Condensed Consolidated Interim Financial Statements

30 June 2017

Kvika banki hf. • Borgartún 25 • 105 Reykjavík • Iceland • Reg. no. 540502-2930

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Endorsement and Statement
by the Board of Directors and the CEO

The Condensed Consolidated Interim Financial Statements of Kvika banki hf. ("Kvika" or the "Bank") for the period 1 January to 30 June 2017 have been prepared in accordance with International Accounting Standard IAS 34 Interim Financial Reporting as adopted by the European Union, and additional requirements in the Icelandic Financial Statement Act. The Condensed Consolidated Interim Financial Statements comprise Kvika and its subsidiaries (together the "Group").

Kvika banki hf. is a specialised investment bank focusing on asset management and capital markets. Kvika provides businesses, investors and individuals with comprehensive investment banking and asset management services as well as selected banking services. Kvika's asset management has an established reputation and offers solutions covering all major asset classes, including fixed-income securities, equities, and alternative investments in both domestic and international markets. At the end of June 2017, the Group had ISK 136 billion of assets under management.

According to the Consolidated Income Statement, the Group's profit for the period 1 January to 30 June 2017 amounted to ISK 946 million. According to the Consolidated Statement of Financial Position, the Group's equity at the end of this period amounted to ISK 8,208 million and total assets amounted to ISK 90,986 million.

Continuing strong performance during the first half of 2017

Net operating income during 1H of 2017 was ISK 2,573 million, significantly above the 1H of 2016 figure of ISK 2,164 million, mostly due to net interest income and net fee and commission income increasing by 24% between the periods. Net interest income amounted to ISK 807 million (1H of 2016: 528 million), net fee income amounted to ISK 1,296 million (1H of 2016 1,165 million) and other operating income amounted to ISK 470 million (1H of 2016: 471 million).

Administrative expenses amounted to ISK 1,609 million and were in line with budget for the period and are 3.5% lower than in 1H of 2016. Profit for the period amounted to ISK 946 million corresponding to an annualised 26.2% return on equity based on the equity position at the beginning of the year adjusted for changes in share capital and transactions with treasury shares during the year.

The Group's total capital ratio at 30 June 2017 is 23.1% (31.12.2016: 20.6%). The Bank's minimum regulatory capital requirement is 11.8%. Therefore, the Bank is well placed to fulfil the additional capital requirements that will be imposed following the implementation of CRD IV during the next few years.

The Bank maintains a strong liquidity position. The Bank's assets are liquid and its access to funding is constantly improving, reflected by the Bank's funding cost decreasing significantly during the year. As at end of June 2017 the Group's 30 day liquidity coverage ratio (LCR) was 193%, well above the minimum level of 100% which became effective on 1 January 2017.

Risk management

The Bank is exposed to various types of risk in its operations. The Bank enforces a risk management framework which is further structured and outlined in the Bank's risk policy guide and rules on risk management. We refer to notes 34-46 on analysis of exposure to various types of risk.

Corporate Governance

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

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

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

Endorsement and Statement
by the Board of Directors and the CEO

Statement by the Board of Directors and the CEO

To the best of our knowledge the Condensed Consolidated Interim Financial Statements of Kvika banki hf. for the period 1 January to 30 June 2017 comply with IAS 34 Interim Financial Reporting as adopted by the EU and additional requirements in the Icelandic Financial Statement Act, and give a true and fair view of the Group's assets, liabilities and financial position as at 30 June 2017 and the financial performance of the Group and changes of cash flows for the period 1 January to 30 June 2017.

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

The Board of Directors and the CEO of the Bank have today discussed the Condensed Consolidated Interim Financial Statements for the period 1 January to 30 June 2017, and confirm them by the means of their signatures.

Reykjavík, 18 August 2017.

Board of Directors

CEO

Review Report on Interim Financial Information

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

We have reviewed the accompanying Condensed Consolidated Interim Statement of financial position of Kvika banki hf. and its subsidiaries (the "Bank") as of 30 June 2017 and the related Condensed Consolidated Interim Income Statement, Condensed Consolidated Interim Statement of Comprehensive Income, Condensed Consolidated Interim Statement of changes in equity and Condensed Consolidated Interim Statement of cash flows for the six-month period then ended, and a summary of significant accounting policies and other explanatory notes.

Management's and the Board of directors Responsibility for the Financial Statements

The board of directors and management is responsible for the preparation and fair presentation of this interim financial information in accordance with International Financial Reporting Standards for Interim Financial Reporting, IAS 34, as adopted by the EU and additional requirements in the Icelandic Financial Statement Act.

Auditor's Responsibility

Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements, ISRE 2410. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information does not give a true and fair view of the financial position of the Bank as at 30 June 2017, and of its financial performance and its cash flows for the six-month period then ended in accordance with International Financial Reporting Standards for Interim Financial Reporting, IAS 34, as adopted by the EU and additional requirements in the Icelandic Financial Statement Act.

Confirmation of Endorsement and Statement by the Board of Directors and the CEO

Pursuant to the requirements of Paragraph 2 Article 104 of the Icelandic Act on Financial Statements No. 3/2006, we confirm to the best of our knowledge that the accompanying Endorsement and Statement by the Board of Directors and the CEO includes all information required by the Icelandic Act on Financial Statements that is not disclosed elsewhere in the Condensed Consolidated Interim Financial Statements.

Kópavogur, 18 August 2017.

Deloitte ehf.

Pálína Árnadóttir
State Authorized Public Accountant

Þorsteinn Pétur Guðjónsson
State Authorized Public Accountant

Kvika Amounts are in ISK thousands

Condensed Consolidated Interim Income Statement
For the period 1 January 2017 to 30 June 2017

	Notes	6m 2017	6m 2016
Interest income		2,500,408	2,202,178
Interest expense		(1,693,787)	(1,673,970)
Net interest income	4	806,621	528,208
Fee and commission income		1,359,806	1,186,736
Fee and commission expense		(63,695)	(21,566)
Net fee and commission income		1,296,111	1,165,170
Net financial income	5, 6	385,011	453,420
Share in profit of associates, net of income tax	19	80,385	0
Other operating income		4,428	17,397
Other operating income		469,825	470,817
Net operating income		2,572,557	2,164,195
Administrative expenses	7	(1,609,144)	(1,668,378)
Impairment of loans and receivables	16	(4,664)	(105,242)
Profit (loss) from assets held for sale		0	(3,395)
Profit before taxes		958,749	387,180
Income tax	9	(13,152)	(8,860)
Special tax on financial institutions	10	0	0
Profit for the period		945,597	378,320

	Notes	6m 2017	6m 2016
Attributable to the shareholders of Kvika banki hf.		945,597	373,050
Attributable to non-controlling interest	18	0	5,270
Profit for the period		945,597	378,320

The notes on pages 11 to 39 are an integral part of these Condensed Consolidated Interim Financial Statements.

Kvika Amounts are in ISK thousands

Condensed Consolidated Interim Statement of Comprehensive Income

For the period 1 January 2017 to 30 June 2017

	Notes	6m 2017	6m 2016
Profit for the period		945,597	378,320
Translation of foreign operations			
Exchange difference on translation of foreign operations		(1,896)	(1,199)
Other comprehensive income that are or may be reclassified to profit and loss, net of tax		(1,896)	(1,199)
Total comprehensive income for the period		943,702	377,121

	Notes	6m 2017	6m 2016
Attributable to the shareholders of Kvika banki hf.		943,702	371,851
Attributable to non-controlling interest		0	5,270
Total comprehensive income for the period		943,702	377,121

The notes on pages 11 to 39 are an integral part of these Condensed Consolidated Interim Financial Statements.

Kvika | Amounts are in ISK thousands

Condensed Consolidated Interim Statement of Financial Position

As at 30 June 2017

Assets	Notes	30.6.2017	31.12.2016
Cash and cash equivalents	11	28,212,792	12,032,879
Receivables from Central Bank		485,428	0
Fixed income securities	12	5,918,409	3,945,778
Shares and other variable income securities	13	1,817,561	3,154,466
Securities used for hedging	14	21,295,067	12,389,392
Loans to customers	15, 16	25,352,041	26,015,321
Derivatives	17	735,231	552,493
Investment in associates	19	255,828	127,262
Investment properties	20	951,712	0
Intangible assets	22	36,099	41,530
Property and equipment	23	50,532	59,135
Deferred tax assets		189,429	189,429
Other assets	16, 24	5,621,867	967,954
Assets classified as held for sale	25	64,268	87,720
Total assets		90,986,263	59,563,359

Liabilities	Notes	30.6.2017	31.12.2016
Deposits from customers	26	47,267,955	32,478,933
Borrowings	27	24,223,325	13,498,785
Issued bills	28	3,929,676	3,922,918
Subordinated liabilities	29	1,079,784	572,385
Short positions held for trading	30	1,033,602	80,186
Derivatives	17	805,799	498,769
Current tax liabilities		13,136	11,039
Deferred tax liabilities		1,789	1,789
Other liabilities	31	4,423,313	1,101,679
Total liabilities		82,778,379	52,166,483

Equity	Notes	30.6.2017	31.12.2016
Share capital	32	1,401,396	1,375,819
Share premium		1,022,200	912,768
Option reserve		4,914	4,771
Warrants reserve		40,300	40,300
Deficit reduction reserve		3,103,697	3,103,697
Other reserves		(18,950)	(17,054)
Restricted retained earnings		607,526	403,553
Retained earnings		1,858,378	1,524,391
Total equity attributable to the shareholders of Kvika banki hf.		8,019,462	7,348,246
Non-controlling interest		188,422	48,630
Total equity		8,207,884	7,396,876
Total liabilities and equity		90,986,263	59,563,359

The notes on pages 11 to 39 are an integral part of these Condensed Consolidated Interim Financial Statements.

Kvika Amounts are in ISK thousands

Condensed Consolidated Interim Statement of Changes in Equity

For the period 1 January 2017 to 30 June 2017

1 January 2017 to 30 June 2017	**Notes**	**Share capital**	**Share premium**	**Option reserve**	**Warrants reserve**	**Deficit reduction reserve**	**Trans-lation reserve**	**Restricted retained earnings**	**Retained earnings**	**Total share-holders' equity**	**Non-controlling interest**	**Total equity**
Equity as at 1 January 2017		1,375,819	912,768	4,771	40,300	3,103,697	(17,054)	403,553	1,524,392	7,348,246	48,630	7,396,876
Profit for the period									945,597	945,597	0	945,597
Restricted retained earnings								203,973	(203,973)	0		0
Exchange difference on translation of foreign operations							(1,896)			(1,896)		(1,896)
Total comprehensive income for the period		0	0	0	0	0	(1,896)	203,973	741,624	943,702	0	943,702
Transactions with owners of the Bank												
Transactions with own shares		25,577	109,432							135,009		135,009
Dividend paid to shareholders									(407,638)	(407,638)		(407,638)
Stock options				143						143		143
Other transactions												
Acquisition of non-controlling interest via purchase											188,422	188,422
Sale of shares in subsidiaries											(48,630)	(48,630)
Equity as at 30 June 2017		1,401,396	1,022,200	4,914	40,300	3,103,697	(18,950)	607,526	1,858,379	8,019,462	188,422	8,207,884

The notes on pages 11 to 39 are an integral part of these Condensed Consolidated Interim Financial Statements

Kvika Amounts are in ISK thousands

Condensed Consolidated Interim Statement of Changes in Equity

For the period 1 January 2016 to 30 June 2016

1 January 2016 to 30 June 2016	**Notes**	**Share capital**	**Share premium**	**Option reserve**	**Warrants reserve**	**Deficit reduction reserve**	**Trans-lation reserve**	**Restricted retained earnings**	**Retained earnings**	**Total share-holders' equity**	**Non-controlling interest**	**Total equity**
Equity as at 1 January 2016		1,590,644	850,445	3,228	11,070	3,850,917	(13,687)	0	0	6,292,617	272,714	6,565,330
Profit for the period									373,050	373,050	5,270	378,320
Exchange difference on translation of foreign operations							(1,199)			(1,199)		(1,199)
Total comprehensive income for the period		0	0	0	0	0	(1,199)	0	373,050	371,851	5,270	377,121
Accumulated deficit set off against the share premium account			0									
Transactions with owners of the Bank												
Capital increase		(252,779)				(747,221)				(1,000,000)		(1,000,000)
Impact of capital decrease on treasury shares		2,205	6,519							8,724		8,724
Impact of capital decrease on treasury shares due to purchased treasury shares			31,195							31,195		31,195
Share-based payment transactions		(42,172)	(142,828)							(185,000)		(185,000)
Other transactions												
Acquisition of non-controlling interest via purchase											(59,503)	(59,503)
Equity as at 30 June 2016		1,297,897	745,332	3,228	11,070	3,103,697	(14,886)	0	373,050	5,519,388	218,480	5,737,868

The notes on pages 11 to 39 are an integral part of these Condensed Consolidated Interim Financial Statements

Kvika Amounts are in ISK thousands

Condensed Consolidated Interim Statement of Cash Flows

For the period 1 January 2017 to 30 June 2017

Cash flows from operating activities	Notes	6m 2017	6m 2016
Profit for the period		945,597	378,320
Adjustments for:			
Indexation and exchange rate difference		387,488	77,049
Share in loss (profit) of associates, net of income tax	19	(80,385)	(0)
Depreciation and amortisation	22, 23	12,627	15,415
Net interest income	4	(806,621)	(528,208)
Impairment of loans and receivables	16	4,664	105,242
Income tax	9	13,152	8,860
Other adjustments		(273)	2,070
		476,248	58,748
Changes in:			
Receivables from Central Bank		(485,428)	(434,204)
Fixed income securities		(1,972,631)	(1,521,345)
Shares and other variable income securities		1,240,093	126,427
Securities used for hedging		(8,905,675)	3,920,751
Loans to customers		469,126	(1,845,900)
Derivatives - assets		(182,738)	(175,892)
Deferred tax assets		0	(13,008)
Other assets		(4,653,913)	(2,411,740)
Deposits from customers		14,481,207	10,816,106
Deposits from credit institutions		0	275,783
Short positions		953,416	2,168,409
Derivatives - liabilities		307,030	(574,952)
Other liabilities		3,310,579	1,075,385
Assets classified as held for sale		21,556	0
		4,582,623	11,405,820
Interest received		2,326,406	2,002,794
Interest paid		(1,290,164)	(1,396,746)
Net cash from operating activities		6,095,113	12,070,617
Cash flows from investing activities			
Acquisition in Investment properties		(951,712)	0
Acquisition of property and equipment	23	(776)	0
Proceeds from the sale of property and equipment		2,600	(10,367)
Proceeds from the sale of a non-controlling interest		0	3,194
Acquisition of a non-controlling interest		188,422	0
Proceeds from the sale of assets classified as held for sale		0	0
Net cash to investing activities		(761,465)	(7,173)
Cash flows from financing activities			
Borrowings		10,738,820	3,560,630
Issued bills		6,758	(137,682)
Subordinated liabilities		427,615	(685)
Proceeds from the sale of a non-controlling interest		0	(25,327)
Dividend paid to shareholders		(407,638)	0
Treasury share transactions		135,009	(145,080)
Reduction of share capital		0	(252,779)
Reduction of deficit reduction reserve		0	(747,221)
Net cash from financing activities		10,900,566	2,251,857
Net increase in cash and cash equivalents		16,234,213	14,315,301
Cash and cash equivalents at the beginning of the year	11	12,032,879	19,916,973
Effects of exchange rate fluctuations on cash and cash equivalents held		(54,301)	(494,106)
Cash and cash equivalents at the end of the period	11	28,212,792	33,738,167

The notes on pages 11 to 39 are an integral part of these Condensed Consolidated Interim Financial Statements.

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Condensed Consolidated Interim Financial Statements

General information

1. Reporting entity

Kvika banki hf. ("Kvika" or the "Bank") is a limited liability company incorporated and domiciled in Iceland, with its registered office at Borgartún 25, Reykjavík. The Bank operates as an bank based on Act No. 161/2002, on Financial Undertakings, and is supervised by the Financial Supervisory Authority of Iceland.

The Condensed Consolidated Interim Financial Statements for the period ended 30 June 2017 comprise Kvika banki hf. and its subsidiaries (together referred to as the Group). The Group is primarily involved in investment and corporate banking, capital markets, asset management and fund management.

The Condensed Consolidated Interim Financial Statements were approved and authorised for issue by the Board of Directors and the CEO on 18 August 2017.

2. Basis of preparation

a. Statement of compliance

The Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Accounting Standard IAS 34 Interim Financial Reporting, as adopted by the European Union. The Consolidated Financial Statements are also prepared in accordance with Icelandic laws on financial statements and regulations on presentation and contents of financial statements.

b. Basis of measurement

The Condensed Consolidated Interim Financial Statements have been prepared using the historical cost basis except for the following:

- Fixed income securities are measured at fair value
- Shares and other variable income securities are measured at fair value
- Securities used for hedging are measured at fair value
- Derivatives are measured at fair value
- Investment properties are measured at fair value
- Short positions are measured at fair value
- Assets classified as held for sale are measured at the lower of cost or fair value less cost to sell

A breakdown of the accounting classification of financial assets and financial liabilities is provided in note 47.

c. Functional and presentation currency

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

The Group's assets and liabilities which are denominated in other currency than ISK are translated to ISK using the exchange rate as at the end of day 30 June 2017.

d. Going concern

The Bank's management and Board of directors has assessed the Group's ability to continue as a going concern and are satisfied that the Group has the resources to continue its operations.

e. Estimates and judgements

The preparation of interim financial statements in accordance with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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

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

Information about areas of estimation uncertainty and critical judgements made by management in applying accounting policies that can have a significant effect on the amounts recognised in the Condensed Consolidated Interim Financial Statements is provided in the Consolidated Financial Statements as at and for the year ended 31 December 2016.

f. Relevance and importance of notes to the reader

In order to enhance the informational value of the Financial Statements, the notes are evaluated based on relevance and importance for the reader. This can result in information, that has been evaluated as neither important or relevant for the reader, not being presented in the notes.

3. Significant accounting policies

The accounting policies and methods of computation applied by the Group in these Condensed Consolidated Interim Financial Statements are the same as those applied by the Group in its Consolidated Financial Statements as at, and for the year ended, 31 December 2016. A number of new international financial reporting standards, amendments to standards and interpretations were not yet effective for the period ended 30 June 2017 and have not been applied in the preparation of these condensed consolidated interim financial statements. Early adoption of standards and amendments is not planned.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

Income statement

4. Net interest income

Interest income is specified as follows:

	6m 2017	6m 2016
Cash and cash equivalents	736,543	688,944
Derivatives	543,276	558,782
Loans to customers	1,207,435	933,214
Other interest income	13,154	21,239
Total	2,500,408	2,202,178

Interest expense is specified as follows:

	6m 2017	6m 2016
Deposits from customers	753,176	651,295
Deposits from credit institutions	0	24,187
Borrowings	757,547	578,358
Issued bills	110,560	137,650
Subordinated liabilities	26,854	22,032
Derivatives	21,859	226,047
Other interest expense	23,791	34,399
Total	1,693,787	1,673,970

Total interest income recognised in respect of financial assets not carried at fair value through profit or loss amounts to ISK 1.957 million (2016: ISK 1.643 million). Total interest expense recognised in respect of financial liabilities not carried at fair value through profit or loss amounts to ISK 1.672 million (2016: ISK 1.448 million).

5. Net financial income

Net financial income is specified as follows:

	6m 2017	6m 2016
Financial assets held for trading		
Fixed income securities	117,395	204,255
Shares and other variable income securities	123,794	(33,738)
Derivatives	63,975	95,760
Financial assets designated at fair value through profit or loss		
Shares and other variable income securities	51,931	162,495
Foreign currency exchange difference	27,916	24,647
Total	385,011	453,420

6. Foreign currency exchange difference

Foreign currency exchange difference is specified as follows:

	6m 2017	6m 2016
Gain on financial instruments at fair value through profit and loss	7,424	30,652
Gain (loss) on other financial instruments	20,491	(6,005)
Total	27,916	24,647

Note 44 provides information about the development of foreign exchange rates against the Icelandic krona.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

7. Administrative expenses

Administrative expenses are specified as follows:

	6m 2017	6m 2016
Salaries and related expenses	1,037,112	1,041,392
Other operating expenses	514,738	577,848
Depositors' and Investors' Guarantee Fund contributions	44,667	33,724
Depreciation and amortisation	12,627	15,415
Total	1,609,144	1,668,378

8. Salaries and related expenses

Salaries and related expenses are specified as follows:

	6m 2017	6m 2016
Salaries	816,671	818,416
Share-based payment expenses	143	0
Pension fund contributions	106,039	100,042
Tax on financial activity	49,160	46,308
Other salary related expenses	65,100	76,626
Total	1,037,112	1,041,392
Average number of full time employees during the period	83	85
Total number of full time employees at the end of the period	84	87

According to Act No. 165/2011, passed in 2011, banks and other financial institutions providing VAT exempt services, must pay a tax based on salary payments, called tax on financial activity. The current tax rate is 5.50% (2016: 5.50%).

9. Income tax

The Group will not pay income tax on its profit for 2017 due to the fact that it has a tax loss carry forward that offsets the calculated income tax. At year end 2016, the tax loss carry forward of the Group amounted to ISK 160 billion. A substantial part of the deferred tax asset is utilisable until end of year 2018 and 2019. Management is of the opinion that the Group's operations in the years to come will result in taxable results which will be offset with the tax loss carry forward. The Group has therefore recognised a part of the tax loss carry forward as a deferred tax asset in the consolidated statement of financial position. The deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. The deferred tax asset is reviewed at each reporting date.

Income tax is recognised based on the tax rates and tax laws enacted during the current year, according to which the domestic corporate income tax rate was 20.0% (2016: 20.0%)

10. Special tax on financial institutions

According to Act No. 155/2010 on Special Tax on Financial Institutions, certain types of financial institutions, including banks, must pay annually a tax based on the carrying amount of their liabilities as determined for tax purposes in excess of ISK 50 billion at year-end. The tax rate is set at 0.376% (2016: 0.376%) and the tax is not a deductible expense for income tax purposes. The tax is presented separately in the consolidated income statement.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

Statement of Financial Position

11. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	30.6.2017	31.12.2016
Deposits with the Central Bank of Iceland	16,232,752	8,363,848
Cash on hand	9,043	15,375
Balances with banks	9,031,282	3,263,947
Foreign bills with government guarantees	361,707	0
Foreign treasury bills	2,578,007	389,709
Total	28,212,792	12,032,879

12. Fixed income securities

Fixed income securities are specified as follows:

	30.6.2017	31.12.2016
Held for trading		
Listed government bonds and bonds with government guarantees	2,361,951	1,521,804
Listed bonds	3,344,003	2,268,305
Unlisted bonds	212,455	155,669
Total	5,918,409	3,945,778

Further discussion about the accounting classification of financial assets is provided in notes 47-49.

13. Shares and other variable income securities

Shares and other variable income securities are specified as follows:

	30.6.2017	31.12.2016
Held for trading		
Listed shares	735,711	1,144,496
Unlisted shares	288,412	136,997
Unlisted unit shares	677,400	1,437,759
Designated at fair value through profit or loss		
Unlisted shares	116,038	430,779
Unlisted unit shares	0	4,434
Total	1,817,561	3,154,466

Further discussion about the accounting classification of financial assets is provided in notes 47-49.

14. Securities used for hedging

Securities used for hedging are specified as follows:

	30.6.2017	31.12.2016
Listed government bonds and bonds with government guarantees	8,405,694	5,298,637
Listed bonds	2,070,264	21,243
Listed shares	10,720,907	6,990,913
Unlisted unit shares	98,202	78,599
Total	21,295,067	12,389,392

Securities used for hedging are classified as held for trading. Further discussion about the accounting classification of financial assets is provided in notes 47-49.

15. Loans to customers

Loans to customers are specified as follows:

	30.6.2017	31.12.2016
Loans to customers, gross amount	25,651,284	26,321,932
Specific allowance for impairment losses	(39,262)	(44,404)
Collective allowance for impairment losses	(259,980)	(262,208)
Total	25,352,041	26,015,321

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

16. Allowance for impairment losses

Change in allowance for impairment losses is specified as follows:

a. Loans to customers

30.6.2017	Specific	Collective	Total
Balance as at 1 January 2017	44,404	262,208	306,611
Charge to the income statement for the period	12,489	(2,227)	10,262
Recoveries	(5,598)	0	(5,598)
Write-offs	(12,033)	0	(12,033)
Balance as at 30 June 2017	39,262	259,980	299,243

31.12.2016	Specific	Collective	Total
Balance as at 1 January 2016	208,880	205,869	414,748
Charge to the income statement for the period	207,497	56,339	263,836
Recoveries	(35,829)	0	(35,829)
Write-offs	(336,144)	0	(336,144)
Balance as at 31 December 2016	44,404	262,208	306,611

b. Other assets - accounts receivable

30.6.2017	Specific	Collective	Total
Balance as at 1 January 2017	73	5,000	5,073
Charge to the income statement for the period	0	0	0
Write-offs	0	0	0
Balance as at 30 June 2017	73	5,000	5,073

31.12.2016	Specific	Collective	Total
Balance as at 1 January 2016	10,132	5,000	15,132
Charge to the income statement for the period	(1,658)	0	(1,658)
Write-offs	(8,401)	0	(8,401)
Balance as at 31 December 2016	73	5,000	5,073

17. Derivatives

Derivatives are specified as follows:

	Notional		Carrying value	
30.6.2017	**Assets**	**Liabilities**	**Assets**	**Liabilities**
Interest rate derivatives	2,537,138	2,503,114	34,024	0
Currency forwards	2,716,732	2,778,405	14,935	76,607
Bond and equity total return swaps	23,959,928	24,193,798	521,703	715,183
Equity options	239,867	23,500	164,568	14,008
Bond options	0	0	0	0
	29,453,665	29,498,816	735,231	805,799

	Notional		Carrying value	
31.12.2016	**Assets**	**Liabilities**	**Assets**	**Liabilities**
Interest rate derivatives	1,020,000	1,020,000	71,224	0
Currency forwards	2,997,361	2,863,685	146,318	12,641
Bond and equity total return swaps	1,075,779	13,709,091	249,496	478,462
Equity options	2,867	0	75,294	0
Bond options	600,000	600,000	10,161	7,665
	5,696,008	18,192,775	552,493	498,769

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

18. Group entities

The main subsidiaries held directly or indirectly by the Group are listed in the table below.

Entity	Nature of operations	Domicile	Share 30.6.2017	Share 31.12.2016
Ármúli fasteignir ehf.	Holding company	Iceland	100%	100%
Burðarás eignarhaldsfélag ehf.	Holding company	Iceland	100%	100%
Fasteignastýring ehf.	Dormant	Iceland	100%	100%
FÍ Fasteignafélag GP ehf.	Real estate fund management	Iceland	100%	100%
Júpíter rekstrarfélag hf.	Fund management	Iceland	100%	100%
Kaldalón Byggingar slhf.	Holding company	Iceland	100%	-
M-Investments ehf.	Holding company	Iceland	100%	100%
Nes Þróunarfélag GP ehf.	Dormant	Iceland	100%	100%
Pivot ehf.	Holding company	Iceland	100%	100%
Straumur eignarhaldsfélag ehf.	Dormant	Iceland	100%	100%
Straumur Equites ehf.	Dormant	Iceland	100%	100%
Straumur fjárfestingar hf.	Dormant	Iceland	100%	100%
Kársnesbyggð ehf.	Holding company	Iceland	50%	-
Horn Florida Ltd.	Holding company	UK	100%	100%

Akta sjóðir hf., was a subsidiary at the beginning of 2017 but is an associate company at end of the period as the Group sold ca. 3% of its shareholding during the period.

19. Investment in associates

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

Entity	Nature of operations	Domicile	Share 30.6.2017	Share 31.12.2016
Akta sjóðir hf.	Fund management	Iceland	49%	51%
Londonderry Associates LLC	Holding company	USA	38%	38%
Nes Þróunarfélag slhf.	Holding company	Iceland	33%	33%

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

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

	30.6.2017	31.12.2016
Balance at the beginning of the year	127,262	0
Disposal of shares in associates	0	(23,152)
Reclassification	48,181	1,429
Share in profit of associates, net of income tax	80,385	148,985
Total	255,828	127,262

20. Investment properties

Investment properties are specified as follows:	30.6.2017	31.12.2016
Balance as at 1 January 2017	0	0
Acquisitions	951,712	0
Total	951,712	0

The Group acquired investment properties through one of its subsidiaries, Kársnesbyggð ehf. The intention is to either earn rental income or capital appreciation or both.

21. Unconsolidated structured entities

Where the Group acts as an agent for the investor, it does not consolidate the investment funds. When the Group holds investments in unconsolidated investment funds, they are classified as financial investments designated at fair value through profit or loss or other financial investments held for trading. The fair value of these investments represents the Group's maximum exposure to loss from its investments in such unconsolidated investment funds.

The nature and purpose of Investment funds is to generate fees from managing assets on behalf of third party investors. These vehicles are financed through the issuance of units to investors.

	30.6.2017	31.12.2016
Investments funds	52,222,776	49,837,884

The following table shows an analysis of the carrying amounts of interests held by the Group in unconsolidated structured entities. The Group's maximum exposure to loss is the carrying amount of the assets held.

	Carrying amount	
	30.6.2017	31.12.2016
Investments funds	492,522	987,600

The Group received management fees during the period:

Investments funds	238,468	481,664

Kvika Amounts are in ISK thousands

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22. Intangible assets

Intangible assets are specified as follows:

30.6.2017	Software	Other	Total
Balance as at 1 January 2017	20,790	20,740	41,530
Acquisitions	0	0	0
Amortisation	(2,991)	(2,440)	(5,431)
Balance as at 30 June 2017	17,799	18,300	36,099
Gross carrying amount	38,924	48,800	87,724
Accumulated amortization and impairment losses	(21,125)	(30,500)	(51,625)
Balance as at 30 June 2017	17,799	18,300	36,099

31.12.2016	Software	Other	Total
Balance as at 1 January 2016	20,304	25,620	45,924
Acquisitions	6,519	0	6,519
Amortisation	(6,033)	(4,880)	(10,913)
Balance as at 31 December 2016	20,790	20,740	41,530
Gross carrying amount	38,924	48,800	87,724
Accumulated amortization and impairment losses	(18,620)	(23,180)	(41,800)
Balance as at 1 January 2016	20,304	25,620	45,924
Gross carrying amount	38,924	48,800	87,724
Accumulated amortization and impairment losses	(18,134)	(28,060)	(46,194)
Balance as at 31 December 2016	20,790	20,740	41,530

23. Property and equipment

Property and equipment is specified as follows:

30.6.2017	Furniture and fixtures	Computer equipment	Other	Equipments
Balance as at 1 January 2017	14,569	10,425	34,141	59,135
Acquisitions	0	491	284	776
Disposals	0	(2,184)	0	(2,184)
Depreciation	(1,724)	(2,531)	(2,940)	(7,195)
Reclassified	0	0	0	0
Balance as at 30 June 2017	12,844	6,201	31,486	50,532
Gross carrying amount	42,802	39,308	197,507	279,616
Accumulated depreciation	(29,957)	(33,107)	(166,021)	(229,085)
Balance as at 30 June 2017	12,844	6,201	31,486	50,532

31.12.2016	Furniture and fixtures	Computer equipment	Other	Equipments
Balance as at 1 January 2016	20,105	25,698	30,946	76,749
Acquisitions	0	0	10,367	10,367
Discontinued	0	0	(4,162)	(4,162)
Disposals	0	0	(4,121)	(4,121)
Depreciation	(4,030)	(10,124)	(5,544)	(19,697)
Reclassified	(1,506)	(5,150)	6,656	0
Balance as at 31 December 2016	14,569	10,425	34,141	59,135
Gross carrying amount	42,802	41,001	56,361	140,163
Accumulated depreciation	(22,697)	(15,302)	(25,415)	(63,414)
Balance as at 1 January 2016	20,105	25,698	30,946	76,749
Gross carrying amount	38,895	39,458	41,933	120,287
Accumulated depreciation	(24,326)	(29,033)	(7,792)	(61,152)
Balance as at 31 December 2016	14,569	10,425	34,141	59,135

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

24. Other assets

Other assets are specified as follows:

	30.6.2017	31.12.2016
Unsettled transactions	4,940,855	108,739
Accounts receivable	347,546	716,360
Sundry assets	333,467	142,855
Total	5,621,867	967,954

25. Assets classified as held for sale

The Group has classified certain assets as held for sale. They are not part of the the Group's core operations. The Group intends to dispose of the majority of these assets in 2018 by offering them for sale either to select investors or through an open sales process.

Assets classified as held for sale are specified as follows:

	30.6.2017	31.12.2016
Buildings and land	64,268	60,220
Unlisted shares	0	27,500
Total	64,268	87,720

26. Deposits from customers

Deposits from customers are specified as follows:

	30.6.2017	31.12.2016
Demand deposits	37,061,014	23,311,754
Time deposits	10,206,941	9,167,179
Total	47,267,955	32,478,933

27. Borrowings

Borrowings are specified as follows:

	30.6.2017	31.12.2016
Money market deposits	24,223,325	13,498,785
Total	24,223,325	13,498,785

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

The Bank has not had any defaults of principal, interest or other breaches with respect to its debt issued and other borrowed funds.

28. Issued bills

Issued bills are specified as follows:

	30.6.2017	31.12.2016
Issued bills	3,929,676	3,922,918
Total	3,929,676	3,922,918

29. Subordinated liabilities

Subordinated liabilities are specified as follows:

	Issued	Maturity	Maturity type	Terms of interest	30.6.2017	31.12.2016
Tier 2 in ISK	2015	2025	At maturity	CPI-Indexed, fixed 5.50%	1,079,784	572,385
Total					1,079,784	572,385

At the interest payment date in the year 2020 the annual interest rate increases from 5.50% p.a. to 7.50% p.a. At the same date, the Group has the right to repay the subordinated bond and on any subsequent interest payment dates until maturity.

Subordinated liabilities are financial liabilities in the form of subordinated capital which, in case of the Group's voluntary or compulsory winding-up, will not be repaid until after the claims of ordinary creditors have been met. In the calculation of the capital ratio, they are included within Tier 2. The Group may only retire subordinated liabilities with the permission of the Icelandic Financial Supervisory Authority.

In the calculation of the capital ratio, subordinated liabilities are included within Tier 2 and are included in the equity base as the amount eligible for Tier 2 capital treatment is amortized on a straight-line basis over the final 5 years to maturity or up to 20% a year.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

30. Short positions held for trading

Short positions held for trading are specified as follows:

	30.6.2017	31.12.2016
Listed government bonds and bonds with government guarantees	371,615	0
Listed bonds	661,987	80,186
Total	1,033,602	80,186

Short positions held for trading are classified as held for trading. Further discussion about the accounting classification of financial liabilites is provided in notes 47-49.

31. Other liabilities

Other liabilities are specified as follows:

	30.6.2017	31.12.2016
Unsettled transactions	3,370,292	204,520
Accounts payable and accrued expenses	131,918	98,330
Special tax on financial institutions	8,948	8,948
Withholding taxes	205,453	380,040
Salaries and salary related expenses	366,151	188,588
Other liabilities	340,552	221,253
Total	4,423,313	1,101,679

32. Equity

a. Share capital

The share capital issued by the Bank is divided into two classes; class A and class B. The total share capital of the Bank is ISK 1,403,631,700; more specifically the share capital in class A amounts to ISK 1,393,631,700 and in class B it amounts to 10,000,000. The nominal value of shares issued by the Bank is ISK 1 per share in both share capital classes. Class A shares carry voting rights of one vote per nominal value of ISK 1 at shareholders' meetings, class B shares do not carry voting rights. Reference is made to the Bank's Articles of Association for more information about rights and restrictions associated with both classes of share capital.

	30.6.2017	31.12.2016
Share capital according to the Bank's Articles of Association	1,403,632	1,403,632
Nominal amount of treasury shares	2,235	27,812
Authorised but not issued shares	390,000	190,000

b. Share capital increase authorizations

The Board of Directors is authorized to increase the class A share capital of the Bank by up to ISK 200,000,000 through subscription for new shares. This authorization is based on temporary provision I to the Articles of Association and is valid until 15 March 2022. The Board of Directors is furthermore authorized to increase the class A share capital of the Bank in stages by up to ISK 50,000,000 in nominal value, for the purposes of fulfilling share option agreements in accordance with the Bank's share incentive scheme. The Board of Directors is also authorized to increase the class B share capital of the Bank by up to ISK 10,000,000 shares, by issuance of new class B shares. Both of these authorizations are based on temporary provision I to the Articles of Association and are valid until 30 November 2021. Temporary provision III to the Articles of Association moreover authorizes the Board of Directors to issue new class A share capital to serve warrants which have been issued in the maximum amount of ISK 130,000,000 nominal value, each of which contains the right to subscribe for one new class A share in the Bank. A copy of the Bank's Articles of Association, including the temporary provisions, is available on the Bank's website, www.kvika.is.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

33. Capital adequacy ratio (CAD)

Equity at the end of the period was ISK 8,208 million (31.12.2016: 7,397 million), equivalent to 9.0% (31.12.2016: 12.4%) of total assets according to the statement of financial position. The capital adequacy ratio of the Group, calculated in accordance with Article 84 of Act No. 161/2002 on Financial Undertakings, was 23.1% (31.12.2016: 20.6%). The minimum according to the Act is 8.0%. The ratio is calculated as follows:

Capital base	**30.6.2017**	**31.12.2016**
Total equity	8,207,884	7,396,876
Goodwill and intangibles	(36,099)	(41,530)
Deferred tax asset	(189,429)	(189,429)
Tier 1 capital	7,982,356	7,165,917
Subordinated liabilities	1,079,784	572,385
Accrued interests	(46,391)	(10,503)
Tier 2 capital	1,033,393	561,881
Shares in financial institutions	(104,860)	(90,798)
Subordinated fixed income securities	(192,992)	(155,786)
Total capital base	8,717,896	7,481,214

Capital requirements	**30.6.2017**	**31.12.2016**
Credit risk	2,077,387	1,912,501
Market risk	264,445	336,155
Operational risk	678,631	654,211
Total Capital requirements	3,020,463	2,902,868
Surplus capital	5,697,433	4,578,346
Capital adequacy ratio (CAD)	23.1%	20.6%
Minimum capital requirements	11.8%	11.8%

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

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

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

Risk management

34. Maximum exposure to credit risk

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

	Public entities	Financial institutions	Corporate customers	Individuals	30.6.2017
Cash and cash equivalents	19,181,510	9,031,282			28,212,792
Receivables from Central Bank	485,428				485,428
Fixed income securities	3,236,423	2,662,523	19,463		5,918,409
Securities used for hedging	9,469,729	1,006,228			10,475,958
Loans to customers		202,617	22,713,009	2,436,415	25,352,041
Derivatives		245,684	457,439	32,107	735,231
Other assets	2,557	36,653	5,249,190		5,288,400
	32,375,648	13,184,987	28,439,101	2,468,522	76,468,258
Loan commitments		204,800	2,932,201	453,617	3,590,618
Financial guarantee contracts			409,248	1,000	410,248
Total	32,375,648	13,389,787	31,780,551	2,923,139	80,469,124

	Public entities	Financial institutions	Corporate customers	Individuals	31.12.2016
Cash and cash equivalents	8,768,932	3,263,947			12,032,879
Receivables from Central Bank					0
Fixed income securities	2,005,306	1,940,472			3,945,778
Securities used for hedging	5,298,637	21,243			5,319,880
Loans to customers		192	23,870,342	2,144,787	26,015,321
Derivatives		197,160	340,307	15,026	552,493
Other assets	901	81,402	742,796		825,099
	16,073,777	5,504,417	24,953,444	2,159,813	48,691,450
Loan commitments	100	249,794	3,114,935	571,296	3,936,125
Financial guarantee contracts			448,970	1,410	450,380
Total	16,073,877	5,754,211	28,517,349	2,732,519	53,077,954

35. Credit quality of financial assets

a. Breakdown

Credit quality of financial assets is specified as follows:

30.6.2017	Neither past due nor individually impaired	Past due but not individually impaired	Individually impaired	Total	Less specific impairment allowance	Less collective impairment allowance	Carrying amount
Cash and cash equivalents	28,212,792			28,212,792			28,212,792
Receivables from Central Bank	485,428			485,428			485,428
Fixed income securities	5,918,409			5,918,409			5,918,409
Securities used for hedging	10,475,958			10,475,958			10,475,958
Loans to customers	24,472,650	1,124,557	54,077	25,651,284	(39,262)	(259,980)	25,352,041
Derivatives	735,231			735,231			735,231
Other assets	5,280,496		12,978	5,293,474	(73)	(5,000)	5,288,400
Total	75,580,962	1,124,557	67,055	76,772,575	(39,336)	(264,980)	76,468,258

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

35. Credit quality of financial assets (cont.)

31.12.2016	Neither past due nor individually impaired	Past due but not individually impaired	Individually impaired	Total	Less specific impairment allowance	Less collective impairment allowance	Carrying amount
Cash and cash equivalents	12,032,879			12,032,879			12,032,879
Receivables from Central Bank				0			0
Fixed income securities	3,945,778			3,945,778			3,945,778
Securities used for hedging	5,319,880			5,319,880			5,319,880
Loans to customers	25,034,535	1,233,180	54,217	26,321,932	(44,404)	(262,208)	26,015,321
Derivatives	552,493			552,493			552,493
Other assets	817,194		12,978	830,172	(73)	(5,000)	825,099
Total	47,702,759	1,233,180	67,195	49,003,135	(44,477)	(267,208)	48,691,450

b. Past due but not individually impaired

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

	30.6.2017	31.12.2016
Past due 1-30 days	435,948	779,818
Past due 31-60 days	91,049	76,763
Past due 61-90 days	306,514	34,066
Past due 91-180 days	28,627	254,053
Past due 180-360 days	262,420	86,645
Past due more than 360 days	0	1,835
Total	1,124,557	1,233,180

c. Individually impaired

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

30.6.2017	Impaired but not Past due	Past due 1-30 days	Past due 31-60 days	Past due 60-90 days	Past due over 90 days	Claim value
Corporate						
Services				3,757	34	3,791
Retail					18,895	18,895
Individuals	56		947	639	42,727	44,368
Total	56	0	947	4,396	61,656	67,055

31.12.2016	Impaired but not Past due	Past due 1-30 days	Past due 31-60 days	Past due 60-90 days	Past due over 90 days	Claim value
Corporate						
Services					33	33
Retail		11,795			409	12,204
Individuals	332		741		53,886	54,959
Total	332	11,795	741	0	54,328	67,195

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

36. Breakdown of loans to customers

a. By industry

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

30.6.2017	Claim value	Impairment allowance	Carrying amount	%
Financial institutions	204,693	(2,076)	202,617	0.8%
Corporate				
Services	8,574,394	(88,678)	8,485,715	33.5%
Holding companies	7,841,135	(79,436)	7,761,699	30.6%
Real estate, construction and industry	3,522,219	(35,682)	3,486,536	13.8%
Retail	1,382,736	(23,264)	1,359,472	5.4%
Other	1,636,162	(16,575)	1,619,587	6.4%
Individual	2,489,946	(53,531)	2,436,415	9.6%
Total	25,651,284	(299,243)	25,352,041	100.0%

31.12.2016	Claim value	Impairment allowance	Carrying amount	%
Financial institutions	194	(2)	192	0.0%
Corporate				
Services	9,854,258	(98,138)	9,756,120	37.5%
Holding companies	8,007,463	(79,674)	7,927,789	30.5%
Real estate, construction and industry	2,934,062	(29,220)	2,904,842	11.2%
Retail	2,050,827	(26,533)	2,024,294	7.8%
Other	1,269,944	(12,647)	1,257,297	4.8%
Individual	2,205,183	(60,397)	2,144,787	8.2%
Total	26,321,932	(306,611)	26,015,321	100.0%

b. By seniority

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

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

The breakdown of loans by categories is as follows:

	Senior I	Senior II	Junior	Mezzanine	30.6.2017
Neither past due nor individually impaired	6,601,947	9,064,684	4,918,802	3,638,923	24,224,356
Past due but not individually impaired	164,424	903,052	31,423	13,972	1,112,871
Individually impaired		10,145		4,669	14,814
Total	6,766,371	9,977,880	4,950,225	3,657,565	25,352,041

	Senior I	Senior II	Junior	Mezzanine	31.12.2016
Neither past due nor individually impaired	7,508,171	9,453,015	5,272,486	2,595,227	24,828,899
Past due but not individually impaired	103,068	850,635	34,232	188,674	1,176,609
Individually impaired			5,092	4,722	9,813
Total	7,611,239	10,303,650	5,311,810	2,788,623	26,015,321

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

37. Collateral and other credit enhancements

a. Valuation

The Group applies the same valuation methods to collateral held as other comparable assets held by the Group. The methods used for financial assets are outlined in note 48. For other types of assets the Group uses third party valuation where possible. Haircuts are then applied to account for liquidity and other factors which may affect the collateral value of the asset or other credit enhancement.

b. Loans to customers

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	30.6.2017
Financial institutions	22,075	28,084	1,639	142,850			194,648
Corporate customers	400,366	100,273	8,896,856	10,095,089	32,458	1,241,314	20,766,356
Individuals	15,560	23,454	983,093	1,104,592			2,126,699
Total	438,001	151,811	9,881,589	11,342,531	32,458	1,241,314	23,087,703

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2016
Financial institutions	1,613		4,593	139,100			145,307
Corporate customers	1,131,224	158,720	8,876,706	9,187,516	79,110	2,291,118	21,724,394
Individuals	596,001	3,717	900,443	1,690,500		72,861	3,263,522
Total	1,728,838	162,437	9,781,742	11,017,116	79,110	2,363,979	25,133,223

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

c. Derivatives

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	30.6.2017
Financial institutions	318,436	116,800	1,763,154				2,198,390
Corporate customers	463,019	35,725	638,299				1,137,043
Individuals	31,534	14,603	25,835				71,972
Total	812,988	167,128	2,427,289	0	0	0	3,407,405

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2016
Financial institutions	121,270	62,716	1,104,215				1,288,201
Corporate customers	425,072	27,040	161,865				613,977
Individuals	12,461	23,435	7,362				43,258
Total	558,804	113,190	1,273,442	0	0	0	1,945,436

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

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

38. Loan-to-value

a. General

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

b. Breakdown

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

	30.6.2017	**%**	**31.12.2016**	**%**
Less than 50%	13,365,153	52.7%	10,532,850	40.5%
51-70%	3,906,814	15.4%	8,883,928	34.1%
71-90%	4,512,117	17.8%	2,921,438	11.2%
91-100%	290,105	1.1%	580,677	2.2%
More than 100%	2,127,827	8.4%	1,912,570	7.4%
No collateral	1,150,024	4.5%	1,183,858	4.6%
Total	25,352,041	100.0%	26,015,321	100.0%

39. Large exposures

In accordance with the Financial Supervisory Authority's regulation no. 625/2013 on financial institutions' large exposures, total exposure towards a customer is classified as a large exposure if it exceeds 10% of the Bank's capital base (see note 33).

According to the regulation a single exposure, net of risk adjusted mitigation, cannot exceed 25% of the capital base. Single large exposures net of risk adjusted mitigation take into account the effects of collateral held by the Bank, and other credit enhancements, in accordance with the Financial Supervisory Authority's regulation no. 625/2013.

		30.6.2017		**31.12.2016**
Large exposures before risk adjusted mitigation	**Number**	**Amount**	**Number**	**Amount**
10-20% of capital base	6	6,011,584	9	8,371,512
20-25% of capital base	0	0	0	0
Exceeding 25% of capital base	3	9,671,922	0	0
Total	9	15,683,506	9	8,371,512
Thereof nostro accounts with foreign banks with S&P rating of A- or higher	3	7,093,914	1	1,066,824
Large exposures net of risk adjusted mitigation	2	1,790,907	4	3,539,017

No single large exposure net of risk adjusted mitigation exceeds 25% of capital base in accordance with the Financial Supervisory Authority's regulation no. 625/2013.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

40. Liquity risk

Maturity analysis of financial assets and financial liabilities

30.6.2017 **Financial assets by type**	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Gross inflow/ (outflow)**	**Carrying amount**
Non-derivative assets							
Cash and cash equivalents	28,212,792					28,212,792	28,212,792
Receivables from Central Bank	485,428					485,428	485,428
Fixed income securities	5,914,428	1,485				5,915,913	5,918,409
Shares and other variable income securities	1,011,769		791,793			1,803,562	1,817,561
Securities used for hedging	21,304,963					21,304,963	21,295,067
Loans to customers	1,726,423	5,739,505	11,278,956	6,563,796	1,407,729	26,716,410	25,352,041
Other assets	4,973,142	233,034	82,224			5,288,400	5,288,400
	63,628,945	5,974,024	12,152,973	6,563,796	1,407,729	89,727,467	88,369,698
Derivative assets							
Inflow	9,596,033	590,220	424,188	37,138		10,647,579	
Outflow	(9,107,752)	(564,464)	(421,965)	(3,114)		(10,097,295)	
	488,281	25,756	2,223	34,024	0	550,284	735,231

Financial liabilities by type	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Gross inflow/ (outflow)**	**Carrying amount**
Non-derivative liabilities							
Deposits from customers	(41,098,253)	(4,779,072)	(1,364,057)	(4,369)		(47,245,751)	47,267,955
Borrowings	(5,925,159)	(12,985,041)	(4,961,809)			(23,872,009)	24,223,325
Issued bills		(2,000,000)	(2,000,000)			(4,000,000)	3,929,676
Subordinated liabilities	(30,409)	(31,213)		(124,853)	(692,365)	(878,839)	1,079,784
Short positions held for trading	(1,042,042)					(1,042,042)	1,033,602
Short positions used for hedging						0	
Other liabilities	(3,637,867)	(541,947)	(239,179)	(4,321)		(4,423,313)	4,423,313
	(51,733,730)	(20,337,272)	(8,565,045)	(133,543)	(692,365)	(81,461,954)	81,957,655
Derivative liabilities							
Inflow	14,417,513	563,394	23,500			15,004,406	
Outflow	(15,170,707)	(629,841)	(24,202)			(15,824,750)	
	(753,195)	(66,447)	(702)	0	0	(820,344)	805,799
Unrecognized financial items							
Loan commitments							
Inflow	690,910	305,213	1,941,543	713,923		3,651,589	
Outflow	(3,590,618)					(3,590,618)	
Financial guarantee contracts							
Inflow	410,248					410,248	
Outflow	(410,248)					(410,248)	
	(2,899,708)	305,213	1,941,543	713,923	0	60,971	
Summary							
Non-derivative assets	63,628,945	5,974,024	12,152,973	6,563,796	1,407,729	89,727,467	
Derivative assets	488,281	25,756	2,223	34,024		550,284	
Non-derivative liabilities	(51,733,730)	(20,337,272)	(8,565,045)	(133,543)	(692,365)	(81,461,954)	
Derivative liabilities	(753,195)	(66,447)	(702)			(820,344)	
Net assets (liabilities) excluding unrecognized items	11,630,302	(14,403,939)	3,589,449	6,464,277	715,365	7,995,453	
Net unrecognized items	(2,899,708)	305,213	1,941,543	713,923		60,971	
Net assets (liabilities)	8,730,594	(14,098,726)	5,530,992	7,178,200	715,365	8,056,424	

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

40. Liquity risk (cont.)

31.12.2016 **Financial assets by type**	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Gross inflow/ (outflow)	Carrying amount
Non-derivative assets							
Cash and cash equivalents	12,032,879					12,032,879	12,032,879
Receivables from Central Bank						0	
Fixed income securities	3,796,989	155,786				3,952,775	3,945,778
Shares and other variable income securities	2,347,676	108,784	398,787			2,855,248	3,154,466
Securities used for hedging	12,386,983					12,386,983	12,389,392
Loans to customers	2,651,812	2,317,530	14,134,985	7,351,537	2,093,201	28,549,065	26,015,321
Other assets	189,555	406,096	229,448			825,099	825,099
	33,405,894	2,988,195	14,763,221	7,351,537	2,093,201	60,602,049	58,362,935
Derivative assets							
Inflow	3,313,749	1,400,801	61,736	14,656		4,790,942	
Outflow	(3,004,761)	(1,310,430)	(4,874)	(295)		(4,320,359)	
	308,989	90,371	56,862	14,361	0	470,583	552,493

Financial liabilities by type	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Gross inflow/ (outflow)	Carrying amount
Non-derivative liabilities							
Deposits from customers	(28,279,499)	(4,971,818)	(128,723)	(24,616)		(33,404,656)	32,478,933
Borrowings	(863,954)	(7,730,163)	(4,881,445)			(13,475,562)	13,498,785
Issued bills		(2,000,000)	(2,000,000)			(4,000,000)	3,922,918
Subordinated liabilities	(30,409)		(30,892)	(123,566)	(685,232)	(870,099)	572,385
Short positions held for trading	(80,366)					(80,366)	80,186
Short positions used for hedging	(2,733)					(2,733)	
Other liabilities	(243,696)	(655,445)	(182,653)	(19,885)		(1,101,679)	1,101,679
	(29,500,657)	(15,357,426)	(7,223,713)	(168,067)	(685,232)	(52,935,095)	51,654,885
Derivative liabilities							
Inflow	11,102,030	107,974	76,717			11,286,721	
Outflow	(11,630,563)	(114,400)	(80,457)			(11,825,420)	
	(528,533)	(6,426)	(3,740)	0	0	(538,699)	498,769
Unrecognized financial items by type							
Loan commitments							
Inflow	159,202	411,530	2,357,881	1,168,847		4,097,461	
Outflow	(3,936,125)					(3,936,125)	
Financial guarantee contracts							
Inflow	450,380					450,380	
Outflow	(450,380)					(450,380)	
	(3,776,922)	411,530	2,357,881	1,168,847	0	161,336	
Summary							
Non-derivative assets	33,405,894	2,988,195	14,763,221	7,351,537	2,093,201	60,602,049	
Derivative assets	308,989	90,371	56,862	14,361		470,583	
Non-derivative liabilities	(29,500,657)	(15,357,426)	(7,223,713)	(168,067)	(685,232)	(52,935,095)	
Derivative liabilities	(528,533)	(6,426)	(3,740)			(538,699)	
Net assets (liabilities) excluding unrecognized items	3,685,693	(12,285,286)	7,592,631	7,197,831	1,407,970	7,598,838	
Net unrecognized items	(3,776,922)	411,530	2,357,881	1,168,847		161,336	
Net assets (liabilities)	(91,229)	(11,873,756)	9,950,512	8,366,678	1,407,970	7,760,175	

Maturity analysis of financial assets and financial liabilities is based on contractual cash flows or, in the case of held for trading securities, expected cash flows. If an amount receivable or payable is not fixed, e.g. for inflation indexed assets and liabilities, the maturity analysis uses estimates based on current conditions.

Cash flows relating to unrecognized balance sheet items (unused loan commitments and financial guarantee contracts) are presented separately from financial assets and financial liabilities. Both contractual outflows and inflows are shown, to fully reflect the nature of these items.

It should be noted that the Group's expected cash flows sometimes vary considerably from the contractual cash flows, most significantly in that demand deposits from customers are expected to remain stable or increase in the long term. In this case the presentation used reflects the worst case scenario from the Group's perspective. Furthermore, the analysis does not consider any measures that could be taken to convert long-term assets to cash through sale.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

41. Interest rate risk associated with trading portfolios

a. Breakdown

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

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	30.6.2017
Fixed income securities			20,875	4,662,136	1,914,195	6,597,207
Short positions - fixed income securities				(167,780)	(1,758,964)	(1,926,744)
Net imbalance	0	0	20,875	4,494,357	155,231	4,670,463

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	31.12.2016
Fixed income securities			60,943	2,355,274	1,581,206	3,997,424
Short positions - fixed income securities				(80,366)	(497,965)	(578,331)
Net imbalance	0	0	60,943	2,274,908	1,083,242	3,419,093

b. Sensitivity analysis

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

	Shift in basis points	Downward	30.6.2017 Upward	Downward	31.12.2016 Upward
Indexed	50	23,701	(23,701)	43,866	(43,866)
Non-indexed	100	61,577	(61,577)	29,431	(29,431)
Total		85,279	(85,279)	73,297	(73,297)

42. Interest rate risk associated with non-trading portfolios

a. Breakdown

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

30.6.2017

Financial assets	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and cash equivalents	25,668,946	2,543,846				28,212,792
Loans to customers	23,855,400	962,468	259,752	221,015	53,407	25,352,041
Financial assets excluding derivatives	49,524,346	3,506,314	259,752	221,015	53,407	53,564,833
Effect of derivatives	13,719,544	18,544	500,000	520,000		14,758,087
Total	63,243,889	3,524,858	759,752	741,015	53,407	68,322,920

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

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

Financial liabilities	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Deposits from customers	47,252,685		12,123		3,147	47,267,955
Deposits from credit institutions						0
Borrowings	5,906,017	12,893,694	4,864,109	559,505		24,223,325
Issued bills		1,976,663	1,953,013			3,929,676
Subordinated liabilities					1,079,784	1,079,784
Financial liabilities excluding derivatives	53,158,702	14,870,357	6,829,245	559,505	1,082,931	76,500,740
Effect of derivatives	2,998,303	34,012				3,032,315
Total	56,157,005	14,904,368	6,829,245	559,505	1,082,931	79,533,055
Total interest repricing gap	7,086,884	(11,379,511)	(6,069,494)	181,510	(1,029,524)	(11,210,135)

31.12.2016

Financial assets	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Cash and cash equivalents	11,643,171	389,709				12,032,879
Loans to customers	24,479,523	987,649	266,547	226,797	54,804	26,015,321
Financial assets excluding derivatives	36,122,694	1,377,358	266,547	226,797	54,804	38,048,200
Effect of derivatives	13,719,544	18,544	500,000	520,000		14,758,087
Total	49,842,237	1,395,902	766,547	746,797	54,804	52,806,287

Financial liabilities	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Deposits from customers	32,459,684	4,398			14,851	32,478,933
Deposits from credit institutions						0
Borrowings	858,746	7,861,950	4,778,090			13,498,785
Issued bills		1,975,136	1,947,782			3,922,918
Subordinated liabilities					572,385	572,385
Financial liabilities excluding derivatives	33,318,429	9,841,484	6,725,872	0	587,236	50,473,020
Effect of derivatives	1,528,157	500,000				2,028,157
Total	34,846,586	10,341,484	6,725,872	0	587,236	52,501,177
Total interest repricing gap	14,995,651	(8,945,582)	(5,959,324)	746,797	(532,432)	305,110

b. Sensitivity analysis

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

	Shift in		**30.6.2017**		**31.12.2016**
Currency	**basis points**	**Downward**	**Upward**	**Downward**	**Upward**
ISK, indexed	50	(21,712)	21,712	(2,987)	2,987
ISK, non-indexed	100	35,131	(35,131)	39,081	(39,081)
Other currencies	20	7	(7)	42	(42)
Total		13,426	(13,426)	36,137	(36,137)

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

43. Exposure towards changes in the CPI

a. Definition

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

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

b. Management

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

c. Balance of CPI linked assets and liabilities

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

	30.6.2017	**31.12.2016**
Assets	7,505,344	6,124,041
Liabilities	(5,947,078)	(4,882,993)
Total	1,558,265	1,241,048

d. Sensitivity to changes in CPI

Given the net balance of CPI linked assets and liabilities, a 1% change in the CPI would, with other things constant, result in the following changes to the Group's pre-tax profit.

	30.6.2017		**31.12.2016**	
	-1%	1%	-1%	1%
Government bonds	(1,532)	1,532	(9,783)	9,783
Other fixed income securities	(23,862)	23,862	(13,328)	13,328
Loans to customers	(24,659)	24,659	(27,930)	27,930
Derivatives	(25,000)	25,000	(10,200)	10,200
Short positions	7,710	(7,710)	3,200	(3,200)
Deposits	41,760	(41,760)	40,130	(40,130)
Subordinated debt	10,000	(10,000)	5,500	(5,500)
	(15,583)	15,583	(12,410)	12,410

The effect on equity would be the same.

44. Currency risk

a. Definition

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

b. Management

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

The Group is subject to limits set by the Central Bank of Iceland regarding the maximum open currency position. At 30 June 2017 and 30 June 2016 the Group's position in foreign currencies was within those limits.

c. Exchange rates

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

	Closing 30.6.2017	**Average 6m 2017**	**Closing 31.12.2016**	**Average 6m 2016**
EUR/ISK	117.8	117.2	119.1	140.6
USD/ISK	103.3	108.4	112.8	126.1

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

44. Currency risk (cont.)

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

30.6.2017

Financial assets	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Cash and cash equivalents	1,897,023	7,474,825	2,140,565	80,136	367,846	11,960,394
Shares and other variable income securities	1,631					1,631
Loans to customers	1,491,336	361,078	755		155,041	2,008,209
Financial assets excluding derivatives	3,389,989	7,835,903	2,141,319	80,136	522,887	13,970,234
Derivatives	641,407	152,094				793,501
Total	4,031,395	7,987,997	2,141,319	80,136	522,887	14,763,735

Financial liabilities	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Deposits from customers	2,136,403	7,181,046	2,200,454	65,794	380,626	11,964,323
Borrowings	35,559					35,559
Financial liabilities excluding derivatives	2,171,962	7,181,046	2,200,454	65,794	380,626	11,999,882
Derivatives	1,885,280		102,529		146,736	2,134,545
Total	4,057,242	7,181,046	2,302,983	65,794	527,362	14,134,427

Net currency position	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Financial assets	4,031,395	7,987,997	2,141,319	80,136	522,887	14,763,735
Financial liabilities	(4,057,242)	(7,181,046)	(2,302,983)	(65,794)	(527,362)	(14,134,427)
Financial guarantee contracts	1,178					1,178
Total	(24,668)	806,951	(161,664)	14,342	(4,475)	630,486

31.12.2016

Financial assets	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Cash and cash equivalents	1,640,515	868,929	394,601	117,095	202,072	3,223,213
Shares and other variable income securities	1,887					1,887
Loans to customers	1,197,770	296,109			146,062	1,639,941
Financial assets excluding derivatives	2,840,173	1,165,038	394,601	117,095	348,134	4,865,041
Derivatives	502,160	169,531				671,691
Total	3,342,333	1,334,569	394,601	117,095	348,134	5,536,732

Financial liabilities	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Deposits from customers	1,355,102	789,223	392,095	71,152	118,460	2,726,032
Borrowings	35,978					35,978
Financial liabilities excluding derivatives	1,391,080	789,223	392,095	71,152	118,460	2,762,010
Derivatives	1,906,080	564,100			111,888	2,582,068
Total	3,297,160	1,353,323	392,095	71,152	230,348	5,344,078

Net currency position	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Financial assets	3,342,333	1,334,569	394,601	117,095	348,134	5,536,732
Financial liabilities	(3,297,160)	(1,353,323)	(392,095)	(71,152)	(230,348)	(5,344,078)
Financial guarantee contracts	32,165					32,165
Total	77,338	(18,754)	2,506	45,943	117,786	224,819

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

44. Currency risk (cont.)

e. Sensitivity to currency risk

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

	30.6.2017		31.12.2016	
Assets and liabilities denominated in foreign currencies	**-10%**	**+10%**	**-10%**	**+10%**
EUR	(2,467)	2,467	7,734	(7,734)
USD	80,695	(80,695)	(1,875)	1,875
GBP	(16,166)	16,166	251	(251)
NOK	1,434	(1,434)	4,594	(4,594)
Other currencies	(448)	448	11,779	(11,779)
Total	63,049	(63,049)	22,482	(22,482)

The effect on equity would be the same.

45. Other price risk

Other price risk arises from changes in the market prices of shares and other variable income securities in the Group's portfolio. The Group directly holds listed and unlisted shares and other variable income securities, while also gaining exposure to listed shares through portfolio options trading. The table below shows the Group's net exposure, including delta-adjusted options exposure.

			30.6.2017			31.12.2016
	Average	**Max**	**Exposure**	**Average**	**Max**	**Exposure**
Listed shares	1,166,393	2,306,390	735,711	1,179,342	1,706,461	1,145,862
Unlisted shares	298,664	404,449	404,450	623,585	819,213	567,776
Unlisted unit shares	1,392,956	3,198,181	677,400	1,396,410	3,216,784	1,442,194
Total			1,817,561			3,155,832

46. Operational risk

a. Definition

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

b. Management

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

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

Financial assets and liabilities

47. Accounting classification of financial assets and liabilities

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

30.6.2017

Financial assets	Held for trading	Designated at fair value	Loans and receivables	Other at amortised cost	Total carrying amount
Cash and cash equivalents			28,212,792		28,212,792
Receivables from Central Bank			485,428		485,428
Fixed income securities	5,918,409				5,918,409
Shares and other variable income securities	1,701,523	116,038			1,817,561
Securities used for hedging	21,295,067				21,295,067
Loans to customers			25,352,041		25,352,041
Derivatives	735,231				735,231
Other assets			5,288,400		5,288,400
Total	29,650,230	116,038	59,338,661	0	89,104,928

Financial liabilities	Held for trading	Designated at fair value	Loans and receivables	Other at amortised cost	Total carrying amount
Deposits from customers				47,267,955	47,267,955
Borrowings				24,223,325	24,223,325
Issued bills				3,929,676	3,929,676
Subordinated liabilities				1,079,784	1,079,784
Short positions held for trading	1,033,602				1,033,602
Derivatives	805,799				805,799
Other liabilities				4,423,313	4,423,313
Total	1,839,400	0	0	80,924,053	82,763,453

31.12.2016

Financial assets	Held for trading	Designated at fair value	Loans and receivables	Other at amortised cost	Total carrying amount
Cash and cash equivalents			12,032,879		12,032,879
Fixed income securities	3,945,778				3,945,778
Shares and other variable income securities	2,719,252	435,213			3,154,466
Securities used for hedging	12,389,392				12,389,392
Loans to customers			26,015,321		26,015,321
Derivatives	552,493				552,493
Other assets			825,099		825,099
Total	19,606,915	435,213	38,873,299	0	58,915,428

Financial liabilities	Held for trading	Designated at fair value	Loans and receivables	Other at amortised cost	Total carrying amount
Deposits from customers				32,478,933	32,478,933
Borrowings				13,498,785	13,498,785
Issued bills				3,922,918	3,922,918
Subordinated liabilities				572,385	572,385
Short positions held for trading	80,186				80,186
Derivatives	498,769				498,769
Other liabilities				1,101,679	1,101,679
Total	578,955	0	0	51,574,699	52,153,654

Notes to the Condensed Consolidated Interim Financial Statements

48. Financial assets and liabilities measured at fair value

a. Fair value hierarchy

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

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

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

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

b. Valuation process

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

c. Valuation techniques

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

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

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

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

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

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

d. Fair value hierarchy classification

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

30.6.2017

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Fixed income securities	5,705,954	212,455		5,918,409
Shares and other variable income securities	833,295	711,040	157,189	1,701,523
Securities used for hedging	21,295,067			21,295,067
Derivatives		595,480	139,751	735,231
Designated at fair value				
Fixed income securities				0
Shares and other variable income securities		1	116,037	116,038
Total	27,834,315	1,518,976	412,977	29,766,268

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Short positions held for trading	1,033,602			1,033,602
Derivatives		805,799		805,799
Total	1,033,602	805,799	0	1,839,400

There were no transfers between levels during the period.

31.12.2016

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Fixed income securities	3,790,109	155,669		3,945,778
Shares and other variable income securities	2,076,963	505,292	136,997	2,719,252
Securities used for hedging	12,389,392			12,389,392
Derivatives		477,199	75,294	552,493
Designated at fair value				
Fixed income securities				0
Shares and other variable income securities		287	434,926	435,213
Total	18,256,464	1,138,447	647,218	20,042,129

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Short positions held for trading	80,186			80,186
Derivatives		498,769		498,769
Total	80,186	498,769	0	578,955

There were no transfers between levels during the period.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

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

e. Reconciliation of changes in Level 3 fair value measurements

30.6.2017	Shares and other var. income securities	Derivatives	Total
Balance as at 1 January 2017	571,924	75,294	647,218
Total gains and losses in profit or loss	27,131	0	27,131
Purchases	71,309	64,457	135,766
Sales	(397,137)	0	(397,137)
Balance as at 30 June 2017	273,226	139,751	412,977

31.12.2016	Shares and other var. income securities	Derivatives	Total
Balance as at 1 January 2016	533,838	0	533,838
Total gains and losses in profit or loss	107,783		107,783
Purchases	481,094	75,294	556,388
Sales	(550,791)		(550,791)
Balance as at 31 December 2016	571,924	75,294	647,218

f. Change in unrealised gains or losses related to Level 3 financial assets held at end of the period

Net financial income - 6m 2017	Shares and other var. income securities
Financial assets designated at fair value through profit or loss	27,131
Total	27,131
Net financial income - 6m 2016	
Financial assets designated at fair value through profit or loss	(7,328)
Total	(7,328)

g. Fair value measurements for Level 3 financial assets

Level 3 assets consist primarily of highly illiquid, unlisted bonds, shares and share certificates. Each asset is evaluated separately but assets within an asset group share a valuation method. The following valuation methods are in use in 2017:

Asset class	Method	Significant unobservable input	Range	Book value 30.6.2017
Unlisted shares	P/B multiplier	Equity	0.5-1.5	273,226
Unlisted unit shares	Investment multiplier	Original investment	0.00	0
Derivatives	Discounted cash flow	Equity	-	139,751
Total				412,977

Asset class	Method	Significant unobservable input	Range	Book value 31.12.2016
Unlisted shares	P/B multiplier	Equity	1.0-1.5	567,489
Unlisted unit shares	Investment multiplier	Original investment	0.05	4,434
Derivatives	Discounted cash flow	Equity	-	75,294
Total				647,218

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

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

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

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

	+10%	-10%
Shares and other variable income securities	13,975	(13,975)
Total	13,975	(13,975)

Notes to the Condensed Consolidated Interim Financial Statements

49. Financial assets and liabilities not measured at fair value

The Group holds financial instruments which are not measured at fair value. Except for loans to customers, the Group believes that the best estimate of the fair value of these financial instruments is equal to the carrying amount at the reporting date and does therefore not report a fair value for these financial instruments. Loans to customers are classified as level 3, in the fair value hierarchy, and have a book value of ISK 25,352,041 thousand at end of June 2017. The estimated fair value of loans to customers at end of June 2017 is ISK 25,248,591 thousand.

Cash and cash equivalents includes several components as detailed in note 11. Cash equivalent assets are either balances available on-demand or on very short notice, or other assets easily converted to cash. Other financial assets consist primarily of short-term receivables. The carrying amount of these assets is therefore a reasonable approximation of their fair value.

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

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

Segment information

50. Business segments

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

a. Reportable segments

The Group defines five reportable segments which reflect the reporting structure of the Bank.

- Corporate Banking
  Corporate Banking offers various forms of banking services and related advisory services, in addition to providing specialized lending services.
- Corporate Finance
  Corporate Finance provides its customers with impartial and independent advice concerning purchases, sales and mergers and acquisitions of companies.
- Capital Markets
  Capital Markets offers securities and foreign currency brokerage, derivatives brokerage and forward contracts to clients, which include institutional investors, corporates and high net worth individuals.
- Proprietary Trading and Treasury
  Proprietary Trading and Treasury provide market making services to its clients as well as providing the Bank with treasury services.
- Asset Management
  Products and services offered include asset management, both domestic and foreign assets, private banking, and private pension plans.

Information about other divisions of the Bank, e.g. non-revenue generating divisions, is presented under the heading Other operations.

6m 2017	**Corporate Banking**	**Corporate Finance**	**Capital Markets**	**Propriatary trading and Treasury**	**Asset Management**	**Support functions and eliminations**	**Total**
Net interest income	730,254	(12)	65,561	9,212	2,017	(410)	806,621
Net fee and commission income	263,066	140,478	412,005	50,132	462,420	(31,990)	1,296,111
Net financial income	127,999	(3,557)	(10,020)	263,167	10,353	(2,590)	385,351
Share in profit of associates	61,754	0	0	0	18,631	0	80,385
Other operating income	12	0	7	441	2,958	1,010	4,428
Net operating income	1,183,085	136,908	467,553	322,952	496,379	(33,980)	2,572,898
Salaries and related expenses	(82,946)	(68,182)	(126,376)	(77,113)	(217,579)	(464,916)	(1,037,112)
Other operating expenses	(171,343)	(18,749)	(38,800)	(20,285)	(75,680)	(247,174)	(572,031)
Impairment of loans and receivables	(4,664)					0	(4,664)
Profit (loss) before cost allocation and tax	924,131	49,977	302,378	225,553	203,120	(746,070)	959,090
Net segment revenue from external customers	919,034	136,908	923,405	131,151	496,379	(33,980)	2,572,898
Net segment revenue from other segments	264,051	0	(455,852)	191,801	0	0	0

6m 2016	**Corporate Banking**	**Corporate Finance**	**Capital Markets**	**Propriatary trading and Treasury**	**Asset Management**	**Support functions and eliminations**	**Total**
Net interest income	484,669	5,930	85,410	(58,525)	10,985	(261)	528,208
Net fee and commission income	185,539	85,111	398,913	34,301	482,695	(21,389)	1,165,170
Net financial income	173,457	0	6,991	268,928	4,044	0	453,420
Share in profit of associates							0
Other operating income	5,293	3,805	1,362	32	1,027	2,483	14,002
Net operating income	848,959	94,847	492,676	244,735	498,751	(19,167)	2,160,800
Salaries and related expenses	(103,750)	(88,879)	(146,049)	(79,656)	(251,826)	(371,232)	(1,041,392)
Other operating expenses	(149,640)	(32,915)	(80,099)	(26,610)	(89,743)	(247,979)	(626,986)
Impairment of loans and receivables	(105,242)	0	0	0	0	0	(105,242)
Profit (loss) before cost allocation and tax	490,327	(26,947)	266,527	138,468	157,183	(638,378)	387,180
Net segment revenue from external customers	595,238	94,847	740,622	250,510	498,751	(19,167)	2,160,800
Net segment revenue from other segments	253,721	0	(247,946)	(5,775)	0	0	0

Internal reporting is based on the results of the Bank, which accounts for around 91% of the net operating income of the Group, and do not take into account the effects of consolidation. As a result, elimination entries are needed to reconcile internal reporting with consolidated results. Elimination entries arise primarily from interest calculated on internal balances, share in the results of subsidiaries and fees charged for services the parent provides to subsidiaries.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

Other information

51. Related parties

a. Definition of related parties

The Group has a related party relationship with the board members of the Bank, the CEO of the Bank and key employees (together referred to as management), associates as disclosed in note 19, shareholders with significant influence over the Bank, close family members of individuals identified as related parties and entities under the control or joint control of related parties.

b. Arm's length

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

c. Effects on statement of financial position

30.6.2017	**Loans & receivables**	**Deposits & payables**
Shareholders	115,506	159,440
Management	2,478	369,353
Associates	440,456	100,171
Total	558,440	628,963

31.12.2016	**Loans & receivables**	**Deposits & payables**
Shareholders	70	136,567
Management	15,066	720,184
Associates	416,056	63,536
Total	431,192	920,287

d. Effects on income statement

6m 2017	**Interest income**	**Interest expense**	**Fees received**	**Fees paid**
Shareholders	819	2,040	1,904	0
Management	265	7,208	459	28,270
Associates	18,337	743	29,624	0
Total	19,421	9,991	31,988	28,270

6m 2016	**Interest income**	**Interest expense**	**Fees received**	**Fees paid**
Shareholders	98	10,056	27	5,036
Management	2,867	23,920	34,475	0
Associates	9	2,173	1,263	3,879
Total	2,974	36,149	35,765	8,915

52. Other matters

In March 2017, the Bank announced that the Board of Directors of the Bank and Virding hf. had reached a mutual decision to suspend discussions concerning a possible merger of the two companies. The discussions had been ongoing since November 2016 with due diligence reports having been prepared in Q1 2017.

In April 2017, the Bank’s then CEO, Sigurdur Atli Jónsson, gave the Board of Directors his notice of resignation.

In May 2017, the Bank announced that Ármann Thorvaldsson had been engaged as CEO of Kvika banki hf. and Marinó Örn Tryggvason as the Bank's deputy CEO.

In June 2017, the Bank announced that owners of 96.69% of the share capital of Virding hf. had approved an offer from the Bank for their shareholdings in Virding hf. The purchase price amounts to ISK 2,560 million and will be paid in cash. The acquisition is subject to certain conditions, including the approval by shareholders of both companies and regulatory consent. On 14 July 2017, a meeting of shareholders in the Bank approved to increase the Board of Directors authorisation to increase the Bank’s share capital. Following that meeting, the regulatory consents are the only remaining conditions.

53. Events after the reporting date

In the beginning of August 2017, the Bank announced that it had signed a contract to acquire the entire share capital of ALDA Asset Management hf. The sale was concluded subject to due diligence and regulatory consents. ALDA operates 11 UCITS and other funds for collective investment and has assets amounting to ISK 45 billion under management.

Following the shareholder meeting in July and the acquisition of ALDA Capital Management hf, the Board of Directors decided to increase the class A share capital of the Bank by a nominal value of ISK 300,000,000 through the issuance of new shares. It is estimated that the subscription for new shares will be completed on 18 September 2017.

There are no other material events after the reporting date.