsistent with the Bank's risk appetite, policies or procedures.

Risk management is mandated to identify, understand, measure and monitor the risks that the Group is exposed to. It provides independent information, analyses and expert judgement on risk exposures, and advice on proposals and risk decisions made by the management and business or support units as to whether they are consistent with the risk appetite and risk polices set by the Board.

Where necessary, risk management makes recommendations to senior management and the Board to improve or clarify risk policies, procedures and limits.

Risk Management provides a holistic view on risk, and compliance to limits to internal and external stakeholders, and ensures an appropriate escalation in the event of limit breaches.

Business and support units are, however, responsible for maintaining their independent view on the risks inherent in their operations and reporting to senior management any foreseeable breaches from limits, policies or strategic direction.

Risk management provides the senior management and the Board with all relevant risk related information to enable it to define the Bank's risk appetite.

The General Counsel is appointed by and reports directly to the CEO. The General Counsel provides legal advice to the Bank's senior management, including the Board of Directors, and manages the Bank's legal department which provides comprehensive legal advice to the Bank's business segments and support units.

The Chief Audit Executive (CAE) is appointed by the Board, reports directly to Board and directs Group Internal Audit with a mandate from the Board. The CAE is responsible for internal audit matters within the Group, including internal audit tasks which have been outsourced.

The Compliance Officer heads the compliance function and is responsible for defining the daily tasks of the department and assessing the adequacy of its professional skills. The Compliance Officer is responsible for monitoring the compliance risk management framework for the Bank and maintaining oversight for compliance risk throughout the Bank.

The Bank's Compliance Officer is selected and engaged by the CEO, subject to Board confirmation. The Compliance Officer cannot be removed without the Board's prior approval. The Financial Supervisory Authority and Chief Audit Executive shall be notified of the dismissal or departure of the Compliance Officer.

The Compliance Officer reports directly to the Board on the overall compliance risk profile of the Bank.

Each employee is responsible for understanding the risk related to their day-to-day work, for knowing and understanding the respective internal and external rules and procedures, for using the alert procedures in the event of possible fraudulent activities and for conducting business in accordance with the Bank's code of conduct.

The Bank's senior management committee structure is twofold. Firstly the two executive committees, the Executive Board and the All Risk Committee, that are responsible for the implementation of the Board approved business strategy, risk appetite and policies. Secondly the four business committees, the Asset and Liability Committee (ALCO), the Senior Credit Committee (SCC), the Investment Committee (IC) and the Operational and Security Committee (OSC), which are responsible for the approval of business or operational proposals subject to internal rules and guidelines issued by the executive committees and the Board.

The members of the senior management committees are appointed by the CEO, and their mandate and rules of procedure are documented in a charter issued by the CEO.

More information about the Group's risk management and risk assessment processes is available in the unaudited Pillar 3 2019 Report, which is available on the Bank's website: www.islandsbanki.is.

46. Credit risk

Credit risk is defined as current or prospective risk to earnings and capital arising from an obligor's potential failure to meet the terms of any financial contract with the Group.

Credit concentration risk is the significantly increased risk that is driven by common underlying factors, e.g. industrial sector, economy, geographical location, type of financial instrument or due to connections or relations among counterparties. This includes exposures to parties under common control and significant exposures to groups of counterparties whose likelihood of default is driven by common underlying factors.

Credit risk arises principally from loans and advances to customers and other banks but also from balances with the Central Bank and off-balance sheet items such as financial guarantees, loan commitments and derivatives.

The Group has policies and procedures dedicated to accepting, measuring, and managing credit risk. The objective of the Group's credit risk management is to achieve an appropriate balance between risk and return and to minimise potential adverse effects of credit risk on the Group's financial performance.

A thorough analysis of the counterparty's financial standing, analysis of past and estimated future cash flows as well as the borrower's general ability to repay its obligations forms the basis for all credit decisions. The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, groups of borrowers, countries and industry segments. The Group measures and consolidates its credit risk for each counterparty or group of connected clients in accordance with internal and external criteria of connection between parties.

The Group employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security in borrower's assets. The principal collateral types for loans are properties, vehicles, equipment, vessels and securities. When applicable, other credit risk mitigants are employed.

47. Maximum credit exposure

The Group's credit risk exposure comprises both on-balance sheet and off-balance sheet items. Maximum exposure to credit risk for on-balance sheet assets is the net carrying amount as reported in the statement of financial position. The maximum exposure for off-balance sheet items is the amount that the Group might have to pay out against financial guarantees and loan commitments, less provisions that have been made because of these items. The maximum credit exposure for a derivative contract is calculated by adding potential future credit exposure to the positive market value of the contract.

The industry breakdown shows the credit exposure by industry classification. The breakdown follows an internal industry classification which is based on the Icelandic ISAT2008 that derives from the European NACE Rev. 2 classification standard.

The Group's credit exposure, before taking account of any collateral held or other credit enhancements, is as follows:

At 31 December 2019	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrial and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	146,638	-	-	-	-	-	-	-	-	-	146,638
Loans to credit institutions	-	-	-	-	-	54,376	-	-	-	-	-	54,376
Bonds and debt instruments	-	33,007	-	-	125	16,131	1,296	52	1,027	1,232	-	52,870
Derivatives	-	-	706	-	1,836	5,788	189	530	-	208	228	9,485
Loans to customers:	349,181	-	126,488	44,420	7,887	2,315	82,288	23,590	12,312	145,559	105,592	899,632
Overdrafts	12,333	-	14,506	3,425	110	2,289	4,927	654	1,204	3,220	6,270	48,938
Credit cards	16,466	-	1,579	271	5	24	437	40	106	63	35	19,026
Mortgages	281,450	-	5	-	-	-	-	-	-	44	-	281,499
Capital leases	5,774	-	28,422	2,700	15	-	7,322	139	39	1,005	207	45,623
Other loans	33,158	-	81,976	38,024	7,757	2	69,602	22,757	10,963	141,227	99,080	504,546
Other financial assets	532	-	199	7	6	4,803	117	41	10	36	6	5,757
Off-balance sheet items:	33,964	-	24,605	16,035	2,974	6,579	18,865	548	3,461	19,036	9,738	135,805
Financial guarantees	1,477	-	6,035	4,914	-	1,172	2,907	95	5	2,004	252	18,861
Undrawn loan commitments	-	-	1,871	8,297	2,442	-	9,726	-	-	11,303	1,804	35,443
Undrawn overdrafts	9,842	-	12,476	2,063	503	5,291	5,135	314	2,733	5,456	7,525	51,338
Credit card commitments	22,645	-	4,223	761	29	116	1,097	139	723	273	157	30,163
Maximum credit exposure	383,677	179,645	151,998	60,462	12,828	89,992	102,755	24,761	16,810	166,071	115,564	1,304,563

Íslandsbanki hf. Consolidated Financial Statements 2019 50 Amounts are in ISK million

47. Cont'd

At 31 December 2018	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrial and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	135,056	-	-	-	-	-	-	-	-	-	135,056
Loans to credit institutions	-	-	-	-	-	41,577	-	-	-	-	-	41,577
Bonds and debt instruments	-	53,341	-	-	447	12,925	1,724	68	724	186	-	69,415
Derivatives	-	-	121	2	2,322	4,687	451	1,090	-	61	205	8,939
Loans to customers:	319,390	-	124,242	29,095	6,858	1,704	79,824	23,799	12,087	142,885	106,715	846,599
Overdrafts	11,769	-	11,699	3,304	31	1,509	4,483	780	754	4,501	9,751	48,581
Credit cards	15,779	-	1,516	251	4	21	433	33	112	59	34	18,242
Mortgages	249,296	-	-	-	-	-	-	-	-	-	-	249,296
Capital leases	6,504	-	27,552	2,270	5	-	7,166	116	48	1,197	258	45,116
Other loans	36,042	-	83,475	23,270	6,818	174	67,742	22,870	11,173	137,128	96,672	485,364
Other financial assets	409	-	451	5	1	6,532	23	34	3	18	35	7,511
Off-balance sheet items:	33,928	-	24,673	18,703	6,091	8,160	12,413	3,817	4,517	20,850	12,805	145,957
Financial guarantees	1,494	-	5,863	4,563	12	1,172	2,416	160	5	1,828	508	18,021
Undrawn loan commitments	-	-	4,986	11,662	5,996	-	4,899	1,100	-	14,629	5,782	49,054
Undrawn overdrafts	10,187	-	9,908	1,830	63	6,863	4,124	2,433	3,884	4,167	6,374	49,833
Credit card commitments	22,247	-	3,916	648	20	125	974	124	628	226	141	29,049
Maximum credit exposure	353,727	188,397	149,487	47,805	15,719	75,585	94,435	28,808	17,331	164,000	119,760	1,255,054

48. Credit exposure covered by collateral

Collateral and other credit mitigants vary between types of obligors and credit facilities. Loans to credit institutions are usually unsecured. For loans to individuals the principal collateral taken is residential property against mortgages. In the case of corporate entities the Group takes a charge over assets such as real estate, vessels, cash and securities as well as other collateral including accounts receivables, inventory, vehicles and equipment. Loans to government entities and to municipalities are more often than not unsecured. Derivative exposures are generally made under ISDA master agreements with Credit Support Annex or corresponding terms with pledged collateral in the form of cash and government bonds.

In some cases the Group uses guarantees as a credit enhancement but since guarantees effectively transfer credit risk from one counterparty to another they do not represent a reduction in maximum exposure to credit risk. Covenants in loan agreements are also an important credit enhancement but do not reduce maximum credit exposure.

Íslandsbanki hf. Consolidated Financial Statements 2019 51 Amounts are in ISK million

48. Cont'd

Valuation of collateral is based on market price, official valuation for tax purposes or expert opinion of the Group's employees, depending on availability. In the case of fishing vessels the associated fishing quota is included in the valuation. Collateral is allocated according to the gross carrying amount of loans and nominal off-balance sheet items, and is measured without including the effect of overcollateralisation. This means that if some loans have collateral values in excess of their gross carrying amount, then the excess is removed in order to reflect the Group's actual maximum exposure to credit risk. The total value of pledged assets can thus be higher than the cover indicates. The maximum credit risk exposure is measured on net carrying value basis, and therefore collateral allocation can in some instances be higher. For capital leases the Group remains the owner of the leased object. In total ISK 37,035 million of the collateral are leased objects.

The following tables show the maximum exposure to credit risk by class of financial asset and collateral held against those exposures. An overview of collateral held by the Group against credit exposure is shown below for exposures in Stages 1 and 2 (non credit-impaired) and exposures in Stage 3 (credit-impaired):

At 31 December 2019

Collateral held against non credit-impaired exposures	Maximum exposure to credit risk	Real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral	Net exposure	Associated ECL
Derivatives	9,485	-	-	1,757	-	-	1,757	7,728	-
Loans and commitments to customers:	1,012,821	622,021	87,217	7,001	49,865	80,043	846,147	166,674	5,056
Individuals	374,718	292,701	7	417	13,317	116	306,558	68,160	1,579
Commerce and services	146,149	63,151	777	961	27,124	25,891	117,904	28,245	1,030
Construction	55,236	40,432	4	653	2,130	3,968	47,187	8,049	495
Energy	10,861	5,655	-	366	8	5	6,034	4,827	34
Financial services	8,894	-	-	123	-	3,621	3,744	5,150	7
Industrial and transportation	99,188	49,944	12	107	6,757	18,566	75,386	23,802	534
Investment companies	23,982	7,748	-	3,281	71	11,930	23,030	952	478
Public sector and non-profit organisations	15,758	958	-	7	29	-	994	14,764	29
Real estate	162,795	148,919	5	1,072	301	1,125	151,422	11,373	702
Seafood	115,240	12,513	86,412	14	128	14,821	113,888	1,352	168
Total	1,022,306	622,021	87,217	8,758	49,865	80,043	847,904	174,402	5,056
Collateral held against credit-impaired exposures									
Loans and commitments to customers:	22,616	17,100	1,481	333	846	830	20,590	2,026	5,931
Individuals	8,427	7,191	17	12	166	2	7,388	1,039	1,245
Commerce and services	4,944	2,980	102	22	561	805	4,470	474	1,864
Construction	5,219	4,919	-	197	19	7	5,142	77	261
Industrial and transportation	1,965	253	1,331	102	72	16	1,774	191	1,559
Investment companies	156	149	-	-	-	-	149	7	111
Public sector and non-profit organisations	15	14	-	-	-	-	14	1	1
Real estate	1,800	1,567	-	-	9	-	1,576	224	595
Seafood	90	27	31	-	19	-	77	13	295
Total	22,616	17,100	1,481	333	846	830	20,590	2,026	5,931

Íslandsbanki hf. Consolidated Financial Statements 2019 52 Amounts are in ISK million

Notes to the Consolidated Financial Statements

48. Cont'd

At 31 December 2018

Collateral held against non credit-impaired exposures	Maximum exposure to credit risk	Real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral	Net exposure	Associated ECL
Derivatives	8,939	-	-	2,232	-	-	2,232	6,707	-
Loans and commitments to customers:	978,396	563,362	89,350	6,149	49,883	69,902	778,646	199,750	4,908
Individuals	347,490	266,508	6	359	13,485	155	280,513	66,977	1,508
Commerce and services	146,286	56,407	733	189	27,574	23,915	108,818	37,468	918
Construction	47,495	28,694	-	379	1,880	3,761	34,714	12,781	624
Energy	12,949	3,737	-	366	-	5	4,108	8,841	32
Financial services	9,864	-	-	309	-	-	309	9,555	17
Industrial and transportation	89,289	39,523	9	82	6,437	15,980	62,031	27,258	481
Investment companies	27,392	9,588	26	2,891	83	11,361	23,949	3,443	358
Public sector and non-profit organisations	16,551	974	-	7	37	2	1,020	15,531	22
Real estate	161,864	144,530	-	1,549	231	1,113	147,423	14,441	737
Seafood	119,216	13,401	88,576	18	156	13,610	115,761	3,455	211
Total	987,335	563,362	89,350	8,381	49,883	69,902	780,878	206,457	4,908

Collateral held against credit-impaired exposures	Maximum exposure to credit risk	Real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral	Net exposure	Associated ECL
Loans and commitments to customers:	14,160	9,003	2,282	106	328	487	12,206	1,954	3,773
Individuals	5,828	5,256	17	7	83	3	5,366	462	887
Commerce and services	2,629	1,023	139	-	78	247	1,487	1,142	1,853
Construction	303	232	-	-	21	14	267	36	19
Industrial and transportation	2,948	317	2,077	99	109	170	2,772	176	492
Investment companies	224	180	-	-	-	-	180	44	117
Public sector and non-profit organisations	53	37	-	-	-	-	37	16	1
Real estate	1,871	1,829	-	-	1	-	1,830	41	209
Seafood	304	129	49	-	36	53	267	37	195
Total	14,160	9,003	2,282	106	328	487	12,206	1,954	3,773

Íslandsbanki hf. Consolidated Financial Statements 2019 53 Amounts are in ISK million

Notes to the Consolidated Financial Statements

49. Credit quality of financial assets

The following table provides the gross carrying amount of loans and credit risk exposure on loan commitments and financial guarantees. Amounts are broken down by risk class and the method by which their respective credit loss allowances (ECL) are calculated, i.e. Stage 1, 2 and 3.

The Group uses internal rating models to assess the default probability of corporate and retail customers. The models assign each customer to one of ten risk classes. One risk class is for customers in default (risk class 10), and nine risk classes are for performing customers (risk classes 1-9). Risk classes are assigned on customer level and not facility level.

The rating of corporate customers is based on a company's most recent financial statement, together with a qualitative assessment of its management, market position and industry sector.

For retail customers the Group uses two different statistical rating models. One model is for individuals and another is for small companies with a total exposure to the Group of less than ISK 150 million. These models are behavioural scoring models and use information about a customer's payment history, amount of debt and deposits, and demographic variables to assess the probability that a customer will default on any of his obligations within 12 months of the rating assessment.

Risk classes 1-4 represent low risk, risk classes 5-6 moderate risk, risk classes 7-8 increased risk, risk class 9 high risk, and risk class 10 represents customers that are in default. Unrated are loans originating from subsidiaries of Íslandsbanki that do not have rating models, in addition to loans that are yet to be rated.

Further information on the risk classes, including the mapping from risk classes to the probability of default, can be found in Section 4.2.2 of the unaudited Pillar 3 2019 Report.

The same customer can have loans and off-balance sheet commitments in Stages 1 and 2 simultaneously. However, if a customer has an exposure in Stage 3 then all other loans and commitments are classified as Stage 3 as well.

At 31 December 2019

Loans to customers:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	226,347	289	-	226,636
Risk class 5-6	388,936	1,385	-	390,321
Risk class 7-8	204,979	14,487	-	219,466
Risk class 9	33,880	7,544	-	41,424
Risk class 10	-	-	27,160	27,160
Unrated	4,676	93	154	4,923
	858,818	23,798	27,314	909,930
Expected credit loss	(3,645)	(953)	(5,700)	(10,298)
Net carrying amount	855,173	22,845	21,614	899,632

Off-balance sheet loan commitments and financial guarantees:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	58,327	25	-	58,352
Risk class 5-6	58,271	253	-	58,524
Risk class 7-8	15,334	1,757	-	17,091
Risk class 9	1,095	186	-	1,281
Risk class 10	-	-	1,233	1,233
Unrated	8	5	-	13
	133,035	2,226	1,233	136,494
Expected credit loss	(403)	(55)	(231)	(689)
Total	132,632	2,171	1,002	135,805

Íslandsbanki hf. Consolidated Financial Statements 2019 54 Amounts are in ISK million

Notes to the Consolidated Financial Statements

49. Cont'd

At 31 December 2019	Risk class 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Unrated	ECL	Total
Loans and commitments to customers:								
Individuals	76,119	151,224	115,042	29,537	9,517	4,530	(2,824)	383,145
Commerce and services	29,718	81,536	31,572	3,968	6,810	383	(2,894)	151,093
Construction	3,354	33,345	17,924	1,120	5,468	-	(756)	60,455
Energy	5,045	3,846	2,004	-	-	-	(34)	10,861
Financial services	8,848	30	17	-	-	6	(7)	8,894
Industrial and transportation	26,474	59,108	11,775	2,363	3,526	-	(2,093)	101,153
Investment companies	2,803	9,198	11,090	1,367	268	1	(589)	24,138
Public sector and non-profit organisations	12,761	2,733	268	11	15	15	(30)	15,773
Real estate	52,934	64,623	42,304	3,631	2,400	-	(1,297)	164,595
Seafood	66,932	43,202	4,561	708	389	1	(463)	115,330
Total	284,988	448,845	236,557	42,705	28,393	4,936	(10,987)	1,035,437

At 31 December 2018

Loans to customers:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	213,012	104	-	213,116
Risk class 5-6	367,843	1,055	-	368,898
Risk class 7-8	184,807	15,339	-	200,146
Risk class 9	38,633	12,363	-	50,996
Risk class 10	-	-	17,215	17,215
Unrated	4,137	41	95	4,273
	808,432	28,902	17,310	854,644
Expected credit loss	(3,277)	(1,079)	(3,689)	(8,045)
Net carrying amount	805,155	27,823	13,621	846,599

Off-balance sheet loan commitments and financial guarantees:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	68,712	30	-	68,742
Risk class 5-6	55,112	194	-	55,306
Risk class 7-8	16,913	1,899	-	18,812
Risk class 9	1,517	1,460	-	2,977
Risk class 10	-	-	623	623
Unrated	130	3	-	133
	142,384	3,586	623	146,593
Expected credit loss	(410)	(142)	(84)	(636)
Total	141,974	3,444	539	145,957

At 31 December 2018	Risk class 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Unrated	ECL	Total
Loans and commitments to customers:								
Individuals	74,325	135,721	101,859	33,354	6,955	3,499	(2,395)	353,318
Commerce and services	33,700	84,690	23,538	5,455	3,718	585	(2,771)	148,915
Construction	3,387	21,930	21,711	1,024	336	53	(643)	47,798
Energy	11,472	544	965	-	-	-	(32)	12,949
Financial services	9,450	419	8	-	-	4	(17)	9,864
Industrial and transportation	34,253	41,922	8,331	4,930	3,705	69	(973)	92,237
Investment companies	5,709	6,976	10,751	4,241	414	-	(475)	27,616
Public sector and non-profit organisations	13,150	3,119	240	-	52	66	(23)	16,604
Real estate	41,768	73,484	44,312	2,909	2,172	36	(946)	163,735
Seafood	54,644	55,399	7,243	2,060	486	94	(406)	119,520
Total	281,858	424,204	218,958	53,973	17,838	4,406	(8,681)	992,556

Íslandsbanki hf. Consolidated Financial Statements 2019 55 Amounts are in ISK million

50. Forbearance and write-offs

When restructuring or modification measures are believed to be more appropriate than collection procedures, the Group offers several debt relief measures and restructuring frameworks for customers in financial difficulties. These forbearance measures include temporary payment holidays, extension of loan terms, capitalisation of arrears and waiving of covenants.

The relationship between forbearance and stages is discussed in Note 66.3.

Once an asset has been classified as forborne, it will remain forborne for a minimum 24-month probation period. In order for a loan to be reclassified out of the forborne category, the customer has to meet all of the following criteria:
- All of the customer's facilities have to be considered performing; and
- The customer does not have any contract that is more than 30 days past due; and
- The probation period of two years has passed from the date of the forbearance event; and
- Regular payments of more than an insignificant amount of principal or interest have been made during at least half of the probation period

The following table provides a summary of the Group's forborne assets.

At 31 December 2019	Stage 1	Stage 2	Stage 3	Total
Individuals	1,615	1,102	1,372	4,089
Companies	13,212	8,469	8,289	29,970
Gross carrying amount	14,827	9,571	9,661	34,059

	Stage 1	Stage 2	Stage 3	Total
Individuals	(12)	(41)	(182)	(235)
Companies	(77)	(249)	(2,167)	(2,493)
Expected credit loss	(89)	(290)	(2,349)	(2,728)

At 31 December 2018	Stage 1	Stage 2	Stage 3	Total
Individuals	1,741	2,020	1,238	4,999
Companies	14,377	2,016	4,588	20,981
Gross carrying amount	16,118	4,036	5,826	25,980

	Stage 1	Stage 2	Stage 3	Total
Individuals	(13)	(92)	(198)	(303)
Companies	(139)	(49)	(1,160)	(1,348)
Expected credit loss	(152)	(141)	(1,358)	(1,651)

Gross carrying amount written off and still subject to enforcement activity	2019	2018
Individuals	578	1,514
Companies	1,253	3,756
Total	1,831	5,270

Íslandsbanki hf. Consolidated Financial Statements 2019 56 Amounts are in ISK million

51. Assets obtained by taking possession of collateral

Details of non-financial assets obtained by the Group during the year by taking possession of collateral held as security against loans.

	31.12.2019	31.12.2018
Property and land	378	1,072
Industrial equipment and vehicles	81	41
Total	459	1,113

The Group pursues realisation of the collateral in an orderly manner. The Group does not generally use the non-cash collateral for its own operations. The Group's employees are not permitted to purchase foreclosed assets.

52. Large exposures disclosure

When the Group's total exposure to a group of connected clients is 10% or higher of the Group's capital base it is considered a large exposure. Both on-balance sheet and off-balance sheet items from all types of financial instruments are included in the exposure as defined by regulation no. 233/2017. The Group has internal criteria that define connections between clients. These criteria reflect the Group's interpretation of Article (1)(a) of the Act on Financial Undertakings no. 161/2002, where groups of connected clients are defined.

The exposure is evaluated both before and after credit risk mitigating effects. After mitigating effects, the Group currently has no large exposures, a decrease of four since the last reporting date. No large exposure is therefore above the maximum 25% single large exposure limit set by the law.

The following tables show the Group's large exposures as a percentage of the Group's capital base, before and after eligible credit risk mitigating effects.

At 31 December 2019

Groups of connected clients:	Before	After
Group 1	75%	-

At 31 December 2018

Groups of connected clients:	Before	After
Group 1	73%	-
Group 2	12%	12%
Group 3	12%	11%
Group 4	11%	11%
Group 5	13%	11%

53. Liquidity risk

The Group defines liquidity risk as the risk of not being able to fund its financial obligations or planned growth, or only being able to do so substantially above the prevailing market cost of funds.

The Group's main source of funding is customer deposits. Treasury is responsible for the Bank's funding and liquidity management in line with internal and regulatory limits and policies. Treasury manages the Bank's intraday liquidity. Risk Management, as the second line of defence, is responsible for independent reporting on the liquidity position to internal and external stakeholders and providing a holistic view on liquidity risk on a consolidated basis.

Íslandsbanki hf. Consolidated Financial Statements 2019 57 Amounts are in ISK million

54. Liquidity coverage and Net stable funding ratio

Key measures for the assessment of liquidity risk are the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The Central Bank of Iceland, which is the main supervisory authority regarding liquidity risk, has incorporated the LCR and the NSFR based on the CRD IV standards into the rules on liquidity ratio and the rules on funding ratio in foreign currencies. In addition, the Group complies with the Financial Supervisory Authority's guidelines no. 2/2010 on best practices in liquidity management and liquidity coverage ratio rules no. 266/2017.

The following tables show the NSFR and the LCR for the Group at year-end 2019 and 2018.

Net stable funding ratio	31.12.2019	31.12.2018
For all currencies	119%	114%
Foreign currencies	156%	149%

Liquidity coverage ratio	31.12.2019	31.12.2018
For all currencies	155%	172%
Foreign currencies	325%	544%

At 31 December 2019	For all currencies		Foreign currencies	
	Unweighted	Weighted	Unweighted	Weighted
Liquid assets level 1*	157,080	157,080	31,858	31,858
Liquid assets level 2	11,942	6,271	3,727	520
Total liquid assets	169,022	163,351	35,585	32,378
Deposits	482,322	139,354	78,089	33,961
Debt issued	1,361	1,361	650	650
Other outflows	81,493	30,997	18,012	5,248
Total outflows	565,176	171,712	96,751	39,859
Short-term deposits with other banks**	54,203	52,335	51,343	50,261
Other inflows	33,984	14,213	6,287	3,558
Restrictions on inflows	-	-	-	(23,925)
Total inflows	88,187	66,548	57,630	29,894
Liquidity coverage ratio		155%		325%

At 31 December 2018	For all currencies		Foreign currencies	
	Unweighted	Weighted	Unweighted	Weighted
Liquid assets level 1*	169,217	169,217	42,608	42,608
Liquid assets level 2	2,754	775	2,754	775
Total liquid assets	171,971	169,992	45,362	43,383
Deposits	455,883	127,018	67,513	25,191
Debt issued	875	875	875	875
Other outflows	72,598	32,095	15,277	5,849
Total outflows	529,356	159,988	83,665	31,915
Short-term deposits with other banks**	39,718	39,718	39,716	39,716
Other inflows	42,739	21,443	9,702	7,950
Restrictions on inflows	-	-	-	(23,730)
Total inflows	82,457	61,161	49,418	23,936
Liquidity coverage ratio		172%		544%

*Level 1 liquid assets include cash and balances with the Central Bank, domestic bonds eligible as collateral against borrowing at the Central Bank and foreign government bonds in accordance with rules no. 266/2017 on liquidity ratio.

**Short-tem deposits with other banks with maturity less than 30 days.

Íslandsbanki hf. Consolidated Financial Statements 2019 58 Amounts are in ISK million

Notes to the Consolidated Financial Statements

54. Cont'd

Deposits by liquidity coverage ratio category

The Group's deposits are categorised by counterparty according to the Liquidity Coverage Ratio (LCR) standard. The groups are listed in order of estimated stability and the respective LCR outflow weight. Deposits are also classified as stable if the customer has an established business relationship with the Bank and is covered by an effective insurance scheme.

	Deposits maturing within 30 days					
At 31 December 2019	Less stable	Weight (%)	Stable	Weight (%)	Term deposits	Total deposits
Retail	228,447	12%	83,773	5%	78,870	391,090
Operational relationships	2,446	25%	-	5%	-	2,446
Corporations	73,739	40%	337	20%	24,589	98,665
Sovereigns, Central Bank and public sector entities	6,813	40%	253	20%	620	7,686
Pension funds	35,405	100%	-	-	24,869	60,274
Domestic financial entities	28,494	100%	-	-	46,371	74,865
Foreign financial entities	8,038	100%	-	-	6,174	14,212
Total	383,382		84,363		181,493	649,238

	Deposits maturing within 30 days					
At 31 December 2018	Less stable	Weight (%)	Stable	Weight (%)	Term deposits	Total deposits
Retail	216,428	12%	80,804	5%	78,476	375,708
Operational relationships	2,572	25%	-	5%	-	2,572
Corporations	63,887	40%	341	20%	22,809	87,037
Sovereigns, Central Bank and public sector entities	7,613	40%	246	20%	591	8,450
Pension funds	30,686	100%	-	-	26,987	57,673
Domestic financial entities	27,467	100%	-	-	24,622	52,089
Foreign financial entities	3,242	100%	-	-	7,807	11,049
Total	351,895		81,391		161,292	594,578

55. Maturity analysis of assets and liabilities

The following tables show the contractual payments of principal and interest for the Group's financial liabilities. Thus, the total figures for each liability class are higher than the respective balance sheet amount. Cash flows for payments of unknown nature, such as for floating rate, CPI-linked or foreign currency denominated instruments, are based on internal yield curves and forecasts.

For dated financial liabilities the amounts are grouped into maturity buckets according to contractual maturities of principal and estimated contractual payments of interest. For demand deposits or other non-dated liabilities, the figures are grouped according to the first possible required payment date.

Maturity analysis 31 December 2019

Financial liabilities	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Deposits from CB and credit institutions	30,925	1,992	16,363	8,468	4,580	-	-	31,403
Deposits from customers	618,313	453,959	78,232	54,994	16,612	62,222	-	666,019
Debt issued and other borrowed funds	306,381	-	6,991	24,861	267,776	90,610	-	390,238
Subordinated loans	22,674	-	158	463	2,865	26,482	-	29,968
Other financial liabilities:	24,772	17,581	2,124	1,276	1,759	2,448	-	25,188
Lease liabilities	4,256	-	116	349	1,759	2,448	-	4,672
Other liabilities	20,516	17,581	2,008	927	-	-	-	20,516
Total	1,003,065	473,532	103,868	90,062	293,592	181,762	-	1,142,816

Íslandsbanki hf. Consolidated Financial Statements 2019 59 Amounts are in ISK million

Notes to the Consolidated Financial Statements

55. Cont'd

Off-balance sheet liabilities show the amount of contractual obligations that the Group has taken towards customers, either by committing to lend out money in the future or as third party guarantees. The amounts shown reflect the maximum amount, not taking into account the Group's ability to reduce overdraft or credit card limits before the current undrawn amount is fully utilised by the customer. These obligations all fall into the first time bucket since contractually, on a case-by-case basis, the Group could be required to fulfil these obligations instantaneously.

Off-balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees	18,861	-	-	-	-	-	18,861
Undrawn loan commitments	35,443	-	-	-	-	-	35,443
Undrawn overdrafts	51,338	-	-	-	-	-	51,338
Credit card commitments	30,163	-	-	-	-	-	30,163
Total	135,805	-	-	-	-	-	135,805
Total non-derivative financial liabilities and off-balance sheet liabilities	609,337	103,868	90,062	293,592	181,762	-	1,278,621

The following table shows the contractual cash flow of the Group's derivative liabilities, i.e. derivatives that have a negative and a positive carrying amount at the reporting date. For derivatives settled on a gross basis, the cash flow for both legs of the derivative is shown, since netting cannot be applied upon settlement.

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	57,542	36,133	43,218	-	-	136,893
Outflow	-	(59,615)	(37,222)	(44,915)	-	-	(141,752)
Total	-	(2,073)	(1,089)	(1,697)	-	-	(4,859)
Net settled derivatives	-	(323)	-	-	-	-	(323)
Total	-	(2,396)	(1,089)	(1,697)	-	-	(5,182)

Maturity classification of assets is based on contractual maturity. For bonds and debt instruments in the banking book the maturity classification is based on contractual maturity dates while for bonds and debt instruments held for trading the maturity classification is based on the estimated liquidation time of the asset.

Financial assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Cash and balances with Central Bank	146,638	28,978	115,981	-	-	1,679	-	146,638
Loans to credit institutions	54,376	20,719	33,656	-	-	-	-	54,375
Bonds and debt instruments	52,870	7,768	23,998	10,120	10,983	-	-	52,869
Loans to customers	899,632	2,972	88,446	87,462	303,668	417,083	-	899,631
Shares and equity instruments	18,426	-	-	-	-	-	18,426	18,426
Other financial assets	5,757	1,889	525	118	17	-	3,259	5,808
Total	1,177,699	62,326	262,606	97,700	314,668	418,762	21,685	1,177,747

Derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	92,680	28,583	74,731	-	-	195,994
Outflow	-	(82,832)	(27,964)	(73,544)	-	-	(184,340)
Total	-	9,848	619	1,187	-	-	11,654
Net settled derivatives	-	273	-	-	-	-	273
Total	-	10,121	619	1,187	-	-	11,927

Íslandsbanki hf. Consolidated Financial Statements 2019 60 Amounts are in ISK million

55. Cont'd

The following tables show the comparative amounts for maturity analysis at year-end 2018.

Maturity analysis 31 December 2018

Financial liabilities	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Deposits from CB and credit institutions	15,619	4,594	3,229	4,992	3,249	-	-	16,064
Deposits from customers	578,959	420,242	81,178	37,952	26,976	38,070	-	604,418
Debt issued and other borrowed funds	300,976	404	24,214	21,178	154,315	141,098	-	341,209
Subordinated loans	16,216	-	90	307	2,242	20,417	-	23,056
Other financial liabilities	27,186	24,431	1,729	1,026	-	-	-	27,186
Total	938,956	449,671	110,440	65,455	186,782	199,585	-	1,011,933

Off-balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees	18,021	-	-	-	-	-	18,021
Undrawn loan commitments	49,054	-	-	-	-	-	49,054
Undrawn overdrafts	49,833	-	-	-	-	-	49,833
Credit card commitments	29,049	-	-	-	-	-	29,049
Total	145,957	-	-	-	-	-	145,957
Total non-derivative financial liabilities and off-balance sheet liabilities	595,628	110,440	65,455	186,782	199,585	-	1,157,890

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	20,124	23,147	49,380	1,771	-	94,422
Outflow	-	(20,638)	(24,189)	(51,654)	(1,943)	-	(98,424)
Total	-	(514)	(1,042)	(2,274)	(172)	-	(4,002)
Net settled derivatives	-	(280)	-	-	-	-	(280)
Total	-	(794)	(1,042)	(2,274)	(172)	-	(4,282)

Financial assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Cash and balances with Central Bank	135,056	47,746	87,310	-	-	-	-	135,056
Loans to credit institutions	41,577	24,152	17,425	-	-	-	-	41,577
Bonds and debt instruments	69,415	-	18,946	24,189	14,409	11,604	267	69,415
Loans to customers	846,599	2,054	90,269	74,716	282,624	396,936	-	846,599
Shares and equity instruments	13,074	-	-	-	-	-	13,074	13,074
Other financial assets	7,511	1,888	475	71	9	-	5,068	7,511
Total	1,113,232	75,840	214,425	98,976	297,042	408,540	18,409	1,113,232

Derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	57,050	22,267	77,126	327	-	156,770
Outflow	-	(56,077)	(21,929)	(74,072)	(343)	-	(152,421)
Total	-	973	338	3,054	(16)	-	4,349
Net settled derivatives	-	869	-	-	-	-	869
Total	-	1,842	338	3,054	(16)	-	5,218

Íslandsbanki hf. Consolidated Financial Statements 2019 61 Amounts are in ISK million

56. Market risk

The Group defines market risk as the current or prospective risk to earnings and capital arising from adverse movements in the level or volatility of prices of market instruments, such as those that arise from changes in interest rates, foreign exchange rates, equity prices, CPI-indexation and commodity prices. Sources of market risk are imbalances in the Group's balance sheet and open positions in bonds, currencies and equities. Derivative contracts are also potential sources of market risk.

Market risk within the Group can broadly be split into two categories, trading book and banking book. The trading book includes market risk exposures related, directly or indirectly, to the Group's short- and medium-term trading in securities, currencies and other capital market instruments and derivatives. All financial assets and liabilities in the trading portfolio are recognised at fair value and all resulting changes are immediately reflected in the income statement. The banking book includes market risk exposures related to securities held for long-term investment purposes, unlisted securities or holdings in subsidiaries or affiliates. A large part of the banking book market risk is due to mismatches in the composition of assets and liabilities, for example with respect to currencies, interest rates, CPI-indexation or other factors that can affect the Group's earnings or earnings volatility. These mismatches are reported to management and are subject to internal and regulatory limits.

57. Interest rate risk

Interest rate risk is defined as the current or prospective risk to earnings or capital arising from adverse movements in interest rates. Sensitivity measures like Basis Point Value (BPV) are used to measure and manage risk arising from its fixed income exposures. The BPV measures the effect of a 0.01 percentage point upward parallel shift in the yield curve on the fair value of these exposures.

Interest rate risk in the trading book

The fixed income trading unit invests mainly in government bonds, bonds issued by the Housing Financing Fund (HFF) which are guaranteed by the Icelandic Government, domestic municipality bonds, and covered bonds issued by other Icelandic banks. Bonds and bills in the Group's liquidity portfolio are also categorised in the trading book. In the following table the total market value (MV) of long and short positions may not be the same as reported in Note 5 since netting between short and long positions is not applied here.

	31.12.2019			31.12.2018		
Trading bonds and debt instruments, long positions	MV	Duration	BPV	MV	Duration	BPV
Indexed	1,143	6.84	(0.78)	1,872	6.13	(1.15)
Non-indexed	31,855	0.41	(1.29)	43,550	0.32	(1.40)
Total	32,998	0.63	(2.07)	45,422	0.56	(2.55)

	31.12.2019			31.12.2018		
Trading bonds and debt instruments, short positions	MV	Duration	BPV	MV	Duration	BPV
Indexed	150	6.00	0.10	-	-	-
Non-indexed	615	4.00	0.28	198	5.00	0.09
Total	765	4.39	0.38	198	5.00	0.09
Net position of trading bonds and debt instruments	32,233	0.54	(1.69)	45,224	0.54	(2.46)

Íslandsbanki hf. Consolidated Financial Statements 2019 62 Amounts are in ISK million

57. Cont'd

The following table shows the interest rate sensitivity of the Group's trading book from a parallel 100 basis points change in all yield curves.

Sensitivity analysis for trading bonds and debt instuments

		31.12.2019		31.12.2018	
		Profit (loss)			
Currency	Parallel shift in yield curve (basis points)	Downward shift	Upward shift	Downward shift	Upward shift
ISK, indexed	100	87	(87)	115	(115)
ISK, non-indexed	100	44	(44)	24	(24)
EUR	100	40	(40)	56	(56)
USD	100	32	(32)	29	(29)
Other total	100	9	(9)	-	-
Total		212	(212)	224	(224)

Interest rate risk in the banking book

Interest rate risk in the banking book arises from the Group's core banking activities. The main source of this type of interest rate risk is the risk of loss from fluctuations in future cash flows or fair value of financial instruments as interest rates change over time, reflecting the fact that the Group's assets and liabilities are of different maturities and are priced relative to different interest rates.

The following table shows the interest sensitivity of the Group's banking book from a parallel 100 basis points change in all yield curves, with all other variables held constant, categorised by the date of next interest rate reset.

Sensitivity analysis for interest rate risk in the banking book

At 31 December 2019

Currency	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
ISK, indexed	55	60	(442)	(1,668)	1,995	193	193
ISK, non-indexed	7	(12)	11	89	(10)	(9)	76
EUR	(17)	(20)	(29)	118	-	(2)	50
SEK	10	-	-	-	-	-	10
USD	(42)	-	-	-	-	(1)	(43)
Other	12	(11)	-	41	-	(6)	36
Total	25	17	(460)	(1,420)	1,985	175	322

At 31 December 2018

Currency	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
ISK, indexed	20	8	110	(3,318)	3,185	72	77
ISK, non-indexed	9	57	(7)	(193)	(77)	(1)	(212)
EUR	87	(25)	13	(1,605)	1,709	-	179
SEK	92	-	(16)	-	-	-	76
USD	(63)	-	-	-	-	-	(63)
Other	(1)	(11)	-	-	-	-	(12)
Total	144	29	100	(5,116)	4,817	71	45

Íslandsbanki hf. Consolidated Financial Statements 2019 63 Amounts are in ISK million

Notes to the Consolidated Financial Statements

58. Currency risk

Currency risk is the risk that earnings or capital may be negatively affected from the fluctuations of foreign exchange rates, due to transactions in foreign currencies or due to a mismatch in the currency composition of assets or liabilities.

The analysis of the Group's foreign currency exposure presented below is based on the contractual currency of the underlying balance sheet items. Additionally, there are off-balance sheet items that carry currency risk and are included in the total currency imbalance. The off-balance sheet amounts below represent the notional amounts of derivatives and unsettled spot agreements.

Currency analysis at 31 December 2019

Assets	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	CAD	Other foreign currencies	Total foreign currencies
Cash and balances with Central Bank	942	319	210	52	24	51	73	114	58	123	1,966
Loans to credit institutions	11,689	25,740	1,650	378	534	116	9,707	1,294	272	687	52,067
Bonds and debt instruments	12,930	10,937	3	-	-	-	8,232	-	-	-	32,102
Loans to customers	112,185	29,486	2,037	581	3,185	3	3,408	635	6,005	33	157,558
Shares and equity instruments	31	3,371	419	-	-	-	27	-	-	-	3,848
Other assets	390	1,866	338	6	-	73	2	20	-	458	3,153
Total assets	138,167	71,719	4,657	1,017	3,743	243	21,449	2,063	6,335	1,301	250,694
Liabilities											
Deposits from credit institutions	9,145	558	1	-	-	-	-	-	-	-	9,704
Deposits from customers	32,247	27,939	3,810	385	395	874	3,317	3,617	453	42	73,079
Debt issued and other borrowed funds	91,809	-	-	-	-	37,768	19,565	-	-	-	149,142
Subordinated loans	-	-	-	-	-	22,674	-	-	-	-	22,674
Other liabilities	1,728	944	558	35	3	162	5	47	2	665	4,149
Total liabilities	134,929	29,441	4,369	420	398	61,478	22,887	3,664	455	707	258,748
Net on-balance sheet position	3,238	42,278	288	597	3,345	(61,235)	(1,438)	(1,601)	5,880	594	(8,054)
Net off-balance sheet position	(4,344)	(41,574)	(231)	(610)	(3,345)	61,127	1,255	1,726	(5,840)	(203)	7,961
Net position	(1,106)	704	57	(13)	-	(108)	(183)	125	40	391	(93)

Íslandsbanki hf. Consolidated Financial Statements 2019 64 Amounts are in ISK million

Notes to the Consolidated Financial Statements

58. Cont'd

Currency analysis at 31 December 2018

Assets	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	CAD	Other foreign currencies	Total foreign currencies
Cash and balances with Central Bank	377	250	135	23	10	54	51	88	29	73	1,090
Loans to credit institutions	15,662	12,614	4,488	258	613	4,683	1,901	530	123	538	41,410
Bonds and debt instruments	32,313	10,968	24	-	-	-	-	-	-	-	43,305
Loans to customers	105,852	31,603	2,037	734	3,213	2	4,318	572	5,710	39	154,080
Shares and equity instruments	45	2,202	398	-	-	-	40	-	-	-	2,685
Other assets	1,270	2,056	834	4	91	83	2	45	-	1,737	6,122
Total assets	155,519	59,693	7,916	1,019	3,927	4,822	6,312	1,235	5,862	2,387	248,692
Liabilities											
Deposits from credit institutions	5,622	538	83	-	96	-	16	-	-	-	6,355
Deposits from customers	26,605	26,819	4,293	329	430	927	3,211	1,728	434	144	64,920
Debt issued and other borrowed funds	113,670	-	-	-	-	41,764	-	-	-	-	155,434
Subordinated loans	-	-	-	-	-	16,216	-	-	-	-	16,216
Other liabilities	2,502	1,269	578	30	266	82	154	138	-	2,098	7,117
Total liabilities	148,399	28,626	4,954	359	792	58,989	3,381	1,866	434	2,242	250,042
Net on-balance sheet position	7,120	31,067	2,962	660	3,135	(54,167)	2,931	(631)	5,428	145	(1,350)
Net off-balance sheet position	(7,589)	(31,140)	(2,964)	(667)	(3,170)	54,350	(2,844)	642	(5,418)	(147)	1,053
Net position	(469)	(73)	(2)	(7)	(35)	183	87	11	10	(2)	(297)

Íslandsbanki hf. Consolidated Financial Statements 2019 65 Amounts are in ISK million

Notes to the Consolidated Financial Statements

58. Cont'd

The following table shows the effect of a 10% depreciation or appreciation of foreign exchange rates where the Group had positions at the reporting date, with all other variables held constant.

Sensitivity analysis for currency risk	31.12.2019		31.12.2018	
	Profit or (loss)			
Currency	-10%	10%	-10%	10%
EUR	111	(111)	47	(47)
USD	(70)	70	7	(7)
GBP	(6)	6	-	-
CHF	1	(1)	1	(1)
JPY	-	-	4	(4)
SEK	11	(11)	(18)	18
NOK	18	(18)	(9)	9
DKK	(13)	13	(1)	1
CAD	(4)	4	(1)	1
Other foreign currencies	(39)	39	-	-
Total	9	(9)	30	(30)

59. Shares and equity instruments

The Group's equity exposure in the trading book arises from flow trading and market making with shares listed on the Nasdaq Iceland Stock Exchange. Shares and equity instruments in the banking book are classified as mandatorily at fair value through profit or loss or are classified as held for sale.

The following table shows how a 10% shift in equity prices would affect the Group's equity and net financial income. Securities used for hedging are excluded.

Sensitivity analysis for shares and equity instruments		31.12.2019		31.12.2018	
		Profit or (loss)			
Portfolio	Change in equity prices	Downward shift	Upward shift	Downward shift	Upward shift
Trading book	10%	(169)	169	(123)	123
Banking book	10%	(806)	806	(639)	639
Total		(975)	975	(762)	762

60. Inflation risk

The Group is exposed to inflation risk since the value of CPI-linked assets exceeds CPI-linked liabilities. The value of these assets and liabilities changes according to changes in the CPI at any given time and all changes in the CPI affect profit and loss. A 1% increase in the index would lead to an ISK 93 million increase in the balance sheet and a 1% decrease would lead to a corresponding decrease, other risk factors held constant.

	31.12.2019	31.12.2018
Bonds and debt instruments	2,103	2,721
Loans to customers	295,725	293,917
Total CPI-linked assets	297,828	296,638

Íslandsbanki hf. Consolidated Financial Statements 2019 66 Amounts are in ISK million

Notes to the Consolidated Financial Statements

60. Cont'd

	31.12.2019	31.12.2018
Deposits from customers	98,766	95,917
Debt issued and other borrowed funds	125,975	118,103
Off-balance sheet position	63,827	70,617
Total CPI-linked liabilities	288,568	284,637
CPI imbalance	9,260	12,001

61. Derivatives

The Group uses derivatives to hedge currency exposure, interest rate risk in the banking book as well as inflation risk. However, the Group is subject to indirect exposure through customers' margin trading. Margin trading is subject to continuous monitoring and collateral requirements. Other derivatives held for trading or for other purposes are insignificant.

62. Capital management

The following table shows the capital base, risk exposure amount, the resulting capital ratios, and leverage for the Group at 31 December 2019 and 31 December 2018.

The Group's regulatory capital requirement is calculated according to CRD IV as implemented through Act no. 161/2002 on Financial Undertakings and regulation no. 233/2017 on prudential requirements for financial undertakings. Capital requirement calculations for credit risk and market risk are based on the standardised approach whereas the capital requirement calculations for operational risk are based on the basic indicator approach.

Article 501 of the capital requirements regulation (EU) no. 575/2013 of the European parliament came into effect in Iceland on 1 January 2020. This article stipulates capital requirements deduction for credit risk on exposures to SMEs and is expected to lower the risk exposure amount by ISK 15.6 billion, which corresponds to a 40 basis point increase in the Group's capital ratio.

The Group aims at managing its capital position and the corresponding capital ratios above the overall regulatory capital requirement. According to the latest SREP report from the Financial Supervisory Authority, applicable as of 30 September 2019, the overall capital requirement is 18.8%. The Group's capital target includes a 0.5-2.0% management buffer on top of the overall capital requirement.

The minimum leverage ratio for Icelandic financial institutions is 3%.

	31.12.2019	31.12.2018
CET1 capital		
Ordinary share capital	10,000	10,000
Share premium	55,000	55,000
Reserves	7,065	6,499
Retained earnings	105,569	102,496
Non-controlling interests	2,428	2,318
Fair value changes due to own credit standing	392	376
Tax assets	(476)	(215)
Intangible assets	(4,330)	(5,002)
Total CET1 capital	175,648	171,472
Tier 2 capital		
Qualifying subordinated liabilities	22,674	16,216
Total capital base	198,322	187,688

Íslandsbanki hf. Consolidated Financial Statements 2019 67 Amounts are in ISK million

62. Cont'd

	31.12.2019	31.12.2018
Risk exposure amount		
- due to credit risk	789,180	750,801
- due to market risk	7,919	7,622
Market risk, trading book	6,488	6,649
Currency risk	1,431	973
- due to credit valuation adjustment	2,027	2,385
- due to operational risk	85,424	85,141
Total risk exposure amount	884,550	845,949
Capital ratios		
Tier 1 ratio	19.9%	20.3%
Total capital ratio	22.4%	22.2%
Leverage ratio		
Exposure amount		
On-balance sheet exposures	1,189,062	1,120,637
Off-balance sheet exposures	38,849	47,119
Derivative exposures	9,461	8,935
Leverage ratio total exposure measure	1,237,372	1,176,691
Tier 1 capital	175,648	171,472
Leverage ratio	14.2%	14.6%

63. Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The Goup's definition of operational risk includes reputational risk, legal risk, model risk, conduct risk and compliance risk among other risk factors.

The ultimate responsibility for ensuring an adequate operational risk management and internal control framework at Íslandsbanki lies with the Board of Directors. The Board has approved an Operational Risk Policy which outlines the Bank's framework for operational risk management. Risk Management is responsible for implementing the Bank's operational risk framework, for developing, maintaining the Operational Risk Policy and for communicating the policy to the Bank's employees.

Íslandsbanki hf. Consolidated Financial Statements 2019 68 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Accounting policies

64. Basis of measurement

The consolidated financial statements are prepared on a historical cost basis, except for the following assets and liabilities, which are measured at fair value: bonds and debt instruments, shares and equity instruments, short positions in listed bonds, derivative financial instruments and certain bonds. Non-current assets and disposal groups held for sale are measured at the lower of its carrying amount and fair value less costs to sell. Recognised financial liabilities designated as hedged items in qualifying fair value hedge relationships are measured at amortised cost adjusted for changes in fair value attributable to the risk being hedged.

65. Changes in presentation

The Group has changed its presentation in the statement of financial position as follows:
- The line item "Non-current assets and disposal groups held for sale" has been included in the line item "Other assets"
- The line item "Non-current liabilities and disposal groups held for sale" has been included in the line item "Other liabilities"

66. Significant accounting policies

The accounting policies set out below have been applied consistently by the Group to the periods presented in these consolidated financial statements.

At 1 January 2019 the Group implemented IFRS 16 - Leases and elected not to restate comparative period information. Accordingly, comparative periods are presented in accordance with IAS 17 - Leases, as described in the Group's audited consolidated financial statements for the year ended 31 December 2018.

Contents

Notes to the Consolidated Financial Statements

66.1 Basis of consolidation

The consolidated financial statements of the Group comprise the financial statements of Íslandsbanki hf., as the parent company, and its subsidiaries presented as those of a single economic entity. The Group consolidates its subsidiaries on the basis of control whereas subsidiaries are entities controlled by the Group.

Control

Subsidiaries are investments that the Group has control over. The Group controls an investment when the Group is exposed, or has rights, to variable returns from its involvement with the investment and has the ability to affect those returns through its power over the investment. The Group has power over an entity when the Group has existing rights that give it the current ability to direct the relevant activities and the ability to exercise its right.

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an entity, the Group considers all relevant facts and circumstances in assessing whether it has power over an entity, including the contractual arrangements with the other vote holders of the entity, rights arising from other contractual arrangements, the Group's voting rights and potential voting rights.

When the Group assesses whether it controls an entity, it also determines whether it is a principal or an agent. If the Group has the power to direct the activities of the entity to generate returns for itself, then it is a principal. If the Group is primarily engaged to act on behalf and for the benefit of other parties, then it is an agent and it does not control the entity when exercising its decision-making rights delegated to it. In assessing whether the Group is a principal or an agent it considers the overall relationship between itself, the entity and other parties involved with the entity. In particular, the Group considers the scope of its decision-making authority over the entity, the rights held by other parties, the remuneration to which it is entitled in accordance with any remuneration agreements and the Group's exposure to variability of returns from other interests that it holds in the entity. Different weightings are applied to each of these factors on the basis of particular facts and circumstances.

The Group reassesses whether or not it controls an entity if facts and circumstances indicate that there are changes to one or more of the elements of control.

Funds management

The Group acts as a manager for Undertakings for Collective Investment in Transferable Securities (UCITS) and investment funds as well as other funds for collective investment that accept capital from investors. Such funds are financed by issuing unit share certificates or shares. The Group does not have any contractual financial responsibility with respect to such custom units. The funds are not consolidated unless they are under the control of the Group.

The Group reviews all the facts and circumstances in order to decide if these funds should be consolidated. The Group is deemed to be a principal and hence controls and consolidates the funds, when it acts as fund manager and cannot be removed without cause, has variable returns through significant unit holdings and/or guarantee, and is able to influence the returns of the funds by exercising its power.

Consolidation

Consolidation of a subsidiary begins when the Group obtains control of the subsidiary and ceases when the Group loses control of the subsidiary.

In preparing the consolidated financial statements, Íslandsbanki combines its financial statements with those of its subsidiaries, line by line, by adding together like items of assets, liabilities, equity, income, expenses and cash flows. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between group entities are eliminated in full on consolidation. The carrying amount of Íslandsbanki's investment in each subsidiary and Íslandsbanki's portion of equity of each subsidiary are eliminated and any related goodwill is recognised as an asset.

If the Group loses control of a subsidiary, it derecognises the related assets (including goodwill), liabilities, non-controlling interests and other components of equity, while any resultant gain or loss is recognised in profit or loss in the line item "Other operating income". Any investment retained by the Group in the former subsidiary is recognised at its fair value at the date when control is lost.

A change in the Group's ownership interest in a subsidiary, without a loss of control, is accounted for as an equity transaction.

When the Group is committed to a sale plan involving the loss of control of a subsidiary and the criteria for classification as held for sale are met (see Note 66.11), it classifies all the assets and liabilities of that subsidiary as held for sale in its consolidated financial statements. This is regardless of whether the Group will retain a non-controlling interest in the subsidiary after the sale. The gain or loss from the sale is recognised in profit or loss in the line item "Profit (loss) from discontinued operations, net of income tax".

Notes to the Consolidated Financial Statements

66.1 Cont'd

Non-controlling interests

Non-controlling interests represent equity in subsidiaries not attributable, directly or indirectly, to the Group.

For each business combination, the Group measures at the acquisition date components of non-controlling interests in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation, at either fair value or the present ownership instruments' proportionate share in the acquiree's identifiable net assets. All other components of non-controlling interests are measured at their acquisition-date fair values, unless another measurement basis is required by the International Financial Reporting Standards.

The Group presents non-controlling interests within equity in the statement of financial position, separately from the equity attributable to equity holders of Íslandsbanki. Profit or loss and each component of other comprehensive income are attributed to equity holders of Íslandsbanki and to non-controlling interests, even if this results in the non-controlling interests having a deficit balance.

When the proportion of the equity held by non-controlling interests changes, the Group adjusts the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to equity holders of Íslandsbanki hf. No adjustments are made to goodwill and no gain or loss is recognised in profit or loss.

Business combinations and goodwill

The Group accounts for each business combination by applying the acquisition method. Under the acquisition method, the Group identifies itself as the acquirer, determines the acquisition date, recognises and measures the identifiable assets acquired, the liabilities assumed and any non-controlling interests in the acquiree, and recognises and measures any goodwill or gain from a bargain purchase.

66.2 Foreign currencies

The financial statements of each of the Group's entities are measured using the functional currency of the respective entity.

On initial recognition transactions in foreign currencies are translated into functional currencies at the spot exchange rate at the date of the transactions. At the end of each reporting period monetary assets and liabilities denominated in foreign currencies are retranslated into functional currencies using the closing rate. 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 measured at fair value are translated into the functional currency using the exchange rate at the date when the fair value was determined.

Foreign currency differences arising on retranslation from one currency to another are recognised in profit or loss (see Note 66.19).

66.3 Financial assets and financial liabilities

Recognition

The Group recognises a financial asset and a financial liability in its statement of financial position on the trade date, which is the date on which the Group becomes party to the contractual provisions of the instrument, except for loans which are recognised on the date when cash is advanced by the Group to the borrowers. At initial recognition, the Group measures a financial asset or a financial liability at its fair value plus, in the case of a financial asset or a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or the financial liability.

Derecognition

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

The Group derecognises financial assets in the following circumstances:
• When the contractual rights to the cash flows from the financial assets expire, or
• When the Group transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which:
- The Group transfers substantially all the risks and rewards of ownership of the financial assets, or
- The Group neither transfers nor retains substantially all the risks and rewards of ownership of the financial assets and it does not retain control of the financial assets.

Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

66.3 Cont'd

The Group enters into transactions whereby it transfers assets recognised in its statement of financial position, but retains either all or substantially all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the statement of financial position of the Group. Transfers of assets with retention of all or substantially all risks and rewards include, for example, repurchase transactions and securities lending.

The Group does not derecognise from its statement of financial position securities which the Group sells under agreements to repurchase at a specified future date ("repos") at a fixed price or at the sale price plus a lender's return. The Group recognises the cash received as a liability in its statement of financial position. The difference between the sale and repurchase prices is recognised as interest expense over the life of the agreement using the effective interest method.

Securities lending and borrowing transactions are usually collateralised by securities or cash. The transfer of securities to counterparties is only reflected in the statement of financial position if the risks and rewards of ownership are also transferred. Cash advanced or received as collateral is recorded as an asset or liability.

In transactions in which the Group neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset and it retains control over the asset, the Group continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

Modifications

Substantial modifications of terms of existing financial assets, or replacements with new ones with significantly different terms, result in the Group derecognising the original financial assets and recognising new financial assets at fair value.

Classification and measurement of financial assets

For the purpose of measuring its financial assets, the Group classifies them at inception in one of the following categories (see also Note 5):
- Financial assets at amortised cost
- Financial assets at fair value through other comprehensive income
- Financial assets at fair value through profit or loss
- Derivative assets held for hedging

The measurement basis of individual financial assets is determined based on an assessment of the cash flow characteristics of the assets and the business models under which they are managed.

The business models

The business models are determined by the Group's key management personnel in the way that assets are managed and their performance is reported to them. The Group determines its business models at a level that reflects the way groups of financial assets are managed together to achieve a particular business objective. This condition is not an instrument-by-instrument approach to classification, but is determined at a higher level of aggregation. The Group's business models fall into the following three categories: Held to collect, Held to collect and for sale, and Other fair value business models, where assets are held for trading or managed on a fair value basis and are neither Held to collect nor Held to collect and for sale.

Solely payments of principal and interest (SPPI)

Financial assets held within the business models Held to collect and Held to collect and for sale, are assessed to evaluate if their contractual cash flows are comprised of solely payments of principal and interest. SPPI payments are those which are consistent with a basic lending arrangement. Principal is the fair value of the financial asset at initial recognition and changes over the life of the financial asset, for example if there are repayments of principal. Interest relates to basic lending returns, including compensation for the time value of money and credit risk associated with the principal amount outstanding over a period of time. Interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, servicing or administrative costs), as well as a profit margin that is consistent with a basic lending arrangement.

Where the contractual terms introduce exposure to risk or variability of cash flows that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets at amortised cost

A financial asset is classified as being subsequently measured at amortised cost if the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest and the asset is held within a business model whose objective is to collect contractual cash flows, i.e. Held to collect.

Financial assets at amortised cost are measured using the effective interest method. Amortised cost is calculated by taking into account the amount at which the assets are measured at initial recognition less principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount (such as due to discounts or premiums on acquisition and fees and costs that are an integral part of the effective interest rate), and minus any reduction for impairment. Accrued interest is included in the carrying amount of the financial asset in the statement of financial position. Impairment losses and reversals of impairment losses are recognised in profit or loss in the line item "Net impairment on financial assets".

66.3 Cont'd

Financial assets at fair value through other comprehensive income (FVOCI)

For shares and equity instruments that are not held for trading, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses, including any related foreign exchange component, in other comprehensive income rather than profit or loss. This election is made on an instrument-by-instrument basis. Shares and equity instruments at FVOCI are not subject to an impairment assessment. Dividends are to be presented in profit or loss, as long as they represent a return on investment. On derecognition there is no recycling of fair value gains and losses to profit or loss.

Financial assets at fair value through profit or loss (FVTPL)

Financial assets classified at fair value through profit or loss are all other financial assets which are not classified at amortised cost or at fair value through other comprehensive income. This includes financial assets classified mandatorily at fair value through profit or loss and financial assets which are irrevocably designated by the Group at initial recognition as at fair value through profit or loss that would otherwise meet the requirements to be measured at amortised cost or at FVOCI. The Group designates financial assets as at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise. During the year the Group did not classify any financial assets as designated at fair value through profit or loss.

Financial assets at fair value through profit or loss are initially recognised and subsequently measured at fair value in the statement of financial position. Changes in fair value are recognised in profit or loss in the line item "Net financial income (expense)", except for interest earned, which is recognised in the line item "Interest income" and foreign exchange gains and losses, which are included in the line item "Net foreign exchange gain (loss)".

Derivative assets held for hedging

Derivative assets held for hedging consist of derivatives with positive fair value which are designated and accounted for as hedging instruments (see Note 66.5).

Classification and measurement of financial liabilities

For the purpose of measuring its financial liabilities, the Group classifies them at inception in one of the following categories (see also Note 5), except for loan commitments and financial guarantees (see Note 66.12):

• Financial liabilities at amortised cost
• Financial liabilities mandatorily at fair value through profit or loss
• Financial liabilities designated as at fair value through profit or loss
• Derivative liabilities held for hedging

Financial liabilities at amortised cost

Financial liabilities at amortised cost are non-derivative financial liabilities. Financial liabilities at amortised cost include deposits, debt issued and other borrowed funds, and subordinated loans.

Financial liabilities at amortised cost are recognised initially at fair value net of transaction costs incurred, and subsequently are carried at amortised cost using the effective interest method. Amortised cost is calculated by taking into account the amount at which the financial liabilities are measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount (such as due to discounts or premiums and fees and costs that are an integral part of the effective interest rate). Accrued interest is included in the carrying amount of the liabilities in the statement of financial position.

The amortised cost of certain bonds issued by the Group, which are designated as hedged items in qualifying fair value hedge relationships, is adjusted for changes in the fair value of the bonds attributable to interest rate risk (see Note 66.5).

Financial liabilities mandatorily at fair value through profit or loss

Financial liabilities mandatorily at fair value through profit or loss are financial liabilities incurred principally for the purpose of generating profits from short-term price fluctuations or from the dealer's margin. Financial liabilities mandatorily at fair value through profit or loss consist of short positions in listed bonds and derivatives with negative fair value which are not classified as financial guarantees or are not designated as hedging instruments.

Financial liabilities mandatorily at fair value through profit or loss are initially recognised and subsequently measured at fair value in the statement of financial position. Changes in fair value are recognised in profit or loss in the line item "Net financial income (expense)", except for interest incurred, which is recognised as "Interest expense" on an accrual basis and foreign exchange gains and losses which are included in the line item "Net foreign exchange gain (loss)".

66.3 Cont'd

Financial liabilities designated as at fair value through profit or loss

Financial liabilities designated as at fair value through profit or loss are recognised at fair value and changes in fair value attributable to changes in the credit risk of those liabilities are recognised in other comprehensive income and are not subsequently reclassified to profit or loss. The remaining fair value changes are included in profit or loss in the line item "Net financial income (expense)", except for interest incurred, which is recognised as "Interest expense" using the effective interest rate method and foreign exchange gains and losses which are included in the line item "Net foreign exchange gain (loss)".

The Group calculates the fair value attributable to changes in credit risk as the difference between the changes in fair value of the financial liability and the amount of changes in fair value attributable to changes in market interest rates. The change in fair value attributable to changes in market interest rates on financial liabilities is calculated by discounting contractual cash flows at the end of the period with the discount rate of the appropriate market interest rate.

Upon initial recognition, the Group determines if the recognition of gains and losses in other comprehensive income creates or enlarges an accounting mismatch in profit or loss, if applicable the whole fair value change is presented in profit or loss.

Derivative liabilities held for hedging

Derivative liabilities held for hedging consist of derivatives with negative fair value which are designated and accounted for as hedging instruments (see Note 66.5).

Reclassification

Financial assets are reclassified between measurement categories if the objective of the business model in which the financial assets are held changes after initial recognition and if the change is significant to the Group's operations.

Financial liabilities are not reclassified.

Determination of fair value

The fair value of a financial instrument is the transaction price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

When available, the Group measures the fair value of financial assets and financial liabilities using quoted prices in an active market for that instrument. A market is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring transactions. The fair value is based on the most recent observed market prices at the reporting date.

If a market for a financial instrument is not active, the Group establishes its fair value using a valuation technique. Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which observable market prices exist, Black-Scholes option pricing models and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group and the counterparty where appropriate.

Periodically, the Group tests the valuation techniques and calibrates against historical data and using prices from observable current market transactions for the same instrument, or based on other available observable market data.

Changes in the fair value of financial assets and financial liabilities are recognised in profit or loss in the line item "Net financial income (expense)".

The Group has an established control framework with respect to the measurement of fair values. The business unit owning the positions is responsible for their valuations and for submitting the valuation to the Bank's Investment Committee for approval. Risk Management provides an independent review of the results, the valuation methods used and of the use of significant unobservable inputs. The final decision on the validity of the valuation is in the hands of the Bank's Investment Committee.

Impairment of financial assets

The impairment model of IFRS 9 is forward-looking and impairment under IFRS 9 should reflect a probability weighted average of possible outcomes. In addition, the expected credit loss model in IFRS 9 employs a dual measurement approach, under which the loss allowance for expected credit losses (ECL) is measured at each reporting date as either 12-month expected credit losses or lifetime expected credit losses, depending on whether there has been a significant increase in credit risk (SICR) of the financial instrument since initial recognition. To satisfy the provisions of the IFRS 9 standard, a significant amount of modelling must be involved. The models which the Group uses for the calculation of the impairment amount are developed according to the Group's modelling framework. This framework imposes structure on the initial model development work, the model documentation including educational material as needed for users, the approval process for models, the implementation of models and the lifetime support for models, including validation and back-testing. The Group's impairment process, which encompasses all the steps needed to derive the appropriate impairment allowance for each accounting period, is documented and approved by the All Risk Committee.

66.3 Cont'd

Stage assignment

At each reporting date, all assets subject to the impairment methodology must be divided into three groups, termed "Stages", reflecting the extent of credit deterioration since initial recognition. This division then has an effect on how the impairment is measured and how interest is recognised.

Stage 1

All assets that have not experienced an SICR are assigned to Stage 1. For these assets, an impairment allowance is recognised which is equal to the expected credit loss arising from credit events occurring within 12 months of the reporting date (12- month ECL). Interest is recognised on the gross carrying amount of the assets.

Stage 2

Assets that the Group determines to have experienced an SICR, but are not credit-impaired, are classified as Stage 2. For these assets, an impairment allowance is recognised which is equal to the expected credit loss arising from all credit events occurring within the expected lifetime of the assets (lifetime ECL). Interest is recognised on the gross carrying amount of the assets.

The Group's definition of an SICR is on the level of an individual asset. The Group assesses that there has been a significant increase in credit risk of an asset if the probability of a credit impairment event, i.e. transfer to Stage 3, occurring over the lifetime of the asset has increased significantly from the origination of the assets. For this purpose, origination does not refer to any modification events which have not resulted in derecognition of the asset. The assessment is based on a defined set of triggers. This includes, as a backstop, the trigger that the asset is more than thirty days past due. Other triggers are internal assessments of outlook, events such as forbearance events which are less severe than a credit event, external credit related information and a significant deterioration in risk assessment compared with the risk assessment done in relation to the origination of the asset. The definition of SICR depends only on the probability of a credit event occurring, it does not take into account collateralisation or any other information related to the expected loss arising from the event. As soon as all triggers for Stage 2 for a particular asset are no longer activated then the asset moves back to Stage 1. Additionally, assets are classed as forborne for two years after a forbearance event has occurred, but forbearance events only cause assets to be in Stage 2 for six months and then they migrate back to Stage 1 unless other triggers apply.

The Group does not employ the low credit risk exemption in the Stage assignment process. In alignment with its operating procedures, the Group has chosen as its accounting policy to measure the impairment allowance for lease receivables at an amount equal to the lifetime ECL only for those assets which have an SICR or are credit-impaired. For other lease receivables the impairment allowance is equal to the 12-month ECL.

Stage 3

This Stage is for assets which are credit-impaired according to the Group's assessment. These assets are therefore experiencing an ongoing credit event. Thus, the 12-month ECL and lifetime ECL are the same amount and this amount is recognised as impairment allowance. For assets in this Stage, interest is recognised on the carrying amount of assets, i.e. net of impairment allowance.

The Group's definition of being credit-impaired is on a customer level, rather than on the level of an individual asset. According to the definition, a customer is credit-impaired when either of the following holds:
a) The Group assesses that it is unlikely that the customer can service all of their commitments to the Group in accordance with the terms of the agreements without recourse to default provisions in the agreements, or
b) The customer is more than 90 days past due on any of their commitments

The assessment in point a) is made based on a defined set of triggers, which includes serious breach of covenants, serious registrations on an internal watchlist, initiation of serious collection actions and serious external credit related information.

Furthermore, there is a defined set of conditions which must be satisfied so that customers that have been assessed as being credit-impaired are no longer subject to this assessment. This includes probation periods and a view to the future outlook of the customer.

Expected credit loss (ECL)

The ECL for each asset is calculated using models for the probability of a credit impairment event occurring (PD), the loss percentage expected in case of such an event (LGD) and the outstanding amount at the time of the event (EAD). In its simplest form the ECL can be calculated as the product of these factors, however, for several reasons, the actual formula must be more complicated than this.

The Group uses the standardised approach for regulatory capital purposes but has used PD models and LGD models for risk management purposes for several years. These models have been adapted for IFRS 9 purposes. For EAD, and for LGD to a certain extent, new models have been developed.

Notes to the Consolidated Financial Statements

66.3 Cont'd

The PD models are either fully automated statistical models, expert models or hybrid. For the models with a component involving expert input there is a process in place to ensure proper review of the model outcome and periodic reassessment of obligors. The inputs into the models include demographic variables, information from financial statements and past payment behaviour, among other variables.

The effects of the economy on the PD is accounted for with the use of scaling factors which map through-the-cycle PD values to point-in-time PD values. The Group has a model to predict these scaling factors based on an economic forecast. The economic forecast is provided by the Group's Chief Economist. The forecast predicts a range of macroeconomic indicators over a horizon of five years. The model is applied to a subset of these indicators and produces a set of scaling factors. The scaling factors are then reviewed by the All Risk Committee with respect to all of the indicators and any other relevant information available and the committee approves their use for the calculation of the impairment. This process is carried out at least quarterly. The Group uses three economic scenarios. In addition to the base forecast, scaling factors are produced for a bull and bear case. This is done in order to represent the whole range of possible future economic developments. The actual impairment allowance is the weighted average of the ECL in these different scenarios.

The table below shows macroeconomic indicators of the Group's Chief Economist's macroeconomic forecast

Change in economic indicators %	2019	2020	2021	2022	2023
Economic growth	(0.1)	1.3	2.8	2.5	2.5
Housing prices in Iceland	3.1	2.8	3.3	3.5	3.5
Purchasing power	1.8	1.9	2.4	2.1	2.2
ISK exchange rate index	8.8	0.3	-	-	-
Policy rate, Central Bank of Iceland	3.9	3.3	3.7	4.0	4.0
Inflation	3.1	2.6	2.8	2.6	2.5
Capital formation	(6.5)	5.7	4.5	4.1	4.1
thereof capital formation in industry	(16.5)	5.5	4.0	4.5	4.5

The LGD model considers several scenarios for how a facility may develop once a credit event has occurred. One possibility is that the facility cures without a loss. If not, the recoveries may be based on the seizing of collateral and to estimate such recoveries, several scenarios for the development of the value of the collateral are considered. Finally, there may be recoveries even though a formal collateral is not in place. These different recovery scenarios are weighted differently depending on the economic scenario under consideration. This leads to a non-linear interaction and thus a difference between the probability weighted average ECL and the ECL in the most likely scenario.

For EAD it is necessary to account for expected prepayments on term loans and for the expected utilisation of commitments such as credit cards, overdrafts, financial guarantees and credit lines. The expected lifetime of agreements may also extend beyond the contractual lifetime for contracts which are generally extended.

Write-off policy
The Group writes off a financial asset, either partially or in full, when there is no realistic prospect of recovery. Where financial assets are secured, write-off is generally after receipt of any proceeds from the realisation of security. In subsequent periods, any recoveries of amounts previously written off are credited to the income statement.

The impairment process
In the Group's impairment framework, the Stage assignment and ECL for each financial asset is calculated from the aforementioned models. The outcome is reviewed by the business units and they can propose changes if they provide sufficient supporting material. The impairment and any proposals for changes are reviewed by an Impairment Council appointed by the All Risk Committee and the impairment allowance is approved by the All Risk Committee on a quarterly basis.

The principle of materiality applies to the above discussion on impairment, whereby exceptions related to non-materiality and immaterial adjustments are not discussed.

66.4 Derivative financial instruments

Derivatives are primarily used in trading activities but are also used to manage the Group's exposure to various risks, such as interest rate risk, inflation risk and currency risk. Derivatives which do not classify as equity instruments of the Group are classified as financial assets or financial liabilities, measured at fair value and presented in the statement of financial position in separate line items as assets or liabilities, depending on whether their fair value at the reporting date is positive (assets) or negative (liabilities).

The Group applies hedge accounting. Accordingly, some of the Group's derivative financial assets and financial liabilities are accounted for as financial assets or financial liabilities mandatorily at fair value through profit or loss while others are accounted for as derivative assets or liabilities held for hedging (see Note 66.3 and Note 66.5).

When derivatives are embedded in other financial instruments or host contracts, such combinations are known as hybrid instruments with the effect that some of the cash flows of a hybrid instrument vary in a way similar to a stand-alone derivative. These embedded derivatives are measured and presented in the consolidated financial statements as if they were free-standing derivatives. The Group accounts for an embedded derivative separately from the host contract when, the host contract is not an asset in the scope of IFRS 9, is not carried at fair value through profit or loss, the terms of the embedded derivative would meet the definition of a derivative if they were contained in a separate contract, and the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract. When the Group is required to separate and account for embedded derivatives as if they were stand-alone contracts, the Group presents the fair value of the embedded derivatives in the statement of financial position in the same line items in which the Group presents the related host contracts.

66.5 Fair value hedge accounting

The Group applies fair value hedge accounting with respect to designated hedging relationships consisting of certain fixed-rate euro denominated bonds as the hedged items and certain euro denominated interest rate swaps as the hedging instruments, whereby the Group pays floating rate interest and receives fixed rate interest. The hedging relationships are designated and accounted for as fair value hedges because the interest rate swaps are hedging the exposure of the Group to changes in the fair value of the bonds arising from changes in interest rates. The Group recognises the changes in the fair value of the interest rate swaps immediately in profit or loss together with the changes in the fair value of the bonds which are attributable to the interest rate risk. The changes in the clean fair value of the swaps and the notes are included in the line item “Net financial income (expense)”, the accrued interest on the notes and the swaps is included in the line item “Interest expense” and foreign exchange gains and losses on the notes are included in the line item "Net foreign exchange gain (loss)".

On initial designation of the hedges, the Group formally documented the relationship between the hedging instruments and hedged items, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationships. The Group makes an assessment, both at inception of the hedge relationships and on an ongoing basis, of whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value of the hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within the range of 80-125%.

If a hedging derivative expires or is sold, terminated or exercised, or a hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, then hedge accounting for the corresponding hedging relationship is discontinued prospectively. Any adjustment up to the point of discontinuation to a hedged item for which the effective interest method is used is amortised to profit or loss as part of the recalculated effective interest rate of the item over its remaining life.

66.6 Cash and cash equivalents

Cash and cash equivalents in the statement of cash flows consist of cash on hand, demand and term deposits with the Central Bank, demand deposits with credit institutions, and short-term loans to credit institutions. Cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, that are subject to an insignificant risk of changes in their fair value and which are used by the Group in the management of its short-term cash commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position and at the reporting date the expected credit loss is considered to be low. Impairment losses and reversals of impairment losses are recognised in profit or loss in the line item "Net impairment on financial assets".

66.7 Investments in associates

Associates are entities over which the Group has significant influence to participate in the financial and operating policy decisions of an entity, but has not control over those policies. It is presumed that the Group has significant influence if the Group holds 20-50% of the voting power of an entity.

The Group accounts for its investments in associates using the equity method. Under the equity method, investments in associates are initially recognised at cost. After the acquisition date the carrying amount of each investment is adjusted to recognise changes in the Group's share of net assets. Distributions received from an associate reduce the carrying amount of the investment. Goodwill relating to acquisitions of associates is included in the carrying amount of the investments and is not tested for impairment separately.

66.7 Cont'd

The consolidated financial statements of the Group include the Group's share of the profit or loss and other comprehensive income of associates, from the date that significant influence commences until the date that significant influence ceases.

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

After application of the equity method, the Group determines whether it is necessary to recognise an impairment loss on its investments in associates. At each reporting date, the Group determines whether there is objective evidence that individual investments in associates are impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying amount, and the impairment loss is recognised in profit or loss.

Upon loss of significant influence over an associate, the Group measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognised in profit or loss.

Income and expenses from investments in associates are recognised in profit or loss in the line item "Other operating income".

66.8 Property and equipment

Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses (see Note 66.21). Where parts of an item of property and equipment have different useful lives, those components are accounted for and depreciated as separate items of property and equipment.

Subsequent costs

The Group recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred, if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other costs are recognised in profit or loss as incurred.

Depreciation

Items of property and equipment are depreciated from the date they are available for use, except for land, which is not depreciated. The depreciable amount of each item of property and equipment is determined after deducting its residual value. Depreciation is recognised in profit or loss in the line item "Other operating expenses" on a straight-line basis over the estimated useful lives of each part of an item of property and equipment.

Right-of-use assets are included in the line item "Property and equipment" (see Note 66.10).

The estimated useful lives are as follows:

Buildings	50 years
Right-of-use assets	3-31 years
Fixtures	6-12 years
Equipment	4-5 years
Vehicles	3 years

The depreciation method, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

66.9 Intangible assets

Software

Software acquired by the Group is measured at cost less accumulated amortisation and impairment losses. Expenditure on internally developed software is recognised as an asset when the Group is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits, and can reliably measure the costs to complete the development. The capitalised costs of internally developed software include all costs directly attributable to developing the software and capitalised borrowing costs, and are amortised over its useful life. Internally developed software is carried at capitalised cost less accumulated amortisation and impairment losses.

Subsequent expenditure on software assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred. Software is amortised on a straight-line basis over its estimated useful live from the date that it is available for use. The amortisation is recognised in profit or loss in the line item "Other operating expenses". The estimated useful life of software is four to ten years.

66.9 Cont'd

Goodwill

The Group recognises any goodwill arising from a business combination as an asset and measures it initially at cost, being the positive difference between (a) the aggregate of the consideration transferred, the amount of any non-controlling interest and the acquisition-date fair value of the Group's previously held equity interest in the acquiree and (b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed by the Group. After initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is tested by the Group for impairment annually or whenever there is an indication that it may be impaired.

66.10 Leases

The Group as a lessee

At the inception of a contract, the Group assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The Group has elected not to separate non-lease components and account for lease and non-lease components of a contract as a single lease component.

The Group recognises a lease liability and a right-of-use asset at the lease commencement date. The Group has elected not to recognise right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The Group recognises lease payments associated with these leases as an expense on a straight-line basis over the lease term.

Lease liabilities

The lease liability is initially measured at the present value of the lease payments, both fixed and variable, discounted using the entity's incremental borrowing rate. The incremental borrowing rate is the rate of interest the Group would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The incremental borrowing rate is subject to estimation when no observable rates are available. The lease liability is measured at amortised cost using the effective interest method and remeasured when there is a change in future payments, e.g. arising from a change in an index or an assessment of whether extension or termination options will be exercised. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made.

The lease term is determined by the Group as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised. An assessment of whether the entity will exercise an extension or termination option is made by management annually. If the assessment of whether the Group will exercise an extension or termination option changes after the commencement date the lease liability is remeasured and a corresponding adjustment is made to the carrying amount of the right-of-use asset.

Right-of-use assets

The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred less any lease incentives received. For any remeasurement of the lease liability a corresponding adjustment is made to the carrying amount of the right-of-use asset or recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero. The right-of-use-asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. Right-of-use assets are subject to impairment.

If a lease modification increases the scope of the lease by adding a right to use of one or more underlying assets and the consideration for the lease increases by an amount commensurate with the stand-alone price for the increased scope and any adjustments to the price that reflects the circumstances of the particular contract, then the modification is accounted for as a separate lease. For lease modifications that are not accounted for as separate leases the lease term of the modified lease is redetermined and the lease liability remeasured using the revised lease payments and discounted using the incremental borrowing rate at the effective date of modification. Any adjustment of the lease liability is then correspondingly made to the right-of-use asset.

The Group presents right-of-use assets in the line item "Property and equipment" and lease liabilities in the line item "Other liabilities" in the statement of financial position. Maturity analysis of lease liabilities is disclosed in Note 55. Interest on lease liabilities is recognised in profit or loss in the line item "Interest expense". Depreciation of right-of-use assets is recognised in profit or loss in the line item "Other operating expenses".

Notes to the Consolidated Financial Statements

66.10 Cont'd

The Group as a lessor

The Group classifies leases based on the substance of the arrangements and the extent of the transfer of risks and rewards incidental to ownership of the leased asset. A lease is classified as an operating lease if the lessor does not transfer substantially all the risks and rewards incidental to ownership. A lease is classified as a finance lease if the lessor transfers substantially all the risks and rewards incidental to ownership.

When the Group is the lessor in a capital lease, the Group recognises a receivable equal to the net investment in the lease and presents it in the line item "Loans to customers" in the statement of financial position. The Group applies its accounting policies for derecognition and impairment of financial assets also to its capital lease receivables. The Group recognises the finance income from capital lease receivables in profit or loss in the line item "Interest revenue" over the period of the capital lease so as to give a constant periodic rate of return on the net investment in the capital lease.

When the Group is lessor in arrangements which involve the legal form of capital leases, but which in substance do not involve leases, the Group classifies them within loans at amortised cost.

66.11 Non-current assets and disposal groups held for sale

Non-current assets and disposal groups are classified as held for sale if the Group expects to recover their carrying amount principally through a sale transaction rather than through continuing use. For this to be the case, the assets, or disposal groups, must be available for immediate sale in their present condition subject only to terms that are usual and customary for sales of such assets, or disposal groups, and their sale must be highly probable. Non-current assets and disposal groups are presented in the line item "Other assets" and Non-current liabilities and disposal groups are presented in the line item "Other liabilities".

Immediately before the initial classification as held for sale, the assets, or components of disposal groups, are remeasured in accordance with applicable accounting policies. Thereafter, the assets, or disposal groups, are measured at the lower of their carrying amount and fair value less costs to sell, except for deferred tax assets and financial assets, which are measured in accordance with the accounting policies of the Group applicable to those assets. Once classified as held for sale, intangible assets are no longer amortised, property and equipment are no longer depreciated and investments in associates are no longer equity accounted. Liabilities associated with assets classified as held for sale are measured in accordance with the accounting policies of the Group applicable to those liabilities.

Income and expenses of non-current assets and disposal groups held for sale are recognised in profit or loss in the line item "Discontinued operations, net of income tax" (see Note 66.23).

66.12 Loan commitments and financial guarantees

Loan commitments are firm commitments of the Group to provide credit under pre-specified terms and conditions. Expected credit loss of loan commitments (see Note 66.3) is recognised in the statement of financial position in the line item "Other liabilities". Loan commitment fees received by the Group are recognised in profit or loss in the line item "Fee and commission income".

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Financial guarantees are issued by the Group to credit institutions and other parties on behalf of its customers so that they can secure loans, overdrafts and banking facilities.

Liabilities arising from financial guarantees issued by the Group are initially measured at their fair value, being the premium received. Subsequently the liabilities are carried at the higher of the amount representing the initial fair value of the guarantee and the expected credit loss allowance of the guarantee (see Note 66.3). Any changes in the liabilities arising from financial guarantees are recognised in profit or loss. The premium received is recognised in profit or loss in the line item "Fee and commission income".

66.13 Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, if it is probable that the Group will be required to settle the obligation with an outflow of resources, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows. When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that the reimbursement will be received and the amount of the receivable can be measured reliably.

66.14 Employee benefits

All Group entities are required to pay, on a mandatory and contractual basis, contributions to public and private pension funds. The Group has no further payment obligations once these contributions have been paid. The Group recognises these contributions as salary related expenses when they become due. The Group does not have a defined benefit pension plan.

Short-term employee benefits include salaries, cash bonuses, non-monetary benefits and compensated absences. Short-term employee benefit obligations are expensed by the Group as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

66.15 Equity

Share capital

The share capital disclosed in the consolidated financial statements represents the total nominal value of ordinary shares issued by the Bank. Incremental costs directly attributable to the issuance of ordinary shares are recognised as a deduction from equity, net of any tax effects.

Dividends on shares

Dividends payable to shareholders of the Bank are recognised as a liability and deducted from equity in the period in which the dividends are approved by the shareholders at the Bank's Annual General meeting. Dividends payable to non-controlling shareholders in subsidiaries are recognised as a liability and deducted from equity in the period in which the dividends are approved by the shareholders' meeting of the subsidiaries. Dividends declared after the reporting date are not recognised as a liability at the reporting date.

Statutory reserve

According to the Act on Public Limited Companies no. 2/1995 the statutory reserve shall amount to 25% of the share capital of the Bank.

Restricted reserves

The Group is to transfer, if applicable, certain amounts from retained earnings to restricted reserves which can therefore not be distributed as dividends to shareholders. These restricted reserves are specified as follows:

Restricted reserve due to capitalised development costs

When the Group capitalises development cost it transfers a corresponding amount from retained earnings to a restricted reserve. In the future the restricted amount is to be transferred back to retained earnings as the capitalised development cost is amortised in profit or loss.

Restricted reserve due to fair value changes of financial assets

The Group transfers fair value changes of financial assets at fair value through profit or loss, net of tax if applicable, from retained earnings to a restricted reserve. Amounts recognised in the reserve are transferred back to retained earnings upon sale of the financial asset.

Restricted reserve due to unrealised profit of subsidiaries and associates

If share of profit of a subsidiary or an associated company is in excess of dividend received or which can be claimed, the Group transfers the difference to a restricted reserve in equity. If the Group's shareholding in a subsidiary or an associate is sold or written off the applicable amount recognised in the reserve is transferred to retained earnings.

Fair value reserve

Fair value reserve comprises all unrealised gains or losses related to fair value changes of equity instruments classified at fair value through other comprehensive income. On derecognition of the equity instruments fair value changes are not reclassified to profit and loss.

Liability credit reserve

Changes in fair value attributable to changes in the credit risk of financial liabilities designated as at fair value through profit or loss are recognised in liability credit reserve. On derecognition the fair value changes are not reclassified to profit or loss.

66.16 Interest income and interest expense

For all financial assets and financial liabilities measured at amortised cost, interest income and interest expense are recognised in profit or loss using the effective interest method.

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 a shorter period, when appropriate, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows, considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation generally includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, as well as transaction costs and all other premiums or discounts.

The effective interest rate is established on initial recognition of financial assets and financial liabilities and their carrying amount is subsequently adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate. The change in carrying amount is recorded as interest income or interest expense. For floating rate instruments, interest income or interest expense is generally recognised based on the current market rate plus or minus amortisation or accretion of the discount or premium based on the original effective interest rate.

Interest on impaired financial assets is calculated by applying the original effective interest rate of the financial asset. For financial assets in Stage 1 and Stage 2 interest is recognised on the gross carrying amount of the assets and for financial assets in Stage 3 interest is recognised on the gross carrying amount of the assets, net of impairment allowance (see Note 66.3).

Interest income and interest expense include gains and losses on derecognition of financial assets and financial liabilities measured at amortised cost.

For financial assets and financial liabilities at fair value through profit and loss, interest income and interest expense are recognised through profit or loss on an accrual basis, except for financial liabilities at fair value through profit or loss (see Note 66.3).

Accrued interest on interest rate swaps, which are designated and accounted for as hedging instruments in fair value hedges of the interest rate risk arising from certain fixed-rate euro denominated bonds issued by the Group (see Note 66.5), is recognised in profit or loss as an adjustment to the interest expense recognised for the bonds.

66.17 Net fee and commission income

Fees and commissions are recognised to reflect the transfer of services to customers at an amount that reflects the consideration that is expected to be received for such services. Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or financial liability are included in the measurement of the effective interest rate.

Fees for loan commitments that are likely to be utilised are recognised as an adjustment to the effective interest rate of the loan. When a loan commitment is not expected to be utilised, fees are recognised in profit or loss on a straight-line basis over the commitment period.

Loan syndication fees are recognised as revenue in profit or loss when the syndication has been completed and the Group has retained no part of the loan package for itself or has retained a part at the same effective interest rate as the other participants.

Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as the arrangement of the acquisition of shares or other securities, or the purchase or sale of businesses, are recognised on completion of the underlying transaction.

Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportionate basis.

Asset management fees related to investment funds are recognised rateably over the period in which the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time. Performance-linked fees or fee components are recognised when the performance criteria are fulfilled.

Where it is assessed that the Group is acting as an agent, the consideration is presented on a net basis.

66.18 Net financial income (expense)

Net financial income (expense) consists of net gain (loss) on financial assets and financial liabilities mandatorily at fair value through profit or loss, net gain (loss) on financial liabilities designated as at fair value through profit or loss and net gain (loss) on fair value hedges.

66.18 Cont'd

Net gain (loss) on financial assets and financial liabilities mandatorily at fair value through profit or loss
Net gain (loss) on financial assets and financial liabilities mandatorily at fair value through profit or loss includes all realised and unrealised fair value changes of financial assets and financial liabilities classified by the Group as mandatorily at fair value through profit or loss, except for interest income and interest expense, which are included in the line items "Interest income" and "Interest expense", and foreign exchange gains and losses, which are included in the line item "Net foreign exchange gain (loss)". Dividend income from financial assets is recognised in the income statement when the Group's right to receive payment is established.

Net gain (loss) on financial liabilities designated as at fair value through profit or loss
Net gain (loss) on financial liabilities designated at fair value through profit or loss includes all realised and unrealised fair value changes of financial liabilities designated by the Group as at fair value through profit or loss, except for changes in fair value attributable to changes in credit risk which is recognised in other comprehensive income, interest incurred which is recognised as "Interest expense" using the effective interest rate method, and foreign exchange gains and losses which are included in the line item "Net foreign exchange gain (loss)".

Net gain (loss) on fair value hedges
Net gain (loss) on fair value hedges includes the changes in the clean fair value of interest rate swaps which are designated and accounted for as hedging instruments in fair value hedges and the changes in the fair value of certain bonds issued by the Group, which are attributable to the interest rate risk of the bonds (see Note 66.5).

66.19 Net foreign exchange gain (loss)

Net foreign exchange gain (loss) disclosed as a separate line item in the income statement comprises all foreign exchange differences arising on the settlement of foreign currency monetary assets and liabilities and on translating foreign currency monetary assets and liabilities at rates different from those at which they were translated on initial recognition during the year or in previous financial statements. Net foreign exchange gain (loss) also includes foreign exchange differences arising on translating non-monetary assets and liabilities which are measured by the Group at fair value in foreign currencies.

66.20 Operating expenses

Operating expenses consist of professional services, information system related expenses, housing expenses, depreciation of property and equipment, amortisation of intangible assets and other operating expenses, such as advertising expenses, office expenses and various public expenses.

66.21 Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the Group estimates the recoverable amount of the asset.

An impairment loss is recognised in profit or loss if the carrying amount of an asset or cash-generating unit exceeds its estimated recoverable amount.

An impairment loss for non-financial assets is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. An impairment loss in respect of goodwill is never reversed.

66.22 Taxes

Income tax expense
Income tax expense comprises special financial activities tax, current tax and deferred tax and is disclosed as a separate line item in the income statement. Income tax expense from discontinued operations is included in the income statement in the line item "Profit (loss) from discontinued operations, net of income tax" (see Note 66.23). Income tax is recognised in profit or loss, except to the extent that it relates to items recognised directly in equity, consistent with the recognition of the underlying item to which it relates.

Bank tax
Bank tax is calculated as 0.376% (2018: 0.376%) of total liabilities at year-end as determined for tax purposes, in excess of ISK 50,000 million, excluding tax liabilities. The Bank tax is considered a non-deductible expense for the calculation of income tax. The Bank tax is shown in a separate line in the income statement and is included in the statement of financial position in the line item "Tax liabilities".

Notes to the Consolidated Financial Statements

66.22 Cont'd

Special financial activities tax

Special financial activities tax is calculated as 6% of taxable profit exceeding ISK 1,000 million. Special financial activities tax is included in the statement of financial position in the line item "Tax liabilities".

Current tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Current tax assets and current tax liabilities are offset in the statement of financial position if the Group has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously. Current tax is included in the statement of financial position in the line item "Tax liabilities".

Deferred tax

Deferred tax is recognised based on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred taxes are not recognised if it arises from the initial recognition of an asset or liability, in a transaction other than a business combination, that at the time of the transaction affects neither the taxable profit nor the accounting profit. In addition, deferred taxes are not recognised if the temporary difference arises from the initial recognition of goodwill.

Deferred tax is measured using tax rates enacted or substantially enacted at the reporting date and are expected to apply when the deferred tax asset is realised or the deferred tax liability is settled.

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

Deferred tax liabilities are included in the statement of financial position in the line item "Tax liabilities" and deferred tax assets are included in the statement of financial position in the line item "Other assets". Deferred taxes that are part of discontinued operations (see Note 66.11) are included in the line items "Other assets" and "Other liabilities", respectively, in the statement of financial position.

Deferred tax assets and deferred tax liabilities are offset in the statement of financial position if the Group has a legally enforceable right to set off current tax assets against current tax liabilities, and the deferred taxes relate to taxes levied by the same taxation authority on either, the same taxable entity, or on different taxable entities which intend to settle the taxes on a net basis or their tax assets and liabilities will be realised simultaneously.

66.23 Discontinued operations, net of income tax

Discontinued operations, net of income tax, are disclosed as a separate line item in the income statement and consist of (i) the post-tax profit or loss from foreclosed assets and disposal groups held for sale, (ii) gain or loss recognised on the measurement to fair value less costs to sell in excess of book value of foreclosed assets, and (iii) profit or loss from sale of foreclosed assets and disposal groups held for sale.

66.24 Offsetting

Financial assets and financial liabilities are set off and the net amount reported in the statement of financial position when, and only when, the Group has a legal right to offset the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

The Group presents income and expenses on a net basis in the income statement only when required or permitted by the accounting standards.

66.25 Earnings per share

The Group presents basic and diluted earnings per share for its ordinary shares. Basic earnings per share are calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share are determined by adjusting the profit or loss attributable to ordinary shareholders of the Bank and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, if any.

66.26 Segment reporting

An operating segment is a distinguishable component of the Group, for which discrete financial information is available, that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. Each operating segment is engaged in providing products or services which are subject to risk and return that are different from those of other operating segments. The segments' operating result are reported to the Board of Directors and the Chief Executive Officer, for the purpose of resource allocation and assessment of segment performance.

Íslandsbanki's Corporate Governance Statement 2019

Unaudited

Unaudited Appendix: Corporate Governance Statement 2019

The Board of Directors of Íslandsbanki is committed to excellence in corporate governance complying with the applicable regulatory standards and best international practices in the field of corporate governance.

Íslandsbanki's governance practises are consistent with general corporate governance guidelines for entities regulated by official supervisors and regulatory instruments. The regulatory framework for corporate governance practices within Íslandsbanki consists of the law applicable to entities subject to the supervision of the Financial Supervisory Authority (FME) as well as other applicable law and regulations, including those imposed by the FME and Nasdaq Iceland, available at their respective websites (www.fme.is and www.nasdaqomxnordic.com). The applicable law includes, inter alia, the Act on Financial Undertakings no. 161/2002, the Act on Securities Transactions no. 108/2007, the Act on Competition no. 44/2005 and the Act on Public Limited Companies no. 2/1995, which along with the Íslandsbanki's Articles of Association lay the foundation for the Bank’s existence and activities. The relevant law is available on the Icelandic legislature’s website (www.althingi.is).

Exemplary in Corporate Governance

Íslandsbanki is committed to maintaining high standards of governance complying with best governance practices. Íslandsbanki was first recognised as “Exemplary in Corporate Governance” in March 2014 by the Centre of Corporate Governance at the Institute for Business Research, University of Iceland. The recognition was awarded following a comprehensive review of the practices of the Board, Board subcommittees and management. The recognition has been renewed annually since.

Íslandsbanki maintains a Matrix for material bank actions, which outlines all major decisions the Bank may wish to take under given circumstances. The policy is a part of the Bank's effort to improve its material actions and enhance stakeholders' trust. The Matrix for material bank actions sets specific conditions to all major decision-making and requires that all such decisions be taken after consultation with the relevant parties within the Bank and on the basis of the best information available at the time.

Compliance with Corporate Governance Guidelines

The Board of Directors follows the Corporate Governance Guidelines (5th ed.) issued by the Iceland Chamber of Commerce, Nasdaq Iceland and SA-Business Iceland (hereinafter the Guidelines), in accordance with Paragraph 7 of Article 54 of the Act on Financial Undertakings no. 161/2002. The Guidelines are available on www.corporategovernance.is. Governance practices of the Bank are consistent with the Guidelines. Íslandsbanki is in full compliance with them except for Article 1.5.

In accordance with Article 1.5 of the Guidelines the shareholders' meeting shall appoint members to a nomination committee or decide how they should be appointed. The Bank's shareholders, as well as the Board, have not deemed it necessary to appoint a nomination committee while the Icelandic Government is the sole owner of the Bank. Board members are nominated by the Icelandic State Financial Investments (ISFI) through a selection process administered by the ISFI in accordance with article 7 of Act no. 88/2009 on the Icelandic State Financial Investments.

Main aspects of Risk Management and Internal Control

Internal Control

The risk management and internal control framework of the Bank is based on the three-lines-of-defence model, as referred to in the European Banking Authority’s Guidelines on Internal Governance and aims for informed decision-making and strong risk awareness throughout the Bank. The framework is intended to ensure effective and efficient operations, adequate control of risks, prudent conduct of business, reliability of financial and non-financial information reported internally and externally, and compliance with laws, regulations, supervisory requirements and the Bank's internal rules.

The first line of defence consists of the Bank's business and support units; the second line of defence is comprised of the Bank's internal control units, Risk Management and Compliance; and the third line of defence is Group Internal Audit which keeps the Board and management informed of the quality of corporate governance, risk management and internal controls, including by performing independent and objective audits.

Risk Management

The Board of Directors approves the risk policy, risk appetite statement and procedure for risk management and ensures that internal procedures for risk management are revised at least annually.

The All Risk Committee, a Senior Management Committee, is comprised of the CEO, all the managing directors of the Bank and other members of management appointed by the CEO. The committee is responsible for the review and implementation of the risk management and internal control policies issued by the Board and monitors that the risk profile of the Bank is within the limits of the risk appetite statement of the Board of Directors. The ARC issues guidelines for risk assessment and individual risk thresholds or limits in accordance with Board approved risk appetite.

Further information on the Bank's risk management structure and internal control can be found in the Bank's unaudited Pillar 3 Report which is available on the Bank's website.

Unaudited Appendix: Corporate Governance Statement 2019

Audit and accounting

The CEO ensures that Directors of the Board are provided with accurate information on the Bank's finances, development and operations on a regular basis and the Board Audit Committee assists the Board in fulfilling its oversight responsibilities concerning the financial reporting process, the system of internal control and the audit process.

The Bank's Finance division is responsible for the preparation of the Group's consolidated financial statements in line with the International Financial Reporting Standards (IFRS) as adopted by the European Union and additional requirements in the Act on Annual Accounts no. 3/2006, the Act on Financial Undertakings no. 161/2002 and rules on accounting for credit institutions. The Board's Audit Committee gives its opinion on annual and interim consolidated financial statements before their submission for Board approval and endorsement. Management reporting is generally presented to the Board 10 times a year. The external auditors review the half year consolidated financial statements and audit the consolidated financial statements.

The consolidated financial statements are published on an annual and quarterly basis.

As is provided for in the Act on Financial Undertakings and the Bank’s Articles of Association, the Bank's external audit firm is elected at the AGM. At the 2016 AGM the Icelandic National Audit Office (INAO) was elected, for the first time, to serve as Íslandsbanki's independent external auditing firm, in accordance with Article 4 of Act no. 46/2016 on the Auditor General and the auditing of government accounts for a term of five years. The INAO has concluded an agreement and trusting Ernst & Young ehf. with carrying out the Bank's external audit on its behalf.

Group Internal Audit

The Chief Audit Executive is appointed by the Board, reports directly to the Board and directs Group Internal Audit with a mandate from the Board. Group Internal Audit operates independently from other departments in accordance with Article 16 of the Act on Financial Undertakings no. 161/2002. The department provides the Board with independent and objective assurance over the effectiveness of risk management, control and governance processes. The Chief Audit Executive is engaged by the Board and is responsible for internal audit on a group basis. The responsibilities and authorisations of the CAE and Group Internal Audit are further outlined in the Group Internal Audit Charter.

Compliance

The Bank's Compliance Officer is hired by the CEO, subject to Board confirmation, conferring the department's mandate. The Compliance officer maintains an independent position within the Bank's organisation and is responsible for monitoring and assessing regularly whether the Bank's operations, regarding securities transactions, are in compliance with applicable law. Furthermore, the Compliance Officer is responsible for assessing and monitoring the Bank's compliance with Act on Measures against Money Laundering and Terrorist Financing no. 64/2006 and the Bank's responsible officer under the US Foreign Account Tax Compliance Act (FATCA) and the OECD Common Reporting Standard (CRS). Moreover, the Compliance Officer is responsible for supervision of compliance risk within the Bank.

Íslandsbanki Values, Code of Conduct and Sustainability

In 2019 the Bank's strategy was revised and the employees of the Bank played a key role in its formulation. Our purpose is moving Iceland forward by empowering our customers to succeed. Íslandsbanki's values are the pillars of the Bank's corporate culture, shaping the conduct and attitudes of its employees. The values of Íslandsbanki are passion, professionalism and collaboration.

In October 2019 the Board approved a Code of Conduct for the Bank's employees. The aim of the code is to promote good operational practices. The document is available on the Bank's website.

Íslandsbanki seeks to work in harmony with the communities in which it operates and strives to have a positive impact in society. This participation in community programmes rests on Íslandsbanki's Sustainability Strategy which is set by the Board. The strategy covers five key areas: business, education, environment, workplace, and community. In addition, the Bank has decided to focus particularly on four of the UN world goals in its course of business, i.e. Climate Action, Gender Equality, Quality Education and Industry, Innovation and Infrastructure. Furthermore, the Bank produces an annual report, Íslandsbanki in the Community: Global Compact, which can be accessed on the Bank's website. For the last eight years Íslandsbanki has been a signatory to the UN Global Compact on social responsibility. The compact is a guide for companies on how to be socially responsible in practice.

The Bank has approved a sustainability policy which is focused on making its operations exemplary in the Iceland business environment based on established international ESG criteria. The Bank aspires to be a leader in sustainable development and to move Iceland forward by empowering its customers to succeed.

Board of Directors

The Board of Directors comprises seven non-executive directors, and two alternates, elected at each AGM for a term of one year. The Chairman of the Board is elected by the shareholders' meeting. There are no limitations on duration of Board membership.

The Board undertakes the Bank's affairs in between shareholders' meetings unless otherwise provided by law or the Bank's Articles of Association. The Board is responsible for setting the Bank's general strategy and instructs the CEO on its further implementation and execution. The Board has a supervisory role in that it oversees that the Bank's organisation and activities are at all times in accordance with the relevant law, regulations and good business practices. The CEO and Chief Audit Executive are hired by the Board.

Unaudited Appendix: Corporate Governance Statement 2019

The Rules of Procedure of the Board are adopted in accordance with Article 70 of the Act on Public Limited Companies no. 2/1995 and Article 54 of the Act on Financial Undertakings no. 161/2002. The Board's current rules of Procedure are available on the Bank's website. According to its Rules of Procedure, at meetings of the Board the presence of at least five members of the Board is required to constitute a quorum. The Board met 19 times in 2019, each time constituting a quorum.

Candidates for board membership are nominated through a selection process administered by ISFI in accordance with Article 7 of Act no. 88/2009 on Icelandic State Financial Investment. The Articles of Association of the Bank provide that the ratio of each gender on the Board of Directors shall not be lower than 40%, currently the Board is comprised of three women and four men. The Board has approved a policy on the suitability of the Board of Directors, the CEO and key function holders. The policy states, among other things, that the composition of the Board shall at any time be diverse, with regard to educational and professional background, gender and age.

The Board subcommittees

The Board subcommittees are three in total and they operate under the terms of a mandate letter from the Board as well as the Rules of Procedure of the Board. The mandate letters of the Board subcommittees are available on the Bank's website. The Board appoints the members of the subcommittees as well as their Chairman. When appointing the subcommittees, the Board shall take into account the expertise, skills and experience needed of a member to be appointed to the relevant subcommittee. All of the subcommittees are constituted of members of the Board.

The Board Audit Committee, comprising three Board members, assists the Board in fulfilling its oversight responsibilities concerning the financial reporting process, the system of internal control, the audit process and the Bank's process for monitoring compliance with the relevant laws and regulations and its code of conduct. The committee met 6 times in 2019, each time constituting a quorum.

The Board Risk Management Committee, comprising three Board members, assists the Board in providing oversight of senior management activities in managing risk relevant to the Bank's operations. This includes credit risk, market risk, operational risk, liquidity risk, compliance risk and reputational risk. The committee's responsibilities include the parent company, its subsidiaries and the whole Group. The committee met 10 times in 2019, each time constituting a quorum.

The Board Corporate Governance, Compensation and Human Resource Committee**,** comprising three Board members, assists the Board in overseeing the development and the regular assessment of the Bank's approach to corporate governance issues and board effectiveness. Furthermore, it is responsible for providing oversight regarding compensation and human resource issues. The committee met 8 times in 2019, each time constituting a quorum.

Structure and composition of Board subcommittees is as follows:

	Board Corporate Governance, Compensation and HR Committee	Audit Committee	Board Risk Management Committee
Friðrik Sophusson	Member		
Anna Þórðardóttir		Chair	
Auður Finnbogadóttir			Member
Árni Stefánsson			Chair
Hallgrímur Snorrason	Member	Member	
Heiðrún Jónsdóttir	Chair	Member	
Tómas Már Sigurðsson			Member

Chair Member

Members of the Board

Friðrik Sophusson, Chairman of the Board, (b. 1943), joined the Board in January 2010. Friðrik has comprehensive experience in fiscal policy-making, management, and public service in Iceland. He has also served on the board of several companies and institutions. He was Managing Director of the Icelandic Management Association from 1972 until 1978, when he was elected to Parliament. During his tenure as an MP, he held the position of Minister of Industry and Energy in 1987-1988 and Minister of Finance in 1991-1998. He was appointed CEO of Landsvirkjun, the National Power Company of Iceland, in 1999 and held that position for almost 11 years.

Friðrik holds a Cand. Jur. from the University of Iceland.

Sub-Committees: Member of the Board Corporate Governance, Compensation and Human Resource Committee.

Unaudited Appendix: Corporate Governance Statement 2019

Anna Þórðardóttir (b. 1960) joined the Board in April 2016. She has been a board member of a number of companies and organisations, including KPMG and the Institute of State Authorised Public Accountants in Iceland. She is currently a member of the board of The Icelandic Center for Future Studies (Framtíðarsetur Íslands) and is chairman of the Board Audit Committee of Hagar and a member of the Audit Committee of Heimavellir. Anna was an employee of KPMG in 1988-2015, where she became partner in 1999. While at KPMG, she was responsible for the audit of the following companies: Reitir, Hagar, 365, Baugur Group, Vodafone, Landfestar, Landey, 10-11 and Félagsbústaðir.

Anna holds a Cand Oecon. in Business Administration from the University of Iceland and is a Chartered Accountant. She has also studied towards a Cand. Merc in Financial studies from Handelhøjskolen in Aarhus, Denmark.

Sub-Committees: Chairman of the Board Audit Committee.

Auður Finnbogadóttir (b. 1967) joined the Board in April 2016. She is a project manager of strategy at Kópavogur municipality. She has extensive experience of working in the financial markets and has served on the board of several companies and institutions. She was Managing Director for MP Bank, Lífsverk pension fund and the pension fund for employees of Kópavogur municipality. She has served as chairman of the board of the Competition Authority in Iceland and Norðlenska Ltd., a production and marketing firm for agricultural products. She has been a member of the board of the Iceland Enterprise Investment Fund, Icelandair Group, Nýi Kaupþing banki, RÚV, the Icelandic National Broadcasting service and Landsnet, the electric transmission grid company of Iceland. She serves as a member of a governmental committee, the Procurement Complaints Committee.

Auður holds an MBA from Reykjavik University and a B.Sc. in International Business from the University of Colorado at Boulder. She completed a diploma program in Public Administration in spring 2018 and is a licensed securities broker by the Icelandic Ministry of Finance and Economic Affairs.

Sub-Committees: Member of the Board Risk Management Committee.

Árni Stefánsson (b. 1966) joined the Board in April 2016. He has extensive management experience in power-intensive industry in Iceland and is currently manager and member of the executive board at the Rio Tinto primary aluminium plant. Previously, he was a manager of the Century Aluminium plant Norðurál in Grundartangi; manager and in the executive board with Landsnet, the electric transmission grid company of Iceland; and manager with Landsvirkjun, the National Power Company of Iceland.

Árni holds an M.Sc. in Electrical Engineering.

Sub-Committees: Chairman of the Board Risk Management Committee.

Hallgrímur Snorrason (b. 1947) joined the Board in April 2016. An independent consultant in official statistics, he was Director-General of Statistics Iceland in 1985-2007 and Deputy Managing Director of the National Economic Institute of Iceland in 1980-1984. Has been a member of the board of several companies, including Útvegsbanki Íslands, Skýrr and Auður Capital. He has also chaired or served on a number of governmental committees, both domestically and in connection with Nordic cooperation, EFTA, EU and the OECD.

Hallgrímur holds a M.Sc. in Economics from the University of Lund in Sweden and a B.Sc. in Economics from the University of Edinburgh, UK.

Sub-Committees: Member of the Board Corporate Governance, Compensation and Human Resource Committee and the Board Audit Committee.

Heiðrún Jónsdóttir (b. 1969) joined the Board in April 2016. She is an attorney at law with Múli Legal Services and serves as a member of the board of Icelandair Group and Reginn, real estate company. Previously, she was Managing Director at Eimskipafélag Íslands, Lex Legal Services, and Legal and Human Resources at KEA. She has been chairman of the board at Norðlenska, Íslensk Verðbréf and Gildi pension fund and has been a member of the board of Síminn, Olíuverzlun Íslands, the Icelandic Banks' Data Centre (RB), Ístak, the securities depository Arion Verðbréfavarsla, Þekking, the Icelandic Pension Funds Association. Heiðrún served as a board member of the board of the Icelandic Bar Association from 2016 -2019 and was the deputy chairman of the board from 2018-2019.

Heiðrún holds a Cand. Jur from the University of Iceland and is a securities broker licensed by the Icelandic Ministry of Finance and Economic Affairs. She completed an Advanced Management Program (AMP) at IESE Business School in Barcelona in 2017.

Sub-Committees: Chairman of the Board Corporate Governance, Compensation and Human Resource Committee and a member of the Board Audit Committee.

Tómas Már Sigurðsson Vice Chairman of the Board, (b. 1968) joined the Board in March 2019. Tómas is currently the Chief Executive Officer at HS Orka. Prior to that, Tómas was the Senior Vice President, Strategic Alliances for Alcoa Corporation, Pittsburgh, USA, CEO of Alcoa Fjarðaál and Alcoa in Iceland but moved to Geneva in 2011 where he became the President of Alcoa Europe. From 2014 to year-end 2018 Tómas was the Executive Vice President and Chief Operating Officer for Alcoa Corporation. He was the chairman of the Iceland Chamber of Commerce from 2009 to 2012 and served as a member of the Federation of Icelandic Industries in 2005-2011. He was also a member of the Executive Committees of the European Aluminium Association, Eurometaux, and the American Chamber of Commerce to the European Union from 2012 to 2014. Tómas sits on a number of boards for Alcoa Corporation and is a member of the Executive Committee of Europe Aluminium and Business Europe.

Tómas holds an M.Sc in Planning from Cornell University, United States and a B.Sc. in Civil and Environmental Engineering from the University of Iceland.

Sub-Committees: Member of the Board Risk Management Committee.

Alternate members of the Board are two; Herdís Gunnarsdóttir and Pálmi Kristinsson, both since April 2016.

None of the members of the Board owns shares in the Bank, neither as a direct ownership nor through associated parties. All members of the Board are as well considered independent from the Bank, its main clients, competitors and shareholder.

Board Performance and Suitability Assessment

At least once a year, as provided for in the Board's Rules of Procedure, the Board assesses its work, procedures and practices as well as each of its members. This performance assessment is intended to improve working methods and increase the efficiency of the Board. The assessment entails an evaluation of the strengths and weaknesses of the Board's work and practices. This is i.a. based on an assessment of the necessary number of board directors, the board structure in relation to knowledge and experience, board procedure and practices. This assessment was last performed by the Board in January 2020.

Furthermore, the Board annually assesses the collective suitability of the Board and individual Board members in accordance with the Board's Rules of Procedure and the Bank's policy on the assessment of the suitability of the Board of Directors, the CEO and key function holders.

The Chief Executive Officer

The Chief Executive Officer (CEO) is responsible for the day-to-day operations of the Bank and that the Bank's business is, at all times, in accordance with the Bank's Articles of Association, policies of the Board and the relevant law. The CEO engages the Bank's Compliance Officer and appoints members of the Executive Committee and other Senior Management Committees.

Birna Einarsdóttir (b. 1961) is the CEO of Íslandsbanki. She holds an MBA from the University of Edinburgh, UK and a Cand. Oecon. in Business Administration from the University of Iceland. Birna first started working with Íslandsbanki's predecessors in 1987 and has been CEO since 15 October 2008. Previous to that she was a Senior Product Manager at the Royal Bank of Scotland and marketing manager for the Icelandic Broadcasting Company Stöð 2 (Channel 2) and Íslensk getspá. Birna is considered independent from the Bank, its main clients, competitors and shareholder.

The CEO is not a shareholder in the Bank, neither directly nor indirectly. No call-option agreements exist between the CEO and the Bank.

The executive committee

The executive committee consists of seven people, including the CEO: Birna Einarsdóttir, CEO since October 2008, Jón Guðni Ómarsson, Chief Financial Officer since October 2011, Sigríður Hrefna Hrafnkelsdóttir, Managing Director of Personal Banking since May 2017, Riaan Dreyer, Director of Information Technology since September 2019, Guðmundur Kristinn Birgisson, Chief Risk Officer since October 2018, Una Steinsdóttir, Managing Director of Business Banking since May 2017 and, Ásmundur Tryggvason Managing Director of Corporate & Investment Banking since January 2019. Riian Dreyer succeeded Sigríður Olgeirsdóttir, who served the position from September 2010. Ásmundur succeeded Vilhelm Már Þorsteinsson, who served the position from May 2017.

Senior Management Committees

Senior Management Committees are advisory committees appointed by the CEO. Senior Management Committees are divided into Executive Committees and Business Committees. The committees are appointed by the CEO, and their letters of mandate and rules of procedure are documented in a charter set by the CEO.

The Executive Committee and the All Risk Committee are responsible for the implementation of the Board approved business strategy, risk appetite and policies and consist of the CEO, all managing directors as well as other members of senior management appointed by the CEO.

- The Executive Committee, chaired by the CEO, is responsible for implementing the Board approved business strategy.
- The All Risk Committee is responsible for the review and implementation of the risk management and internal control policies issued by the Board and monitors that the risk profile of the Bank is within the limits of the risk appetite statement of the Board of Directors.

The Business Committees decide on individual business proposals in accordance with the rules and procedures issued by the All Risk Committee, The Executive Committee and the Board. The Bank's Business Committees are The Asset and Liability Committee, the Senior Credit Committee, the Investment Committee and the Operational and Security Committee

- The Senior Credit Committee decides on proposals on lending and is the formal venue for discussion and review of individual loan proposals.
- The Asset and Liability Committee decides on proposals regarding market risk, liquidity risk, funding, capital and internal and external pricing.
- The Investment Committee decides on proposals regarding the purchase, sale and valuation of equity stakes and other investments of the Bank.
- The Operational and Security Committee decides on proposals regarding new products and services, continuous operation and material changes in systems and procedures.

Arrangement of communications between shareholders and the Board

The Board communicates with shareholders in accordance with the relevant laws, the Bank's Articles of Association and the Board's Rules of Procedure. Members of the Board of Directors shall, in their duties and decision-making, safeguard the interests of the Bank and its shareholders in accordance with the applicable law, rules, regulations and guidelines.

The Bank is wholly owned by the Icelandic Government since January 2016. The shares are administered by Icelandic State Financial Investments (ISFI) in accordance with the Act on Icelandic State Financial Investments no. 88/2009. Shareholders' meetings, the supreme authority of the Bank, are the general forum for informing and communicating with shareholders. Following each publishing of financial results of the Bank a meeting is held with the ISFI to present the relevant financial results. In between meetings of the Bank's shareholders the Chairman of the Board, on behalf of the Board of directors, is responsible for communications with shareholders.

Information on infringements of laws and regulations that the appropriate supervisory or ruling body has determined

In its decision no. 49/2019 the Consumer Agency of Iceland came to the conclusion that the Bank had infringed article 7(4)(f., g., i & l) of Act no. 33/2013 on Consumer loans as its standard information disclosure form for consumer loans was insufficient. A fine was not imposed on the Bank. This decision has been appealed by the Bank. Information on legal cases relating to Íslandsbanki can be found in the notes to the consolidated financial statements.

This Corporate Governance Statement was approved by Íslandsbanki's Board of Directors on 12 February 2020.

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