



Condensed Interim
Consolidated Financial Statements

31 March 2019

Table of Contents

	Page
Endorsement and Statement by the Board of Directors and the CEO	1
Condensed Interim Consolidated Income Statement	3
Condensed Interim Consolidated Statement of Comprehensive Income	4
Condensed Interim Consolidated Statement of Financial Position	5
Condensed Interim Consolidated Statement of Changes in Equity	6
Condensed Interim Consolidated Statement of Cash Flows	8
Notes to the Condensed Interim Consolidated Financial Statements	9
- General information	10
- Income statement	12
- Statement of Financial Position	15
- Risk management	21
- Financial assets and financial liabilities	35
- Other information	39

Endorsement and Statement by the Board of Directors and the CEO

The Condensed Interim Consolidated Financial Statements of Kvika banki hf. ("Kvika" or the "Bank") for the period 1 January to 31 March 2019 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 Interim Consolidated Financial Statements comprise Kvika and its subsidiaries (together the "Group"). The Condensed Interim Consolidated Financial Statements have not been audited or reviewed by the Bank's independent auditors.

Kvika is a specialized bank focusing on asset management and investment services. 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.

Kvika's shares were admitted to trading on Nasdaq OMX Iceland's main market in March 2019. The Bank's annual general meeting was held at 14 March 2019. At the meeting, the shareholders of the Bank approved a dividend payment of approximately ISK 443 million, which was subsequently paid at 26 March 2019. Further, the shareholders approved a resolution permitting the Bank to purchase up to 10% of own shares subject to regulatory approvals. This authorisation applies until the next annual general meeting in 2020.

Q1 2019: Strong results on the back of favourable market conditions

The Bank results in the first quarter of 2019 were strong as had been indicated by a positive profit announcement published 14 April. The main cause of the good results is that due to favourable market circumstances during the quarter, fee and commission income exceeded expectations.

In November 2018 Kvika acquired all issued shares of GAMMA Capital Management hf. ("GAMMA"), a licenced fund management company focusing on asset- and fund management with ISK 135 billion of assets under management and 22 employees. The completion of the acquisition was subject to approval from competition authorities which granted their approval 6 March 2019. Consequently the acquisition was finalised and the operations of GAMMA are included in the Group's Financial Statements from 1 March 2019. At the end of March 2019 Kvika had ISK 442 billion of assets under management, compared to ISK 291 billion at year end 2018.

According to the Condensed Interim Consolidated Statement of Financial Position, equity at the end of the period amounted to ISK 13,220 million (31.12.2018: ISK 12,970 million) and total assets amounted to ISK 115,106 million (31.12.2018: ISK 88,274 million).

The Group's net operating income during the quarter was ISK 2,289 million (Q1 2018: ISK 1,643 million). Net interest income amounted to ISK 424 million (Q1 2018: ISK 412 million). Net fee income amounted to ISK 1,657 million (Q1 2018: ISK 1,012 million). Other operating income amounted to ISK 208 million (Q1 2018: ISK 219 million). Administrative expenses during the quarter amounted to ISK 1,301 million (Q1 2018: ISK 1,018 million).

Profit for the period amounted to ISK 709 million (Q1 2018: ISK 644 million), corresponding to an annualised 22.4% 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.

The Group's total capital ratio at 31.3.2019 is 22.5% (31.3.2018: 25.1%). The Bank's minimum regulatory capital requirement based on Financial Supervisory Authority's Supervisory Review and Evaluation Process (SREP) is 14.5%. The minimum regulatory capital requirement including the additional capital requirements imposed following the implementation of CRD IV is 20.25% as at 31 December 2018.

The Bank maintains a strong liquidity position. The Bank's assets are liquid and its access to funding is good, reflected in ample liquidity position. At the end of March 2019 the Group's 30 day liquidity coverage ratio (LCR) was 175%, well above the minimum level of 100%.

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 37-49 on analysis of exposure to various types of risk.

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 Interim Consolidated Financial Statements of Kvika banki hf. for the period 1 January to 31 March 2019 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 31 March 2019 and the financial performance of the Group and changes of cash flows for the period 1 January to 31 March 2019.

Further, in our opinion the Condensed Interim Consolidated 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 Interim Consolidated Financial Statements for the period 1 January to 31 March 2019, and confirm them by the means of their signatures.

Reykjavík, 27 May 2019.

Board of Directors

CEO



Condensed Interim Consolidated Income Statement

For the period 1 January 2019 to 31 March 2019

	Notes	3m 2019	3m 2018
Interest income		1,208,482	1,113,109
Interest expense		(784,038)	(700,733)
Net interest income	6	424,443	412,375
Fee and commission income		1,701,621	1,054,913
Fee and commission expense		(44,919)	(43,231)
Net fee and commission income		1,656,702	1,011,683
Net financial income	7	208,763	195,963
Share in profit of discontinued operations		0	(2,365)
Share in (loss) profit of associates, net of income tax	23	(26,876)	25,085
Other operating income		26,415	0
Other operating income		208,301	218,684
Net operating income		2,289,447	1,642,742
Administrative expenses	9	(1,300,920)	(1,018,174)
Net impairment	11	590	29,922
Revaluation of contingent consideration		(137,539)	0
Profit before taxes		851,578	654,490
Income tax	12	(99,102)	(10,363)
Special tax on financial institutions	14	(43,730)	0
Profit for the period		708,745	644,127

	Notes	3m 2019	3m 2018
Attributable to the shareholders of Kvika banki hf.		709,074	644,127
Attributable to non-controlling interest	22	(328)	0
Profit for the period		708,745	644,127
Earnings per share	15		
Basic earnings per share (ISK per share)		0.38	0.36
Diluted earnings per share (ISK per share)		0.34	0.33

The notes on pages 10 to 39 are an integral part of these Condensed Interim Consolidated Financial Statements.

Condensed Interim Consolidated Statement of Comprehensive Income

For the period 1 January 2019 to 31 March 2019

	Notes	3m 2019	3m 2018
Profit for the period		708,745	644,127
Translation of foreign operations			
Exchange difference on translation of foreign operations		15,716	(1,077)
Items that may be reclassified subsequently to profit and loss, net of tax		15,716	(1,077)
Total comprehensive income for the period		724,461	643,049
	Notes	3m 2019	3m 2018
Attributable to the shareholders of Kvika banki hf.		724,790	643,049
Attributable to non-controlling interest		(328)	0
Total comprehensive income for the period		724,461	643,049

The notes on pages 10 to 39 are an integral part of these Condensed Interim Consolidated Financial Statements.

Condensed Interim Consolidated Statement of Financial Position

As at 31 March 2019

Assets	Notes	31.3.2019	31.12.2018
Cash and balances with Central Bank	16	32,217,519	21,339,185
Fixed income securities	17	4,035,173	5,127,335
Shares and other variable income securities	18	4,470,646	2,926,675
Securities used for hedging	19	27,326,993	21,526,794
Loans to customers	20	28,709,999	29,443,573
Derivatives	21	1,338,076	1,213,266
Investment in associates	23	747,955	774,832
Investment properties	24	968,989	950,000
Intangible assets	25	3,142,025	2,379,281
Property and equipment		586,873	42,894
Deferred tax assets		593,832	608,858
Other assets	26	10,955,193	1,941,070
Assets classified as held for sale		13,100	0
Total assets		115,106,374	88,273,762
Liabilities			
Deposits from customers	27	56,751,979	47,893,959
Borrowings	28	20,950,697	15,634,648
Issued bills	29	3,772,801	3,577,718
Issued bonds	30	3,058,649	3,160,215
Subordinated liabilities	31	1,987,848	1,947,511
Short positions held for trading	32	364,887	805,334
Derivatives	21	1,445,216	593,934
Current tax liabilities		94,390	3,140
Deferred tax liabilities		491,943	76,980
Other liabilities	33	12,968,105	1,610,323
Total liabilities		101,886,514	75,303,763
Equity			
Share capital	34	1,844,996	1,844,996
Share premium		2,881,165	2,881,165
Option reserve		5,133	4,297
Warrants reserve	35	202,527	202,527
Deficit reduction reserve		3,103,697	3,103,697
Other reserves		3,692	(12,023)
Restricted retained earnings		506,896	506,896
Retained earnings		4,610,538	4,376,900
Total equity attributable to the shareholders of Kvika banki hf.		13,158,644	12,908,455
Non-controlling interest		61,216	61,544
Total equity		13,219,860	12,969,999
Total liabilities and equity		115,106,374	88,273,762

The notes on pages 10 to 39 are an integral part of these Condensed Interim Consolidated Financial Statements.

Condensed Interim Consolidated Statement of Changes in Equity

For the period 1 January 2019 to 31 March 2019

	Notes	Share capital	Share premium	Option reserve	Warrants reserve	Deficit reduction reserve	Translation reserve	Restricted retained earnings	Retained earnings	Total share-holders' equity	Non-controlling interest	Total equity
1 January 2019 to 31 March 2019												
Equity as at 1 January 2019		1,844,996	2,881,165	4,297	202,527	3,103,697	(12,023)	506,896	4,376,900	12,908,455	61,544	12,969,999
Impact of adopting IFRS 16									(32,637)	(32,637)		(32,637)
Restated opening balance under IFRS 16		1,844,996	2,881,165	4,297	202,527	3,103,697	(12,023)	506,896	4,344,263	12,875,818	61,544	12,937,362
Profit for the period									709,074	709,074	(328)	708,745
Translation of foreign operations												
Exchange difference on translation of foreign operations							15,716			15,716		15,716
Total comprehensive income for the period		0	0	0	0	0	15,716	0	709,074	724,790	(328)	724,461
Transactions with owners of the Bank												
Dividend paid to shareholders									(442,799)	(442,799)		(442,799)
Stock options				836						836		836
Equity as at 31 March 2019		1,844,996	2,881,165	5,133	202,527	3,103,697	3,692	506,896	4,610,538	13,158,644	61,216	13,219,860

The notes on pages 10 to 39 are an integral part of these Condensed Interim Consolidated Financial Statements

Condensed Interim Consolidated Statement of Changes in Equity

For the period 1 January 2018 to 31 March 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
1 January 2018 to 31 March 2018												
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	11,010,985
Profit for the period									644,127	644,127	0	644,127
Translation of foreign operations												
Exchange difference on translation of foreign operations							(1,077)			(1,077)		(1,077)
Total comprehensive income for the period		0	0	0	0	0	(1,077)	0	644,127	643,049	0	643,049
Transactions with owners of the Bank												
Capital increase		19,957	65,094		(4,024)					81,027		81,027
Transactions with own shares		10,000	60,242							70,242		70,242
Stock options				833						833		833
Other transactions									8,421	8,421		8,421
Equity as at 31 March 2018		1,835,018	2,847,919	1,736	203,024	3,103,697	(22,799)	254,844	3,539,696	11,763,135	51,423	11,814,557

The notes on pages 10 to 39 are an integral part of these Condensed Interim Consolidated Financial Statements

Condensed Interim Consolidated Statement of Cash Flows

For the period 1 January 2019 to 31 March 2019

	Notes	3m 2019	3m 2018
Cash flows from operating activities			
Profit for the period		708,745	644,127
Adjustments for:			
Indexation and exchange rate difference		520,183	(446,131)
Share in loss (profit) of associates, net of income tax	23	26,876	(25,085)
Depreciation and amortisation		26,421	6,326
Net interest income	6	(424,443)	(412,375)
Net impairment		136,949	(29,922)
Income tax		99,102	10,363
Other adjustments		0	41,347
		1,093,833	(211,351)
Changes in:			
Fixed income securities		830,503	334,165
Shares and other variable income securities		(627,575)	335,339
Securities used for hedging		(5,800,200)	(2,912,424)
Loans to customers		814,966	(241,887)
Derivatives - assets		(124,810)	147,354
Other assets		(8,400,705)	(4,271,776)
Deposits from customers		8,602,614	3,197,628
Short positions		(440,447)	131,147
Derivatives - liabilities		851,282	366,008
Other liabilities		10,938,673	4,874,895
		6,644,301	1,960,447
Interest received		1,163,697	1,063,175
Interest paid		(493,145)	(452,962)
Net cash from operating activities		8,408,686	2,359,309
Cash flows from investing activities			
Net proceeds from the sale of property and equipment		(100,618)	0
Acquisition of subsidiary, net of cash		(667,280)	0
Proceeds from the sale of assets classified as held for sale		(2,528)	(1,002)
Net cash to investing activities		(770,426)	(1,002)
Cash flows from financing activities			
Borrowings		4,054,651	9,584,623
Issued bills		195,083	2,274
(Increase) decrease in warrants		0	(4,024)
Dividend paid to shareholders		(442,799)	0
Treasury share transactions		0	155,294
Increase (reduction) of retained earnings		0	7,344
Net cash from financing activities		3,806,935	9,745,510
Net increase in cash and balances with Central Bank		11,445,195	12,103,817
Cash and balances with Central Bank at the beginning of the year	16	21,339,185	19,985,823
Change in cash and cash equivalents due to acquisition of subsidiary		8,016	0
Effects of exchange rate fluctuations on cash and balances with Central Bank		(574,876)	533,415
Cash and balances with Central Bank at the end of the period	16	32,217,519	32,623,055
Investing and financing activities not affecting cash flows due to a acquisitions, refer to note 5			
Assets and liabilities acquired from GAMMA Capital Management hf.		1,842,958	0

The notes on pages 10 to 39 are an integral part of these Condensed Interim Consolidated Financial Statements.

Notes to the Condensed Interim Consolidated Financial Statements

General information	Page	Risk management	Page
1 Reporting entity	10	37 Maximum exposure to credit risk	21
2 Basis of preparation	10	38 Credit quality of financial assets	21
3 Significant accounting policies	11	39 Collateral and other credit enhancements	26
4 Changes in accounting policies	11	40 Loan-to-value	26
5 Acquisition of GAMMA Capital Management hf.	11	41 Large exposures	27
		42 Liquidity risk	27
		43 Market risk	30
		44 Interest rate risk	30
Income statement		45 Interest rate risk associated with trading portfolios	30
6 Net interest income	12	46 Interest rate risk associated with non-trading portfolios	31
7 Net financial income	12	47 Exposure towards changes in the CPI	32
8 Foreign currency exchange difference	12	48 Currency risk	32
9 Administrative expenses	13	49 Other price risk	34
10 Salaries and related expenses	13	50 Operational risk	34
11 Net impairment	13		
12 Income tax	13	Financial assets and liabilities	
13 Special tax on financial activity	14	51 Accounting classification of financial assets and financial liabilities ..	35
14 Special tax on financial institutions	14	52 Financial assets and financial liabilities measured at fair value	36
15 Earnings per share	14		
		Other information	
Statement of Financial Position		53 Pledged assets	39
16 Cash and balances with Central Bank	15	54 Related parties	39
17 Fixed income securities	15	55 Others matters	39
18 Shares and other variable income securities	15	56 Events after the reporting date	39
19 Securities used for hedging	15		
20 Loans to customers	16		
21 Derivatives	16		
22 Group entities	16		
23 Investment in associates	17		
24 Investment properties	17		
25 Intangible assets	17		
26 Other assets	17		
27 Deposits from customers	18		
28 Borrowings	18		
29 Issued bills	18		
30 Issued bonds	18		
31 Subordinated liabilities	18		
32 Short positions held for trading	19		
33 Other liabilities	19		
34 Equity	19		
35 Warrants	20		
36 Capital adequacy ratio (CAD)	20		

Notes to the Condensed Interim Consolidated 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 Interim Consolidated Financial Statements for the period ended 31 March 2019 comprise Kvika banki hf. and its subsidiaries (together referred to as the Group). Kvika is a specialized bank focusing on asset management and investment services. 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 Interim Consolidated Financial Statements were approved and authorised for issue by the Board of Directors and the CEO on 27 May 2019.

2. Basis of preparation

a. Statement of compliance

The Condensed Interim Consolidated 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 Condensed Interim Consolidated Financial Statements are also prepared in accordance with Icelandic laws on financial statements.

The Condensed Interim Consolidated 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 2018, which are available at www.kvika.is.

b. Basis of measurement

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

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 31 March 2019.

d. Going concern

The Bank's management 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 Interim Consolidated Financial Statements, is provided in the Consolidated Financial Statements as at and for the year ended 31 December 2018

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.

Notes to the Condensed Interim Consolidated Financial Statements

3. Significant accounting policies

The accounting policies applied in the Condensed Interim Consolidated Financial Statements are consistent with those applied in the Consolidated Financial Statements as at and for the year ended 31 December 2018, except for IFRS 16 Leases, which became effective on 1 January 2019. Refer to note 4 for more information on the impact of IFRS 16 Leases on the Group's accounting policies.

4. Changes in accounting policies

The Group has initially adopted IFRS 16 Leases from 1 January 2019. The Group has not early adopted any standards, interpretations or amendments that have been issued but are not effective.

At the commencement date of a lease, the Group recognizes a liability to make lease payments and an asset representing the right to use the underlying asset during the lease term. The Group will elect to use the exemptions authorized by the standard on lease contracts for which the lease terms ends within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value. Interest expense on the lease liability and the depreciation expense on the right-of-use asset are recognized separately in the Condensed Interim Consolidated Financial Statements.

5. Acquisition of GAMMA Capital Management hf.

On 19 November 2018, the Bank and the shareholders of GAMMA Capital Management hf. ("GAMMA") signed a sales and purchase agreement regarding the Bank's acquisition of all the share capital in GAMMA. The transaction was subject to approval from regulatory authorities and approval from Kvika's shareholders. In early March 2019 the final conditions were fulfilled and is GAMMA and its subsidiaries a part of the Group and the Consolidated Financial Statements from 1 March 2019. The purchase price is composed of several items, some of which are conditional based on certain conditions, such as the amount of performance related fees which GAMMA will receive over a certain period. Most of the purchase price will be paid by cash although a part of it, about ISK 499 million, will be paid by buying unit shares from GAMMA and delivering them to the sellers. At the acquisition date, the purchase price is estimated to amount to ISK 2,542 million. As at 31 March 2019 ISK 667 million have been paid and ISK 2,012 million are recognised as a contingent consideration on the Group's Condensed Interim Consolidated Statement of Financial Position. The amount of the contingent consideration is subject to change and fair value changes will be recognised through the Consolidated Income Statement.

A part of the purchase price, ISK 200 million, will be deposited into an escrow account to be used to offset possible claims that the Bank might set forth during the three years following the acquisition date. After that time, these funds will be paid to the former owners of GAMMA. In 2018, the Bank incurred transaction costs and costs related to the acquisition amounting to ISK 44 million.

In accordance with IFRS 3, Business Combinations, the purchase price of GAMMA was allocated to identifiable assets and liabilities acquired. The following table summarises the recognised amounts of assets and liabilities acquired by the Group at the date of the acquisition. Assets acquired from GAMMA and its subsidiaries were recognised at the fair value amount of ISK 3,689 million. The liabilities assumed from GAMMA and its subsidiaries were recognised at the fair value amount of ISK 1,846 million. The purchase price allocation of GAMMA, as outlined below, is a preliminary assessment and will be finalised in the course of the financial year 2019.

Identifiable assets acquired and liabilities assumed

Assets	Fair value
Cash and balances with Central Bank	8,016
Shares and other variable income securities	916,396
Property and equipment	545,223
Other assets	2,219,698
Total	3,689,334
Liabilities	
Borrowings	1,156,667
Deferred tax liabilities	387,323
Other liabilities	302,387
Total	1,846,377
Non-controlling interest	0
Total identifiable net assets	1,842,958
Goodwill on acquisition	699,360
Acquisition price	2,542,318

Other assets are mostly comprised of receivables, such as asset management and fund management fees. It is management's opinion that there is no indication that these receivables will not be collected in full. Certain assets that are owned by GAMMA form a part of the estimated book value of the contingent consideration as the purchase price will change if the book value of those assets changes. As a result, a large part of the economical risk of those assets lies with the selling shareholders and not the Group.

As the acquisition took place in March, the operating figures for the period are mostly composed of figures related to the Group before the acquisition of GAMMA. If the acquisition had occurred on 1 January 2019, it is estimated that the consolidated revenue would have been ISK 2,394 million and the consolidated profit for the year would have been ISK 625 million.

Notes to the Condensed Interim Consolidated Financial Statements

Income statement

6. Net interest income

Interest income is specified as follows:

	3m 2019	3m 2018
Cash and balances with Central Bank	172,103	252,662
Derivatives	339,924	238,339
Loans to customers	675,532	592,550
Other interest income	20,923	29,558
Total	1,208,482	1,113,109

Interest expense is specified as follows:

	3m 2019	3m 2018
Deposits from customers	352,533	311,984
Borrowings	260,058	266,437
Issued bills	46,273	48,211
Issued bonds	45,629	21,741
Subordinated liabilities	41,578	23,737
Derivatives	5,456	2,181
Other interest expense*	32,512	26,442
Total	784,038	700,733

* Thereof is lease liabilities' interest expense amounting to ISK 5 million

Total interest income recognised in respect of financial assets not carried at fair value through profit or loss amounts to ISK 786 million (3m 2018: ISK 875 million). Total interest expense recognised in respect of financial liabilities not carried at fair value through profit or loss amounts to ISK 739 million (3m 2018: ISK 699 million).

7. Net financial income

Net financial income is specified as follows:

	3m 2019	3m 2018
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss		
Fixed income securities	(80,121)	63,355
Shares and other variable income securities	246,470	95,484
Derivatives	(48,914)	37,652
Loans to customers	55,428	854
Foreign currency exchange difference	35,900	(1,381)
Total	208,763	195,963

8. Foreign currency exchange difference

Foreign currency exchange difference is specified as follows:

	3m 2019	3m 2018
Gain (loss) on financial instruments at fair value through profit and loss	491,349	(59,950)
(Loss) gain on other financial instruments	(455,449)	58,569
Total	35,900	(1,381)

Note 48 provides information about the development of foreign exchange rates against the Icelandic krona.

Notes to the Condensed Interim Consolidated Financial Statements

9. Administrative expenses

Administrative expenses are specified as follows:	3m 2019	3m 2018
Salaries and related expenses	873,484	700,308
Other operating expenses	373,295	289,445
Depositors' and Investors' Guarantee Fund contributions	27,720	22,777
Depreciation and amortisation	8,750	5,644
Depreciation of right of use asset	17,671	0
Total	1,300,920	1,018,174

10. Salaries and related expenses

Salaries and related expenses are specified as follows:	3m 2019	3m 2018
Salaries	591,476	549,901
Performance based payments excluding share-based payments	83,642	7,200
Share-based payment expenses	836	833
Pension fund contributions	73,603	68,054
Tax on financial activity	55,970	31,208
Other salary related expenses	67,957	43,113
Total	873,484	700,308
Average number of full time employees during the period	117	109
Total number of full time employees at the end of the period	133	110

According to Act No. 165/2011, passed in 2011, banks and other financial institutions providing VAT exempt services, must pay a tax based on salary payments, called tax on financial activity. The current tax rate is 5.50% (2018: 5.50%).

The amount of performance based payments that has been expensed is based on the results for 2019, the Group's 2019 budget and the guidelines on performance based payments set forth in the Bank's remuneration policy. The performance based payments have not been allocated to any employees or business segments and are subject to approval by the Board of Directors.

11. Net impairment

	3m 2019	3m 2018
Net change in impairment of loans	(6,644)	(29,922)
Net change in impairment of other assets	8,220	0
Net change in impairment of loan commitments, guarantees and unused credit facilities	(2,166)	0
Net impairment	(590)	(29,922)

12. Income tax

The Bank and most of its subsidiaries will not pay income tax on its profit for 2019 due to the fact that it has a tax loss carry forward that offsets the calculated income tax. At year end 2018, the tax loss carry forward of the Group amounted to ISK 104 billion. A substantial part of the tax loss carry forward is utilisable until end of year 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.

Notes to the Condensed Interim Consolidated Financial Statements

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% (2018: 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% (2018: 0.376%) and the tax is not a deductible expense for income tax purposes. The tax is presented separately in the consolidated income statement. In 2019 the Bank has begun expensing this tax proportionally during the year instead of expensing the whole amount at the end of the year.

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 diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Bank has issued warrants and stock options that have a dilutive effect.

	3m 2019	3m 2018
Net earnings attributable to equity holders of the Bank	709,074	644,127
Weighted average number of outstanding shares	1,844,996	1,811,728
Adjustments for warrants and stock options	236,330	122,364
Total	2,081,326	1,934,093
Basic earnings per share (ISK)	0.38	0.36
Diluted earnings per share (ISK)	0.34	0.33

Notes to the Condensed Interim Consolidated Financial Statements

Statement of Financial Position

16. Cash and balances with Central Bank

Cash and balances with Central Bank are specified as follows:

	31.3.2019	31.12.2018
Deposits with Central Bank	16,741,908	8,934,131
Cash on hand	15,765	9,114
Balances with banks	10,036,844	6,903,004
Foreign treasury bills	3,660,000	3,472,741
Included in cash and cash equivalents	30,454,517	19,318,990
Restricted balances with Central Bank - average maintenance level	759,451	708,656
Restricted balances with Central Bank - fixed reserve requirement	759,451	708,656
Receivables from Central Bank	244,100	602,882
Total	32,217,519	21,339,185

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:

	31.3.2019	31.12.2018
Mandatorily measured at fair value through profit or loss		
Listed government bonds and bonds with government guarantees	436,274	1,841,982
Listed bonds	3,597,415	3,150,409
Unlisted bonds	1,483	134,944
Total	4,035,173	5,127,335

18. Shares and other variable income securities

Shares and other variable income securities are specified as follows:

	31.3.2019	31.12.2018
Mandatorily measured at fair value through profit or loss		
Listed shares	1,212,793	751,470
Unlisted shares	1,745,857	1,391,018
Unlisted unit shares	1,511,995	784,187
Total	4,470,646	2,926,675

19. Securities used for hedging

Securities used for hedging are specified as follows:

	31.3.2019	31.12.2018
Listed government bonds and bonds with government guarantees	8,068,638	7,625,469
Listed bonds	10,285,774	4,487,698
Listed shares	8,954,525	9,395,761
Unlisted unit shares	18,057	17,866
Total	27,326,993	21,526,794

Notes to the Condensed Interim Consolidated Financial Statements

20. Loans to customers

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

	Individuals		Corporates		Total	
	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
31.3.2019						
Loans to customers at amortised cost	4,617,574	4,580,638	22,176,512	21,999,118	26,794,086	26,579,756
Loans to customers at fair value through profit or loss	0	0	2,130,243	2,130,243	2,130,243	2,130,243
Total	4,617,574	4,580,638	24,306,756	24,129,361	28,924,329	28,709,999

	Individuals		Corporates		Total	
	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
31.12.2018						
Loans to customers at amortised cost	5,407,411	5,364,291	22,096,616	21,918,759	27,504,028	27,283,050
Loans to customers at fair value through profit or loss	0	0	2,160,522	2,160,522	2,160,522	2,160,522
Total	5,407,411	5,364,291	24,257,139	24,079,282	29,664,550	29,443,573

21. Derivatives

Derivatives are specified as follows:

	Notional		Carrying value	
	Assets	Liabilities	Assets	Liabilities
31.3.2019				
Interest rate derivatives	4,861,823	4,607,641	254,182	0
Currency forwards	973,058	977,543	1,607	6,091
Bond and equity total return swaps	29,720,911	30,074,512	957,606	1,314,444
Equity options	11,760	11,760	124,680	124,680
	35,567,552	35,671,456	1,338,076	1,445,216
31.12.2018				
Interest rate derivatives	4,803,789	4,607,104	196,684	0
Currency forwards	400,192	413,565		13,372
Bond and equity total return swaps	22,983,930	22,547,910	966,627	530,607
Equity options	7,900	7,900	49,955	49,955
	28,195,811	27,576,479	1,213,266	593,934

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	Share
			31.3.2019	31.12.2018
Fí Fasteignafélag GP ehf.	Real estate fund management	Iceland	100%	100%
GAMMA Capital Management hf.	Fund management	Iceland	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%
Netgíró lán II 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%

Notes to the Condensed Interim Consolidated 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 31.3.2019	Share 31.12.2018
Akta sjóðir hf.	Fund management	Iceland	49%	49%
Kjölfesta GP ehf.	Holding company	Iceland	50%	50%
Kortabjónustan hf.	Payment Institution	Iceland	47%	47%

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

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

	31.3.2019	31.12.2018
Balance at the beginning of the year	774,832	676,610
Acquisition of shares in associates	0	408,671
Dividend paid	0	(7,500)
Share in (loss) profit of associates, net of income tax	(26,876)	(302,949)
Total	747,955	774,832

24. Investment properties

Investment properties are specified as follows:

	31.3.2019	31.12.2018
Balance as at 1 January 2019	950,000	953,874
Acquisitions	18,989	31,544
Disposal	0	(150,000)
Revaluation on investment properties	0	114,582
Total	968,989	950,000

25. Intangible assets

Intangible assets are specified as follows:

31.3.2019	Goodwill	Software	Other	Total
Balance as at 1 January 2019	2,244,521	118,428	16,332	2,379,281
Acquisitions	0	24,913	42,393	67,305
Additions through a business combination	699,360	0	0	699,360
Amortisation	0	(1,604)	(2,317)	(3,921)
Balance as at 31 March 2019	2,943,881	141,737	56,407	3,142,025
Gross carrying amount	2,943,881	70,355	48,800	3,063,036
Accumulated amortisation and impairment losses	0	71,382	7,607	78,989
Balance as at 31 March 2019	2,943,881	141,737	56,407	3,142,025
31.12.2018	Goodwill	Software	Other	Total
Balance as at 1 January 2018	2,244,521	23,959	15,860	2,284,340
Acquisitions	0	98,952	5,352	104,304
Amortisation	0	(4,482)	(4,880)	(9,362)
Translation difference	0	0	0	0
Balance as at 31 December 2018	2,244,521	118,428	16,332	2,379,281
Gross carrying amount	2,244,521	45,442	48,800	94,242
Accumulated amortisation and impairment losses	0	(21,484)	(32,940)	(54,424)
Balance as at 1 January 2018	2,244,521	23,959	15,860	2,284,340
Gross carrying amount	2,244,521	38,924	48,800	87,724
Accumulated amortisation and impairment losses	0	79,505	(32,468)	47,036
Balance as at 31 December 2018	2,244,521	118,428	16,332	2,379,281

26. Other assets

Other assets are specified as follows:

	31.3.2019	31.12.2018
Unsettled transactions	5,672,042	120,563
Accounts receivable	2,500,100	1,283,215
Right of use asset	345,020	0
Sundry assets	2,438,031	537,292
Total	10,955,193	1,941,070

Notes to the Condensed Interim Consolidated Financial Statements

27. Deposits from customers

Deposits from customers are specified as follows:

	31.3.2019	31.12.2018
Demand deposits	40,261,812	32,463,907
Time deposits	16,490,167	15,430,052
Total	56,751,979	47,893,959

28. Borrowings

Borrowings are specified as follows:

	31.3.2019	31.12.2018
Loans from credit institutions	1,610,134	1,215,343
Money market deposits	18,141,931	14,407,558
Other borrowings	1,198,633	11,747
Total	20,950,697	15,634,648

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:

	31.3.2019	31.12.2018
Issued bills	3,772,801	3,577,718
Total	3,772,801	3,577,718

30. Issued bonds

Issued bonds are specified as follows:

Currency, nominal value	First issued	Maturity	Maturity type	Terms of interest	31.3.2019	31.12.2018
KVB 17 02, ISK 2,160 million	2017	2020	At maturity	Floating, 1 month REIBOR + 1.25%	1,875,812	1,963,336
Total					1,875,812	1,963,336
Unlisted senior unsecured bonds, total					1,182,837	1,196,879
Total					3,058,649	3,160,215

Unlisted senior unsecured bonds are composed of KVB 17 01, KVB 18 01, KVB 18 03 and KVB 18 04 which were issued in 2017 and 2018 and mature in 2019, 2020 and 2021 respectively. For further information on the bonds, refer to the issue descriptions which are available on Nasdaq CSD Iceland's website.

31. Subordinated liabilities

Subordinated liabilities:

Currency, nominal value	First issued	Maturity	Maturity type	Terms of interest	31.3.2019	31.12.2018
KVB 15 01, ISK 1,000 million	2015	2025	At maturity	CPI-Indexed, fixed 5.50%	1,113,685	1,093,162
KVB 18 02, ISK 800 million	2018	2028	At maturity	CPI-Indexed, fixed 7.50%	874,163	854,350
Total					1,987,848	1,947,511

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 and are a part of 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. The Group may only retire subordinated liabilities with the permission of the Icelandic Financial Supervisory Authority.

Notes to the Condensed Interim Consolidated Financial Statements

32. Short positions held for trading

Short positions held for trading are specified as follows:

	31.3.2019	31.12.2018
Listed government bonds and bonds with government guarantees	364,887	569,471
Listed bonds	0	235,863
Total	364,887	805,334

33. Other liabilities

Other liabilities are specified as follows:

	31.3.2019	31.12.2018
Unsettled transactions	8,846,814	186,794
Expected credit loss allowance for loan commitments, guarantees and unused credit facilities	15,273	17,439
Accounts payable and accrued expenses	469,948	250,522
Special taxes on financial institutions and financial activities	194,066	150,336
Withholding taxes	291,885	461,153
Salaries and salary related expenses	664,918	313,274
Lease liability	378,220	0
Contingent consideration	2,012,578	0
Other liabilities	94,404	230,806
Total	12,968,105	1,610,323

34. Equity

a. Share capital

The nominal value of shares issued by the Bank is ISK 1 per share. 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.

	31.3.2019	31.12.2018
Share capital according to the Bank's Articles of Association	1,844,996	1,844,996
Nominal amount of treasury shares	0	0
Authorised but not issued shares	938,635	838,635

b. Changes made to the nominal amount of share capital

No changes were made to the Bank's share capital during the period from 1 January to 31 March 2019.

c. Share capital increase authorisations

According to the Bank's Articles of Association dated 14 March 2019, 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.

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.

The Board of Directors is, according to temporary provision II to the Bank's Articles of Association, authorised to issue warrants for 100 million new shares until the Bank's annual general meeting in 2020. The Board is furthermore, until 14 March 2024, authorised to increase share capital to serve warrants issued under the aforementioned authorisation.

Temporary provision III to the Articles of Association moreover authorises the Board of Directors to issue new share capital in the maximum amount of ISK 58,635,392 nominal value, to serve warrants which have been issued. This authorisation is valid until 31 December 2019.

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 200 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 31 December 2022.

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.

Notes to the Condensed Interim Consolidated Financial Statements

35. Warrants

The Bank has issued warrants for shares in the total nominal amount of ISK 687,986,137 as at 31 March 2019. The number of owners of these warrants is 104 and they purchased the warrants for a total consideration of ISK 202,527,258. The purchase price of the warrants was determined using market standard methodology and a valuation from an independent appraiser as applicable. Should the owners of the warrants exercise their warrants, the Bank is obliged to issue new shares and sell to the warrant owners at a predefined price, usually referred to as strike price. If all the warrants would be exercised, the Bank's share capital would increase to 2,532,982,445, and the newly issued shares would represent 27.2% of the Bank's total issued capital, post dilution.

Issue Date	Nominal amount	Purchase price of warrants	Annual increase of strike price	Strik price at expiry date	Exercise period
October 2016	58,486,138	11,793,759	5.0%	4.20	Until October 2019
September 2017	201,333,333	60,601,333	7.5%	6.64	Sept. 2019 - Sept. 2020
September 2017	201,333,333	60,601,333	7.5%	7.67	Sept. 2020 - Sept. 2022
September 2017	201,333,333	60,601,333	7.5%	7.67	Sept. 2021 - Sept. 2022
December 2017	7,333,333	2,471,333	7.5%	7.55	Dec. 2019 - Dec. 2020
December 2017	7,333,333	2,471,333	7.5%	8.73	Dec. 2020 - Dec. 2022
December 2017	7,333,333	2,471,333	7.5%	8.73	Dec. 2021 - Dec. 2022
May 2018	1,166,667	505,167	7.5%	9.25	Dec. 2019 - Dec. 2020
May 2018	1,166,667	505,167	7.5%	10.69	Dec. 2020 - Dec. 2022
May 2018	1,166,667	505,167	7.5%	10.69	Dec. 2021 - Dec. 2022
Total	687,986,137	202,527,258			

36. Capital adequacy ratio (CAD)

Equity at the end of the period was ISK 13,220 million (31.12.2018: 12,970 million), equivalent to 11.5% of total assets according to the statement of financial position (31.12.2018: 14.7%). The capital adequacy ratio of the Group, calculated in accordance with Article 84 of Act No. 161/2002 on Financial Undertakings, was 21.1% (31.12.2018: 25.1%). The minimum according to the Act is 8.0%. The ratio is calculated as follows:

	31.3.2019	31.12.2018
Own funds		
Total equity	13,219,860	12,969,999
Goodwill and intangibles	(3,142,025)	(2,379,281)
Shares in financial institutions	(175,756)	(172,206)
Subordinated fixed income securities	(54,595)	(54,595)
Deferred tax asset	(593,832)	(608,858)
Common equity Tier 1 capital (CET 1)	9,253,652	9,755,059
Tier 2 capital	1,898,092	1,886,506
Total own funds	11,151,744	11,641,565
Risk weighted assets		
Credit risk	35,771,185	31,948,930
Market risk	3,785,743	4,474,728
Operational risk	10,019,764	10,019,764
Total Capital requirements	49,576,691	46,443,422
Capital adequacy ratio (CAD)	22.5%	25.1%
CET1 ratio	18.7%	21.0%
Capital adequacy ratio, adjusted for retained earnings originating in 2019	21.1%	25.1%
CET1 ratio, adjusted for retained earnings originating in 2019	17.2%	21.0%
Minimum Capital adequacy ratio requirement	14.5%	14.5%
Minimum CET 1 ratio requirement	13.9%	13.9%
Surplus own funds	3,963,983	4,907,430
Surplus CET 1	2,360,252	3,296,682

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 20.25% as at 31 December 2018.

Notes to the Condensed Interim Consolidated Financial Statements

Risk management

37. Maximum exposure to credit risk

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

	Public entities	Financial institutions	Corporate customers	Individuals	
31.3.2019					31.3.2019
Cash and balances with Central Bank	22,180,675	10,036,844			32,217,519
Fixed income securities	808,511	2,632,911	593,751		4,035,173
Securities used for hedging	9,767,836	7,821,792	764,784		18,354,412
Loans to customers	73,172	9,448,469	14,483,579	4,629,334	28,634,554
Derivatives	745,459	554,917	37,699		1,338,076
Other assets	12,434	59,038	10,883,722		10,955,193
	33,588,088	30,553,970	26,763,534	4,629,334	95,534,926
Loan commitments		814,982	2,208,515	707,941	3,731,437
Financial guarantee contracts		1,677,500	606,862		2,284,362
Total	33,588,088	33,046,452	29,578,911	5,337,275	101,550,726
31.12.2018					31.12.2018
Cash and balances with Central Bank	14,436,181	6,903,004			21,339,185
Fixed income securities	2,829,688	1,968,174	329,473		5,127,335
Shares and other variable income securities					0
Securities used for hedging	7,850,853	3,157,437	1,104,877		12,113,167
Loans to customers		54,260	24,044,069	5,345,243	29,443,573
Derivatives		624,399	541,364	47,503	1,213,266
Other assets	23,517	56,377	1,766,389	94,786	1,941,070
	25,140,239	12,763,651	27,786,172	5,487,532	71,177,595
Loan commitments		255,329	2,818,631	388,975	3,462,935
Financial guarantee contracts		100,000	823,074		923,074
Total	25,140,239	13,118,980	31,427,877	5,876,508	75,563,603

38. Credit quality of financial assets

The tables below show financial assets subject to the impairment requirements of IFRS 9 broken down by credit quality bands where band i denotes the lowest and iv the highest credit risk. Assets serviced by debtors already recognised as being in default by the rating agency are shown outside credit quality bands. 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 which are non-rated relate to Legal Entities not rated by rating agency or Individuals where individual rating has not been obtained. Probability of default for these exposures is based on average probability for similar exposures and is furthermore individually assessed by credit specialists.

a. Credit quality of financial assets by credit quality band is specified as follows:

	Stage 1	Stage 2	Stage 3	FVTPL	Total
31.3.2019					
<i>Loans to customers:</i>					
Credit quality band I	17,507,988	310,441		710,378	18,528,807
Credit quality band II	3,356,588	0		740,368	4,096,956
Credit quality band III	1,001,255	641,336		466,418	2,109,010
Credit quality band IV	164,945	74,331			239,276
In default		0	367,481		367,481
Non-rated	3,366,817	2,904		213,079	3,582,799
Gross carrying amount	25,397,593	1,029,012	367,481	2,130,243	28,924,329
Impairment due to expected credit loss	(135,846)	(20,681)	(57,803)		(214,330)
Book value	25,261,747	1,008,331	309,678	2,130,243	28,709,999

Notes to the Condensed Interim Consolidated Financial Statements

38. Credit quality of financial assets (cont.)

<i>Loan commitments, guarantees and unused credit facilities:</i>	Stage 1	Stage 2	Stage 3	FVTPL	Total
Credit quality band I	2,068,091	0			2,068,091
Credit quality band II	2,387,031	0		127,145	2,514,176
Credit quality band III	16,097	329,790		179,618	525,505
Credit quality band IV		8,111			8,111
In default			20,839		20,839
Non-rated	878,011				878,011
Gross carrying amount	5,349,231	337,900	20,839	306,763	6,014,734
Impairment due to expected credit loss	(11,444)	(1,154)	(2,675)		(15,273)
Book value	5,337,787	336,746	18,164	306,763	5,999,461

31.12.2018

<i>Loans to customers:</i>	Stage 1	Stage 2	Stage 3	FVTPL	Total
Credit quality band I	16,152,412	10,693	11,158	648,966	16,823,228
Credit quality band II	5,493,100	31,662		858,937	6,383,699
Credit quality band III	596,103	287,862	31,814	373,741	1,289,520
Credit quality band IV	51,116	281,862			332,978
In default		156,446	309,702		466,147
Non-rated	2,999,188	1,090,911		278,879	4,368,979
Gross carrying amount	25,291,919	1,859,436	352,673	2,160,522	29,664,550
Expected credit loss	(160,684)	(27,930)	(32,363)		(220,977)
Book value	25,131,235	1,831,506	320,310	2,160,522	29,443,573

<i>Loan commitments, guarantees and unused credit facilities:</i>	Stage 1	Stage 2	Stage 3	FVTPL	Total
Credit quality band I	2,802,424	971			2,803,394
Credit quality band II	753,562	326		183,141	937,030
Credit quality band III	280,896	3,101			283,997
Credit quality band IV	76	5,716			5,792
In default			5,108		5,108
Non-rated	350,688				350,688
Gross carrying amount	4,187,646	10,113	5,108	183,141	4,386,008
Expected credit loss	(15,462)	(683)	(1,293)		(17,439)
Book value	4,172,184	9,430	3,814	183,141	4,368,569

b. Breakdown of loans to customers into not past due and past due

31.3.2019

	Claim value	Expected credit loss	Carrying amount
Not past due	27,637,681	(201,334)	27,436,347
Past due 1-30 days	1,163,613	(7,628)	1,155,985
Past due 31-60 days	65,193	(158)	65,035
Past due 61-90 days	12,116		12,116
Past due 91-180 days	23,904		23,904
Past due 181-360 days			0
Past due more than 360 days	21,821	(5,210)	16,611
Total	28,924,329	(214,330)	28,709,999

31.12.2018

	Claim value	Expected credit loss	Carrying amount
Not past due	28,900,493	(197,946)	28,702,547
Past due 1-30 days	570,167	(4,857)	565,309
Past due 31-60 days	158,379	(3,921)	154,458
Past due 61-90 days			0
Past due 91-180 days	11,158	(2)	11,156
Past due 181-360 days			0
Past due more than 360 days	24,353	(14,251)	10,102
Total	29,664,550	(220,977)	29,443,573

Notes to the Condensed Interim Consolidated Financial Statements

38. Credit quality of financial assets (cont.)

c. Breakdown of loans to customers by industry

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

	Claim value	Expected credit loss	Carrying amount	%
31.3.2019				
Public entities	73,172	0	73,172	0.3%
Financial institutions	171	(1)	171	0.0%
Corporate				
Services	11,212,602	(81,451)	11,131,151	38.8%
Holding companies	6,479,745	(18,262)	6,461,483	22.5%
Real estate, construction and industry	2,970,986	(47,638)	2,923,348	10.2%
Retail	1,269,097	(9,465)	1,259,632	4.4%
Other	2,300,982	(20,577)	2,280,405	7.9%
Individual	4,617,574	(36,936)	4,580,637	16.0%
Total	28,924,329	(214,330)	28,709,999	100.0%
31.12.2018				
Financial institutions	3,988	(8)	3,979	0.0%
Corporate				
Services	11,393,477	(112,157)	11,281,320	38.3%
Holding companies	6,707,672	(18,015)	6,689,657	22.7%
Real estate, construction and industry	2,834,688	(33,759)	2,800,929	9.5%
Retail	1,034,244	(12,819)	1,021,424	3.5%
Other	2,283,070	(22,098)	2,260,972	7.7%
Individual	5,407,411	(22,120)	5,385,291	18.3%
Total	29,664,550	(220,977)	29,443,573	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 is as follows:

	Senior I	Senior II	Junior	Mezzanine	31.3.2019
Amortised cost - Stage 1	7,741,139	7,561,725	3,938,911	5,794,115	25,035,890
Amortised cost - Stage 2	276,822	87,937	363,186	470,222	1,198,166
Amortised cost - Stage 3	107,744	210,363		27,593	345,700
Fair value through profit and loss	182,513	747,612	1,033,588	166,530	2,130,243
Total	8,308,218	8,607,636	5,335,685	6,458,461	28,709,999
31.12.2018					
Amortised cost - Stage 1	6,030,827	8,442,103	4,316,905	6,143,591	24,933,426
Amortised cost - Stage 2	1,283,008	345,169	173,640	170,558	1,972,375
Amortised cost - Stage 3	163,415	65,451		148,383	377,250
Fair value through profit and loss	181,415	837,798	907,762	233,548	2,160,522
Total	7,658,665	9,690,522	5,398,306	6,696,080	29,443,573

Notes to the Condensed Interim Consolidated 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.

31.3.2019

Expected credit loss allowance total

	Stage 1	Stage 2	Stage 3	Total
Transfers of financial assets:				
Balance as at 31 December 2018	155,146	28,614	54,657	238,416
Transfer to Stage 1 - (Initial recognition)	5,825	(4,359)	(1,466)	0
Transfer to Stage 2 - (significantly increased credit risk)	(7,318)	7,379	(60)	0
Transfer to Stage 3 - (credit impaired)	(616)	(55)	671	0
Net remeasurement of loss allowance	3,256	2,770	4,477	10,503
New financial assets, originated or purchased	20,441	834	9,067	30,342
Derecognitions and maturities	(29,443)	(13,347)	(6,868)	(49,658)
Balance as at 31 March 2019	147,290	21,835	60,478	229,603

Expected credit loss allowance for loans to customers

	Stage 1	Stage 2	Stage 3	Total
Transfers of financial assets:				
Balance as at 31 December 2018	139,680	27,930	53,363	220,973
Transfer to Stage 1 - (Initial recognition)	5,723	(4,257)	(1,466)	0
Transfer to Stage 2 - (significantly increased credit risk)	(7,096)	7,156	(60)	0
Transfer to Stage 3 - (credit impaired)	(607)	(55)	661	0
Net remeasurement of loss allowance	4,839	2,642	4,025	11,506
New financial assets, originated or purchased	18,225	380	8,135	26,740
Derecognitions and maturities	(24,917)	(13,117)	(6,855)	(44,889)
Balance as at 31 March 2019	135,846	20,681	57,803	214,330

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

	Stage 1	Stage 2	Stage 3	Total
Transfers of financial assets:				
Balance as at 31 December 2018	15,466	683	1,293	17,443
Transfer to Stage 1 - (Initial recognition)	102	(102)		0
Transfer to Stage 2 - (significantly increased credit risk)	(222)	222		0
Transfer to Stage 3 - (credit impaired)	(9)	(1)	10	0
Net remeasurement of loss allowance	(1,583)	128	452	(1,003)
New financial assets, originated or purchased	2,216	453	933	3,603
Derecognitions and maturities	(4,527)	(230)	(13)	(4,769)
Balance as at 31 March 2019	11,444	1,154	2,675	15,273

31.12.2018

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)	2,673	(223)	(2,450)	0
Transfer to Stage 2 - (significantly increased credit risk)	(15,005)	15,032	(26)	0
Transfer to Stage 3 - (credit impaired)	(614)	(30,814)	31,429	0
Net remeasurement of loss allowance	(2,893)	(512)	(24,586)	(27,990)
New financial assets, originated or purchased	101,385	12,792	6,913	121,091
Derecognitions and maturities	(61,553)	(18,204)	(25,258)	(105,015)
Write-offs			(9,671)	(9,671)
Balance as at 31 December 2018	176,146	28,614	33,657	238,416

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

Notes to the Condensed Interim Consolidated Financial Statements

38. Credit quality of financial assets (cont.)

Transfers of financial assets:

Transfer to Stage 1 - (Initial recognition)	2,396	(215)	(2,181)	0
Transfer to Stage 2 - (significantly increased credit risk)	(14,871)	14,898	(26)	0
Transfer to Stage 3 - (credit impaired)	(568)	(30,814)	31,383	0
Net remeasurement of loss allowance	(1,998)	(911)	(25,243)	(28,152)
New financial assets, originated or purchased	92,969	12,747	6,888	112,603
Derecognitions and maturities	(54,475)	(17,411)	(25,184)	(97,069)
Write-offs			(9,671)	(9,671)
Balance as at 31 December 2018	160,684	27,930	32,363	220,977

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)	277	(8)	(269)	0
Transfer to Stage 2 - (significantly increased credit risk)	(134)	134		0
Transfer to Stage 3 - (credit impaired)	(46)		46	0
Net remeasurement of loss allowance	(895)	399	657	162
New financial assets, originated or purchased	8,416	46	26	8,488
Derecognitions and maturities	(7,078)	(793)	(75)	(7,945)
Write-offs				0
Balance as at 31 December 2018	15,462	683	1,293	17,439

Notes to the Condensed Interim Consolidated 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 52. 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	31.3.2019
Financial institutions	2,282	18,537	53,673	419,907			494,399
Corporate customers	1,110,308	92,516	8,111,960	9,790,647	117,394	682,297	19,905,123
Individuals	13,006	18,902	487,696	411,156			930,760
Total	1,125,596	129,955	8,653,329	10,621,710	117,394	682,297	21,330,282

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2018
Financial institutions	604	49,588	46,164	310,655			407,011
Corporate customers	1,441,389	194,594	8,209,045	9,974,043	173,193	976,223	20,968,489
Individuals	10,568	40,665	1,220,231	434,033			1,705,498
Total	1,452,561	284,848	9,475,440	10,718,732	173,193	976,223	23,080,997

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	31.3.2019
Financial institutions	763,720	151,992	1,206,846				2,122,558
Corporate customers	654,379	10,864	689,739				1,354,982
Individuals	61,078	2,324	47,011				110,413
Total	1,479,177	165,180	1,943,596	0	0	0	3,587,953

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2018
Financial institutions	596,407	233,346	1,329,991				2,159,744
Corporate customers	571,234	154,567	768,923				1,494,725
Individuals	34,028		103,944				137,972
Total	1,201,669	387,913	2,202,858	0	0	0	3,792,441

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:

	31.3.2019	%	31.12.2018	%
Less than 50%	12,165,144	42.4%	10,041,505	34.1%
51-70%	3,385,594	11.8%	6,286,414	21.4%
71-90%	3,008,664	10.5%	4,542,377	15.4%
91-100%	448,469	1.6%	525,403	1.8%
More than 100%	4,572,195	15.9%	3,216,506	10.9%
No collateral:				
Purchased short-term retail claims	3,464,207	12.1%	3,511,938	11.9%
Other loans with no collateral	1,665,727	5.8%	1,319,429	4.5%
Total	28,709,999	100.0%	29,443,573	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.

Notes to the Condensed Interim Consolidated 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.

	31.3.2019		31.12.2018	
	Number	Amount	Number	Amount
Large exposures before risk adjusted mitigation				
10-20% of capital base	7	8,828,799	9	6,740,154
20-25% of capital base	1	2,382,911	0	2,359,382
Exceeding 25% of capital base	2	6,567,533	2	3,472,741
Total	10	17,779,243	11	12,572,277
Thereof nostro accounts with foreign banks with S&P rating of A- or higher	2	5,272,593	2	2,359,382
Large exposures net of risk adjusted mitigation	3	4,983,678	2	2,359,382

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 regulatory requirement is 100%. The minimum regulatory requirement for foreign currencies NSFR is 100%.

The Group was in compliance with internal and external liquidity requirements throughout the years 2019 and 2018. At end of March 2019 the LCR was 175% and at year-end 2018 it was 277%.

Notes to the Condensed Interim Consolidated Financial Statements

42. Liquidity risk (cont.)

c. Maturity analysis of financial assets and financial liabilities

31.3.2019	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Gross inflow/ (outflow)	Carrying amount
Financial assets by type							
<i>Non-derivative assets</i>							
Cash and balances with Central Bank	29,766,119	2,451,400				32,217,519	32,217,519
Fixed income securities	3,892,395	54,595	88,183			4,035,173	4,035,173
Shares and other variable income securities	1,491,704	2	2,978,941			4,470,646	4,470,646
Securities used for hedging	27,326,993					27,326,993	27,326,993
Loans to customers	2,472,060	5,434,058	13,381,035	7,990,093	487,921	29,765,167	28,709,999
Other assets	8,395,445	692,100	528,141	1,339,507		10,955,193	10,955,193
	73,344,717	8,632,154	16,976,300	9,329,600	487,921	108,770,692	107,715,524
<i>Derivative assets</i>							
Inflow	6,049,416	271,888	28,552	195,641		6,545,497	
Outflow	(5,090,002)	(234,496)	(1,278)	(5,980)		(5,331,756)	
	959,414	37,393	27,274	189,661	0	1,213,741	1,338,076
Financial liabilities by type							
<i>Non-derivative liabilities</i>							
Deposits from customers	(40,103,795)	(12,968,207)	(1,420,983)	(2,054,249)	(211,761)	(56,758,995)	56,751,979
Borrowings	(7,674,075)	(7,694,763)	(5,335,123)	(263,004)		(20,966,965)	20,950,697
Issued bills		(1,840,000)	(2,000,000)			(3,840,000)	3,772,801
Issued bonds		(21,366)	(1,055,763)	(2,564,873)		(3,642,002)	3,058,649
Subordinated liabilities			(59,612)	(364,714)	(2,459,294)	(2,883,621)	1,987,848
Short positions held for trading	(364,887)					(364,887)	364,887
Other liabilities	(9,229,815)	(1,038,886)	(631,158)	(2,068,245)		(12,968,105)	12,968,105
	(57,372,572)	(23,563,223)	(10,502,639)	(7,315,087)	(2,671,055)	(101,424,575)	99,854,966
<i>Derivative liabilities</i>							
Inflow	23,631,281	567,988				24,199,269	
Outflow	(24,942,910)	(576,571)				(25,519,480)	
	(1,311,628)	(8,583)	0	0	0	(1,320,211)	1,445,216
Unrecognised financial items							
<i>Loan commitments</i>							
Inflow	438,382	782,904	2,074,972	605,947		3,902,205	
Outflow	(3,731,437)					(3,731,437)	
<i>Financial guarantee contracts</i>							
Inflow	354,543	102,288	1,578,246	215,446	33,840	2,284,362	
Outflow	(2,284,362)					(2,284,362)	
	(5,222,874)	885,191	3,653,218	821,393	33,840	170,768	
Summary							
Non-derivative assets	73,344,717	8,632,154	16,976,300	9,329,600	487,921	108,770,692	
Derivative assets	959,414	37,393	27,274	189,661		1,213,741	
Non-derivative liabilities	(57,372,572)	(23,563,223)	(10,502,639)	(7,315,087)	(2,671,055)	(101,424,575)	
Derivative liabilities	(1,311,628)	(8,583)				(1,320,211)	
Net assets (liabilities) excluding unrecognised items	15,619,931	(14,902,258)	6,500,934	2,204,174	(2,183,133)	7,239,647	
Net unrecognised items	(5,222,874)	885,191	3,653,218	821,393	33,840	170,768	
Net assets (liabilities)	10,397,057	(14,017,067)	10,154,152	3,025,567	(2,149,293)	7,410,415	

Notes to the Condensed Interim Consolidated Financial Statements

42. Liquidity risk (cont.)

31.12.2018	Up to 1	1-3	3-12	1-5	Over 5	Gross	Carrying
Financial assets by type	month	months	months	years	years	inflow/ (outflow)	amount
<i>Non-derivative assets</i>							
Cash and balances with Central Bank	21,339,185					21,339,185	21,339,185
Fixed income securities	4,936,503	54,595	133,230			5,124,328	5,127,335
Shares and other variable income securities	989,332		1,937,344			2,926,675	2,926,675
Securities used for hedging	21,526,794					21,526,794	21,526,794
Loans to customers	3,665,736	6,002,954	14,048,774	7,601,019	508,769	31,827,251	29,443,573
Other assets	592,443	592,986	353,118	402,522		1,941,070	1,941,070
	53,049,993	6,650,536	16,472,465	8,003,541	508,769	84,685,303	82,304,631
<i>Derivative assets</i>							
Inflow	9,646,806	86,784	47,909	155,880		9,937,378	
Outflow	(8,681,151)	(85,812)	(1,533)	(5,571)		(8,774,068)	
	965,654	972	46,376	150,309	0	1,163,311	1,213,266
<i>Financial liabilities by type</i>							
<i>Non-derivative liabilities</i>							
Deposits from customers	(32,904,108)	(11,450,562)	(2,066,844)	(1,912,032)	(83,029)	(48,416,575)	47,893,959
Borrowings	(1,427,044)	(8,447,186)	(5,668,787)			(15,543,017)	15,634,648
Issued bills		(1,800,000)	(1,840,000)			(3,640,000)	3,577,718
Issued bonds	(16,226)	(24,923)	(499,311)	(3,137,596)		(3,678,055)	3,160,215
Subordinated liabilities			(120,119)	(360,527)	(2,431,190)	(2,911,837)	1,947,511
Short positions held for trading	(805,334)					(805,334)	805,334
Other liabilities	(322,295)	(762,318)	(470,901)	(54,809)		(1,610,323)	1,610,323
	(35,475,008)	(22,484,990)	(10,665,961)	(5,464,964)	(2,514,219)	(76,605,142)	74,629,708
<i>Derivative liabilities</i>							
Inflow	12,213,045	510,776	399,690			13,123,511	
Outflow	(12,728,897)	(525,531)	(420,750)			(13,675,178)	
	(515,852)	(14,755)	(21,060)	0	0	(551,667)	593,934
Unrecognised financial items by type							
<i>Loan commitments</i>							
Inflow	505,137	1,014,347	1,417,147	601,431		3,538,062	
Outflow	(3,462,935)					(3,462,935)	
<i>Financial guarantee contracts</i>							
Inflow	923,074					923,074	
Outflow	(923,074)					(923,074)	
	(2,957,798)	1,014,347	1,417,147	601,431	0	75,127	
Summary							
Non-derivative assets	53,049,993	6,650,536	16,472,465	8,003,541	508,769	84,685,303	
Derivative assets	965,654	972	46,376	150,309		1,163,311	
Non-derivative liabilities	(35,475,008)	(22,484,990)	(10,665,961)	(5,464,964)	(2,514,219)	(76,605,142)	
Derivative liabilities	(515,852)	(14,755)	(21,060)			(551,667)	
Net assets (liabilities) excluding unrecognised items	18,024,787	(15,848,237)	5,831,820	2,688,886	(2,005,450)	8,691,805	
Net unrecognised items	(2,957,798)	1,014,347	1,417,147	601,431		75,127	
Net assets (liabilities)	15,066,989	(14,833,890)	7,248,967	3,290,317	(2,005,450)	8,766,933	

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.

Notes to the Condensed Interim Consolidated Financial Statements

43. Market risk

a. Definition

Market risk constitutes risk due to changes in the market prices of financial instruments and comprises interest rate risk, currency risk and other price risk. Notes 44-49 relate to market risk exposure.

b. Management

The Group has a strict policy on controlling market risk and to keep the exposure within set limits. The risk management unit monitors market risk limits on a daily basis and reports regularly to the ALCO committee and to the CEO.

44. Interest rate risk

a. Definition

The Group's exposure to interest rate risk is twofold. On the one hand, the Group has a proprietary portfolio of bonds, where market rates affect prices and any fluctuations are recognised in the income statement. On the other hand, the Group has mismatch in assets and liabilities with fixed interest terms. These include loans and swap contracts for securities on the asset side and borrowings and deposits on the liability side. This mismatch does not create an immediate effect on the income statement but nevertheless affects the Group's economic value.

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

b. Management

The Group takes measures to minimise interest rate risk by matching the interest rate profile and duration of assets with the Group's liabilities as well as using derivative and non-derivative financial instruments to manage effectively the risk of an adverse impact on the Group's earnings.

45. 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	31.3.2019
Fixed income securities	62,009	6,690	1,446,980	569,797	1,949,696	4,035,173
Short positions - fixed income securities				(329,420)	(35,466)	(364,887)
Net imbalance	62,009	6,690	1,446,980	240,377	1,914,230	3,670,286
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	31.12.2018
Fixed income securities		17,913	999,491	1,561,987	2,547,944	5,127,335
Short positions - fixed income securities				(755,454)	(49,880)	(805,334)
Net imbalance	0	17,913	999,491	806,534	2,498,063	4,322,001

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	31.3.2019 Upward	Downward	31.12.2018 Upward
Indexed	50	75,430	(75,430)	70,216	(70,216)
Non-indexed	100	12,242	(12,242)	69,481	(69,481)
Total		87,672	(87,672)	139,697	(139,697)

Notes to the Condensed Interim Consolidated Financial Statements

46. 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:

31.3.2019

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	28,557,520	3,660,000				32,217,519
Loans to customers	24,491,081	1,086,866	1,938,760	1,169,074	24,219	28,709,999
Financial assets excluding derivatives	53,048,601	4,746,866	1,938,760	1,169,074	24,219	60,927,518
Effect of derivatives	29,588,899	893,834	1,000,000	3,100,000		34,582,734
Total	82,637,500	5,640,700	2,938,760	4,269,074	24,219	95,510,252
Financial liabilities	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Deposits from customers	56,751,979					56,751,979
Borrowings	7,807,651	7,655,615	5,237,360	250,071		20,950,697
Issued bills		1,951,654	1,821,147			3,772,801
Issued bonds	253,262		929,523	1,875,864		3,058,649
Subordinated liabilities					1,987,848	1,987,848
Financial liabilities excluding derivatives	64,812,892	9,607,269	7,988,030	2,125,935	1,987,848	86,521,974
Effect of derivatives	4,603,016	4,089				4,607,104
Total	69,415,908	9,611,358	7,988,030	2,125,935	1,987,848	91,129,079
Total interest repricing gap	13,221,592	(3,970,658)	(5,049,270)	2,143,139	(1,963,629)	4,381,174

31.12.2018

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	17,867,444	3,471,741				21,339,185
Loans to customers	23,872,709	1,432,779	2,821,790	1,158,425	157,870	29,443,573
Financial assets excluding derivatives	41,740,153	4,904,520	2,821,790	1,158,425	157,870	50,782,758
Effect of derivatives	22,590,158	597,560	1,500,000	3,100,000		27,787,718
Total	64,330,311	5,502,080	4,321,790	4,258,425	157,870	78,570,476
Financial liabilities	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Deposits from customers	47,893,959					47,893,959
Borrowings	1,437,087	8,610,188	5,587,373			15,634,648
Issued bills		1,779,152	1,798,565			3,577,718
Issued bonds	266,454		399,725	2,494,035		3,160,215
Subordinated liabilities					1,947,511	1,947,511
Financial liabilities excluding derivatives	49,597,500	10,389,341	7,785,664	2,494,035	1,947,511	72,214,051
Effect of derivatives	4,607,104					4,607,104
Total	54,204,604	10,389,341	7,785,664	2,494,035	1,947,511	76,821,155
Total interest repricing gap	10,125,707	(4,887,261)	(3,463,874)	1,764,389	(1,789,641)	1,749,321

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:

Currency	Shift in basis points	31.3.2019		31.12.2018	
		Downward	Upward	Downward	Upward
ISK, indexed	50	9,780	(9,595)	11,837	(11,614)
ISK, non-indexed	100	(33,610)	30,717	(42,882)	41,861
Other currencies	20	(2,109)	1,370	(2,228)	1,157
Total		(25,939)	22,492	(33,273)	31,404

Notes to the Condensed Interim Consolidated Financial Statements

47. 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 inflation indexation of assets and liabilities denominated in ISK. 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.

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 exposure to the CPI 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:

	31.3.2019	31.12.2018
Assets	9,251,171	7,180,237
Liabilities	(7,578,412)	(5,927,047)
Total	1,672,759	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.

	31.3.2019		31.12.2018	
	-1%	1%	-1%	1%
Government bonds	(5,047)	5,047	(2,295)	2,295
Other fixed income securities	(20,008)	20,008	(20,049)	20,049
Loans to customers	(31,457)	31,457	(24,459)	24,459
Derivatives	(36,000)	36,000	(25,000)	25,000
Short positions	9,068	(9,068)	2,784	(2,784)
Deposits	48,716	(48,716)	46,487	(46,487)
Subordinated debt	18,000	(18,000)	10,000	(10,000)
	(16,728)	16,728	(12,532)	12,532

The effect on equity would be the same.

48. 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 31 March 2019 and 31 December 2018 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	Average	Closing	Average
	31.3.2019	3m 2019	31.12.2018	3m 2018
EUR/ISK	137.5	136.2	133.2	124.3
USD/ISK	122.6	119.9	116.3	101.1

Notes to the Condensed Interim Consolidated Financial Statements

48. Currency risk (cont.)

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

31.3.2019

Financial assets

	EUR	USD	GBP	CAD	Other currencies	Total
Cash and balances with Central Bank	3,163,736	8,531,967	997,137	106,370	805,033	13,604,244
Fixed income securities						0
Shares and other variable income securities	7	21	435,579		33	435,639
Loans to customers	960,341	113,780	64,212		53,384	1,191,716
Other assets	283,329	131,044	363,059		189,614	967,046
Financial assets excluding derivatives	4,407,413	8,776,812	1,859,986	106,370	1,048,064	16,198,644
Derivatives	1,040,176	61,911	19,257			1,121,344
Total	5,447,589	8,838,723	1,879,243	106,370	1,048,064	17,319,989

Financial liabilities

	EUR	USD	GBP	CAD	Other currencies	Total
Deposits from customers	5,032,789	7,145,919	1,115,416	62,420	786,168	14,142,713
Borrowings	40,645					40,645
Issued bonds		296,159				296,159
Other liabilities	365,529	357,621	12,146	5,573	193,850	934,718
Financial liabilities excluding derivatives	5,438,963	7,799,699	1,127,562	67,993	980,018	15,414,234
Derivatives	67,456	61,911	559,020			688,387
Total	5,506,419	7,861,610	1,686,582	67,993	980,018	16,102,622

Net currency position

	EUR	USD	GBP	CAD	Other currencies	Total
Financial assets	5,447,589	8,838,723	1,879,243	106,370	1,048,064	17,319,989
Financial liabilities	(5,506,419)	(7,861,610)	(1,686,582)	(67,993)	(980,018)	(16,102,622)
Financial guarantee contracts	9,712					9,712
Total	(49,119)	977,113	192,661	38,377	68,046	1,227,079

31.12.2018

Financial assets

	EUR	USD	GBP	NOK	Other currencies	Total
Cash and balances with Central Bank	2,976,108	6,152,291	200,764	93,690	847,261	10,270,114
Fixed income securities	133,230					133,230
Shares and other variable income securities	6	18	385,394		31	385,449
Loans to customers	1,452,927	110,112	140,375		158,935	1,862,349
Other assets	330,613	143,642	337,106			811,361
Financial assets excluding derivatives	4,892,884	6,406,062	1,063,639	93,690	1,006,227	13,462,503
Derivatives	417,793	32,155	17,884			467,832
Total	5,310,678	6,438,217	1,081,523	93,690	1,006,227	13,930,335

Financial liabilities

	EUR	USD	GBP	NOK	Other currencies	Total
Deposits from customers	5,112,003	5,736,753	1,062,588	109,446	894,284	12,915,074
Borrowings	39,407					39,407
Issued bonds		278,201				278,201
Other liabilities	2,160	290,825	4,925		1,407	299,317
Financial liabilities excluding derivatives	5,153,569	6,305,779	1,067,513	109,446	895,691	13,531,999
Derivatives	18,103	32,155				50,258
Total	5,171,673	6,337,934	1,067,513	109,446	895,691	13,582,258

Net currency position

	EUR	USD	GBP	NOK	Other currencies	Total
Financial assets	5,310,678	6,438,217	1,081,523	93,690	1,006,227	13,930,335
Financial liabilities	(5,171,673)	(6,337,934)	(1,067,513)	(109,446)	(895,691)	(13,582,258)
Financial guarantee contracts	7,934					7,934
Total	146,940	100,283	14,009	(15,756)	110,536	356,012

Notes to the Condensed Interim Consolidated Financial Statements

48. 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.

Assets and liabilities denominated in foreign currencies	31.3.2019		31.12.2018	
	-10%	+10%	-10%	+10%
EUR	(4,912)	4,912	14,694	(14,694)
USD	97,711	(97,711)	10,028	(10,028)
GBP	19,266	(19,266)	1,401	(1,401)
CAD	3,838	(3,838)	760	(760)
NOK	1,356	(1,356)	(1,576)	1,576
Other currencies	5,449	(5,449)	10,293	(10,293)
Total	122,708	(122,708)	35,601	(35,601)

The effect on equity would be the same.

49. 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.

	31.3.2019			31.12.2018		
	Average	Max	Exposure	Average	Max	Exposure
Listed shares	793,282	1,538,678	1,212,793	840,266	1,306,331	751,470
Unlisted shares	1,066,532	2,313,555	1,745,857	971,302	1,432,666	1,391,018
Unlisted unit shares	956,882	1,574,919	1,511,995	1,018,325	1,978,813	784,187
Total			4,470,646			2,926,675

50. Operational risk

a. Definition

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

b. Management

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

Notes to the Condensed Interim Consolidated Financial Statements

Financial assets and financial liabilities

51. Accounting classification of financial assets and financial liabilities

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

31.3.2019		Amortised cost	Manda- torily at fair value through P/L	Total carrying amount
Financial assets				
Cash and balances with Central Bank	32,217,519			32,217,519
Fixed income securities			4,035,173	4,035,173
Shares and other variable income securities			4,470,646	4,470,646
Securities used for hedging			27,326,993	27,326,993
Loans to customers	26,579,756		2,130,243	28,709,999
Derivatives			1,338,076	1,338,076
Other assets	10,955,193			10,955,193
Total	69,752,468		39,301,131	109,053,600
Financial liabilities				
Deposits from customers	56,751,979			56,751,979
Borrowings	20,950,697			20,950,697
Issued bills	3,772,801			3,772,801
Issued bonds	3,058,649			3,058,649
Subordinated liabilities	1,987,848			1,987,848
Short positions held for trading			364,887	364,887
Derivatives			1,445,216	1,445,216
Other liabilities	10,955,527		2,012,578	12,968,105
Total	97,477,502		3,822,680	101,300,182
31.12.2018				
Financial assets				
Cash and balances with Central Bank	21,339,185			21,339,185
Fixed income securities			5,127,335	5,127,335
Shares and other variable income securities			2,926,675	2,926,675
Securities used for hedging			21,526,794	21,526,794
Loans to customers	27,283,050		2,160,522	29,443,573
Derivatives			1,213,266	1,213,266
Other assets	1,941,070			1,941,070
Total	50,563,305		32,954,592	83,517,897
Financial liabilities				
Deposits from customers	47,893,959			47,893,959
Borrowings	15,634,648			15,634,648
Issued bills	3,577,718			3,577,718
Issued bonds	3,160,215			3,160,215
Subordinated liabilities	1,947,511			1,947,511
Short positions held for trading			805,334	805,334
Derivatives			593,934	593,934
Other liabilities	1,610,323			1,610,323
Total	73,824,374		1,399,268	75,223,642

Notes to the Condensed Interim Consolidated Financial Statements

52. Financial assets and financial 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 financial 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.

Notes to the Condensed Interim Consolidated Financial Statements

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

d. Fair value hierarchy classification

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

31.3.2019

Financial assets	Level 1	Level 2	Level 3	Carrying amount
Mandatorily measured at fair value through profit and loss				
Fixed income securities	4,033,690		1,483	4,035,173
Shares and other variable income securities	2,085,161	266,391	2,119,094	4,470,646
Securities used for hedging	27,326,993			27,326,993
Loans to customers			2,130,243	2,130,243
Derivatives		1,338,076		1,338,076
Total	33,445,844	1,604,467	4,250,821	39,301,131
Financial liabilities				
Mandatorily measured at fair value through profit and loss				
Short positions held for trading	364,887			364,887
Derivatives		1,445,216		1,445,216
Other liabilities			2,012,578	2,012,578
Total	364,887	1,445,216	2,012,578	3,822,680

There were no transfers between levels during the period.

31.12.2018

Financial assets	Level 1	Level 2	Level 3	Carrying amount
Mandatorily measured at fair value through profit and loss				
Fixed income securities	4,992,391		134,944	5,127,335
Shares and other variable income securities	1,686,097	376,399	864,180	2,926,675
Securities used for hedging	21,476,591	50,203		21,526,794
Loans to customers			2,160,522	2,160,522
Derivatives		1,213,266		1,213,266
Total	28,155,079	1,639,867	3,159,646	32,954,592
Financial liabilities				
Mandatorily measured at fair value through profit and loss				
Short positions held for trading	805,334			805,334
Derivatives		593,934		593,934
Total	805,334	593,934	0	1,399,268

There were no transfers between levels during the period.

Notes to the Condensed Interim Consolidated Financial Statements

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

e. Reconciliation of changes in Level 3 fair value measurements

	Shares and				Total
	Fixed income securities	other var. income securities	Loans to customers	Other liabilities	
31.3.2019					
Balance as at 31 December 2018	134,944	864,180	2,160,522	0	3,159,646
Total gains and losses in profit or loss	(133,461)	88,748	44,827	(137,539)	(137,425)
Purchases	0	1,426,078	337,082		1,763,161
Repayments	0		(412,189)		(412,189)
Acquisition of subsidiary		0		(1,875,038)	(1,875,038)
Sales		(259,912)			(259,912)
Balance as at 31 March 2019	1,483	2,119,094	2,130,243	(2,012,578)	2,238,243

	Shares and				Total
	Fixed income securities	other var. income securities	Loans to customers	Other liabilities	
31.12.2018					
Balance as at 1 January 2018	0	531,405	0	0	531,405
Reclassification into Level 3 in accordance with IFRS 9			2,081,352		2,081,352
Total gains and losses in profit or loss	11,059	(17,865)	237,973		231,167
Purchases	127,400	521,140	596,618		1,245,158
Repayments	(3,515)		(755,420)		(758,936)
Capital decrease		(16,638)			(16,638)
Sales		(153,863)			(153,863)
Balance as at 31 December 2018	134,944	864,180	2,160,522	0	3,159,646

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

	Shares and other var. income securities
Net financial income - 3m 2019	
Financial assets mandatorily measured at fair value through profit or loss	88,748
Total	88,748
Net financial income - 12m 2018	
Financial assets mandatorily measured at fair value through profit or loss	(17,865)
Total	(17,865)

g. Fair value measurements for Level 3 financial assets and liabilities

Level 3 assets consist primarily of illiquid, unlisted bonds, shares and share certificates and loans measured at fair value. Each asset is evaluated separately but assets within an asset group share a valuation method. The following valuation methods are in use in 2019:

Asset class	Method	Significant unobservable input	Range	Book value 31.3.2019
Unlisted bonds	Expected recovery	Value of assets	90-100%	1,483
Unlisted shares	Market price	Recent trades	-	2,119,094
Loans to customers	Expert model	Value of assets and collateral	-	2,130,243
Total				4,250,821

Asset class	Method	Significant unobservable input	Range	Book value 31.12.2018
Unlisted bonds	Expected recovery	Value of assets	90-100%	134,944
Unlisted shares	Market price	Recent trades	-	864,180
Loan to customers	Expert model	Value of assets and collateral	-	2,160,522
Total				3,159,646

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	211,909	(211,909)
Total	211,909	(211,909)

Notes to the Condensed Interim Consolidated Financial Statements

Other information

53. Pledged assets

The Group has pledged assets, in the ordinary course of banking business, to the Central Bank of Iceland to the amount of ISK 2.7 billion as at 31 March 2019 (2018: ISK 2.7 billion) to secure settlement in the Icelandic clearing systems. Further pledges have been placed in the ordinary course of banking business for netting and set-off arrangements in the total amount of ISK 0.3 billion as at 31 March 2019 (2018: ISK 0.9 billion).

54. 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

	Loans & receivables	Deposits & payables
31.3.2019		
Management	126,730	302,583
Associates	4,699	2,886,334
Total	131,429	3,188,918
31.12.2018		
Management	79,231	212,291
Associates	7,450	3,004,717
Total	86,681	3,217,008

d. Effects on income statement

	Interest income	Interest expense	Fees received	Fees paid
3m 2019				
Management	3,419	758	439	2,629
Associates	22	12,552	9,745	0
Total	3,441	13,310	10,184	2,629
3m 2018				
Shareholders	0	105	1,246	134
Management	820	1,015	846	2,248
Associates	0	26,214	9,608	0
Total	820	27,334	11,700	2,382

55. Other matters

Legal proceedings

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. The case was subsequently appealed by the plaintiff to the Court of Appeal (Icelandic: Landsréttur) which acquitted the Bank of the plaintiff's claims on 30 November 2018. The plaintiff appealed to the Supreme Court of Iceland which will hear the case on 24 May 2019.

56. Events after the reporting date

There are no material events after the reporting date.