Condensed Consolidated

Interim Financial Statements

30 June 2018

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 2018 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 is a commercial bank, focusing on investment banking activities. The Bank operates four business segments, Asset Management, Corporate Finance, Corporate Banking 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 end of June 2018, the Group had ISK 271 billion of assets under management.

Operating results

According to the Consolidated Statement of Financial Position, equity at end of the period amounted to ISK 12,230 million (2017: ISK 10,982 million) and total assets amounted to ISK 103,409 million (2017: ISK 75,597 million). The Group's total capital ratio at 30 June 2018 was 24.6% (31.12.2017: 21.1%).

The Group's net operating income during 1H 2018 was ISK 3,037 million (1H 2017: ISK 2,573 million). Net fee and commission income increased significantly between the periods and amounted to ISK 1,916 million (1H 2017: ISK 1,296 million). Net interest income amounted to ISK 794 million (1H 2017: ISK 807 million) and other operating income amounted to ISK 327 million (1H 2017: ISK 470 million). Administrative expenses during the period amounted to ISK 1,987 million (1H 2017: ISK 1,609 million). The acquisitions of Virðing hf. and Alda sjóðir hf. took place in the latter half of 2017 and should be taken into consideration when comparing operating figures for 2017 and 2018.

Profit for the period amounted to ISK 1,023 million (1H 2017: ISK 946 million), corresponding to an annualised 18.5% 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 period.

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. Refer to notes 37-47 on analysis of exposure to various types of risk.

Corporate governance

The Board of Directors emphasizes good corporate governance and adherence to 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 address e.g. competence of Board members to participate in individual decisions, confidentiality and information disclosure between the CEO and the Board. The 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 three out of five 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. At a board meeting in April 2018, the Board decided to divide the Risk, Audit and Remuneration Committee into three units to make better use of expertise available. The units are called the Audit Committee, the Risk Committee and the Remuneration Committee. Each of the previously mentioned committees 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 2018 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 2018 and the financial performance of the Group and changes of cash flows for the period 1 January to 30 June 2018.

Further, in our opinion the Condensed Consolidated Interim Financial Statements and the Endorsement of the Board of Directors and the CEO give 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 2018, and confirm them by the means of their signatures.

Reykjavík, 23 August 2018.

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 2018 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 2018, 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, 23 August 2018.

Deloitte ehf.

Pálína Árnadóttir
State Authorized Public Accountant

Guðmundur Ingólfsson
State Authorized Public Accountant

Kvika Amounts are in ISK thousands

Condensed Consolidated Interim Income Statement

For the period 1 January 2018 to 30 June 2018

	Notes	6m 2018	6m 2017
Interest income		2,219,497	2,500,408
Interest expense		(1,425,662)	(1,693,787)
Net interest income	6	793,835	806,621
Fee and commission income	7	1,988,858	1,359,806
Fee and commission expense		(72,569)	(63,695)
Net fee and commission income		1,916,288	1,296,111
Net financial income	8	294,749	385,011
Share in (loss) profit of associates, net of income tax	23	(3,603)	80,385
Other operating income (expense)		35,742	4,428
Other operating income		326,888	469,825
Net operating income		3,037,011	2,572,557
Administrative expenses	9	(1,986,730)	(1,609,144)
Net impairment	11	5,462	(4,664)
Profit before taxes		1,055,744	958,749
Income tax	12	(32,765)	(13,152)
Profit for the period		1,022,978	945,597

	Notes	6m 2018	6m 2017
Attributable to the shareholders of Kvika banki hf.		1,012,738	945,597
Attributable to non-controlling interest	22	10,240	0
Profit for the period		1,022,978	945,597
Earnings per share			
Basic earnings per share (ISK per share)	15	0.55	0.68
Diluted earnings per share (ISK per share)	15	0.50	0.66

The notes on pages 11 to 48 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK thousands

Condensed Consolidated Interim Statement of Comprehensive Income

For the period 1 January 2018 to 30 June 2018

	Notes	6m 2018	6m 2017
Profit for the period		1,022,978	945,597
Translation of foreign operations			
Exchange difference on translation of foreign operations		295	(1,896)
Items that may be reclassified subsequently to profit and loss, net of tax		295	(1,896)
Total comprehensive income for the period		1,023,273	943,702

	Notes	6m 2018	6m 2017
Attributable to the shareholders of Kvika banki hf.		1,013,033	943,702
Attributable to non-controlling interest		10,240	0
Total comprehensive income for the period		1,023,273	943,702

The notes on pages 11 to 48 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 2018

Assets	Notes	30.6.2018	31.12.2017
Cash and balances with Central Bank	16	38,451,909	20,493,739
Fixed income securities	17	4,958,350	5,598,409
Shares and other variable income securities	18	2,661,920	2,837,375
Securities used for hedging	19	18,042,611	14,026,433
Loans to customers	20	26,879,778	25,338,250
Derivatives	21	1,142,242	1,052,652
Investment in associates	23	669,257	676,610
Investment properties	24	803,874	953,874
Intangible assets	25	2,319,220	2,284,340
Property and equipment		47,901	57,251
Deferred tax assets		466,778	464,414
Other assets	26	6,965,170	1,797,913
Assets classified as held for sale		0	15,260
Total assets		103,409,010	75,596,519

Liabilities	Notes	30.6.2018	31.12.2017
Deposits from customers	27	54,028,869	41,749,497
Borrowings	28	21,708,822	13,731,375
Issued bills	29	3,546,061	3,934,757
Issued bonds	30	3,057,516	1,401,879
Subordinated liabilities	31	1,707,619	1,058,741
Short positions held for trading	32	90,666	370,163
Derivatives	21	556,379	364,692
Current tax liabilities		4,156	789
Deferred tax liabilities		84,549	65,658
Other liabilities	33	6,394,434	1,936,693
Total liabilities		91,179,070	64,614,243

Equity	Notes	30.6.2018	31.12.2017
Share capital	34	1,844,996	1,805,060
Share premium		2,879,153	2,722,583
Option reserve		2,588	903
Warrants reserve	35	204,539	207,048
Deficit reduction reserve		3,103,697	3,103,697
Other reserves		(21,426)	(21,722)
Restricted retained earnings		364,053	254,844
Retained earnings		3,790,678	2,858,439
Total equity attributable to the shareholders of Kvika banki hf.		12,168,278	10,930,854
Non-controlling interest		61,663	51,423
Total equity		12,229,940	10,982,276
Total liabilities and equity		103,409,010	75,596,519

The notes on pages 11 to 48 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 2018 to 30 June 2018

1 January 2018 to 30 June 2018	Notes	Share capital	Share premium	Option reserve	Warrants reserve	Deficit reduction reserve	Translation reserve	Restricted retained earnings	Retained earnings	Total shareholders' equity	Non-controlling interest	Total equity
Equity as at 1 January 2018		1,805,060	2,722,583	903	207,048	3,103,697	(21,722)	254,844	2,858,439	10,930,854	51,423	10,982,276
Impact of adopting IFRS 9									28,709	28,709		28,709
Restated opening balance under IFRS 9		1,805,060	2,722,583	903	207,048	3,103,697	(21,722)	254,844	2,887,148	10,959,563	51,423	11,010,986
Profit for the period									1,012,738	1,012,738	10,240	1,022,978
Restricted retained earnings								109,208	(109,208)	0		0
Translation of foreign operations												
Exchange difference on translation of foreign operations							295			295		295
Total comprehensive income for the period		0	0	0	0	0	295	109,208	903,530	1,013,033	10,240	1,023,273
Transactions with owners of the Bank												
Capital increase		29,936	96,327		(2,509)					123,754		123,754
Transactions with own shares		10,000	60,242							70,242		70,242
Stock options				1,685						1,685		1,685
Equity as at 30 June 2018		1,844,996	2,879,153	2,588	204,539	3,103,697	(21,426)	364,053	3,790,678	12,168,278	61,663	12,229,940

The notes on pages 11 to 48 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	1,524,391	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)			
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	1,858,378	8,019,462	188,422	8,207,884

The notes on pages 11 to 48 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 2018 to 30 June 2018

Cash flows from operating activities	Notes	6m 2018	6m 2017
Profit for the period		1,022,978	945,597
Adjustments for:			
Indexation and exchange rate difference		437,804	387,488
Share in loss (profit) of associates, net of income tax	23	3,603	(80,385)
Depreciation and amortisation	25	11,441	12,627
Net interest income	6	(793,835)	(806,621)
Net impairment		(5,462)	4,664
Income tax	12	32,765	13,152
Other adjustments		(5,491)	(273)
		703,802	476,248
Changes in:			
Fixed income securities		640,058	(1,972,631)
Shares and other variable income securities		175,455	1,240,093
Securities used for hedging		(4,016,178)	(8,905,675)
Loans to customers		(1,451,159)	469,126
Derivatives - assets		(89,590)	(182,738)
Deferred tax assets and tax liabilities		(12,872)	0
Other assets		(5,165,128)	(4,653,913)
Deposits from customers		11,813,438	14,481,207
Short positions		(279,498)	953,416
Derivatives - liabilities		191,687	307,030
Other liabilities		4,440,307	3,310,579
Assets classified as held for sale		0	21,556
		6,246,521	5,068,051
Interest received		2,145,581	2,326,406
Interest paid		(891,651)	(1,290,164)
Net cash from operating activities		8,204,253	6,580,541
Cash flows from investing activities			
Acquisition of Investment properties		0	(951,712)
Proceeds from the sale of Investment properties		160,000	0
Acquisition of intangible assets	25	(39,567)	0
Acquisition of property and equipment		(3,893)	(776)
Proceeds from the sale of property and equipment		6,201	2,600
Dividends from associates		3,750	0
Acquisition of non-controlling interests		0	188,422
Proceeds from the sale of assets classified as held for sale		11,700	0
Net cash from (to) investing activities		138,191	(761,465)
Cash flows from financing activities			
Borrowings		7,958,341	10,738,820
Issued bills		(388,696)	6,758
Issued bonds		1,655,637	0
Subordinated liabilities		600,000	427,615
Decrease in warrants		(2,509)	0
Dividend paid to shareholders		0	(407,638)
Treasury share transactions		196,506	135,009
Net cash from financing activities		10,019,280	10,900,565
Net increase in cash and balances with Central Bank		18,361,723	16,719,641
Cash and balances with Central Bank at the beginning of the year	16	20,493,739	12,032,879
Effects of exchange rate fluctuations on cash and balances with Central Bank held		(403,553)	(54,301)
Cash and balances with Central Bank at the end of the period	16	38,451,909	28,698,219

The notes on pages 11 to 48 are an integral part of these Condensed Consolidated Interim Financial Statements.

Notes to the Condensed Consolidated Interim Financial Statements

General information

Income statement

Statement of Financial Position

Risk management

Financial assets and liabilities

Segment information

Other information

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 a 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 2018 comprise Kvika banki hf. and its subsidiaries (together referred to as the Group). Kvika is a commercial bank, focusing on investment banking activities. The Bank operates four business segments, Asset Management, Corporate Finance, Corporate Banking and Capital Markets. Kvika provides businesses, investors and individuals with comprehensive investment banking and asset management services as well as selected banking services.

The Condensed Consolidated Interim Financial Statements were approved and authorised for issue by the Board of Directors and the CEO on 23 August 2018.

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 and additional requirements in the Icelandic Financial Statement Act. The Consolidated Financial Statements are also prepared in accordance with Icelandic laws on financial statements and regulations on presentation and contents of financial statements.

The Condensed Consolidated Interim Financial Statements do not include all of the information required for full Consolidated Financial Statements, and should be read in conjunction with the Bank's Consolidated Financial Statements for the financial year ending 31 December 2017, which are available at www.kvika.is, and the changes to accounting polices as outlined in note 55.

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;
- loans to customers which 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; and
- assets classified as held for sale are measured at the lower of cost or fair value less cost to sell.

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 2018.

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, except regarding changes due to the adoption of IFRS 9, is provided in the Consolidated Financial Statements as at and for the year ended 31 December 2017. Refer to note 55 for information about areas of estimation and judgement regarding IFRS 9.

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.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

3. Significant accounting policies

The accounting policies applied in the Consolidated Interim Financial Statements are consistent with those applied in the Consolidated Financial Statements as at and for the year ended 31 December 2017, except for changes to the accounting for financial instruments resulting from the adoption of IFRS 9, and the accounting for revenue from contracts with customers resulting from adoption of IFRS 15. IFRS 9 replaces IAS 39 for annual periods on or after 1 January 2018. The impact from the implementation of IFRS 9 on the opening balance sheet at 1 January 2018 is disclosed in note 4. The Group has not restated comparative information for 2017 for financial instruments in scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. New classification and measurement categories for IFRS 9 have replaced the ones used under IAS 39. For further details on the accounting policy under IFRS 9, see note 55. To view the effects of the changes on individual portfolios of financial assets and liabilities, see note 5. The impact of adopting IFRS 15 was negligible, refer to note 55 for more information.

4. Reconciliation of Consolidated Statement of Financial Position

The table below shows a reconciliation of the Consolidated Statement of Financial Position carrying amounts in accordance with IAS 39 to the Consolidated Statement of Financial Position carrying amounts in accordance with IFRS 9 on 1 January 2018.

	IAS 39 31.12.2017	Impact of Impairment	Total impact	IFRS 9 1.1.2018
Assets:				
Cash and balances with Central Bank	20,493,739	-	-	20,493,739
Fixed income securities	5,598,409	-	-	5,598,409
Shares and other variable income securities	2,837,375	-	-	2,837,375
Securities used for hedging	14,026,433	-	-	14,026,433
Loans to customers	25,338,250	28,709	28,709	25,366,959
Derivatives	1,052,652	-	-	1,052,652
Investment in associates	676,610	-	-	676,610
Investment properties	953,874	-	-	953,874
Intangible assets	2,284,340	-	-	2,284,340
Property and equipment	57,251	-	-	57,251
Deferred tax assets	464,414	-	-	464,414
Other assets	1,797,913	-	-	1,797,913
Assets classified as held for sale	15,260	-	-	15,260
Total assets	75,596,519	28,709	28,709	75,625,229
Liabilities:				
Deposits from customers	41,749,497	-	-	41,749,497
Borrowings	13,731,375	-	-	13,731,375
Issued bills	3,934,757	-	-	3,934,757
Issued bonds	1,401,879	-	-	1,401,879
Subordinated liabilities	1,058,741	-	-	1,058,741
Short positions held for trading	370,163	-	-	370,163
Derivatives	364,692	-	-	364,692
Current tax liabilities	789	-	-	789
Deferred tax liabilities	65,658	-	-	65,658
Other liabilities	1,936,693	-	-	1,936,693
Total liabilities	64,614,243	0	0	64,614,243
Equity:				
Share capital	1,805,060	-	-	1,805,060
Share premium	2,722,583	-	-	2,722,583
Option reserve	903	-	-	903
Warrants reserve	207,048	-	-	207,048
Deficit reduction reserve	3,103,697	-	-	3,103,697
Other reserves	(21,722)	-	-	(21,722)
Restricted retained earnings	254,844	-	-	254,844
Retained earnings	2,858,439	28,709	28,709	2,887,148
Total equity attributable to the shareholders	10,930,854	28,709	28,709	10,959,563
Non-controlling interest	51,423	-	-	51,423
Total equity	10,982,276	28,709	28,709	11,010,986
Total liabilities and equity	75,596,519	28,709	28,709	75,625,229

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

5. Financial assets and financial liabilities classification transition from IAS 39 to IFRS 9

The table below shows the original measurement categories in accordance with IAS 39 and the new measurement categories in accordance with IFRS 9 for the Group's financial assets and financial liabilities as at 1 January 2018

Financial assets:	Measurement category under IAS 39	Measurement category under IFRS 9	Carrying amount IAS 39	Reclassifi-cation	Remeasure-ment	Carrying amount IFRS 9
Cash and balances with Central Bank	Amortised cost	Amortised cost	20,493,739	-	-	20,493,739
Fixed income securities:			5,598,409	-	-	5,598,409
Fixed income securities	FVTPL *	FVTPL ***	*5,598,409*	-	-	*5,598,409*
Fixed income securities	FVTPL**	FVTPL ***	-	-	-	*0*
Shares and other variable income sec.:			2,837,375	-	-	2,837,375
Shares and other variable income sec.	FVTPL *	FVTPL ***	*2,833,752*	-	-	*2,833,752*
Shares and other variable income sec.	FVTPL**	FVTPL ***	*3,623*	-	-	*3,623*
Securities used for hedging	FVTPL *	FVTPL ***	14,026,433	-	-	14,026,433
Loans to customers:	Amortised cost	Amortised cost	25,338,250	-	28,709	25,366,959
Loans to customers	Amortised cost	Amortised cost	*25,338,250*	*(1,749,637)*	*28,709*	*23,617,322*
Loans to customers	Amortised cost	FVTPL ***	*0*	*1,749,637*	-	*1,749,637*
Derivatives	FVTPL *	FVTPL ***	1,052,652	-	-	1,052,652
Other assets	Amortised cost	Amortised cost	1,797,913	-	-	1,797,913
Total financial assets			71,144,771	0	28,709	71,173,480
Financial liabilities:						
Deposits from customers	Amortised cost	Amortised cost	41,749,497	-	-	41,749,497
Borrowings	Amortised cost	Amortised cost	13,731,375	-	-	13,731,375
Issued bills	Amortised cost	Amortised cost	3,934,757	-	-	3,934,757
Issued bonds	Amortised cost	Amortised cost	1,401,879	-	-	1,401,879
Subordinated liabilities	Amortised cost	Amortised cost	1,058,741	-	-	1,058,741
Short positions held for trading	FVTPL *	FVTPL ***	370,163	-	-	370,163
Derivatives	FVTPL *	FVTPL ***	364,692	-	-	364,692
Other liabilities	Amortised cost	Amortised cost	1,936,693	-	-	1,936,693
Total financial liabilities			64,547,796	0	0	64,547,796

FVTPL * - Held for trading
FVTPL ** - Designated at fair value through profit or loss
FVTPL *** - Mandatorily measured at fair value through profit or loss

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

Income statement

6. Net interest income

Interest income is specified as follows:

	6m 2018	6m 2017
Cash and balances with Central Bank	513,249	736,543
Derivatives	506,840	543,276
Loans to customers	1,170,961	1,207,435
Other interest income	28,448	13,154
Total	2,219,497	2,500,408

Interest expense is specified as follows:

	6m 2018	6m 2017
Deposits from customers	669,202	753,176
Borrowings	507,529	757,547
Issued bills	93,991	110,560
Issued bonds	53,341	0
Subordinated liabilities	51,082	26,854
Derivatives	3,549	21,859
Other interest expense	46,970	23,791
Total	1,425,662	1,693,787

Total interest income recognised in respect of financial assets not carried at fair value through profit or loss amounts to ISK 1,649 million (2017: ISK 1,957 million). Total interest expense recognised in respect of financial liabilities not carried at fair value through profit or loss amounts to ISK 1,422 million (2017: ISK 1,672 million).

7. Fee and commission income

Fee and commission income is specified as follows:

	6m 2018	6m 2017
Corporate Banking	341,207	290,899
Capital Markets	360,522	442,150
Asset Management	964,961	428,624
Other	322,168	198,134
Total	1,988,858	1,359,806

8. Net financial income

Net financial income is specified as follows:

	6m 2018
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	
Fixed income securities	125,781
Shares and other variable income securities	85,737
Derivatives	20,707
Loans to customers	46,883
Foreign currency exchange difference	15,641
Total	294,749

	6m 2017
Financial assets held for trading	
Fixed income securities	117,395
Shares and other variable income securities	123,794
Derivatives	63,975
Financial assets designated at fair value through profit or loss	
Shares and other variable income securities	51,931
Foreign currency exchange difference	27,916
Total	385,011

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

9. Administrative expenses

Administrative expenses are specified as follows:	6m 2018	6m 2017
Salaries and related expenses	1,350,926	1,037,112
Other operating expenses	574,815	514,738
Depositors' and Investors' Guarantee Fund contributions	49,548	44,667
Depreciation and amortisation	11,441	12,627
Total	1,986,730	1,609,144

10. Salaries and related expenses

Salaries and related expenses are specified as follows:	6m 2018	6m 2017
Salaries	1,064,278	816,671
Performance based payments excluding share-based payments	1,573	0
Share-based payment expenses	1,685	143
Pension fund contributions	135,434	106,039
Tax on financial activity	62,351	49,160
Other salary related expenses	85,605	65,100
Total	1,350,926	1,037,112

11. Net impairment

	6m 2018
Net change in impairment of loans	(22,056)
Net change in impairment of other assets	(1,977)
Net change in impairment of loan commitments, guarantees and unused credit facilities	18,571
Net impairment	(5,462)

Net impairment under IAS 39	6m 2017
Net change in specific impairment for the period	6,891
Net change in collective impairment for the period	(2,227)
Net impairment	4,664

12. Income tax

The Group will not pay income tax on its profit for 2018 due to the fact that it has a tax loss carry forward that offsets the calculated income tax. At year end 2017, the tax loss carry forward of the Group amounted to ISK 159 billion. A substantial part of the tax loss carry forward 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 to be utilisable against future taxable profits. 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% (2017: 20.0%)

13. Special tax on financial activity

The special tax on financial activity is an additional income tax which becomes effective when the income tax base exceeds ISK 1,000 million. It is levied on the same entities as the tax on financial activity according to Act No. 90/2003. The tax rate is set at 6.0% (2017: 6.0%) and the tax is not a deductible expense for income tax purposes. The tax is presented separately in the consolidated income statement.

14. 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% (2017: 0.376%) and the tax is not a deductible expense for income tax purposes. The tax is presented separately in the consolidated income statement.

15. Earnings per share

The calculation of basic earnings per share is based on earnings attributable to shareholders and a weighted average number of shares outstanding during the period. The calculation of diluted earnings per share is based on earnings attributable to shareholders and the weighted average number of outstanding shares plus incremental shares due to issued warrants.

	6m 2018	6m 2017
Net earnings attributable to equity holders of the Bank	1,012,738	945,597
Weighted average number of outstanding shares	1,825,808	1,389,587
Incremental shares	199,989	36,400
Total	2,025,797	1,425,987
Basic earnings per share (ISK)	0.55	0.68
Diluted earnings per share (ISK)	0.50	0.66

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

Statement of Financial Position

16. Cash and balances with Central Bank

Cash and balances with Central Bank are specified as follows:

	30.6.2018	31.12.2017
Deposits with Central Bank	23,324,035	7,660,601
Cash on hand	10,162	24,813
Balances with banks	10,131,840	7,043,106
Foreign treasury bills	3,502,290	3,789,480
Included in cash and cash equivalents	36,968,327	18,517,999
Restricted balances with Central Bank - average maintenance level	741,791	1,467,824
Restricted balances with Central Bank - fixed reserve requirement	741,791	0
Receivables from Central Bank	0	507,916
Total	38,451,909	20,493,739

The Bank holds mandatory reserve deposit accounts with the Central Bank of Iceland in compliance with the Central Bank's new Rules on Minimum Reserve Requirements No. 585/2018. Under these rules the reserve requirement is divided into two parts: a fixed reserve requirement bearing no interest and an average maintenance level requirement bearing the same interest as that on deposit-taking institutions' current accounts with the Central Bank. The new rules came into effect for the reserve maintenance period starting 21 June 2018. The mandatory reserve deposit with the Central Bank and the receivables from the Central Bank are not available for the Group to use in its daily operations.

17. Fixed income securities

Fixed income securities are specified as follows:

Mandatorily measured at fair value through profit or loss	**30.6.2018**
Listed government bonds and bonds with government guarantees	1,681,672
Listed bonds	3,062,623
Unlisted bonds	214,055
Total	4,958,350
Held for trading	**31.12.2017**
Listed government bonds and bonds with government guarantees	1,767,992
Listed treasury bills	499,267
Listed bonds	3,110,155
Unlisted bonds	220,994
Total	5,598,409

Further discussion about the accounting classification of financial assets is provided in note 48-50.

18. Shares and other variable income securities

Shares and other variable income securities are specified as follows:	**30.6.2018**
Mandatorily measured at fair value through profit or loss	
Listed shares	720,557
Unlisted shares	867,637
Unlisted unit shares	1,073,726
Total	2,661,920
	31.12.2017
Held for trading	
Listed shares	1,266,507
Unlisted shares	687,328
Unlisted unit shares	879,916
Designated at fair value through profit or loss	
Unlisted shares	3,623
Total	2,837,375

Further discussion about the accounting classification of financial assets is provided in note 48-50.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

19. Securities used for hedging

Securities used for hedging are specified as follows:

	30.6.2018	31.12.2017
Listed government bonds and bonds with government guarantees	6,583,512	3,519,268
Listed bonds	2,274,951	1,740,609
Listed shares	9,129,941	8,681,677
Unlisted unit shares	54,207	84,880
Total	18,042,611	14,026,433

Securities used for hedging are classified as mandatorily measured at fair value through profit or loss. Securities used for hedging were classified in 2017 as held for trading. Further discussion about the accounting classification of financial assets is provided in notes 48-50.

20. Loans to customers

The breakdown of the loan portfolio by individuals and corporates is specified as follows:

	Individuals		**Corporates**		**Total**	
30.6.2018	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
Loans to customers at amortised cost	6,092,197	6,051,374	19,389,695	19,214,059	25,481,892	25,265,432
Loans to customers at fair value through profit or loss	0	0	1,614,345	1,614,345	1,614,345	1,614,345
Total	6,092,197	6,051,374	21,004,040	20,828,404	27,096,237	26,879,778

31.12.2017	
Loans to customers, gross amount	25,626,960
Specific allowance for impairment losses	(28,436)
Collective allowance for impairment losses	(260,274)
Total	25,338,250

21. Derivatives

Derivatives are specified as follows:

	Notional		**Carrying value**	
30.6.2018	**Assets**	**Liabilities**	**Assets**	**Liabilities**
Interest rate derivatives	4,240,760	4,105,522	135,238	0
Currency forwards	988,699	982,419	6,672	392
Bond and equity total return swaps	18,573,853	18,131,292	915,880	471,533
Equity options	99,831	7,900	84,453	84,453
	23,903,142	23,227,133	1,142,242	556,379

	Notional		**Carrying value**	
31.12.2017	**Assets**	**Liabilities**	**Assets**	**Liabilities**
Interest rate derivatives	3,596,957	3,503,988	92,969	0
Currency forwards	1,027,214	1,022,872	8,126	3,784
Bond and equity total return swaps	15,009,156	14,429,317	889,858	310,019
Equity options	245,967	0	61,699	50,889
	19,879,293	18,956,176	1,052,652	364,692

22. Group entities

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

Entity	**Nature of operations**	**Domicile**	**Share 30.6.2018**	**Share 31.12.2017**
FÍ Fasteignafélag GP ehf.	Real estate fund management	Iceland	100%	100%
Júpíter rekstrarfélag hf.	Fund management	Iceland	100%	100%
M-Investments ehf.	Holding company	Iceland	100%	100%
Netgíró reikningar ehf.	Holding company	Iceland	100%	100%
Netgíró lán ehf.	Holding company	Iceland	100%	100%
Rafklettur ehf.	Holding company	Iceland	100%	100%
Rekstrarfélag Virðingar hf.	Fund management	Iceland	100%	100%
AC GP 3 ehf.	Fund management	Iceland	80%	80%
Kvika Securities ltd.	Business consultancy services	UK	100%	100%

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

23. 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 30.6.2018	Share 31.12.2017
Akta sjóðir hf.	Fund management	Iceland	49%	49%
Kjölfesta GP ehf.	Holding company	Iceland	50%	50%
Kortaþjónustan hf.	Payment Institution	Iceland	42%	42%

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

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

	30.6.2018	31.12.2017
Balance at the beginning of the year	676,610	127,262
Additions through a merger	0	8,558
Acquisition of shares in associates	0	611,216
Dividend paid	(3,750)	0
Disposal of shares in associates	0	(182,519)
Reclassification	0	48,181
Share in (loss) profit of associates, net of income tax	(3,603)	63,912
Total	669,257	676,610

24. Investment properties

Investment properties are specified as follows:	30.6.2018	31.12.2017
Balance as at 1 January 2018	953,874	0
Acquisitions	0	861,616
Disposal	(150,000)	0
Revaluation on investment properties	0	92,258
Total	803,874	953,874

25. Intangible assets

Intangible assets are specified as follows:

30.6.2018	Goodwill	Software	Other	Total
Balance as at 1 January 2018	2,244,521	23,959	15,860	2,284,340
Acquisitions	0	39,567	0	39,567
Amortisation	0	(2,247)	(2,440)	(4,687)
Balance as at 30 June 2018	2,244,521	61,279	13,420	2,319,220
Gross carrying amount	2,244,521	85,010	48,800	2,378,330
Accumulated amortisation and impairment losses	0	(23,731)	(35,380)	(59,111)
Balance as at 30 June 2018	2,244,521	61,279	13,420	2,319,220

31.12.2017	Goodwill	Software	Other	Total
Balance as at 1 January 2017	0	20,790	20,740	41,530
Acquisitions	0	8,680	40,000	48,680
Additions through a business combination	2,244,521	0	0	2,244,521
Amortisation	0	(5,511)	(44,880)	(50,391)
Balance as at 31 December 2017	2,244,521	23,959	15,860	2,284,340
Gross carrying amount	0	45,442	48,800	94,242
Accumulated amortisation and impairment losses	0	(24,652)	(28,060)	(52,712)
Balance as at 1 January 2017	0	20,790	20,740	41,530
Gross carrying amount	2,244,521	38,924	48,800	87,724
Accumulated amortisation and impairment losses	0	(14,965)	(32,940)	(47,905)
Balance as at 31 December 2017	2,244,521	23,959	15,860	2,284,340

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

26. Other assets

Other assets are specified as follows:

	30.6.2018	31.12.2017
Unsettled transactions	5,204,134	290,598
Accounts receivable	1,342,309	1,147,904
Sundry assets	418,727	359,411
Total	6,965,170	1,797,913

27. Deposits from customers

Deposits from customers are specified as follows:

	30.6.2018	31.12.2017
Demand deposits	40,912,598	33,097,311
Time deposits	13,116,270	8,652,186
Total	54,028,869	41,749,497

28. Borrowings

Borrowings are specified as follows:

	30.6.2018	31.12.2017
Loans from credit institutions	1,063,355	609,897
Money market deposits	20,615,627	13,076,921
Other borrowings	29,839	44,557
Total	21,708,822	13,731,375

Money market deposits typically have a principal of ISK 5-500 million and maturity between 1 day and 6 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.

29. Issued bills

Issued bills are specified as follows:

	30.6.2018	31.12.2017
Issued bills	3,546,061	3,934,757
Total	3,546,061	3,934,757

30. Issued bonds

Issued bonds are specified as follows:

Currency, nominal value	First issued	Maturity	Maturity type	Terms of interest	30.6.2018	31.12.2017
KVB 17 02, ISK 2,160 million	2017	2020	At maturity	Floating, 1 month REIBOR + 1.25%	2,160,808	1,031,433
Total					2,160,808	1,031,433
Unlisted senior unsecured bonds, total					896,708	370,446
Total					3,057,516	1,401,879

Unlisted senior unsecured bonds are composed of KVB 17 01 and KVB 18 01 which were issued in 2017 and 2018 and mature in 2019 and 2020, respectively. For further information on the bonds, refer to the issue descriptions which are available on Nasdaq CSD Iceland's website.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

31. Subordinated liabilities

Subordinated liabilities:

Currency, nominal value	First issued	Maturity	Maturity type	Terms of interest	30.6.2018	31.12.2017
KVB 15 01, ISK 1,000 million	2015	2025	At maturity	CPI-Indexed, fixed 5.50%	1,101,450	1,058,741
KVB 18 02, ISK 600 million	2018	2028	At maturity	CPI-Indexed, fixed 7.50%	606,169	0
Total					1,707,619	1,058,741

At the interest payment date in the year 2020 for KVB 15 01, 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.

At the interest payment date in the year 2023 for KVB 18 02, 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 categorised as Tier 2 and are included in the equity base. The amount eligible for Tier 2 capital treatment is amortised on a straight-line basis over the final 5 years to maturity or up to 20% a year.

32. Short positions held for trading

Short positions held for trading are specified as follows:

	30.6.2018	31.12.2017
Listed government bonds and bonds with government guarantees	0	305,041
Listed bonds	90,666	65,122
Total	90,666	370,163

Short positions held for trading are classified as mandatorily measured at fair value through profit or loss. Short positions held for trading were classified in 2017 as held for trading. Further discussion about the accounting classification of financial liabilites is provided in notes 48-50.

33. Other liabilities

Other liabilities are specified as follows:

	30.6.2018	31.12.2017
Unsettled transactions	5,073,921	556,716
Expected credit loss allowance for loan commitments, guarantees and unused credit facilities	18,571	0
Accounts payable and accrued expenses	184,919	219,834
Special taxes on financial institutions and financial activities	75,305	75,336
Withholding taxes	268,843	472,874
Salaries and salary related expenses	400,029	403,924
Other liabilities	372,846	208,009
Total	6,394,434	1,936,693

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

34. Equity

a. Share capital

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

	30.6.2018	**31.12.2017**
Share capital according to the Bank's Articles of Association	1,844,996	1,815,061
Nominal amount of treasury shares	0	10,000
Authorised but not issued shares	838,635	878,571

b. Changes made to the nominal amount of share capital

The Bank's share capital was increased twice during the first half of 2018, in total for a nominal value of ISK 30 million. In March 2018 and in May 2018 the share capital was increased by ISK 19,957,356 and ISK 9,978,678, respectively, in nominal value in relation to exercise of issued warrants.

c. Share capital increase authorisations

According to the Bank's Articles of Association dated 18 May 2018, the Board of Directors is authorised to increase the share capital of the Bank by up to ISK 100 million through subscription for new shares. This authorisation is based on temporary provision I to the Articles of Association and is valid until 15 March 2022.

Temporary provision IV to the Articles of Association authorises the Board of Directors to issue warrants and increase the share capital accordingly. According to section A of temporary provision IV the Board of Directors is authorised to increase share capital by up to ISK 480 million to serve issued warrants. According to section B of temporary provision IV the Board of Directors is furthermore granted a conditioned authorisation to increase the share capital by an additional amount of ISK 400 million to serve issued warrants. The authorisation under section B of temporary provision IV is directly linked to the Board of Directors' authorisation under section A of temporary provision I.

The aforementioned authorisation under section B of temporary provision IV currently stands at ISK 150 million. However, should the Board of Directors utilise its authorisation according to section A of temporary provision I and increase the Bank's share capital by ISK 100 million, the authorisation under section B of temporary provision IV will increase from ISK 150 million to ISK 200 million, as stipulated in the provision. The Board of Directors' authorisation under temporary provision IV to increase share capital thus currently totals ISK 630 million but can increase to ISK 680 million by the usage by the Board of Directors of its authorisation pursuant to section A of temporary provision I. This authorisation is valid until 14 July 2022.

The Board of Directors is furthermore authorised to increase the 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. This authorisation is based on temporary provision I, cf. paragraph B of the provision, to the Articles of Association and is valid until 30 November 2021.

Temporary provision III to the Articles of Association moreover authorises the Board of Directors to issue new share capital to serve warrants which have been issued in the maximum amount of ISK 58,635,392 nominal value, each of which contains the right to subscribe for one new 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, reference is made to them for more information.

35. Warrants

In October 2016 the Bank issued warrants for ISK 130,000,000 in nominal value, the warrants are valid for 36 months from date of issue. The subscription rate for each new share on exercise of the warrants shall be equal to 3.84 per share with a 5% annual increase. During 1H 2018 a part of the warrants were exercised for a nominal value of ISK 29,936,034. The holders of the remaining warrants issued in October 2016 are authorised to subscribe for ISK 58,635,392 in nominal value.

In 2017 and during 1H 2018 the Bank issued warrants for ISK 629,500,000 in nominal value. The warrants issued in 2017 are valid for five years from date of issue and the warrants issued in 2018 are valid until 18 December 2022. The holders of the warrants issued in 2017 can exercise them as follows: (1) to a third (1/3) of the subscription shares in the period from when two years have elapsed from the issue of the warrants until three years have elapsed from the issue of the warrants, (2) to a third (1/3) of the subscription shares in the period from when three years have elapsed from the issue of the warrants until five years have elapsed from the issue of the warrants, and (3) to a third (1/3) of the subscription shares in the period from when four years have elapsed from the issue of the warrants until five years have elapsed from the issue of the warrants. The holders of the warrants issued in 2018 can exercise them as follows: (1) to a third (1/3) of the subscription shares in the period from 18 December 2019 until 18 December 2020, (2) to a third (1/3) of the subscription shares in the period from 18 December 2020 until 18 December 2022, and (3) to a third (1/3) of the subscription shares in the period from 18 December 2021 until 18 December 2022. The subscription rate for each new share on exercise of the warrants shall be 5.56 with a 7.5% annual increase for 604,000,000 in nominal value issued in September 2017, 6.30 with a 7.5% annual increase for 22,000,000 in nominal value issued in December 2017 and 7.90 with a 7.5% annual increase for 3,500,000 in nominal value issued in May 2018. A more detailed coverage on the warrants and their terms can be found in the Bank's Articles of Association, reference is made to them for more information.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

36. Capital adequacy ratio (CAD)

Equity at the end of the period was ISK 12,230 million (31.12.2017: 10,982 million), equivalent to 11.8% of total assets according to the statement of financial position (31.12.2017: 14.5%). The capital adequacy ratio of the Group, calculated in accordance with Article 84 of Act No. 161/2002 on Financial Undertakings, was 24.6% (31.12.2017: 21.1%). The minimum according to the Act is 8.0%. The ratio is calculated as follows:

Capital base	**30.6.2018**	**31.12.2017**
Total equity	12,229,940	10,982,276
Goodwill and intangibles	(2,319,220)	(2,284,340)
Deferred tax asset	(466,778)	(464,414)
Tier 1 capital	9,443,943	8,233,523
Subordinated liabilities	1,707,619	1,058,741
Accrued interests	(53,097)	(19,097)
Tier 2 capital	1,654,522	1,039,643
Shares in financial institutions	(229,677)	(216,862)
Subordinated fixed income securities	(212,568)	(201,855)
Total capital base	10,656,220	8,854,450

Capital requirements	**30.6.2018**	**31.12.2017**
Credit risk	2,368,007	2,140,527
Market risk	353,665	480,415
Operational risk	738,179	738,179
Total Capital requirements	3,459,851	3,359,121
Surplus capital	7,196,369	5,495,329
Capital adequacy ratio (CAD)	24.6%	21.1%

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 the SREP from 2017, is 14.5%. The minimum regulatory capital requirement including the additional capital requirements imposed following the implementation of CRD IV is 19.5% as at 31 December 2017 and 20.25% from 1 January 2018.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

Risk management

37. Maximum exposure to credit risk

The maximum exposure to credit risk of on-balance sheet and off-balance sheet financial instruments subject to the impairment requirements of IFRS 9, before taking into account any collateral held or other credit enhancements, is specified as follows:

	Public entities	Financial institutions	Corporate customers	Individuals	30.6.2018
Cash and balances with Central Bank	34,949,620	3,502,290			38,451,909
Fixed income securities	2,744,547	2,053,427	160,376		4,958,350
Securities used for hedging	7,009,947	1,399,397	449,119		8,858,463
Loans to customers		65,407	20,923,491	5,890,879	26,879,778
Derivatives		352,613	737,170	52,459	1,142,242
Other assets	29,083	63,184	6,779,429	93,475	6,965,170
	44,733,197	7,436,317	29,049,586	6,036,813	87,255,913
Loan commitments		89,681	2,801,386	506,502	3,397,570
Financial guarantee contracts			685,097		685,097
Total	44,733,197	7,525,999	32,536,068	6,543,315	91,338,579

Maximum exposure to credit risk and collateral held against different types of financial instruments under IAS 39.

	Public entities	Financial institutions	Corporate customers	Individuals	31.12.2017
Cash and balances with Central Bank	16,704,260	3,789,480			20,493,739
Fixed income securities	3,332,061	2,247,209	19,139		5,598,409
Securities used for hedging	4,051,933	1,207,944			5,259,877
Loans to customers		60,005	21,728,318	3,549,927	25,338,250
Derivatives		349,086	664,121	39,445	1,052,652
Other assets	33,732	41,520	1,626,143	96,517	1,797,913
	24,121,985	7,695,243	24,037,721	3,685,890	59,540,839
Loan commitments		298,838	2,128,138	382,601	2,809,577
Financial guarantee contracts			434,237		434,237
Total	24,121,985	7,994,080	26,600,097	4,068,492	62,784,654

38. Credit quality of financial assets

The tables below show financial assets subject to the impairment requirements of IFRS 9 broken down by rating scale where credit score 9-10 denotes the highest risk. Assets measured at fair value through profit or loss are not subject to the impairment requirements of IFRS 9 but are nevertheless included in the tables in order to give a more complete picture of the credit quality of loans to customers and reconcile the tables to the carrying amount on the balance sheet. Exposures where the probability of default are assessed on portfolio level relate to individually rated exposures where the net expected credit loss is based on composition of batches with similar characteristics. Exposures which are non-rated relate to Legal Entities or Individuals with no Credit Score. Probability of default for these exposures is based on average probability for similar exposures and is furthermore individually assessed by credit specialists. Comparative figures have not been restated.

a. Credit quality of financial assets by rating class is specified as follows:

30.6.2018

Loans to customers:	Stage 1	Stage 2	Stage 3	FVTPL	Total
Credit score 1-4	10,709,479	122,246	0	54,320	10,886,046
Credit score 5-6	4,891,902	71,305	2,033	1,195,217	6,160,456
Credit score 7-8	627,386	576,854	0	108,442	1,312,681
Credit score 9-10	189,259	426,312	0	0	615,571
PD assessed on portfolio level	3,962,460	0	0	0	3,962,460
In default	0	0	252,458	0	252,458
Non-rated	3,492,527	156,661	1,010	256,366	3,906,564
Gross carrying amount	23,873,013	1,353,378	255,501	1,614,345	27,096,237
Expected credit loss	(139,844)	(33,715)	(42,901)	0	(216,460)
Book value	23,733,169	1,319,663	212,600	1,614,345	26,879,778

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

38. Credit quality of financial assets (cont.)

Loan commitments, guarantees and unused credit facilities:	Stage 1	Stage 2	Stage 3	FVTPL	Total
Credit score 1-4	1,548,199	969	0	0	1,549,167
Credit score 5-6	1,174,926	2,677	0	415,327	1,592,930
Credit score 7-8	21,354	415,344	0	0	436,698
Credit score 9-10	52,646	9,275	0	0	61,921
PD assessed on portfolio level	0	0	0	0	0
In default	0	0	6,925	0	6,925
Non-rated	434,987	0	37	0	435,025
Gross carrying amount	3,232,113	428,263	6,963	415,327	4,082,666
Expected credit loss	(15,411)	(1,235)	(1,926)	0	(18,571)
Book value	3,216,702	427,029	5,037	415,327	4,064,095

Credit quality by class of financial assets, under IAS 39, is specified as follows:

31.12.2017	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 balances with Central Bank	20,493,739			20,493,739			20,493,739
Fixed income securities	5,598,409			5,598,409			5,598,409
Securities used for hedging	5,259,877			5,259,877			5,259,877
Loans to customers	23,767,646	1,813,169	46,146	25,626,960	(28,436)	(260,274)	25,338,250
Derivatives	1,052,652			1,052,652			1,052,652
Other assets	1,802,986		16,300	1,819,286	(16,373)	(5,000)	1,797,913
Total	57,975,309	1,813,169	62,445	59,850,923	(44,809)	(265,274)	59,540,839

b. Breakdown of loans to customers into not past due and past due, under IFRS 9

30.6.2018	Claim value	Expected credit loss	Carrying amount
Not past due	25,162,026	(152,184)	25,009,842
Past due 1-30 days	1,463,557	(23,326)	1,440,231
Past due 31-60 days	163,510	(1,124)	162,386
Past due 61-90 days	51,521	(1,123)	50,398
Past due 91-180 days	67,792	(6,596)	61,196
Past due 181-360 days	161,233	(16,413)	144,820
Past due more than 360 days	26,598	(15,693)	10,904
Total	27,096,237	(216,460)	26,879,778

Past due but not individually impaired, under IAS 39

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.

	31.12.2017
Past due 1-30 days	1,522,288
Past due 31-60 days	96,162
Past due 61-90 days	990
Past due 91-180 days	188,984
Past due 181-360 days	4,745
Past due more than 360 days	0
Total	1,813,169

Individually impaired, under IAS 39

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

31.12.2017	Impaired but not Past due	Past due 1-30 days	Past due 31-60 days	Past due 61-90 days	Past due over 90 days	Claim value
Corporate						
Services					16,109	16,109
Retail					18,895	18,895
Individuals			432		27,010	27,442
Total	0	0	432	0	62,013	62,445

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

38. Credit quality of financial assets (cont.)

c. Breakdown of loans to customers by industry

The breakdown of the loan portfolio, under IFRS 9, by industries is specified as follows:

30.6.2018	**Claim value**	**Expected credit loss**	**Carrying amount**	**%**
Financial institutions	5,035	(16)	5,019	0.0%
Corporate				
Services	9,978,290	(87,795)	9,890,495	36.8%
Holding companies	5,943,499	(25,425)	5,918,075	22.0%
Real estate, construction and industry	2,444,760	(26,712)	2,418,048	9.0%
Retail	1,162,157	(29,865)	1,132,293	4.2%
Other	1,470,299	(5,823)	1,464,476	5.4%
Individual	6,092,197	(40,825)	6,051,373	22.5%
Total	27,096,237	(216,460)	26,879,778	100.0%

The breakdown of the loan portfolio, under IAS 39, by industries is specified as follows:

31.12.2017	**Claim value**	**Impairment allowance**	**Carrying amount**	**%**
Financial institutions	60,655	(650)	60,005	0.2%
Corporate				
Services	8,596,517	(101,670)	8,494,847	33.5%
Holding companies	7,244,461	(77,675)	7,166,786	28.3%
Real estate, construction and industry	3,319,089	(35,587)	3,283,502	13.0%
Retail	1,202,059	(22,133)	1,179,925	4.7%
Other	1,620,635	(17,376)	1,603,258	6.3%
Individual	3,583,545	(33,617)	3,549,927	14.0%
Total	25,626,960	(288,710)	25,338,250	100.0%

d. Breakdown of loans to customers 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 to customers by categories, under IFRS 9, is as follows:

	Senior I	**Senior II**	**Junior**	**Mezzanine**	**30.6.2018**
Amortised cost - Stage 1	6,143,969	8,755,738	3,690,743	4,871,966	23,462,417
Amortised cost - Stage 2	102,785	633,949	311,933	426,533	1,475,199
Amortised cost - Stage 3	145,443	62,941		119,432	327,816
Fair value through profit and loss		230,109	868,043	516,193	1,614,345
Total	6,392,197	9,682,737	4,870,719	5,934,124	26,879,778

The breakdown of loans to customers by categories, under IAS 39, is as follows:

	Senior I	**Senior II**	**Junior**	**Mezzanine**	**31.12.2017**
Neither past due nor individually impaired	5,879,042	9,995,383	4,093,497	3,554,139	23,522,061
Past due but not individually impaired	387,816	535,733	323,319	551,611	1,798,480
Individually impaired		9,447		8,262	17,709
Total	6,266,858	10,540,564	4,416,817	4,114,011	25,338,250

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

38. Credit quality of financial assets (cont.)

e. **Allowance for expected credit loss on loans to customers and loan commitments, guarantees and unused credit facilities**

The following tables show changes in the expected credit loss allowance of loans to customers and for loan commitments, guarantees and unused credit facilities during the period.

30.6.2018

Expected credit loss allowance total

	Stage 1	Stage 2	Stage 3	Total
General and specific loss provision at 31.12.2017	243,944	10,856	33,911	288,710
Net remeasurement	(91,791)	39,687	23,395	(28,709)
Opening expected credit loss balance at 1.1.2018	152,153	50,543	57,305	260,001
Transfers of financial assets:				
Transfer to Stage 1 - (Initial recognition)	2,544	(49)	(2,496)	0
Transfer to Stage 2 - (significantly increased credit risk)	(2,875)	2,875		0
Transfer to Stage 3 - (credit impaired)	(941)	(8)	949	0
Net remeasurement of loss allowance	2,431	(11,645)	19,980	10,767
New financial assets, originated or purchased	49,297	11,771		61,068
Derecognitions and maturities	(47,355)	(18,537)	(21,242)	(87,135)
Write-offs			(9,671)	(9,671)
Total	155,255	34,950	44,826	235,031

Expected credit loss allowance for loans to customers

	Stage 1	Stage 2	Stage 3	Total
General and specific loss provision at 31.12.2017	243,944	10,856	33,911	288,710
Net remeasurement	(106,713)	38,782	22,487	(45,444)
Opening expected credit loss balance at 1.1.2018	137,231	49,638	56,398	243,266
Transfers of financial assets:				
Transfer to Stage 1 - (Initial recognition)	2,276	(48)	(2,228)	0
Transfer to Stage 2 - (significantly increased credit risk)	(2,704)	2,704		0
Transfer to Stage 3 - (credit impaired)	(895)	(8)	903	0
Net remeasurement of loss allowance	2,397	(12,478)	18,670	8,588
New financial assets, originated or purchased	42,550	11,753		54,304
Derecognitions and maturities	(41,011)	(17,846)	(21,172)	(80,028)
Write-offs			(9,671)	(9,671)
Total	139,844	33,715	42,901	216,460

Expected credit loss allowance for loan commitments, guarantees and unused credit facilities

	Stage 1	Stage 2	Stage 3	Total
General and specific loss provision at 31.12.2017				0
Net remeasurement	14,922	905	908	16,735
Opening expected credit loss balance at 1.1.2018	14,922	905	908	16,735
Transfers of financial assets:				
Transfer to Stage 1 - (Initial recognition)	268	(0)	(268)	0
Transfer to Stage 2 - (significantly increased credit risk)	(171)	171		0
Transfer to Stage 3 - (credit impaired)	(46)	(0)	46	0
Net remeasurement of loss allowance	35	834	1,310	2,178
New financial assets, originated or purchased	6,747	17		6,764
Derecognitions and maturities	(6,344)	(692)	(70)	(7,106)
Write-offs				0
Total	15,411	1,235	1,926	18,571

The following table reconciles the opening and closing loss allowance balance as measured under IAS 39. The comparative amounts have not been restated after the implementation of IFRS 9.

31.12.2017	Specific	Collective	Total
Balance as at 1 January 2017	44,404	262,208	306,611
Charge to the income statement for the period	20,677	(1,934)	18,744
Recoveries	(20,815)	0	(20,815)
Write-offs	(15,829)	0	(15,829)
Balance as at 31 December 2017	28,436	260,274	288,710

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

39. 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 49. 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	30.6.2018
Financial institutions	972	59,590	194,672				255,234
Corporate customers	1,203,239	100,242	8,238,222	8,762,237	201,952	178,578	18,684,471
Individuals	34,227	4,034	1,021,226	709,589			1,769,075
Total	1,238,438	163,866	9,454,120	9,471,826	201,952	178,578	20,708,780

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2017
Financial institutions	25,499	52,629	176,586				254,714
Corporate customers	605,792	81,471	8,026,087	10,357,144	29,483	453,024	19,553,001
Individuals	19,562	23,918	1,010,639	808,731			1,862,850
Total	650,853	158,018	9,213,312	11,165,875	29,483	453,024	21,670,565

Amounts have been adjusted to exclude collateral in excess of claim value, i.e. overcollateralisation. 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	30.6.2018
Financial institutions	237,557	120,597	1,176,900				1,535,054
Corporate customers	890,537	105,623	846,398				1,842,558
Individuals	63,385		79,558				142,943
Total	1,191,479	226,220	2,102,856	0	0	0	3,520,554

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2017
Financial institutions	182,198	188,761	1,283,782				1,654,741
Corporate customers	672,466	48,134	771,690				1,492,290
Individuals	31		63,024				63,054
Total	854,695	236,894	2,118,496	0	0	0	3,210,085

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

40. 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:

	30.6.2018	%	31.12.2017	%
Less than 50%	11,971,691	44.5%	11,880,633	46.9%
51-70%	3,739,063	13.9%	4,149,003	16.4%
71-90%	2,363,200	8.8%	3,013,046	11.9%
91-100%	19,075	0.1%	509,725	2.0%
More than 100%	4,104,329	15.3%	3,890,730	15.4%
No collateral:				
Purchased short-term retail claims	3,962,362	14.7%	1,385,120	5.5%
Other loans with no collateral	720,059	2.7%	509,992	2.0%
Total	26,879,777	100.0%	25,338,250	100.0%

The Group has entered into an agreement to purchase short term consumer credit (the claims) from an originator. The purchase of claims are subject to conditions such as credit rating of the borrower and maximum maturity of 24 months. Further, the originator receives final payment of the purchased claim when the claim is fully repaid, until then a part of the purchase price is held as collateral against defaults.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

41. 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 36).

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.

		30.6.2018		31.12.2017
Large exposures before risk adjusted mitigation	**Number**	**Amount**	**Number**	**Amount**
10-20% of capital base	5	6,859,649	9	9,531,399
20-25% of capital base	0	0	0	0
Exceeding 25% of capital base	1	6,364,576	2	7,126,328
Total	6	13,224,225	11	16,657,727
Thereof nostro accounts with foreign banks with S&P rating of A- or higher	2	8,262,511	2	4,521,688
Large exposures net of risk adjusted mitigation	1	1,897,935	2	2,275,732

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.

42. Liquidity risk

a. Definition

Liquidity risk is the risk that the Group will encounter difficulty in meeting contractual payment obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. This risk mainly arises from mismatches in the timing of cash flows. The Group has internal rules that require certain matching of the maturities of assets and liabilities. Furthermore, to ensure the ability to meet liquidity needs, the Group maintains a stock of highly liquid unencumbered assets, e.g. cash, treasury bills and treasury bonds.

b. Management

Liquidity is managed by treasury and monitored by risk management. Liquidity position is reported to the ALCO committee. The Central Bank of Iceland sets minimum requirements for the coverage ratio between cash flows of assets and liabilities (LCR) and stable funding in foreign currencies (NSFR). The minimum 30 day LCR was 100% in 2017 and is unchanged for 2018. (100% for non-ISK assets). The minimum NSFR in foreign currencies was 100% in 2017 and is unchanged for 2018.

The Group was in compliance with internal and external liquidity requirements throughout the years 2018 and 2017. At end of June 2018 the LCR was 324% and at year-end 2017 it was 215%.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

42. Liquidity risk (cont.)

Maturity analysis of financial assets and financial liabilities

30.6.2018 **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 balances with Central Bank	38,451,909					38,451,909	38,451,909
Fixed income securities	4,751,836	212,568				4,964,404	4,958,350
Shares and other variable income securities	1,570,361	1	1,091,558			2,661,920	2,661,920
Securities used for hedging	18,042,611					18,042,611	18,042,611
Loans to customers	3,232,865	4,547,854	13,971,693	5,531,740	625,935	27,910,087	26,879,778
Other assets	5,631,712	667,089	281,370	385,000		6,965,170	6,965,170
	71,681,294	5,427,512	15,344,621	5,916,740	625,935	98,996,101	97,959,739
Derivative assets							
Inflow	11,219,950	1,303,085	384,627	127,533		13,035,195	
Outflow	(10,330,312)	(1,275,637)	(372,932)	(5,220)		(11,984,101)	
	889,638	27,448	11,695	122,313	0	1,051,094	1,142,242

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	(37,719,966)	(12,745,810)	(2,046,653)	(1,653,201)	(80,774)	(54,246,404)	54,028,869
Borrowings	(3,445,140)	(11,242,284)	(7,184,826)			(21,872,250)	21,708,822
Issued bills		(2,000,000)	(1,600,000)			(3,600,000)	3,546,061
Issued bonds	(13,005)	(27,439)	(111,607)	(3,283,968)		(3,436,019)	3,057,516
Subordinated liabilities		(58,204)	(45,152)	(308,782)	(2,156,879)	(2,569,018)	1,707,619
Short positions held for trading	(90,666)					(90,666)	90,666
Other liabilities	(5,333,579)	(619,192)	(394,007)	(47,655)		(6,394,434)	6,394,434
	(46,602,356)	(26,692,930)	(11,382,245)	(5,293,605)	(2,237,654)	(92,208,790)	90,533,987
Derivative liabilities							
Inflow	6,056,950	611,558				6,668,508	
Outflow	(6,522,473)	(616,902)				(7,139,374)	
	(465,523)	(5,344)	0	0	0	(470,867)	556,379
Unrecognised financial items							
Loan commitments							
Inflow	183,135	447,368	1,953,078	869,251		3,452,832	
Outflow	(3,397,570)					(3,397,570)	
Financial guarantee contracts							
Inflow	685,097					685,097	
Outflow	(685,097)					(685,097)	
	(3,214,434)	447,368	1,953,078	869,251	0	55,262	
Summary							
Non-derivative assets	71,681,294	5,427,512	15,344,621	5,916,740	625,935	98,996,101	
Derivative assets	889,638	27,448	11,695	122,313		1,051,094	
Non-derivative liabilities	(46,602,356)	(26,692,930)	(11,382,245)	(5,293,605)	(2,237,654)	(92,208,790)	
Derivative liabilities	(465,523)	(5,344)				(470,867)	
Net assets (liabilities) excluding unrecognised items	25,503,054	(21,243,315)	3,974,070	745,448	(1,611,719)	7,367,538	
Net unrecognised items	(3,214,434)	447,368	1,953,078	869,251		55,262	
Net assets (liabilities)	22,288,619	(20,795,947)	5,927,148	1,614,699	(1,611,719)	7,422,800	

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

42. Liquidity risk (cont.)

31.12.2017 **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 balances with Central Bank	20,493,739					20,493,739	20,493,739
Fixed income securities	5,406,714	201,855			80,858	5,689,427	5,598,409
Shares and other variable income securities	2,131,471		1,208,706			3,340,177	2,837,375
Securities used for hedging	14,024,316					14,024,316	14,026,433
Loans to customers	4,063,760	2,748,727	12,829,736	6,069,743	648,233	26,360,200	25,338,250
Other assets	640,310	609,507	227,096	321,000		1,797,913	1,797,913
	46,760,310	3,560,089	14,265,538	6,390,743	729,092	71,705,772	70,092,119
Derivative assets							
Inflow	9,947,067		375,150	96,957		10,419,174	
Outflow	(9,052,929)		(375,990)	(3,988)		(9,432,907)	
	894,138	0	(840)	92,969	0	986,267	1,052,652

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	(33,377,234)	(4,140,390)	(3,049,209)	(1,253,664)	(84,226)	(41,904,723)	41,749,497
Borrowings	(648,116)	(3,675,998)	(9,487,237)	(446)	(75,926)	(13,887,723)	13,731,375
Issued bills		(2,000,000)	(2,000,000)			(4,000,000)	3,934,757
Issued bonds	(7,992)	(15,452)	(70,203)	(748,361)		(842,007)	1,401,879
Subordinated liabilities			(57,457)	(171,101)	(1,267,459)	(1,496,017)	1,058,741
Short positions held for trading	(370,163)					(370,163)	370,163
Other liabilities	(636,290)	(756,258)	(493,383)	(50,761)		(1,936,693)	1,936,693
	(35,039,794)	(10,588,098)	(15,157,490)	(2,224,332)	(1,427,611)	(64,437,326)	64,183,104
Derivative liabilities							
Inflow	4,595,729	315,474				4,911,204	
Outflow	(4,874,413)	(350,460)				(5,224,873)	
	(278,684)	(34,986)	0	0	0	(313,670)	364,692
Unrecognised financial items by type							
Loan commitments							
Inflow	695,435	445,258	1,168,098	563,953		2,872,743	
Outflow	(2,809,577)					(2,809,577)	
Financial guarantee contracts							
Inflow	434,237					434,237	
Outflow	(434,237)					(434,237)	
	(2,114,143)	445,258	1,168,098	563,953	0	63,165	
Summary							
Non-derivative assets	46,760,310	3,560,089	14,265,538	6,390,743	729,092	71,705,772	
Derivative assets	894,138		(840)	92,969		986,267	
Non-derivative liabilities	(35,039,794)	(10,588,098)	(15,157,490)	(2,224,332)	(1,427,611)	(64,437,326)	
Derivative liabilities	(278,684)	(34,986)				(313,670)	
Net assets (liabilities) excluding unrecognised items	12,335,970	(7,062,995)	(892,792)	4,259,380	(698,519)	7,941,044	
Net unrecognised items	(2,114,143)	445,258	1,168,098	563,953		63,165	
Net assets (liabilities)	10,221,827	(6,617,737)	275,306	4,823,333	(698,519)	8,004,209	

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 unrecognised 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

43. 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	30.6.2018
Fixed income securities	212,568		129,798	2,066,620	2,549,364	4,958,350
Short positions - fixed income securities					(90,666)	(90,666)
Net imbalance	212,568	0	129,798	2,066,620	2,458,699	4,867,685

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	31.12.2017
Fixed income securities	499,064			2,066,324	3,033,020	5,598,409
Short positions - fixed income securities					(370,163)	(370,163)
Net imbalance	499,064	0	0	2,066,324	2,662,857	5,228,246

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	30.6.2018 Upward	Downward	31.12.2017 Upward
Indexed	50	65,083	(65,083)	50,527	(50,527)
Non-indexed	100	102,439	(102,439)	144,730	(144,730)
Total		167,523	(167,523)	195,257	(195,257)

44. 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:

30.6.2018

Financial assets	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and balances with Central Bank	34,949,620	3,502,290				38,451,909
Loans to customers	24,922,631	410,854	958,902	409,586	177,805	26,879,778
Financial assets excluding derivatives	59,872,250	3,913,143	958,902	409,586	177,805	65,331,687
Effect of derivatives	17,155,077	1,418,776	513,227	3,727,533		22,814,613
Total	77,027,328	5,331,919	1,472,129	4,137,119	177,805	88,146,300

Financial liabilities	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Deposits from customers	54,025,597	188	3,083			54,028,869
Borrowings	3,443,158	11,171,291	7,094,372			21,708,822
Issued bills		1,979,748	1,566,313			3,546,061
Issued bonds				3,057,516		3,057,516
Subordinated liabilities					1,707,619	1,707,619
Financial liabilities excluding derivatives	57,468,756	13,151,227	8,663,769	3,057,516	1,707,619	84,048,887
Effect of derivatives	4,105,522					4,105,522
Total	61,574,278	13,151,227	8,663,769	3,057,516	1,707,619	88,154,409
Total interest repricing gap	15,453,050	(7,819,308)	(7,191,640)	1,079,603	(1,529,814)	(8,110)

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

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

31.12.2017

Financial assets	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Cash and balances with Central Bank	16,196,343	3,789,480				19,985,823
Loans to customers	22,759,578	1,780,949	531,258	211,702	54,762	25,338,250
Financial assets excluding derivatives	38,955,922	5,570,429	531,258	211,702	54,762	45,324,073
Effect of derivatives	13,675,973	350,460		3,500,000		17,526,433
Total	52,631,895	5,920,889	531,258	3,711,702	54,762	62,850,506

Financial liabilities	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Deposits from customers	41,734,119		15,378			41,749,497
Borrowings	748,130	3,647,174	9,314,837	44,557	75,926	13,830,625
Issued bills		1,979,218	1,955,539			3,934,757
Issued bonds				1,302,629		1,302,629
Subordinated liabilities					1,058,741	1,058,741
Financial liabilities excluding derivatives	42,482,249	5,626,392	11,285,753	1,347,186	1,134,667	61,876,248
Effect of derivatives	3,901,598					3,901,598
Total	46,383,847	5,626,392	11,285,753	1,347,186	1,134,667	65,777,847
Total interest repricing gap	6,248,048	294,496	(10,754,495)	2,364,516	(1,079,905)	(2,927,340)

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		**30.6.2018**		**31.12.2017**
Currency	**basis points**	**Downward**	**Upward**	**Downward**	**Upward**
ISK, indexed	50	(1,080)	1,080	(30,256)	30,256
ISK, non-indexed	100	95,561	(95,561)	90,343	(90,343)
Other currencies	20	45	(45)	22	(22)
Total		94,525	(94,525)	60,109	(60,109)

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

45. 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:

	30.6.2018	31.12.2017
Assets	7,496,295	7,180,237
Liabilities	(6,468,009)	(5,927,047)
Total	1,028,286	1,253,191

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.

	30.6.2018		31.12.2017	
	-1%	1%	-1%	1%
Government bonds	(4,590)	4,590	(2,295)	2,295
Other fixed income securities	(15,008)	15,008	(20,049)	20,049
Loans to customers	(24,365)	24,365	(24,459)	24,459
Derivatives	(31,000)	31,000	(25,000)	25,000
Short positions	800	(800)	2,784	(2,784)
Deposits	47,880	(47,880)	46,487	(46,487)
Subordinated debt	16,000	(16,000)	10,000	(10,000)
	(10,283)	10,283	(12,532)	12,532

The effect on equity would be the same.

46. 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 2018 and 30 June 2017 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 30.6.2018	Average 6m 2018	Closing 31.12.2017	Average 6m 2017
EUR/ISK	123.8	123.8	125.1	117.2
USD/ISK	106.4	102.3	104.4	108.4

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

46. Currency risk (cont.)

Breakdown of financial assets and financial liabilities denominated in foreign currencies

30.6.2018

Financial assets	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Cash and balances with Central Bank	1,490,204	9,461,456	1,118,117	82,165	1,452,557	13,604,499
Shares and other variable income securities	6	18			29	53
Loans to customers	2,116,718	104,259	136,694		134,536	2,492,208
Other assets	334,476	174,812	32,971		337	542,596
Financial assets excluding derivatives	3,941,403	9,740,544	1,287,783	82,165	1,587,460	16,639,355
Derivatives	545,645	575,790	16,853			1,138,288
Total	4,487,048	10,316,334	1,304,636	82,165	1,587,460	17,777,643

Financial liabilities	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Deposits from customers	4,044,104	9,738,711	1,264,798	83,579	1,328,527	16,459,719
Borrowings	36,984					36,984
Other liabilities			10,599			10,599
Financial liabilities excluding derivatives	4,081,088	9,738,711	1,275,397	83,579	1,328,527	16,507,302
Derivatives	547,622	79,923			120,616	748,162
Total	4,628,710	9,818,635	1,275,397	83,579	1,449,143	17,255,464

Net currency position	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Financial assets	4,487,048	10,316,334	1,304,636	82,165	1,587,460	17,777,643
Financial liabilities	(4,628,710)	(9,818,635)	(1,275,397)	(83,579)	(1,449,143)	(17,255,464)
Financial guarantee contracts	20,965	7,591				28,556
Total	(120,697)	505,290	29,239	(1,414)	138,317	550,735

31.12.2017

Financial assets	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Cash and balances with Central Bank	1,490,412	7,222,010	755,602	154,130	1,023,763	10,645,918
Shares and other variable income securities	6	17	15,806		28	15,857
Loans to customers	2,401,215	167,266			171,349	2,739,830
Other assets	301,083	108,898	20,413	269	23,638	454,301
Financial assets excluding derivatives	4,192,716	7,498,192	791,821	154,400	1,218,779	13,855,907
Derivatives	375,150	209,183				584,333
Total	4,567,866	7,707,375	791,821	154,400	1,218,779	14,440,240

Financial liabilities	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Deposits from customers	3,390,665	7,694,264	737,308	117,500	861,476	12,801,213
Borrowings	37,737					37,737
Other liabilities	138,333	27,019	121,113	38,420	101,885	426,770
Financial liabilities excluding derivatives	3,566,735	7,721,283	858,421	155,920	963,361	13,265,720
Derivatives	500,200	60,290			152,544	713,034
Total	4,066,935	7,781,573	858,421	155,920	1,115,905	13,978,754

Net currency position	**EUR**	**USD**	**GBP**	**NOK**	**Other currencies**	**Total**
Financial assets	4,567,866	7,707,375	791,821	154,400	1,218,779	14,440,240
Financial liabilities	(4,066,935)	(7,781,573)	(858,421)	(155,920)	(1,115,905)	(13,978,754)
Financial guarantee contracts	28,053	26,105				54,158
Total	528,984	(48,093)	(66,600)	(1,520)	102,874	515,644

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

46. 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.

	30.6.2018		31.12.2017	
Assets and liabilities denominated in foreign currencies	**-10%**	**+10%**	**-10%**	**+10%**
EUR	(12,070)	12,070	52,898	(52,898)
USD	50,529	(50,529)	(4,809)	4,809
GBP	2,924	(2,924)	(6,660)	6,660
NOK	(141)	141	(152)	152
Other currencies	13,832	(13,832)	10,287	(10,287)
Total	55,073	(55,073)	51,564	(51,564)

The effect on equity would be the same.

47. 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.

	30.6.2018			31.12.2017		
	Average	**Max**	**Exposure**	**Average**	**Max**	**Exposure**
Listed shares	888,592	1,395,059	720,557	1,114,793	2,306,393	1,266,507
Unlisted shares	686,999	955,408	867,637	467,468	955,408	690,951
Unlisted unit shares	871,012	1,927,525	1,073,726	1,017,295	1,710,146	879,916
Total			2,661,920			2,837,375

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

Financial assets and liabilities

48. Accounting classification of financial assets and liabilities

The accounting classification of financial assets and liabilities under IFRS 9 is specified as follows:

30.6.2018 **Financial assets**	**Amortised cost**	**Manda-torily at fair value through P/L**	**Total carrying amount**
Cash and balances with Central Bank	38,451,909		38,451,909
Fixed income securities		4,958,350	4,958,350
Shares and other variable income securities		2,661,920	2,661,920
Securities used for hedging		18,042,611	18,042,611
Loans to customers	25,265,432	1,614,345	26,879,778
Derivatives		1,142,242	1,142,242
Other assets	6,965,170		6,965,170
Total	70,682,512	28,419,469	99,101,981

Financial liabilities	**Amortised cost**	**Manda-torily at fair value through P/L**	**Total carrying amount**
Deposits from customers	54,028,869		54,028,869
Borrowings	21,708,822		21,708,822
Issued bills	3,546,061		3,546,061
Issued bonds	3,057,516		3,057,516
Subordinated liabilities	1,707,619		1,707,619
Short positions held for trading		90,666	90,666
Derivatives		556,379	556,379
Other liabilities	6,394,434		6,394,434
Total	90,443,321	647,044	91,090,366

31.12.2017*

Financial assets	**Held for trading**	**Designated at fair value**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Cash and balances with Central Bank			20,493,739		20,493,739
Fixed income securities	5,598,409				5,598,409
Shares and other variable income securities	2,833,752	3,623			2,837,375
Securities used for hedging	14,026,433				14,026,433
Loans to customers			25,338,250		25,338,250
Derivatives	1,052,652				1,052,652
Other assets			1,797,913		1,797,913
Total	23,511,246	3,623	47,629,902	0	71,144,771

Financial liabilities	**Held for trading**	**Designated at fair value**	**Loans and receivables**	**Other at amortised cost**	**Total carrying amount**
Deposits from customers				41,749,497	41,749,497
Borrowings				13,731,375	13,731,375
Issued bills				3,934,757	3,934,757
Issued bonds				1,401,879	1,401,879
Subordinated liabilities				1,058,741	1,058,741
Short positions held for trading	370,163				370,163
Derivatives	364,692				364,692
Other liabilities				1,936,693	1,936,693
Total	734,855	0	0	63,812,941	64,547,796

* Comparative figures have not been restated in accordance with IFRS 9.

Notes to the Condensed Consolidated Interim Financial Statements

49. 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 recognised 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

49. 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:

30.6.2018

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Mandatorily measured at fair value through profit and loss				
Fixed income securities	4,744,295	212,568	1,487	4,958,350
Shares and other variable income securities	1,183,711	755,984	722,225	2,661,920
Securities used for hedging	18,017,525	25,086		18,042,611
Loans to customers			1,614,345	1,614,345
Derivatives		1,142,242		1,142,242
Total	23,945,531	2,135,880	2,338,058	28,419,469

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Mandatorily measured at fair value through profit and loss				
Short positions held for trading	90,666			90,666
Derivatives		556,379		556,379
Total	90,666	556,379	0	647,044

There were no transfers between levels during the period.

31.12.2017

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Fixed income securities	5,296,556	301,852		5,598,409
Shares and other variable income securities	1,718,159	587,810	527,782	2,833,752
Securities used for hedging	14,003,674	22,760		14,026,433
Derivatives		1,052,652	0	1,052,652
Designated at fair value				
Shares and other variable income securities			3,623	3,623
Total	21,018,390	1,965,074	531,405	23,514,869

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Held for trading				
Short positions held for trading	370,163			370,163
Derivatives		364,692		364,692
Total	370,163	364,692	0	734,855

There were no transfers between levels during the period.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

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

e. Reconciliation of changes in Level 3 fair value measurements

30.6.2018	Fixed income securities	Shares and other var. income securities	Loans to customers	Derivatives	Total
Balance as at 1 January 2018	0	531,405	0	0	531,405
Total gains and losses in profit or loss	147	(36,558)			(36,411)
Additions through a business combination					0
Purchases	1,491	240,000			241,491
Repayments	(151)	0			(151)
Capital decrease		(12,622)			(12,622)
Sales					0
Reclassification into Level 3 in accordance with IFRS 9			1,614,345		1,614,345
Balance as at 30 June 2018	1,487	722,225	1,614,345	0	2,338,058

31.12.2017	Fixed income securities	Shares and other var. income securities	Loans to customers	Derivatives	Total
Balance as at 1 January 2017	0	571,924	0	75,294	647,218
Total gains and losses in profit or loss		32,479		(139,751)	(107,272)
Additions through a business combination		670			670
Purchases		587,238		64,457	651,695
Repayments		77,691			77,691
Capital decrease		(6,311)			(6,311)
Sales		(732,286)			(732,286)
Balance as at 31 December 2017	0	531,405	0	0	531,405

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

Net financial income - 6m 2018	Shares and other var. income securities
Financial assets mandatorily measured at fair value through profit or loss	(36,558)
Total	(36,558)
Net financial income - 6m 2017	
Financial assets designated at fair value through profit or loss	32,479
Total	32,479

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 2018:

Asset class	Method	Significant unobservable input	Range	Book value 30.6.2018
Unlisted bonds	Expected recovery	Value of assets	90-100%	1,487
Unlisted shares	Market price	Recent trades	-	722,225
Loans to customers	Expert model	Value of assets and collateral	-	1,614,345
Total				2,338,058

Asset class	Method	Significant unobservable input	Range	Book value 31.12.2017
Unlisted shares	P/B multiplier	Equity	1.0-1.5	531,405
Total				531,405

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	72,223	(72,223)
Total	72,223	(72,223)

Notes to the Condensed Consolidated Interim Financial Statements

50. 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 25,265,432 thousand at end of June 2018. The estimated fair value of loans to customers at end of June 2018 is ISK 25,088,412 thousand.

Cash and balances with Central Bank includes several components as detailed in note 16. These 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

51. 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.

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 specialised 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 Support functions and eliminations.

6m 2018	Corporate Banking	Corporate Finance	Capital Markets	Proprietary trading and Treasury	Asset Management	Support functions and eliminations	Total
Net interest income	724,299	(197)	76,118	(19,189)	2,203	10,601	793,835
Net fee and commission income	323,610	280,635	314,365	24,900	1,043,404	(70,625)	1,916,288
Net financial income	107,051	212	1,187	184,408	2,178	(288)	294,749
Share in profit of associates	677	0	0	0	(4,280)	0	(3,603)
Other operating income (expense)	52,457	0	69	1,331	13,154	(31,269)	35,742
Net operating income	1,208,094	280,649	391,740	191,451	1,056,659	(91,582)	3,037,011
Salaries and related expenses	(107,471)	(143,159)	(171,154)	(84,515)	(358,221)	(486,408)	(1,350,926)
Other operating expenses	(174,242)	(23,131)	(41,378)	(22,118)	(129,906)	(245,029)	(635,803)
Net impairment	3,485	(1,673)	(504)	0	(838)	4,993	5,462
Profit (loss) before cost allocation and tax	929,866	112,687	178,705	84,818	567,693	(818,025)	1,055,744
Net segment revenue from external customers	940,865	260,649	818,758	62,851	1,045,469	(91,582)	3,037,011
Net segment revenue from other segments	267,229	20,000	(427,018)	128,599	11,190	0	0

6m 2017	Corporate Banking	Corporate Finance	Capital Markets	Proprietary 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 (expense)	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)
Net impairment	(4,664)	0	0	0	0	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

Internal reporting is based on the results of the Bank, which accounts for around 89% (2017: 91%) of the net operating income of the Group, and does 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

52. 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 23, 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

30.6.2018	Loans & receivables	Deposits & payables
Shareholders	1,083	197,144
Management	104,212	156,902
Associates	258,061	8,001,694
Total	363,356	8,355,740

31.12.2017	Loans & receivables	Deposits & payables
Shareholders	0	50,427
Management	2,061	122,464
Associates	267,495	4,783,028
Total	269,556	4,955,918

d. Effects on income statement

6m 2018	Interest income	Interest expense	Fees received	Fees paid
Shareholders	0	752	2,768	134
Management	3,086	1,744	611	4,885
Associates	3	59,146	19,885	0
Total	3,090	61,642	23,264	5,019

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

Notes to the Condensed Consolidated Interim Financial Statements

53. Other matters

Legal proceedings

The trustee of a bankrupt estate of a former client of Virðing (now the Bank) has filed a suit against the Bank with a subpoena which was brought to the courts on 25 September 2014. In the matter the bankrupt estate seeks to rescind payments that the bankrupt client made to Virðing and has made a claim for damages of ISK 287 million plus interest. The payments were made based on an agreement from 2010 for final settlement of the client's liabilities towards Virðing. Virðing (now the Bank) has claimed an acquittal in the matter, on the grounds that the legal requirements to rescind the measures of the bankrupt client have not been met, especially with regards to the insolvency of the bankrupt client, in addition to the fact that the trustee of the bankrupt estate himself confirmed the agreement for final settlement in the spring of 2014 and has therefore forfeited the bankrupt estate's right to the law suit. In addition to the aforementioned, standard time limits for rescission in accordance with the act on bankruptcy had lapsed with respect to the timing of the subpoena. Should the claims made by the bankrupt estate be confirmed, Kvika would have to pay the bankrupt estate damages but would instead be able to file its original claim against the bankrupt client plus penalty interest. That amount is higher than the claim made by the bankrupt estate, however the value of the estate's net assets is not clear at the moment. It is anticipated that the matter will be heard before the courts on 5 October 2018.

Virðing (now the Bank) was sued for damages with a subpoena which was brought to the courts on 1 November 2016. The main claim in the suit is a payment of ISK 301 million plus interest while the reserve claim is that the courts recognise that the Bank is liable to pay damages. The matter involves an alleged insufficient advice by Auður Capital hf. (which later merged with Virðing) in relation to the plaintiff's investment as a co-investor in a fund which is managed by Virðing (now the Bank). The District Court of Reykjavik ruled in the case on 24 January 2018 and acquitted the Bank of the plaintiff's claims and awarded the Bank ISK 3 million in legal costs. The plaintiff has appealed to the National Court (Icelandic: Landsréttur). The date on which the case will be heard has not been decided.

Merger of the class B share capital with the class A share capital

On a meeting of shareholders on 18 January 2018 a resolution was passed on merging the class B share capital with the class A share capital of the Bank, and amending the Articles of Association accordingly.

Letter of intent regarding Kvika's acquisition of GAMMA Capital Management hf.

In June 2018, the Bank and the shareholders of GAMMA Capital Management hf. ("GAMMA") signed a letter of intent regarding the Bank's acquisition of all the share capital in GAMMA. The intended transaction is subject to a number of conditions, such as due diligence, approval of regulatory authorities and approval from Kvika's shareholders. The purchase price amounts to ISK 3,750 million, with part of it conditional based on certain conditions, and will be paid both by cash as well as shares in the Bank. More information can be found on the Bank's website, www.kvika.is.

54. Events after the reporting date

Intended listing on the Nasdaq Iceland main market

On a meeting in July, the Board of Directors of the Bank approved a proposal to look into listing the Bank's shares on the NASDAQ OMX Iceland Main Market during the following six to twelve months.

There are no other material events after the reporting date.

Notes to the Condensed Consolidated Interim Financial Statements

Accounting policies

55. Changes to accounting policies

The accounting policies applied in the Consolidated Interim Financial Statements are consistent with those applied in the Group's audited Consolidated Financial Statements as at and for the year ended 31 December 2017, except for changes to the accounting for financial instruments resulting from the adoption of IFRS 9, and the accounting for revenue from contracts with customers resulting from adoption of IFRS 15. Those changes are described below.

IFRS 9 - Financial Instruments

The Group adopted a new IFRS standard, IFRS 9 - Financial Instruments, which replaced IAS 39 as of 1 January 2018. As a result of the application of IFRS 9, the Group changed its accounting policies in the areas outlined below, and these new policies were applicable from 1 January 2018. As permitted by the transition provisions of IFRS 9, the Group elected not to restate comparative period information; accordingly, all comparative period information is presented in accordance with previous accounting policies, as described in the Group's Consolidated Financial Statements as at and for the year ended 31 December 2017. Adjustments to carrying amounts of financial assets and financial liabilities at the date of initial application were recognised in equity as of 1 January 2018. New or amended interim disclosures have been provided for the current period, where applicable, and comparative period disclosures are consistent with those made in the prior year.

Financial assets

The Group's financial assets are classified into one of two measurement categories, i.e. at amortised cost or at fair value through profit or loss. The measurement basis of individual financial assets is determined based on an assessment of the cash flow characteristics of the assets and the business models under which they are managed.

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Group changes its business model and if the change is significant to the Group's operations.

Financial liabilities

The Group's financial liabilities are classified into one of two measurement categories, i.e. at amortised cost or at fair value through profit or loss. Financial liabilities held for trading are measured at fair value through profit or loss, all other financial liabilities are measured at amortised cost.

Business model assessment

The Group makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Group's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated - e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Group's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at fair value through profit or loss because they are neither held to collect contractual cash flows nor held to both collect contractual cash flows and to sell financial assets.

Cash flow characteristics assessment

Financial assets held within the business models Held to collect and Held to collect and sell are assessed to evaluate if their contractual cash flows are comprised of solely payments of principal and interest (SPPI). SPPI payments are those which are consistent with a basic lending arrangement. Principal is the fair value of the financial asset at initial recognition and may change over the life of the instruments, e.g. due to repayments. Interest relates to basic lending returns, including compensation for the time value of money and credit risk associated with the principal amount outstanding and for other basic lending risks (expected losses, liquidity risks and administrative costs), as well as a profit margin.

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

Notes to the Condensed Consolidated Interim Financial Statements

55. Changes to accounting policies (cont.)

Financial assets at amortised cost

A financial asset is measured at amortised cost if the contractual terms of the financial asset give rise to cash flows that are solely payment of principal and interest and the asset is held within a business model whose objective is to collect contractual cash flows, i.e. Held to collect. After initial measurement, financial assets in this category are carried at amortised cost using the effective interest rate method. Amortisation is included in interest income in the Consolidated Statement of Comprehensive Income. The majority of the Group's loans to customers are carried at amortised cost using the effective interest rate method. Interest on loans to customers is recognised as interest income.

Impairment on financial assets measured at amortised cost is calculated using the expected credit loss approach. Loans and debt securities measured at amortised cost are presented net of allowance for credit losses in the Consolidated Statement of Financial Position.

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

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

Financial assets at fair value through profit or loss are measured in the Consolidated Statement of Financial Position at fair value. Loans to customers which are measured at fair value through profit or loss are assets whose cash flows do no represent payments that are solely payments of principal and interest but are non-trading assets. Interest on loans to customers measured at fair value through profit or loss is recognised as interest income. Changes in fair value, as well as any gains or losses realised on disposal, are recognised in the line item Net financial income (expense) in the Consolidated Statement of Comprehensive Income.

Impairment

IFRS 9 replaces the incurred loss model in IAS 39 with an expected credit loss (ECL) model. The adoption of IFRS 9 has had a significant impact on the Group's impairment methodology. The two main reasons for this impact are, on the one hand, that the impairment model of IFRS 9 is intended to reflect expected credit loss as opposed to the incurred loss model of IAS 39 and, on the other hand, that impairment under IFRS 9 should reflect a probability weighted average of possible outcomes in contrast to IAS 39 where the single most likely outcome was accounted for. IFRS 9 further requires that certain off-balance sheet items be subjected to impairment assessment, these include financial guarantees and undrawn loan commitments. ECL for off-balance sheet items is separately calculated and included in other liabilities.

Expected Credit Loss

IFRS 9 requires the Group to recognise a loss allowance for expected credit losses on:

- debt instruments measured at amortised cost;
- debt instruments measured at fair value through other comprehensive income;
- lease receivables;
- contract assets (as defined in IFRS 15 Revenue from Contracts with Customers);
- loan commitments that are not measured at fair value through profit or loss; and
- financial guarantee contracts (except those accounted for as insurance contracts).

IFRS 9 requires an expected loss allowance to be estimated for each of these types of asset or exposure. However, the standard specifies three different approaches depending on the type of asset or exposure:

1. For trade receivables and contract assets without a significant financing component a simplified (lifetime expected loss) approach can be applied.
2. For assets that are credit-impaired at purchase or origination lifetime expected loss approach shall be applied.
3. For other assets/exposures a general (or three-stage) approach shall be applied.

Notes to the Condensed Consolidated Interim Financial Statements

55. Changes to accounting policies (cont.)

The general approach

The Group measures the ECL on each balance sheet date according to a three-stage expected credit loss impairment model.

Stage 1 covers financial assets that have not deteriorated significantly in credit quality since initial recognition or (where the optional low credit risk simplification is applied) have low credit risk.

Stage 2 covers financial assets that have deteriorated significantly in credit quality since initial recognition (unless the low credit risk simplification has been applied and is relevant) but that do not have objective evidence of a credit loss event.

Stage 3 covers financial assets that have objective evidence of a credit loss event at the reporting date.

12-month expected credit losses are recognised in stage 1, while lifetime expected credit losses are recognised in stages 2 and 3. IFRS 9 draws a distinction between financial instruments that have not deteriorated significantly in credit quality since initial recognition and those that have. '12-month expected credit losses' are recognised for the first of these two categories. 'Lifetime expected credit losses' are recognised for the second category. Measurement of the expected credit losses is determined by a probability-weighted estimate of credit losses over the expected life of the financial instrument.

An asset moves from 12-month expected credit losses to lifetime expected credit losses when there has been a significant deterioration in credit quality since initial recognition. Hence the 'boundary' between 12-month and lifetime losses is based on the change in credit risk not the absolute level of risk at the reporting date.

There is also an important operational simplification that permits companies to stay in '12-month expected credit losses' if the absolute level of credit risk is 'low'. This applies even if the level of credit risk has increased significantly.

There is also a third stage. This applies to assets for which there is objective evidence of impairment (essentially the same as objective evidence of an incurred loss in IAS 39). In Stage 3 the credit loss allowance is still based on lifetime expected losses but the calculation of interest income is different.

In the periods subsequent to initial recognition, interest is calculated based on the amortised cost net of the loss provision, whereas the calculation is based on the gross carrying value in Stages 1 and 2.

Finally, it is possible for an instrument for which lifetime expected credit losses have been recognised to revert to 12-month expected credit losses should the credit risk of the instrument subsequently improve so that the requirement for recognising lifetime expected credit losses is no longer met.

Expected credit losses

Expected credit losses are defined as the difference between all the contractual cash flows that are due to an entity and the cash flows that it actually expects to receive ('cash shortfalls'). This difference is discounted at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets).

12 month expected credit losses

12-month expected credit losses are a portion of the lifetime expected credit losses. They are calculated by multiplying the probability of a default occurring on the instrument in the next 12 months by the total (lifetime) expected credit losses that would result from that default. They are not the expected cash shortfalls over the next 12 months. They are also not the credit losses on financial instruments that are forecast to actually default in the next 12 months.

Lifetime expected credit losses

Lifetime expected credit losses are the expected shortfalls in contractual cash flows, taking into account the potential for default at any point during the life of the financial instrument.

Definition of default

The Group considers a financial asset to be in default if one of the following applies:

- the borrower is 60 days past due of one of his exposures with the Bank;
- the borrower is registered as in delinquency by Creditinfo (Icelandic: vanskilaskrá);
- the borrower is registered in public records as filed for bankruptcy, has terminated his business or is no longer a going concern;
- the borrower is considered to be unlikely to pay as determined by the Bank's Risk Management department. Events that are likely to lead to default as determined by the Risk Management department include the following:
  - breach of covenants of loan commitments;
  - loan concessions or stressed restructuring; or
  - Risk Management's internal risk assessment is 4 or 5.
- the borrower has been in default in accordance with above at any point for the previous three months.

The Risk Management department can manually override automatic default triggers if the following applies:

- the reason for reported default triggers is known to the Bank and not considered to be lack of willingness or ability to pay.
- re-financing of borrower's exposures is expected and has been confirmed.

Kvika Amounts are in ISK thousands

Notes to the Condensed Consolidated Interim Financial Statements

55. Changes to accounting policies (cont.)

Probability of default and credit risk rating

The Group utilises an external Probability of Default model (PD model) developed and maintained by Creditinfo Iceland, an Icelandic credit bureau, for the Group. The PD model is based on information compiled by Creditinfo on the creditworthiness of corporates and individuals in Iceland based both on personal and demographic factors. It predicts the probability of default in the next 12 months. The model has been calibrated to using historical default rate information representative of the Group's portfolio. The model is designed as a point in time model and correlation between forecasted and actual default rates and macroeconomic forecasts has been identified. This enables the Group to calculate different forward looking probabilities of default given different forecasts for changes in gross domestic product, inflation rate and unemployment rate. Lifetime PD for loans in stage 3 is 100% as by definition they are already in default.

For the purpose of estimating lifetime PD for loans in stage 2 the Group has determined that 12 month PD is an appropriate proxy for marginal PD over the lifetime of the loan. The 12 month PD is adjusted with a survival rate for each year until maturity with the following formula: $PD_t = PD_{12} * SR_t$ where PD_{12} is the 12 month PD from the credit rating model and SR_t is the survival rate at time t, which is calculated recursively as $SR_t = SR_{t-1} * (1-PD_t)$. The Group monitors the appropriateness of the assumption as a part of it’s yearly validation and monitoring process.

Significant increase in credit risk

When considering whether a significant increase in credit risk (SICR) has occurred the Group considers both quantitative and qualitative factors. In general the Group will rely on a quantitative analysis based on the PD model but will additionally consider qualitative factors based on the information available to the Group.

Quantitative SICR assessment

The Group has defined the following criteria’s for SICR:

1. 20 days past due of any of the client's exposures
2. Grading migrations – SICR has occurred if the current grade has increased compared to the origination grade more or equal to the following thresholds:

Origination grade	Threshold grade
1	7
2	7
3	7
4	7
5	7
6	8
7	8
8	9
9	10

Migration of one or two risk grading in the PD model is considered to be a significant increase in risk and therefore warrant a transfer to stage 2, depending on the origination grade. However, the Group considers risk grades less than 5 for corporations to be low risk and therefore excludes any movement between categories that does not result in a rating above that level. Ratings above 10 are considered to indicative of default and therefore warrant elevation to stage 3 unless overridden based on other available information or expert judgement.

Qualitative SICR assessment

Risk Management is responsible for managing the credit risk of the Group which includes a qualitative SICR assessment. Risk Management reviews on a monthly basis large exposures, unsecured loans and loans that are past due on a loan by loan basis.

Exposure at default

Lifetime definition

The Group considers the lifetime of each exposure to be the contractual maturity of each loan. The Group considers this to be the case as any lending subsequent to that period would be based on an independent lending decision at that time based on the prevailing market terms. The Group only considers contractual cash flows when estimating exposure at default. The average lifetime of the Group's exposures is short and historically the Group has had few prepayments and no changes in that pattern are foreseen. It does therefore not consider the likelihood of prepayment when concluding on the lifetime of the assets.

Committed facilities

The Group considers the off-balance portion of exposure at default to be 50% (credit conversion factor) of any facilities not drawn upon that are considered committed. Such facilities include overdrafts, credit cards and guarantees. The credit conversion factor is subject to expert review on a case by case basis. The bank does not consider credit line facilities to be committed facilities as disbursements are subject to predetermined conditions and constitute a separate credit review. These predetermined conditions will in most cases lead directly to an increase in posted collateral and disbursements therefore stay within acceptable collateral coverage.

Notes to the Condensed Consolidated Interim Financial Statements

55. Changes to accounting policies (cont.)

Expected credit loss measurement

IFRS 9 requires the Group to determine an expected credit loss (ECL) amount on a probability-weighted basis as the difference between the cash flows that are due to the Group in accordance with the contractual terms of a financial instrument and the cash flows that the Group expects to receive. The Group has implemented an ECL model which is consistent with regulatory and best practices. The model is based on four components.

Probability of Default (PD). This is an estimate of the likelihood of default over a given time horizon. The Bank uses an external PD model developed by CreditInfo for the Group.

Exposure at Default (EAD). This is an estimate of the exposure at a future date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities.

Loss Given Default (LGD). This is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from any collateral. It is expressed as a percentage of EAD and derived from value of underlying collaterals.

Discount rate. This is used to discount an expected loss to present value at the reporting date using the effective interest rate (EIR) at initial recognition.

Forward looking probability weighted scenarios

The Group's management has identified and probability weighted three macro-economic scenarios. The development of macro-economic variables and the corresponding weights are based on the Group‘s management judgement. The Group incorporates the following forward-looking macro-economic variables into its probability weighted expected credit loss calculations: (i) gross domestic product, (ii) inflation rate and (iii) unemployment rate.

IFRS 15 - Revenue from Contracts with Customers

IFRS 15 - Revenue from Contracts with Customers became effective as at 1 January 2018 and replaced various IFRS standards and interpretations on revenue recognition related to sale of goods and services. IFRS 15 establishes a single comprehensive framework for accounting for revenue arising from sale of goods and services through contracts which fall under its scope. The standard does not apply to revenue arising from financial instruments. The Group adopted the standard using the modified retrospective method, with the effect of initial application recognised on the date of initial application and without restatement of the comparative periods. The adoption of the standard by the Group did not result in changes to the timing or amount of revenue recognition and therefore it was not necessary to recognise any amount in equity upon adoption.