



**KVKA**

Condensed Interim  
Consolidated Financial Statements

30 September 2019

## Table of Contents

	<b>Page</b>
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 30 September 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 on 14 March 2019. At the meeting, the shareholders of the Bank approved a dividend payment of approximately ISK 443 million, which was subsequently paid on 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.

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 September 2019 Kvika had ISK 417 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 14,849 million (31.12.2018: ISK 12,970 million) and total assets amounted to ISK 112,550 million (31.12.2018: ISK 88,274 million).

The Group's net operating income during the period was ISK 5,615 million (1-3Q 2018: ISK 4,311 million). Net interest income amounted to ISK 1,326 million (1-3Q 2018: ISK 1,234 million). Net fee income amounted to ISK 3,600 million (1-3Q 2018: ISK 2,774 million). Other operating income amounted to ISK 689 million (1-3Q 2018: ISK 303 million). Administrative expenses during first half amounted to ISK 3,899 million (1-3Q 2018: ISK 2,909 million).

Profit for the period amounted to ISK 1,913 million (1-3Q 2018: ISK 1,403 million), corresponding to an annualised 20.3% 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 30.09.2019 is 22.9% (31.12.2018: 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 buffer is 20.75% as at 30 September 2019.

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 September 2019 the Group's 30 day liquidity coverage ratio (LCR) was 260%, 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 38-48 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 30 September 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 30 September 2019 and the financial performance of the Group and changes of cash flows for the period 1 January to 30 September 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 30 September 2019, and confirm them by the means of their signatures.

Reykjavík, 14 November 2019.

Board of Directors

CEO



## Condensed Interim Consolidated Income Statement

For the period 1 January 2019 to 30 September 2019

	Notes	9m 2019	9m 2018
Interest income .....		3,804,018	3,439,615
Interest expense .....		(2,477,810)	(2,205,150)
<b>Net interest income</b>	6	1,326,208	1,234,465
Fee and commission income .....		3,712,750	2,882,892
Fee and commission expense .....		(112,581)	(109,052)
<b>Net fee and commission income</b>		3,600,169	2,773,839
Net financial income .....	7	436,207	288,132
Share in profit (loss) of associates, net of income tax .....	23	163,458	(36,036)
Other operating income .....		89,286	50,905
<b>Other operating income</b>		688,951	303,001
<b>Net operating income</b>		5,615,328	4,311,305
Administrative expenses .....	9	(3,898,609)	(2,908,510)
Net impairment .....	11	(95,296)	41,513
Revaluation of contingent consideration .....	5	374,920	0
<b>Profit before taxes</b>		1,996,343	1,444,308
Income tax .....	12	34,862	(41,184)
Special tax on financial institutions .....	14	(118,555)	0
<b>Profit for the period</b>		1,912,651	1,403,124
	Notes	9m 2019	9m 2018
Attributable to the shareholders of Kvika banki hf. ....		1,914,908	1,392,884
Attributable to non-controlling interest .....	22	(2,257)	10,239
<b>Profit for the period</b>		1,912,651	1,403,124
<b>Earnings per share</b>	15		
Basic earnings per share (ISK per share) .....		1.04	0.76
Diluted earnings per share (ISK per share) .....		0.91	0.68

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 30 September 2019

	Notes	9m 2019	9m 2018
<b>Profit for the period</b>		1,912,651	1,403,124
Translation of foreign operations			
Exchange difference on translation of foreign operations .....		3,621	4,262
<b>Items that may be reclassified subsequently to profit and loss, net of tax</b>		3,621	4,262
<b>Total comprehensive income for the period</b>		1,916,272	1,407,385
	Notes	9m 2019	9m 2018
Attributable to the shareholders of Kvika banki hf. ....		1,918,528	1,397,146
Attributable to non-controlling interest .....		(2,257)	10,239
<b>Total comprehensive income for the period</b>		1,916,272	1,407,385

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 30 September 2019

Assets	Notes	30.9.2019	31.12.2018
Cash and balances with Central Bank .....	16	28,332,626	21,339,185
Fixed income securities .....	17	5,428,964	5,127,335
Shares and other variable income securities .....	18	3,579,262	2,926,675
Securities used for hedging .....	19	27,117,592	21,526,794
Loans to customers .....	20	30,654,137	29,443,573
Derivatives .....	21	1,896,029	1,213,266
Investment in associates .....	23	962,513	774,832
Investment properties .....	24	999,787	950,000
Intangible assets .....	25	3,164,027	2,379,281
Property and equipment .....		567,151	42,894
Deferred tax assets .....		590,401	608,858
Other assets .....	26	9,257,910	1,941,070
<b>Total assets</b>		<b>112,550,400</b>	<b>88,273,762</b>
<b>Liabilities</b>			
Deposits from customers .....	27	58,632,152	47,893,959
Borrowings .....	28	20,252,603	15,634,648
Issued bills .....	29	3,939,850	3,577,718
Issued bonds .....	30	2,733,510	3,160,215
Subordinated liabilities .....	31	1,957,455	1,947,511
Short positions held for trading .....	32	934,325	805,334
Short positions used for hedging .....	33	119,312	0
Derivatives .....	21	1,125,911	593,934
Current tax liabilities .....		118,657	3,140
Deferred tax liabilities .....		286,292	76,980
Other liabilities .....	34	7,601,552	1,610,323
<b>Total liabilities</b>		<b>97,701,618</b>	<b>75,303,763</b>
<b>Equity</b>			
Share capital .....	35	1,927,449	1,844,996
Share premium .....		3,203,671	2,881,165
Option reserve .....		6,833	4,297
Warrants reserve .....	36	232,980	202,527
Deficit reduction reserve .....		3,103,697	3,103,697
Other reserves .....		(8,403)	(12,023)
Restricted retained earnings .....		399,885	506,896
Retained earnings .....		5,923,382	4,376,900
<b>Total equity attributable to the shareholders of Kvika banki hf.</b>		<b>14,789,494</b>	<b>12,908,455</b>
Non-controlling interest .....		59,287	61,544
<b>Total equity</b>		<b>14,848,782</b>	<b>12,969,999</b>
<b>Total liabilities and equity</b>		<b>112,550,400</b>	<b>88,273,762</b>

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 30 September 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
<b>1 January 2019 to 30 September 2019</b>												
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)
<b>Restated opening balance under IFRS 16</b> .....		<b>1,844,996</b>	<b>2,881,165</b>	<b>4,297</b>	<b>202,527</b>	<b>3,103,697</b>	<b>(12,023)</b>	<b>506,896</b>	<b>4,344,263</b>	<b>12,875,818</b>	<b>61,544</b>	<b>12,937,362</b>
Profit for the period .....									1,914,908	1,914,908	(2,257)	1,912,651
Translation of foreign operations												
Exchange difference on translation of foreign operations .....							3,621			3,621		3,621
Total comprehensive income for the period .....		0	0	0	0	0	3,621	0	1,914,908	1,918,528	(2,257)	1,916,272
Restricted retained earnings .....								(107,010)	107,010	0		0
Transactions with owners of the Bank												
Capital increase .....		82,453	309,534							391,987		391,987
Dividend paid to shareholders .....									(442,799)	(442,799)		(442,799)
Stock options .....				2,536						2,536		2,536
Warrants sold .....					43,424					43,424		43,424
Warrants exercised .....			12,971		(12,971)					0		0
<b>Equity as at 30 September 2019</b>		<b>1,927,449</b>	<b>3,203,671</b>	<b>6,833</b>	<b>232,980</b>	<b>3,103,697</b>	<b>(8,403)</b>	<b>399,885</b>	<b>5,923,382</b>	<b>14,789,494</b>	<b>59,287</b>	<b>14,848,782</b>

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 30 September 2018

1 January 2018 to 30 September 2018	Notes	Share capital	Share premium	Option reserve	Warrants reserve	Deficit reduction reserve	Translation reserve	Restricted retained earnings	Retained earnings	Total shareholders' equity	Non-controlling interest	Total equity
Equity as at 1 January 2018 .....		1,805,060	2,722,583	903	207,048	3,103,697	(21,722)	254,844	2,858,439	10,930,854	51,423	10,982,276
Impact of adopting IFRS 9 .....									28,709	28,709		28,709
<b>Restated opening balance under IFRS 9 .....</b>		<b>1,805,060</b>	<b>2,722,583</b>	<b>903</b>	<b>207,048</b>	<b>3,103,697</b>	<b>(21,722)</b>	<b>254,844</b>	<b>2,887,148</b>	<b>10,959,563</b>	<b>51,423</b>	<b>11,010,985</b>
Profit for the period .....									1,392,884	1,392,884	10,239	1,403,124
Translation of foreign operations												
Exchange difference on translation of foreign operations .....							4,262			4,262		4,262
Total comprehensive income for the period .....		0	0	0	0	0	4,262	0	1,392,884	1,397,146	10,239	1,407,385
Restricted retained earnings .....								109,208	(109,208)	0		0
Transactions with owners of the Bank												
Capital increase .....		29,936	96,327		(2,509)					123,754		123,754
Transactions with own shares .....		10,000	60,242							70,242		70,242
Stock options .....				2,539						2,539		2,539
<b>Equity as at 30 September 2018</b>		<b>1,844,996</b>	<b>2,879,153</b>	<b>3,442</b>	<b>204,539</b>	<b>3,103,697</b>	<b>(17,460)</b>	<b>364,053</b>	<b>4,170,824</b>	<b>12,553,245</b>	<b>61,662</b>	<b>12,614,907</b>

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 30 September 2019

	Notes	9m 2019	9m 2018
<b>Cash flows from operating activities</b>			
Profit for the period .....		1,912,651	1,403,124
Adjustments for:			
Indexation and exchange rate difference .....		601,615	713,748
Share in (profit) loss of associates, net of income tax .....	23	(163,458)	36,036
Depreciation and amortisation .....		47,706	16,672
Net interest income .....	6	(1,326,208)	(1,234,465)
Net impairment .....		95,296	(41,513)
Income tax .....		83,693	41,184
Other adjustments .....		493,624	(622)
		1,744,919	934,164
Changes in:			
Fixed income securities .....		(568,708)	1,258,321
Shares and other variable income securities .....		(235,525)	(448,837)
Securities used for hedging .....		(5,590,798)	(8,923,524)
Loans to customers .....		(1,131,969)	(4,616,902)
Derivatives - assets .....		(682,763)	(243,551)
Deferred tax assets and tax liabilities .....		(215,461)	(20,117)
Other assets .....		(5,698,450)	(4,017,651)
Deposits from customers .....		10,089,872	4,795,151
Short positions .....		248,303	156,095
Derivatives - liabilities .....		531,977	187,751
Other liabilities .....		4,877,277	4,766,044
		1,623,755	(7,107,222)
Interest received .....		3,622,145	3,344,710
Interest paid .....		(1,816,379)	(1,449,300)
<b>Net cash from (to) operating activities</b>		5,174,440	(4,277,649)
<b>Cash flows from investing activities</b>			
Net proceeds from the sale of investment properties .....		0	160,000
Acquisition of intangible assets .....	25	(106,676)	(67,509)
Acquisition of property and equipment .....		(5,450)	(3,893)
Proceeds from the sale of property and equipment .....		0	6,201
Dividend from associates .....		3,750	3,750
Acquisition of subsidiary, net of cash .....		(892,174)	0
Net investment in associates .....		19,227	0
Proceeds from the sale of assets classified as held for sale .....		0	11,700
<b>Net cash (to) from investing activities</b>		(981,323)	110,248
<b>Cash flows from financing activities</b>			
Borrowings .....		3,031,417	7,671,594
Issued bills .....		362,132	(589,795)
Issued bonds .....		82,453	1,666,608
Subordinated liabilities .....		0	600,000
Increase (decrease) in warrants .....		30,453	(2,509)
Dividend paid to shareholders .....		(442,799)	0
Treasury share transactions .....		322,506	196,506
<b>Net cash from financing activities</b>		3,386,161	9,542,404
Net increase in cash and balances with Central Bank .....		7,579,279	5,375,003
Cash and balances with Central Bank at the beginning of the year .....	16	21,339,185	20,493,739
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 .....		(593,853)	(787,579)
<b>Cash and balances with Central Bank at the end of the period</b>	16	28,332,626	25,081,164
<b>Investing and financing activities not affecting cash flows due to a acquisitions, refer to note 5</b>			
Assets and liabilities acquired from GAMMA Capital Management hf. ....		1,090,717	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

#### 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 30 September 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 14 November 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](http://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 30 September 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. The Group has applied IFRS 16 using the modified retrospective approach, with no restatement of comparative information.

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, was paid by buying unit shares from GAMMA and delivering them to the sellers. At the acquisition date, the purchase price was estimated to amount to ISK 2,542 million. As at 30 September 2019 ISK 1,578 million have been paid and ISK 589 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 are 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 before end of February 2020.

#### 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
<b>Total</b>	<b>3,689,334</b>
Liabilities	
Borrowings .....	1,156,667
Deferred tax liabilities .....	387,323
Other liabilities .....	302,387
<b>Total</b>	<b>1,846,377</b>
Non-controlling interest .....	0
<b>Total identifiable net assets</b> .....	<b>1,842,958</b>
Goodwill on acquisition .....	699,360
Acquisition price .....	2,542,318

Other assets are mostly comprised of receivables, such as fund management fees. Out of the ISK 2,220 million which are recognised as other assets, ISK 1,612 relate to long-term performance related fees from the management of certain closed-end funds and ISK 468 million relate to accrued fees from funds which are managed by GAMMA. At the acquisition date, it was management's opinion that there was no indication that these receivables would 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 former 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 5,708 million and the consolidated profit for the year would have been ISK 1,828 million.

## Notes to the Condensed Interim Consolidated Financial Statements

### Income statement

#### 6. Net interest income

Interest income is specified as follows:

	9m 2019	9m 2018
Cash and balances with Central Bank .....	621,005	766,236
Derivatives .....	1,164,545	800,580
Loans to customers .....	1,939,694	1,815,644
Other interest income .....	78,774	57,156
<b>Total</b>	<b>3,804,018</b>	<b>3,439,615</b>

Interest expense is specified as follows:

	9m 2019	9m 2018
Deposits from customers .....	1,182,919	1,051,191
Borrowings .....	804,248	795,168
Issued bills .....	144,128	135,710
Issued bonds .....	130,997	95,657
Subordinated liabilities .....	135,669	92,859
Derivatives .....	9,141	3,693
Other interest expense* .....	70,708	30,872
<b>Total</b>	<b>2,477,810</b>	<b>2,205,150</b>

\* Thereof are lease liabilities' interest expense amounting to ISK 13 million

Total interest income recognised in respect of financial assets not carried at fair value through profit or loss amounts to ISK 2,525 million (9m 2018: ISK 2,575 million). Total interest expense recognised in respect of financial liabilities not carried at fair value through profit or loss amounts to ISK 2,477 million (9m 2018: ISK 2,201 million).

#### 7. Net financial income

Net financial income is specified as follows:

	9m 2019	9m 2018
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss		
Fixed income securities .....	92,812	198,555
Shares and other variable income securities .....	366,812	846
Derivatives .....	(48,914)	20,707
Loans to customers .....	55,619	58,734
Foreign currency exchange difference .....	(30,123)	9,290
<b>Total</b>	<b>436,207</b>	<b>288,132</b>

#### 8. Foreign currency exchange difference

Foreign currency exchange difference is specified as follows:

	9m 2019	9m 2018
Gain on financial instruments at fair value through profit and loss .....	260,817	252,745
Loss on other financial instruments .....	(290,939)	(243,455)
<b>Total</b>	<b>(30,123)</b>	<b>9,290</b>

## Notes to the Condensed Interim Consolidated Financial Statements

### 9. Administrative expenses

Administrative expenses are specified as follows:	<b>9m 2019</b>	<b>9m 2018</b>
Salaries and related expenses .....	2,511,054	1,986,217
Other operating expenses .....	1,221,639	835,248
Depositors' and Investors' Guarantee Fund contributions .....	65,427	70,374
Depreciation and amortisation .....	47,706	16,672
Depreciation of right of use asset .....	52,782	0
<b>Total</b>	<b>3,898,609</b>	<b>2,908,510</b>

### 10. Salaries and related expenses

Salaries and related expenses are specified as follows:	<b>9m 2019</b>	<b>9m 2018</b>
Salaries .....	1,816,296	1,547,127
Performance based payments excluding share-based payments .....	140,686	1,573
Share-based payment expenses .....	2,536	2,539
Pension fund contributions .....	238,350	208,287
Tax on financial activity .....	130,962	95,485
Other salary related expenses .....	182,225	131,204
<b>Total</b>	<b>2,511,054</b>	<b>1,986,217</b>
Average number of full time employees during the period .....	125	110
Total number of full time employees at the end of the period .....	122	112

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 the first nine months of 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

	<b>9m 2019</b>	<b>9m 2018</b>
Net change in impairment of loans .....	27,314	(55,868)
Net change in impairment of other assets .....	64,298	(1,995)
Net change in impairment of loan commitments, guarantees and unused credit facilities .....	3,684	16,350
<b>Total</b>	<b>95,296</b>	<b>(41,513)</b>

### 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.

## 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 began 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.

	9m 2019	9m 2018
Net earnings attributable to equity holders of the Bank	1,914,908	1,392,884
Weighted average number of outstanding shares .....	1,849,165	1,832,275
Adjustments for warrants and stock options .....	249,263	202,808
<b>Total</b>	<b>2,098,427</b>	<b>2,035,083</b>
Basic earnings per share (ISK) .....	1.04	0.76
Diluted earnings per share (ISK) .....	0.91	0.68



## 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:

	30.9.2019	31.12.2018
Deposits with Central Bank .....	17,783,095	8,934,131
Cash on hand .....	19,872	9,114
Balances with banks .....	4,673,898	6,903,004
Foreign treasury bills .....	3,449,493	3,472,741
<b>Included in cash and cash equivalents</b>	<b>25,926,357</b>	<b>19,318,990</b>
Restricted balances with Central Bank - average maintenance level .....	864,087	708,656
Restricted balances with Central Bank - fixed reserve requirement .....	864,087	708,656
Receivables from Central Bank .....	678,095	602,882
<b>Total</b>	<b>28,332,626</b>	<b>21,339,185</b>

The Bank holds mandatory reserve deposit accounts with the Central Bank of Iceland in compliance with the Central Bank's 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 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:

	30.9.2019	31.12.2018
Mandatorily measured at fair value through profit or loss		
Listed government bonds and bonds with government guarantees .....	1,380,887	1,841,982
Listed bonds .....	3,549,180	3,150,409
Unlisted bonds .....	498,897	134,944
<b>Total</b>	<b>5,428,964</b>	<b>5,127,335</b>

#### 18. Shares and other variable income securities

Shares and other variable income securities are specified as follows:

	30.9.2019	31.12.2018
Mandatorily measured at fair value through profit or loss		
Listed shares .....	993,212	751,470
Unlisted shares .....	1,935,040	1,391,018
Unlisted unit shares .....	651,010	784,187
<b>Total</b>	<b>3,579,262</b>	<b>2,926,675</b>

#### 19. Securities used for hedging

Securities used for hedging are specified as follows:

	30.9.2019	31.12.2018
Listed government bonds and bonds with government guarantees .....	9,738,743	7,625,469
Listed bonds .....	5,049,625	4,487,698
Listed shares .....	12,232,836	9,395,761
Unlisted unit shares .....	96,389	17,866
<b>Total</b>	<b>27,117,592</b>	<b>21,526,794</b>

#### 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
<b>30.9.2019</b>						
Loans to customers at amortised cost .....	4,355,613	4,334,178	24,377,563	24,151,820	28,733,176	28,485,998
Loans to customers at fair value through profit or loss .....	0	0	2,168,139	2,168,139	2,168,139	2,168,139
<b>Total</b>	<b>4,355,613</b>	<b>4,334,178</b>	<b>26,545,702</b>	<b>26,319,960</b>	<b>30,901,316</b>	<b>30,654,137</b>
<b>31.12.2018</b>						
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
<b>Total</b>	<b>5,407,411</b>	<b>5,364,291</b>	<b>24,257,139</b>	<b>24,079,282</b>	<b>29,664,550</b>	<b>29,443,573</b>

## Notes to the Condensed Interim Consolidated Financial Statements

### 21. Derivatives

Derivatives are specified as follows:

	Notional		Carrying value	
	Assets	Liabilities	Assets	Liabilities
<b>30.9.2019</b>				
Interest rate derivatives .....	3,300,698	3,104,224	196,473	0
Currency forwards .....	1,932,317	1,939,380	5,309	12,371
Bond and equity total return swaps .....	30,389,546	29,826,383	1,507,153	944,798
Equity options .....	326,760	11,760	187,094	168,741
<b>Total</b>	<b>35,949,321</b>	<b>34,881,747</b>	<b>1,896,029</b>	<b>1,125,911</b>
<b>31.12.2018</b>				
Interest rate derivatives .....	4,803,789	4,607,104	196,684	0
Currency forwards .....	400,192	413,565	0	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
<b>Total</b>	<b>28,195,811</b>	<b>27,576,479</b>	<b>1,213,266</b>	<b>593,934</b>

### 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
			30.9.2019	31.12.2018
Fí Fasteignafélag GP ehf. ....	Real estate fund management	Iceland	100%	100%
GAMMA Capital Management hf. ....	Fund management	Iceland	100%	-
Júpiter 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%
AC GP 3 ehf. ....	Fund management	Iceland	80%	80%
Kvika Securities Ltd. ....	Business consultancy services	UK	100%	100%

### 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	Share
			30.9.2019	31.12.2018
Akta sjóðir hf. ....	Fund management	Iceland	34%	49%
Kjölfesta GP ehf. ....	Holding company	Iceland	50%	50%
KORTA hf. ....	Payment Institution	Iceland	45%	47%
Gláma fjárfestingar slhf. ....	Holding company	Iceland	24%	-

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

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

	30.9.2019	31.12.2018
Balance at the beginning of the year .....	774,832	676,610
Acquisition of shares in associates .....	47,201	408,671
Dividend received .....	(3,750)	(7,500)
Disposal of shares in associates .....	(19,227)	0
Revaluation of shares in associates .....	167,422	(167,422)
Share in profit (loss) of associates, net of income tax .....	(3,964)	(135,527)
<b>Total</b>	<b>962,513</b>	<b>774,832</b>

## Notes to the Condensed Interim Consolidated Financial Statements

### 24. Investment properties

Investment properties are specified as follows:	<b>30.9.2019</b>	<b>31.12.2018</b>
Balance at year beginning .....	950,000	953,874
Acquisitions .....	49,787	31,544
Disposal .....	0	(150,000)
Revaluation on investment properties .....	0	114,582
<b>Total</b>	<b>999,787</b>	<b>950,000</b>

### 25. Intangible assets

Intangible assets are specified as follows:

<b>30.9.2019</b>	<b>Goodwill</b>	<b>Software</b>	<b>Other</b>	<b>Total</b>
Balance as at 1 January 2019 .....	2,244,521	118,428	16,332	2,379,281
Acquisitions .....	0	42,857	63,819	106,676
Additions through a business combination .....	699,360	0	0	699,360
Amortisation .....	0	(12,106)	(9,185)	(21,291)
<b>Balance as at 30 September 2019</b>	<b>2,943,881</b>	<b>149,180</b>	<b>70,966</b>	<b>3,164,027</b>
Gross carrying amount .....	2,943,881	88,300	48,800	3,080,981
Accumulated amortisation and impairment losses .....	0	60,880	22,166	83,046
<b>Balance as at 30 September 2019</b>	<b>2,943,881</b>	<b>149,180</b>	<b>70,966</b>	<b>3,164,027</b>
<b>31.12.2018</b>	<b>Goodwill</b>	<b>Software</b>	<b>Other</b>	<b>Total</b>
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)
<b>Balance as at 31 December 2018</b>	<b>2,244,521</b>	<b>118,428</b>	<b>16,332</b>	<b>2,379,281</b>
Gross carrying amount .....	2,244,521	45,442	48,800	94,242
Accumulated amortisation and impairment losses .....	0	(21,484)	(32,940)	(54,424)
<b>Balance as at 1 January 2018</b>	<b>2,244,521</b>	<b>23,959</b>	<b>15,860</b>	<b>2,284,340</b>
Gross carrying amount .....	2,244,521	38,924	48,800	87,724
Accumulated amortisation and impairment losses .....	0	79,505	(32,468)	47,036
<b>Balance as at 31 December 2018</b>	<b>2,244,521</b>	<b>118,428</b>	<b>16,332</b>	<b>2,379,281</b>

### 26. Other assets

Other assets are specified as follows:

	<b>30.9.2019</b>	<b>31.12.2018</b>
Unsettled transactions .....	5,391,639	120,563
Accounts receivable .....	2,998,805	1,283,215
Right of use asset .....	313,488	0
Sundry assets .....	553,977	537,292
<b>Total</b>	<b>9,257,910</b>	<b>1,941,070</b>

### 27. Deposits from customers

Deposits from customers are specified as follows:

	<b>30.9.2019</b>	<b>31.12.2018</b>
Demand deposits .....	44,888,407	32,463,907
Time deposits .....	13,743,745	15,430,052
<b>Total</b>	<b>58,632,152</b>	<b>47,893,959</b>

### 28. Borrowings

Borrowings are specified as follows:

	<b>30.9.2019</b>	<b>31.12.2018</b>
Loans from credit institutions .....	800,668	1,215,343
Money market deposits .....	19,451,935	14,407,558
Other borrowings .....	0	11,747
<b>Total</b>	<b>20,252,603</b>	<b>15,634,648</b>

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.

## Notes to the Condensed Interim Consolidated Financial Statements

### 29. Issued bills

Issued bills are specified as follows:

	30.9.2019	31.12.2018
Issued bills .....	3,939,850	3,577,718
<b>Total</b>	<b>3,939,850</b>	<b>3,577,718</b>

### 30. Issued bonds

Issued bonds are specified as follows:

Currency, nominal value	First issued	Maturity	Maturity type	Terms of interest	30.9.2019	31.12.2018
KVB 17 02, ISK 2,160 million .....	2017	2020	At maturity	Floating, 1 month REIBOR + 1.25%	1,879,376	1,963,336
<b>Total</b>					<b>1,879,376</b>	<b>1,963,336</b>
Unlisted senior unsecured bonds, total .....					854,134	1,196,879
<b>Total</b>					<b>2,733,510</b>	<b>3,160,215</b>

Unlisted senior unsecured bonds are composed of KVB 18 01, KVB 18 03 and KVB 18 04 which were issued in 2018 and mature in 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	30.9.2019	31.12.2018
KVB 15 01, ISK 1,000 million .....	2015	2025	At maturity	CPI-Indexed, fixed 5.50%	1,100,894	1,093,162
KVB 18 02, ISK 800 million .....	2018	2028	At maturity	CPI-Indexed, fixed 7.50%	856,561	854,350
<b>Total</b>					<b>1,957,455</b>	<b>1,947,511</b>

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.

### 32. Short positions held for trading

Short positions held for trading are specified as follows:

	30.9.2019	31.12.2018
Listed government bonds and bonds with government guarantees .....	254,421	569,471
Listed bonds .....	679,904	235,863
<b>Total</b>	<b>934,325</b>	<b>805,334</b>

### 33. Short positions used for hedging

Short positions used for hedging are specified as follows:

	30.9.2019	31.12.2018
Treasury bills .....	119,312	0
<b>Total</b>	<b>119,312</b>	<b>0</b>

### 34. Other liabilities

Other liabilities are specified as follows:

	30.9.2019	31.12.2018
Unsettled transactions .....	4,787,765	186,794
Expected credit loss allowance for loan commitments, guarantees and unused credit facilities .....	21,123	17,439
Accounts payable and accrued expenses .....	421,892	250,522
Special taxes on financial institutions and financial activities .....	268,890	150,336
Withholding taxes .....	241,221	461,153
Salaries and salary related expenses .....	651,004	313,274
Lease liability .....	347,240	0
Contingent consideration .....	588,896	0
Other liabilities .....	273,521	230,806
<b>Total</b>	<b>7,601,552</b>	<b>1,610,323</b>

## Notes to the Condensed Interim Consolidated Financial Statements

### 35. Share capital

#### 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.

	30.9.2019	31.12.2018
Share capital according to the Bank's Articles of Association .....	1,927,449	1,844,996
Nominal amount of treasury shares .....	0	0
Authorised but not issued shares .....	856,033	838,635

#### b. Changes made to the nominal amount of share capital

The Bank's share capital was increased twice during the third quarter of 2019, for a total nominal amount of 82,452,796. In August it was increased by 29,936,034 and in September 2019 it was increased by 52,516,762 to serve issued warrants.

#### c. Share capital increase authorisations

According to the Bank's Articles of Association dated 26 September 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 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 456,033,345 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 606,033,345 but can increase to ISK 656,033,345 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](http://www.kvika.is), reference is made to them for more information.

### 36. Warrants

The Bank has issued warrants for shares. At 30 September 2019 the total nominal amount of outstanding warrants was ISK 651,533,341. The number of owners of these warrants is 116 and they purchased the warrants for a total consideration of ISK 226,943,535. 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 2,575,982,445 and the newly issued shares would represent 25.3% of the Bank's total issued capital, post dilution.

Issue Date	Nominal amount	Purchase price of warrants	Annual increase of strike price	Strike price at expiry date	Exercise period
September 2017 .....	177,366,675	53,387,369	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
April 2019 .....	17,500,000	16,520,000	7.5%	15.05	Dec. 2020 - Dec. 2022
April 2019 .....	17,500,000	16,520,000	7.5%	15.05	Dec. 2020 - Dec. 2022
August 2019 .....	5,500,000	5,192,000	7.5%	15.05	Dec. 2020 - Dec. 2022
August 2019 .....	5,500,000	5,192,000	7.5%	15.05	Dec. 2021 - Dec. 2022
<b>Total</b>	<b>651,533,341</b>	<b>226,943,535</b>			

## Notes to the Condensed Interim Consolidated Financial Statements

### 37. Capital adequacy ratio (CAD)

Equity at the end of the period was ISK 14,849 million (31.12.2018: 12,970 million), equivalent to 13.2% 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 22.9% (31.12.2018: 25.1%). The minimum according to the Act is 8.0%. The ratio is calculated as follows:

	30.9.2019	31.12.2018
<b>Own funds</b>		
Total equity .....	14,848,782	12,969,999
Unaudited retained (positive) earnings from current period .....	(458,243)	0
Expected dividends according to Dividend Policy .....	(362,469)	0
<b>Capital eligible as CET1 Capital</b>	<b>14,028,070</b>	<b>12,969,999</b>
Goodwill and intangibles .....	(3,164,027)	(2,379,281)
Shares in financial institutions .....	(126,891)	(172,206)
Subordinated fixed income securities .....	(93,154)	(54,595)
Deferred tax asset .....	(590,401)	(608,858)
<b>Common equity Tier 1 capital (CET 1)</b>	<b>10,053,598</b>	<b>9,755,059</b>
Tier 2 capital .....	1,928,371	1,886,506
<b>Total own funds</b>	<b>11,981,969</b>	<b>11,641,565</b>
<b>Risk weighted assets</b>		
Credit risk .....	36,744,922	31,948,930
Market risk .....	5,554,994	4,474,728
Operational risk .....	10,019,764	10,019,764
<b>Total Capital requirements</b>	<b>52,319,679</b>	<b>46,443,422</b>
<b>Capital ratios</b>		
Capital adequacy ratio .....	22.9%	25.1%
CET1 ratio .....	19.2%	21.0%
Total own funds including unaudited (positive) retained earnings and expected dividends .....	12,323,994	
Capital adequacy ratio, adjusted .....	23.6%	
CET1 ratio, adjusted .....	19.9%	
Minimum Capital adequacy ratio requirement .....	14.5%	14.5%
Minimum Capital adequacy ratio requirement including supervisory buffers .....	20.8%	20.3%
Minimum CET 1 ratio requirement including supervisory buffers .....	14.4%	13.9%

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 buffer is 20.75% as at 30 September 2019.

## Notes to the Condensed Interim Consolidated Financial Statements

### Risk management

#### 38. 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:

<b>30.9.2019</b>	<b>Public entities</b>	<b>Financial institutions</b>	<b>Corporate customers</b>	<b>Individuals</b>	<b>30.9.2019</b>
<b>On-balance sheet exposure</b>					
Cash and balances with Central Bank .....	23,658,728	4,673,898			28,332,626
Fixed income securities .....	1,970,690	2,579,109	879,165		5,428,964
Loans to customers .....		10,436,389	15,883,571	4,334,178	30,654,137
Derivatives .....		890,366	953,150	52,512	1,896,029
Other assets .....	106,991	262,592	8,888,327		9,257,910
	25,736,410	18,842,354	26,604,213	4,386,690	75,569,667
<b>Off-balance sheet exposure</b>					
Loan commitments .....		2,080,815	1,526,894	1,678,219	5,285,928
Financial guarantee contracts .....		163,182	704,679		867,861
<b>Maximum exposure to credit risk</b>	25,736,410	21,086,352	28,835,786	6,064,909	81,723,457
<b>31.12.2018</b>	<b>Public entities</b>	<b>Financial institutions</b>	<b>Corporate customers</b>	<b>Individuals</b>	<b>31.12.2018</b>
<b>On-balance sheet exposure</b>					
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
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
	17,289,386	9,606,214	26,681,296	5,487,532	59,064,428
<b>Off-balance sheet exposure</b>					
Loan commitments .....		255,329	2,818,631	388,975	3,462,935
Financial guarantee contracts .....		100,000	823,074		923,074
<b>Maximum exposure to credit risk</b>	17,289,386	9,961,542	30,323,000	5,876,508	63,450,436

#### 39. 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:

<b>30.9.2019</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>FVTPL</b>	<b>Total</b>
<i>Loans to customers:</i>					
Credit quality band I .....	16,903,689	226,344	18,902	729,062	17,877,998
Credit quality band II .....	4,167,810	21,096		735,856	4,924,762
Credit quality band III .....	729,236	1,549,235		703,221	2,981,692
Credit quality band IV .....	545,835	480,784			1,026,619
In default .....		55,607	105,806		161,413
Non-rated .....	3,926,068	2,763			3,928,832
<b>Gross carrying amount</b>	26,272,638	2,335,830	124,708	2,168,139	30,901,316
Expected credit loss .....	(172,363)	(41,754)	(33,061)		(247,178)
<b>Book value</b>	26,100,275	2,294,076	91,647	2,168,139	30,654,137

## Notes to the Condensed Interim Consolidated Financial Statements

### 39. Credit quality of financial assets (cont.)

<i>Loan commitments, guarantees and unused credit facilities:</i>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>FVTPL</b>	<b>Total</b>
Credit quality band I .....	2,454,224	1,389	21	6,227	2,461,861
Credit quality band II .....	298,897	133		121,642	420,672
Credit quality band III .....	28,463	413,939		48,280	490,681
Credit quality band IV .....	118,381	39,861			158,241
In default .....	100,000		8,733		108,733
Non-rated .....	2,513,601				2,513,601
<b>Total off-balance sheet amount</b>	<b>5,513,565</b>	<b>455,322</b>	<b>8,754</b>	<b>176,149</b>	<b>6,153,790</b>
Expected credit loss .....	(16,304)	(2,901)	(1,918)		(21,123)
<b>Net off-balance sheet amount</b>	<b>5,497,261</b>	<b>452,420</b>	<b>6,836</b>	<b>176,149</b>	<b>6,132,666</b>

#### 31.12.2018

<i>Loans to customers:</i>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>FVTPL</b>	<b>Total</b>
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
<b>Gross carrying amount</b>	<b>25,291,919</b>	<b>1,859,436</b>	<b>352,673</b>	<b>2,160,522</b>	<b>29,664,550</b>
Expected credit loss .....	(160,684)	(27,930)	(32,363)		(220,977)
<b>Book value</b>	<b>25,131,235</b>	<b>1,831,506</b>	<b>320,310</b>	<b>2,160,522</b>	<b>29,443,573</b>

<i>Loan commitments, guarantees and unused credit facilities:</i>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>FVTPL</b>	<b>Total</b>
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
<b>Total off-balance sheet amount</b>	<b>4,187,646</b>	<b>10,113</b>	<b>5,108</b>	<b>183,141</b>	<b>4,386,008</b>
Expected credit loss .....	(15,462)	(683)	(1,293)		(17,439)
<b>Net off-balance sheet amount</b>	<b>4,172,184</b>	<b>9,430</b>	<b>3,814</b>	<b>183,141</b>	<b>4,368,569</b>

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

<b>30.9.2019</b>	<b>Claim value</b>	<b>Expected credit loss</b>	<b>Carrying amount</b>
Not past due .....	30,163,479	(239,513)	29,923,966
Past due 1-30 days .....	654,727	(5,767)	648,960
Past due 31-60 days .....	48,589	(54)	48,535
Past due 61-90 days .....	23,598	(824)	22,775
Past due 91-180 days .....	10,922	(1,021)	9,901
Past due 181-360 days .....			0
Past due more than 360 days .....			0
<b>Total</b>	<b>30,901,316</b>	<b>(247,178)</b>	<b>30,654,137</b>

<b>31.12.2018</b>	<b>Claim value</b>	<b>Expected credit loss</b>	<b>Carrying amount</b>
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
<b>Total</b>	<b>29,664,550</b>	<b>(220,977)</b>	<b>29,443,573</b>





## Notes to the Condensed Interim Consolidated Financial Statements

### 39. Credit quality of financial assets (cont.)

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

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

#### 30.9.2019

##### Expected credit loss allowance total

	Stage 1	Stage 2	Stage 3	Total
<b>Transfers of financial assets:</b>				
<b>Balance as at 31 December 2018</b>	176,146	28,614	33,657	238,416
Transfer to Stage 1 - (Initial recognition) .....	9,073	(8,973)	(100)	0
Transfer to Stage 2 - (significantly increased credit risk) .....	(10,088)	10,149	(60)	0
Transfer to Stage 3 - (credit impaired) .....	(1,581)		1,581	0
Net remeasurement of loss allowance .....	(23,123)	10,089	2,677	(10,357)
New financial assets, originated or purchased .....	109,718	19,590	18,251	147,558
Derecognitions and maturities .....	(71,478)	(14,812)	(19,431)	(105,721)
Write-offs .....			(1,594)	(1,594)
<b>Balance as at 30 September 2019</b>	188,667	44,655	34,979	268,302

##### Expected credit loss allowance for loans to customers

	Stage 1	Stage 2	Stage 3	Total
<b>Transfers of financial assets:</b>				
<b>Balance as at 31 December 2018</b>	160,684	27,930	32,363	220,977
Transfer to Stage 1 - (Initial recognition) .....	8,972	(8,871)	(100)	0
Transfer to Stage 2 - (significantly increased credit risk) .....	(8,150)	8,211	(60)	0
Transfer to Stage 3 - (credit impaired) .....	(1,575)		1,575	0
Net remeasurement of loss allowance .....	(24,136)	9,639	2,677	(11,820)
New financial assets, originated or purchased .....	102,127	19,411	17,523	139,062
Derecognitions and maturities .....	(65,558)	(14,566)	(19,324)	(99,447)
<b>Balance as at 30 September 2019</b>	172,363	41,754	33,061	247,178

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

	Stage 1	Stage 2	Stage 3	Total
<b>Transfers of financial assets:</b>				
<b>Balance as at 31 December 2018</b>	15,462	683	1,293	17,439
Transfer to Stage 1 - (Initial recognition) .....	101	(101)		0
Transfer to Stage 2 - (significantly increased credit risk) .....	(1,938)	1,938		0
Transfer to Stage 3 - (credit impaired) .....	(6)		6	0
Net remeasurement of loss allowance .....	1,014	449	(1)	1,462
New financial assets, originated or purchased .....	7,591	178	727	8,496
Derecognitions and maturities .....	(5,920)	(246)	(108)	(6,274)
<b>Balance as at 30 September 2019</b>	16,304	2,901	1,918	21,123

#### 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)
<b>Opening expected credit loss balance at 1.1.2018</b>	152,153	50,543	57,305	260,001
<b>Transfers of financial assets:</b>				
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)
<b>Balance as at 31 December 2018</b>	176,146	28,614	33,657	238,416

## Notes to the Condensed Interim Consolidated Financial Statements

### 39. Credit quality of financial assets (cont.)

*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)
<b>Opening expected credit loss balance at 1.1.2018</b>	<b>137,231</b>	<b>49,638</b>	<b>56,398</b>	<b>243,266</b>

#### 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)
<b>Balance as at 31 December 2018</b>	<b>160,684</b>	<b>27,930</b>	<b>32,363</b>	<b>220,977</b>

*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
<b>Opening expected credit loss balance at 1.1.2018</b>	<b>14,922</b>	<b>905</b>	<b>908</b>	<b>16,735</b>

#### 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
<b>Balance as at 31 December 2018</b>	<b>15,462</b>	<b>683</b>	<b>1,293</b>	<b>17,439</b>

## Notes to the Condensed Interim Consolidated Financial Statements

### 40. 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 51. For other types of assets the Group uses third party valuation where possible. Haircuts are then applied to account for liquidity and other factors which may affect the collateral value of the asset or other credit enhancement.

#### b. Loans to customers

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	30.9.2019
Financial institutions .....	41,107	83,289		649,949			774,345
Corporate customers .....	649,463	839,631	8,205,443	10,887,369	125,362	112,634	20,819,901
Individuals .....	5,596	3,924	538,717	735,659			1,283,896
<b>Total</b>	<b>696,167</b>	<b>926,844</b>	<b>8,744,160</b>	<b>12,272,977</b>	<b>125,362</b>	<b>112,634</b>	<b>22,878,142</b>

	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
<b>Total</b>	<b>1,452,561</b>	<b>284,848</b>	<b>9,475,440</b>	<b>10,718,732</b>	<b>173,193</b>	<b>976,223</b>	<b>23,080,997</b>

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

#### c. Derivatives

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	30.9.2019
Financial institutions .....	782,278	243,719	1,390,646				2,416,643
Corporate customers .....	693,048	51,448	1,628,715				2,373,212
Individuals .....	47,075		98,655				145,729
<b>Total</b>	<b>1,522,401</b>	<b>295,167</b>	<b>3,118,016</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>4,935,583</b>

	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
<b>Total</b>	<b>1,201,669</b>	<b>387,913</b>	<b>2,202,858</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>3,792,441</b>

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

### 41. Loan-to-value

#### a. General

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

#### b. Breakdown

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

	30.9.2019	%	31.12.2018	%
Less than 50% .....	13,590,933	44.3%	10,041,505	34.1%
51-70% .....	4,019,184	13.1%	6,286,414	21.4%
71-90% .....	2,687,247	8.8%	4,542,377	15.4%
91-100% .....	510,883	1.7%	525,403	1.8%
More than 100% .....	4,836,259	15.8%	3,216,506	10.9%
No collateral:				
Purchased short-term retail claims .....	2,817,079	9.2%	3,511,938	11.9%
Other loans with no collateral .....	2,192,553	7.2%	1,319,429	4.5%
<b>Total</b>	<b>30,654,137</b>	<b>100.0%</b>	<b>29,443,573</b>	<b>100.0%</b>

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

### 42. 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 37).

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

	30.9.2019		31.12.2018	
	Number	Amount	Number	Amount
<b>Large exposures before risk adjusted mitigation</b>				
10-20% of capital base .....	6	9,089,519	5	6,740,154
20-25% of capital base .....	0	0	1	2,359,382
Exceeding 25% of capital base .....	1	3,449,493	1	3,472,741
<b>Total</b>	7	12,539,012	7	12,572,277
Thereof nostro accounts with foreign banks with S&P rating of A- or higher .....	1	1,599,327	1	2,359,382
Thereof foreign governments and central banks exposures .....	1	3,449,493	0	
Large exposures net of risk adjusted mitigation .....	2	3,374,288	1	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.

### 43. 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 September 2019 the LCR was 260% and at year-end 2018 it was 277%.

## Notes to the Condensed Interim Consolidated Financial Statements

### 43. Liquidity risk (cont.)

#### c. Maturity analysis of financial assets and financial liabilities

30.9.2019	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 .....	26,063,849	2,226,420				28,290,269	28,332,626
Fixed income securities .....	5,246,155	93,154	89,655			5,428,964	5,428,964
Shares and other variable income securities .....	1,547,183		2,032,079			3,579,262	3,579,262
Securities used for hedging .....	27,117,592					27,117,592	27,117,592
Loans to customers .....	4,984,506	4,353,513	13,695,856	7,905,232	412,595	31,351,702	30,654,137
Other assets .....	6,252,225	464,789	577,829	1,963,066		9,257,910	9,257,910
	71,211,511	7,137,876	16,395,419	9,868,299	412,595	105,025,699	104,370,492
<i>Derivative assets</i>							
Inflow .....	14,595,806	192,299	170,952	29,746		14,988,803	
Outflow .....	(13,096,124)	(180,804)	(2,929)	(1,295)		(13,281,152)	
	1,499,682	11,496	168,022	28,451	0	1,707,651	1,896,029
<b>Financial liabilities by type</b>							
<i>Non-derivative liabilities</i>							
Deposits from customers .....	(44,718,501)	(9,977,842)	(1,937,993)	(2,095,114)	(167,772)	(58,897,222)	58,632,152
Borrowings .....	(3,775,474)	(7,038,881)	(9,406,597)	(261,378)		(20,482,329)	20,252,603
Issued bills .....		(2,000,000)	(2,000,000)			(4,000,000)	3,939,850
Issued bonds .....		(16,356)	(633,278)	(2,501,577)		(3,151,211)	2,733,510
Subordinated liabilities .....			(122,818)	(368,409)	(2,362,810)	(2,854,036)	1,957,455
Short positions held for trading .....	(934,325)					(934,325)	934,325
Short positions used for hedging .....	(119,312)					(119,312)	119,312
Other liabilities .....	(5,192,724)	(912,207)	(852,917)	(643,705)		(7,601,552)	7,601,552
	(54,740,335)	(19,945,285)	(14,953,603)	(5,870,181)	(2,530,581)	(98,039,986)	96,170,759
<i>Derivative liabilities</i>							
Inflow .....	16,084,069	442,625				16,526,694	
Outflow .....	(17,027,972)	(456,920)				(17,484,892)	
	(943,903)	(14,295)	0	0	0	(958,198)	1,125,911
<b>Unrecognised financial items</b>							
<i>Loan commitments</i>							
Inflow .....	1,428,856	495,487	2,615,886	864,206		5,404,435	
Outflow .....	(5,285,928)					(5,285,928)	
<i>Financial guarantee contracts</i>							
Inflow .....	96,957	18,165	295,700	423,200	33,840	867,861	
Outflow .....	(867,861)					(867,861)	
	(4,627,976)	513,652	2,911,586	1,287,405	33,840	118,507	
<b>Summary</b>							
Non-derivative assets .....	71,211,511	7,137,876	16,395,419	9,868,299	412,595	105,025,699	
Derivative assets .....	1,499,682	11,496	168,022	28,451		1,707,651	
Non-derivative liabilities .....	(54,740,335)	(19,945,285)	(14,953,603)	(5,870,181)	(2,530,581)	(98,039,986)	
Derivative liabilities .....	(943,903)	(14,295)				(958,198)	
<b>Net assets (liabilities) excluding unrecognised items</b> .....	17,026,955	(12,810,209)	1,609,838	4,026,568	(2,117,986)	7,735,166	
Net unrecognised items .....	(4,627,976)	513,652	2,911,586	1,287,405	33,840	118,507	
<b>Net assets (liabilities)</b> .....	12,398,978	(12,296,558)	4,521,424	5,313,974	(2,084,146)	7,853,673	

## Notes to the Condensed Interim Consolidated Financial Statements

### 43. Liquidity risk (cont.)

31.12.2018	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Gross inflow/ (outflow)	Carrying amount
<b>Financial assets by type</b>							
<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
<b>Financial liabilities by type</b>							
<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
<b>Unrecognised financial items by type</b>							
<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	
<b>Summary</b>							
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)	
<b>Net assets (liabilities) excluding unrecognised items .....</b>	<b>18,024,787</b>	<b>(15,848,237)</b>	<b>5,831,820</b>	<b>2,688,886</b>	<b>(2,005,450)</b>	<b>8,691,805</b>	
<b>Net unrecognised items .....</b>	<b>(2,957,798)</b>	<b>1,014,347</b>	<b>1,417,147</b>	<b>601,431</b>		<b>75,127</b>	
<b>Net assets (liabilities) .....</b>	<b>15,066,989</b>	<b>(14,833,890)</b>	<b>7,248,967</b>	<b>3,290,317</b>	<b>(2,005,450)</b>	<b>8,766,933</b>	

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

### 44. Interest rate risk associated with trading portfolios

#### a. Breakdown

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

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	30.9.2019
Fixed income securities .....			660,098	1,702,944	3,065,923	5,428,964
Short positions - fixed income securities .....		(81,561)		(368,303)	(484,461)	(934,325)
<b>Net imbalance</b>	0	(81,561)	660,098	1,334,641	2,581,462	4,494,639

  

	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)
<b>Net imbalance</b>	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	30.9.2019 Downward	30.9.2019 Upward	31.12.2018 Downward	31.12.2018 Upward
Indexed .....	50	111,073	(111,073)	70,216	(70,216)
Non-indexed .....	100	85,867	(85,867)	69,481	(69,481)
<b>Total</b>		196,940	(196,940)	139,697	(139,697)

### 45. Interest rate risk associated with non-trading portfolios

#### a. Breakdown

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

#### 30.9.2019

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 .....	24,883,134	3,449,493				28,332,626
Loans to customers .....	25,615,785	845,205	3,096,693	726,918	369,537	30,654,137
Financial assets excluding derivatives	50,498,919	4,294,697	3,096,693	726,918	369,537	58,986,764
Effect of derivatives .....	30,360,619	229,624	2,500,000	600,000		33,690,243
<b>Total</b>	80,859,538	4,524,321	5,596,693	1,326,918	369,537	92,677,007

  

Financial liabilities	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Deposits from customers .....	58,632,152					58,632,152
Borrowings .....	3,772,672	6,958,931	9,271,000	250,000		20,252,603
Issued bills .....		1,979,300	1,960,550			3,939,850
Issued bonds .....	305,094		549,040	1,879,376		2,733,510
Subordinated liabilities .....					1,957,455	1,957,455
Financial liabilities excluding derivatives	62,709,918	8,938,231	11,780,590	2,129,376	1,957,455	87,515,570
Effect of derivatives .....	502,770	2,601,454				3,104,224
<b>Total</b>	63,212,688	11,539,685	11,780,590	2,129,376	1,957,455	90,619,794

  

<b>Total interest repricing gap</b>	17,646,850	(7,015,364)	(6,183,897)	(802,458)	(1,587,918)	2,057,213
-------------------------------------	------------	-------------	-------------	-----------	-------------	-----------



## Notes to the Condensed Interim Consolidated Financial Statements

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

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
<b>Total</b>	<b>64,330,311</b>	<b>5,502,080</b>	<b>4,321,790</b>	<b>4,258,425</b>	<b>157,870</b>	<b>78,570,476</b>
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
<b>Total</b>	<b>54,204,604</b>	<b>10,389,341</b>	<b>7,785,664</b>	<b>2,494,035</b>	<b>1,947,511</b>	<b>76,821,155</b>
<b>Total interest repricing gap</b>	<b>10,125,707</b>	<b>(4,887,261)</b>	<b>(3,463,874)</b>	<b>1,764,389</b>	<b>(1,789,641)</b>	<b>1,749,321</b>

#### 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	30.9.2019		31.12.2018	
		Downward	Upward	Downward	Upward
ISK, indexed .....	50	21,890	(21,070)	11,837	(11,614)
ISK, non-indexed .....	100	(50,409)	47,431	(42,882)	41,861
Other currencies .....	20	(1,360)	290	(2,228)	1,157
<b>Total</b>		<b>(29,878)</b>	<b>26,651</b>	<b>(33,273)</b>	<b>31,404</b>

## Notes to the Condensed Interim Consolidated Financial Statements

### 46. 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:

	<b>30.9.2019</b>	<b>31.12.2018</b>
Assets .....	9,759,136	7,180,237
Liabilities .....	(8,048,209)	(5,927,047)
<b>Total</b>	<b>1,710,927</b>	<b>1,253,191</b>

#### 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.

	<b>30.9.2019</b>		<b>31.12.2018</b>	
	-1%	1%	-1%	1%
Government bonds .....	(5,071)	5,071	(2,295)	2,295
Other fixed income securities .....	(24,053)	24,053	(20,049)	20,049
Loans to customers .....	(37,467)	37,467	(24,459)	24,459
Derivatives .....	(31,000)	31,000	(25,000)	25,000
Short positions .....	9,885	(9,885)	2,784	(2,784)
Deposits .....	52,597	(52,597)	46,487	(46,487)
Subordinated debt .....	18,000	(18,000)	10,000	(10,000)
	(17,109)	17,109	(12,532)	12,532

The effect on equity would be the same.

### 47. Currency risk

#### a. Definition

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

#### b. Management

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

The Group is subject to limits set by the Central Bank of Iceland regarding the maximum open currency position. At 30 September 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:

	<b>Closing</b>	<b>Average</b>	<b>Closing</b>	<b>Average</b>
	<b>30.9.2019</b>	<b>9m 2019</b>	<b>31.12.2018</b>	<b>9m 2018</b>
EUR/ISK .....	135.1	137.6	133.2	122.9
USD/ISK .....	123.7	122.3	116.3	105.2

## Notes to the Condensed Interim Consolidated Financial Statements

### 47. Currency risk (cont.)

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

30.9.2019

##### Financial assets

	EUR	USD	GBP	CAD	Other currencies	Total
Cash and balances with Central Bank .....	1,725,590	1,632,131	274,364	348,947	421,335	4,402,366
Fixed income securities .....		3,449,493				3,449,493
Shares and other variable income securities .....		185,508	431,530		1	617,039
Securities used for hedging .....	1,185,454					1,185,454
Loans to customers .....	619,730	110,546	1,047,578		28,660	1,806,514
Other assets .....	1,733,965	160,900	871,883		205,620	2,972,368
Financial assets excluding derivatives	5,264,738	5,538,579	2,625,354	348,947	655,616	14,433,234
Derivatives .....	2,043,816	56,911	18,353			2,119,080
<b>Total</b>	<b>7,308,554</b>	<b>5,595,490</b>	<b>2,643,707</b>	<b>348,947</b>	<b>655,616</b>	<b>16,552,314</b>

##### Financial liabilities

	EUR	USD	GBP	CAD	Other currencies	Total
Deposits from customers .....	4,716,524	4,840,363	692,641	308,121	621,625	11,179,274
Borrowings .....	39,887					39,887
Issued bonds .....		305,094				305,094
Other liabilities .....	1,467,483	284,056	186,705	16,506	43,312	1,998,062
Financial liabilities excluding derivatives	6,223,894	5,429,513	879,347	324,627	664,937	13,522,318
Derivatives .....	112,279	56,911	1,522,200			1,691,391
<b>Total</b>	<b>6,336,174</b>	<b>5,486,424</b>	<b>2,401,547</b>	<b>324,627</b>	<b>664,937</b>	<b>15,213,709</b>

##### Net currency position

	EUR	USD	GBP	CAD	Other currencies	Total
Financial assets .....	7,308,554	5,595,490	2,643,707	348,947	655,616	16,552,314
Financial liabilities .....	(6,336,174)	(5,486,424)	(2,401,547)	(324,627)	(664,937)	(15,213,709)
Financial guarantee contracts .....	6,483					6,483
<b>Total</b>	<b>978,863</b>	<b>109,065</b>	<b>242,161</b>	<b>24,320</b>	<b>(9,321)</b>	<b>1,345,088</b>

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
<b>Total</b>	<b>5,310,678</b>	<b>6,438,217</b>	<b>1,081,523</b>	<b>93,690</b>	<b>1,006,227</b>	<b>13,930,335</b>

##### 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
<b>Total</b>	<b>5,171,673</b>	<b>6,337,934</b>	<b>1,067,513</b>	<b>109,446</b>	<b>895,691</b>	<b>13,582,258</b>

##### 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
<b>Total</b>	<b>146,940</b>	<b>100,283</b>	<b>14,009</b>	<b>(15,756)</b>	<b>110,536</b>	<b>356,012</b>

## Notes to the Condensed Interim Consolidated Financial Statements

### 47. 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	30.9.2019		31.12.2018	
	-10%	+10%	-10%	+10%
EUR .....	97,886	(97,886)	14,694	(14,694)
USD .....	10,907	(10,907)	10,028	(10,028)
GBP .....	24,216	(24,216)	1,401	(1,401)
CAD .....	2,432	(2,432)	760	(760)
NOK .....	(784)	784	(1,576)	1,576
Other currencies .....	(148)	148	10,293	(10,293)
<b>Total</b>	<b>134,509</b>	<b>(134,509)</b>	<b>35,601</b>	<b>(35,601)</b>

The effect on equity would be the same.

### 48. 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.

	Average		30.9.2019		31.12.2018	
	Average	Max	Exposure	Average	Max	Exposure
Listed shares .....	916,056	2,718,021	993,212	840,266	1,306,331	751,470
Unlisted shares .....	1,841,031	2,130,422	1,935,040	971,302	1,432,666	1,391,018
Unlisted unit shares .....	773,382	998,994	651,010	1,018,325	1,978,813	784,187
<b>Total</b>			<b>3,579,262</b>			<b>2,926,675</b>

### 49. 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

#### 50. Accounting classification of financial assets and financial liabilities

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

<b>30.9.2019</b>		<b>Amortised cost</b>	<b>Manda- torily at fair value through P/L</b>	<b>Total carrying amount</b>
<b>Financial assets</b>				
Cash and balances with Central Bank .....	28,332,626			28,332,626
Fixed income securities .....			5,428,964	5,428,964
Shares and other variable income securities .....			3,579,262	3,579,262
Securities used for hedging .....			27,117,592	27,117,592
Loans to customers .....	28,485,998		2,168,139	30,654,137
Derivatives .....			1,896,029	1,896,029
Other assets .....	9,257,910			9,257,910
<b>Total</b>	<b>66,076,534</b>		<b>40,189,987</b>	<b>106,266,521</b>
<b>Financial liabilities</b>				
Deposits from customers .....	58,632,152			58,632,152
Borrowings .....	20,252,603			20,252,603
Issued bills .....	3,939,850			3,939,850
Issued bonds .....	2,733,510			2,733,510
Subordinated liabilities .....	1,957,455			1,957,455
Short positions held for trading .....			934,325	934,325
Short positions used for hedging .....			119,312	119,312
Derivatives .....			1,125,911	1,125,911
Other liabilities .....	7,012,656		588,896	7,601,552
<b>Total</b>	<b>94,528,226</b>		<b>2,768,444</b>	<b>97,296,670</b>
<b>31.12.2018</b>				
<b>Financial assets</b>				
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
<b>Total</b>	<b>50,563,305</b>		<b>32,954,592</b>	<b>83,517,897</b>
<b>Financial liabilities</b>				
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
<b>Total</b>	<b>73,824,374</b>		<b>1,399,268</b>	<b>75,223,642</b>

## Notes to the Condensed Interim Consolidated Financial Statements

### 51. 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

### 51. 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:

#### 30.9.2019

Financial assets	Level 1	Level 2	Level 3	Carrying amount
Mandatorily measured at fair value through profit and loss				
Fixed income securities .....	5,427,484		1,480	5,428,964
Shares and other variable income securities .....	2,368,129	33,687	1,177,446	3,579,262
Securities used for hedging .....	27,030,432	87,161		27,117,592
Loans to customers .....			2,168,139	2,168,139
Derivatives .....		1,896,029		1,896,029
<b>Total</b>	<b>34,826,045</b>	<b>2,016,877</b>	<b>3,347,066</b>	<b>40,189,987</b>
<b>Financial liabilities</b>				<b>Carrying amount</b>
Mandatorily measured at fair value through profit and loss				
Short positions held for trading .....	934,325			934,325
Short positions used for hedging .....	119,312			119,312
Derivatives .....		1,125,911		1,125,911
Other liabilities .....			588,896	588,896
<b>Total</b>	<b>1,053,637</b>	<b>1,125,911</b>	<b>588,896</b>	<b>2,768,444</b>

Transfers from Level 3 to Level 1 amounted to ISK 360 million during the period due to listing of a company on Nasdaq First North Growth Market.

#### 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
<b>Total</b>	<b>28,155,079</b>	<b>1,639,867</b>	<b>3,159,646</b>	<b>32,954,592</b>
<b>Financial liabilities</b>				<b>Carrying amount</b>
Mandatorily measured at fair value through profit and loss				
Short positions held for trading .....	805,334			805,334
Derivatives .....		593,934		593,934
<b>Total</b>	<b>805,334</b>	<b>593,934</b>	<b>0</b>	<b>1,399,268</b>

There were no transfers between levels during the period.

## Notes to the Condensed Interim Consolidated Financial Statements

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

#### e. Reconciliation of changes in Level 3 fair value measurements

	Shares and		Loans to	Other	Total
	Fixed	other var.			
	income	income	customers	liabilities	
	securities	securities			
<b>30.9.2019</b>					
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	(133,463)	223,490	78,231	374,920	543,179
Purchases		1,030,150	520,583		1,550,733
Repayments			(591,198)	1,578,502	987,304
Acquisition of subsidiary		928,327		(2,542,318)	(1,613,991)
Sales		(1,508,236)			(1,508,236)
Transfers in (out) of Level 3		(360,466)			(360,466)
<b>Balance as at 30 September 2019</b>	<b>1,480</b>	<b>1,177,446</b>	<b>2,168,139</b>	<b>(588,896)</b>	<b>2,758,170</b>
	Fixed	Shares and	Loans to	Other	Total
	income	other var.	customers	liabilities	
	securities	securities			
<b>31.12.2018</b>					
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)
<b>Balance as at 31 December 2018</b>	<b>134,944</b>	<b>864,180</b>	<b>2,160,522</b>	<b>0</b>	<b>3,159,646</b>

#### f. 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
				<b>30.9.2019</b>
Unlisted bonds	Expected recovery	Value of assets	0-5%	1,480
Unlisted shares	Market price	Recent trades	-	1,177,446
Loans to customers	Expert model	Value of assets and collateral	-	2,168,139
<b>Total</b>				<b>3,347,066</b>
				<b>31.12.2018</b>
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
<b>Total</b>				<b>3,159,646</b>

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.

#### g. 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	117,745	(117,745)
Loans to customers	216,814	(216,814)
<b>Total</b>	<b>334,559</b>	<b>(334,559)</b>



## Notes to the Condensed Interim Consolidated Financial Statements

### Other information

#### 52. 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 30 September 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 1.1 billion as at 30 September 2019 (2018: ISK 0.5 billion).

#### 53. 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
<b>30.9.2019</b>		
Management .....	0	70,949
Associates .....	76,649	3,974,629
<b>Total</b>	<b>76,649</b>	<b>4,045,578</b>
<b>31.12.2018</b>		
Management .....	79,231	212,291
Associates .....	7,450	3,004,717
<b>Total</b>	<b>86,681</b>	<b>3,217,008</b>

##### d. Effects on income statement

	Interest income	Interest expense	Fees received	Fees paid
<b>9m 2019</b>				
Management .....	4,095	2,296	2,690	9,680
Associates .....	903	40,582	36,783	0
<b>Total</b>	<b>4,998</b>	<b>42,878</b>	<b>39,472</b>	<b>9,680</b>
<b>9m 2018</b>				
Shareholders .....	0	752	2,768	134
Management .....	3,086	1,744	611	4,885
Associates .....	3	59,146	19,885	0
<b>Total</b>	<b>3,090</b>	<b>61,642</b>	<b>23,264</b>	<b>5,019</b>

#### 54. Events after the reporting date

There are no material events after the reporting date.