Consolidated Financial Statements

31 December 2019

Kvika banki hf. • Katrínartún 2 • 105 Reykjavík • Iceland • Reg. no. 540502-2930

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Endorsement and Statement
by the Board of Directors and the CEO

The Consolidated Financial Statements of Kvika banki hf. ("Kvika" or the "Bank") for the year 2019 have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, and additional requirements in the Icelandic Financial Statement Act. The Consolidated Financial Statements comprise Kvika and its subsidiaries (together 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. 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. The Bank is listed on the main list of Nasdaq OMX Iceland.

2019: Large increase in net fee and commission income driven by asset management

The Group's results in 2019 were strong as a result of the profit from asset managment and capital markets operations being well above budget.

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 acquisition was subject to regulatory approvals, the final of which was granted on 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 December 2019 the Group had ISK 426 billion of assets under management, compared to ISK 291 billion at year end 2018.

According to the Consolidated Statement of Financial Position, equity at the end of the year amounted to ISK 15,515 million (31.12.2018: ISK 12,970 million) and total assets amounted to ISK 105,584 million (31.12.2018: ISK 88,274 million).

The Group's net operating income during the year was ISK 7,426 million (2018: ISK 5,705 million). Net interest income amounted to ISK 1,776 million (2018: ISK 1,701 million). Net fee income amounted to ISK 4,804 million (2018: ISK 3,698 million). Other operating income amounted to ISK 845 million (2018: ISK 306 million). Administrative expenses during the year amounted to ISK 5,059 million (2018: ISK 4,008 million).

Profit for the year amounted to ISK 2,660 million (2018: ISK 1,752 million), corresponding to an annualised 21.0% return on equity based on the equity position at the beginning of the year adjusted for changes in share capital and transactions with treasury shares during the year.

The Group's total capital ratio at 31.12.2019 is 24.1% (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 15.1%. The minimum regulatory capital requirement including the additional capital requirements imposed following the implementation of CRD IV is 21.35% as at 31 December 2019 but increases to 22.35% from 1 January 2020.

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 December 2019 the Group's 30 day liquidity coverage ratio (LCR) was 246%, well above the minimum level of 100%.

The Bank's Board of Directors propose that no dividend will be paid in the year 2020 on 2019 operations.

Operational outlook

The Bank is well funded and has ample liquidity in both ISK and foreign currencies. Successfully executed mergers have increased recurring revenues and reduced fluctuations in operations, in addition to the fact that various opportunities accompany Kvika‘s unique position as the only bank that does not operate a network of branches and does not have significant overhead expenses. The emphasis will continue to be on strengthening the Bank’s foundations in order to enable it to seize those opportunities that exist and, as before, the emphasis will be on operations that utilise little equity, as that is usually where there is less risk and increased returns on equity. It is anticipated that the balance sheet will grow at a moderate pace and that the loan portfolio will continue to be diversified with regards to its risk profile.

Kvika is faced with numerous possibilities in the coming year, the most significant of which are the integration of the asset management operations of Kvika, the continued build-up of Kvika's subsidiary in London, the online deposits of Auður and investments in infrastructure and human resources. The objectives for the next two years are for Kvika’s asset management to be one of the two highest grossing asset management operations in the country, to have the highest grossing corporate finance operations, one of the two capital markets operations with the highest turnover and the most profitable financing operations in the country.

Economic outlook

Growth in Iceland has now stalled, after years of robust economic activity, in large part due to a decline in tourist arrivals. New risks associated with the COVID-19 virus have dampened hopes of a swift turnaround in this trend this year. Aside from reduced tourism receipts, subdued investment activity weighs most heavily on economic growth. Consumer purchasing power is still increasing, underpinning the strong position of the general consumer in Iceland in recent years, due to wage hikes and low inflation. This trend has, however, weighed on businesses. Employee costs have increased, making businesses more vulnerable today as top line growth stalls in many sectors due to the economic slowdown. Slower investment growth can also be directly attributed, in part, to the substantial investments associated with the tourist industry in recent years. Loan growth among deposit institutions has slowed rapidly due to a refocus within the industry on increased returns, fewer attractive investment projects and increased risk aversion in times of slow growth. All in all, these are natural consequences of the current economic outlook, which will likely lead to restructuring among business, already apparent to some degree in rising unemployment numbers. Current economic headwinds are, however, supported by low public debt and the economy’s net positive and historically high international investment position.

Endorsement and Statement
by the Board of Directors and the CEO

Share capital and shareholders

The Bank's issued share capital amounted to ISK 1,995 million as at 31 December 2019 (31.12.2018: ISK 1,845 million). At the end of the year the Bank held treasury shares with a nominal value of ISK 50 million (31.12.2018: ISK 0 million). The Bank's share capital was increased by a nominal value of ISK 150 million during the year.

At the Bank's annual general meeting, which was held on 14 March 2019, 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 Bank´s annual general meeting in 2020. In 2019, the Board of Directors set up a share buyback program and through it, during the year 2019, 50 million shares in nominal value were purchased.

The Bank had 825 shareholders at year-end 2019 (2018: 733), none of which held more than 10% of shares in the Bank (2018: 0). The ten largest shareholders are as follows:

Shareholder	**31.12.2019**	**31.12.2018**
Lífeyrissjóður verzlunarmanna	8.77%	9.49%
K2B fjárfestingar ehf.	6.69%	7.70%
Arion banki hf.	6.40%	4.91%
Íslandsbanki hf.	5.22%	4.26%
Vátryggingafélag Íslands hf.	4.71%	8.66%
Landsbankinn hf.	3.78%	0.00%
Lífsverk lífeyrissjóður	3.11%	3.58%
Sindrandi ehf.	3.10%	2.48%
Almenni lífeyrissjóðurinn	2.54%	0.12%
Lífeyrissj.starfsm.rík. A-deild	2.19%	0.64%
	46.51%	41.84%

Further information about the shareholders of the Bank is provided in note 67.

Risk management

The objective of risk management is to promote a good and efficient culture of risk awareness within the Group and to increase the understanding of employees and management on the Group's risk taking, in addition to an assessment process related to risk and capital position. An emphasis is placed on being up to speed on the latest developments and adoption of rules related to risk management, such as regarding capital- and liquidity management. The Group is faced with various kinds of risk that relate to its operations as a financial institution and arise from its day-to-day operations. An active risk management entails analysing risk, measuring it and taking actions to limit it, as well as monitoring risk factors. The Group’s risk management, and its main operations, are described in the notes accompanying the Consolidated Financial Statements. Refer to notes 44-57 on analysis of exposure to various types of risk.

Corporate governance

In the year 2018 the Bank completed a corporate governance assessment process resulting in an award from the Centre for Corporate Governance in Iceland for exemplary corporate governance in 2018-2019. The award is valid for three years as long as there are no material changes in ownership or the Board of Directors of the Bank. The Board of Directors intends to have such an assessment carried out on a regular basis and maintain the aforementioned award.

In accordance with the Bank´s articles of association, five members and two alternate members are elected to the Board of Directors each year at the Annual General Meeting. The eligibility of members of the Board is subject to statutory law. It is the Bank´s policy concerning election of the Board of Directors that the Board collectively has sufficient knowledge, competency and experience to understand the Bank´s operations, including the main risk factors. The ratio of each gender of members of the Board and alternate members shall be at least 40%. The election of Board members is furthermore governed by the provisions of the Act on Public Limited Liability Companies No. 2/1995 and the Act on Financial Undertakings No. 161/2002.

The Bank´s articles of association may be amended at lawfully convened shareholders´ meetings, provided that the notice of the meeting indicates that such amendments are scheduled and outlines the main substance of the amendments. An amendment takes effect only if approved with at least 2/3 of the votes casted and by shareholders controlling at least 2/3 of the shares represented at the meeting. However, the provisions of the articles of association regarding the voting rights of shareholders and equality among them cannot be amended except with the consent of all the shareholders who are subject to the curtailment of rights, cf. paragraph 3 of Article 94 of the Act on Public Limited Liability Companies No. 2/1995.

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

The Board determines compensation for the CEO. The Board of Directors has delegated certain tasks to three separate subcommittees, the Risk Committee, Audit Committee and Remuneration Committee. In accordance with the Bank's articles of association, three members have been appointed to each committee, thereof at least two Board members. It is not permitted to appoint employees of the Bank to any committee. Members shall have the necessary experience and knowledge for each committee's tasks according to applicable laws and rules. Each committee has incorporated procedural rules which have been confirmed by the Board of Directors.

More information about the Bank's corporate governance can be found in an appendix to these financial statements which contains a corporate governance statement. A signed copy of the statement is available on the Bank's website, www.kvika.is.

Endorsement and Statement
by the Board of Directors and the CEO

Non-financial information

Kvika is a specialised bank focusing on asset management and investment services. Kvika’s value is long-term thinking and the bank’s policy is to have a positive long-term impact on the community. This means that when decisions are made their long-term effects are always taken into account, whether they concern the internal matters of the bank or its customers. Kvika’s operations are governed by the provisions of the Icelandic Financial Statement Act no. 3/2006 on non-financial reporting, which, among other things, apply to the status and influence of the company in respect of environmental, social and human resources issues. This information is included in an unaudited appendix to these financial statements, along with information regarding human rights and how the bank counteracts corruption and bribery. Non-financial reporting is inter alia based on Nasdaq’s common ESG reporting guide for Nordic countries, the purpose of which is to serve as an informal guide for companies for the reporting of non-financial information. Kvika's ESG report can be found at the Bank's website, www.kvika.is.

Statement by the Board of Directors and the CEO

To the best of our knowledge the Consolidated Financial Statements of Kvika banki hf. for the year 2019 comply with International Financial Reporting Standards as adopted by the EU and additional requirements in the Icelandic Financial Statement Act, and give a true and fair view of the Group's assets, liabilities and financial position as at 31 December 2019 and the financial performance of the Group and changes of cash flows for the year 2019.

Further, in our opinion the 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 Consolidated Financial Statements for the year 2019, and confirm them by the means of their signatures.

Reykjavík, 27 February 2020.

Board of Directors

[redacted]

[redacted]

[redacted]

CEO

Independent Auditors' Report

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

Opinion

We have audited the consolidated financial statements of Kvika banki hf. for the year ended December 31, 2019 which comprise, the consolidated income statement and statement of comprehensive income, the consolidated statement of financial position, the consolidated statement of changes in equity, the consolidated statement of cash flows for the year then ended and the notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of Kvika banki hf. as at December 31, 2019, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional requirements in the Icelandic Financial Statement Act.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the consolidated Financial Statements section of our report. We are independent of Kvika banki hf. in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and we have fulfilled our ethical responsibilities in accordance with the code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

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

Key Audit Matters	How the matter was addressed in our audit
Impairment charges for loans	
Loans for the group amounted to ISK 30,502 million at year end and the total allowance account for the group amounted to ISK 396.7 million against loans at amortized cost, unused credit facilities and guarantees at 31 December 2019. Measurement of loan impairment charges is considered a key audit matter as the determination of assumptions for expected credit losses is highly subjective due to the level of judgement applied by management. The most significant judgements are: • Assumptions used in the expected credit loss models to incorporate future looking information. • Timely identification of exposures with significant increase in credit risk and credit impaired exposures. • Valuation of collateral and assumptions of future cash flows on manually assessed credit-impaired exposures. • Management overlays for particular exposures, which are not appropriately captured in the expected credit loss model. Management has provided further information about the loan impairment charges and provisions for guarantees in notes 22, 45 and 81 to the consolidated financial statements.	Based on our risk assessment and industry knowledge, we have examined the impairment charges for loans and provisions for undrawn loan commitments and evaluated the methodology applied as well as the assumptions made according to the description of the key audit matter. During our audit we have evaluated whether the groups expected credit loss models are compliant to IFRS 9. Our examination included the following elements: • Testing of key controls over assumptions used in the expected credit loss models. • Substantively testing the valuation of collateral with particular focus on management overlays applied to collateral value. • Substantively testing the PD model from Credit Info and how it has been calibrated to represent the banks portfolio. • Testing the appropriateness of forward looking information and how they have been applied in the expected credit loss models. • We have reviewed the disclosures to the consolidated financial statements to confirm compliance with IFRS.

Independent Auditors' Report

Business combination	
The bank acquired Gamma Capital Management hf. (Gamma) during the year 2019. The purchase price was estimated to be ISK 2,542 million resulting in goodwill of ISK 699 million. In accordance with IFRS 3, business combinations, the purchase price was allocated to identifiable assets and liabilities acquired recognized at the fair value of ISK 1,843 million. Part of the purchase price was a contingent consideration that is recognized at fair value through profit and loss in accordance with IFRS 3. At year end the contingent consideration amounted 495 million and is mostly based on the fair value of performance related receivables. The purchase price allocation (PPA) is considered a key audit matter as it requires judgment on behalf of management due to the valuation of performance related receivables at the acquisition date. It also has a direct effect on the amount of goodwill recognized on acquisition date by the Group. During the year the contingent consideration has decreased significantly resulting in 447.5 million recognized through the Consolidated income statement. Management has provided further information about the purchase price allocation in notes 4 and 107 regarding information about the use of estimates and judgements to the consolidated financial statements.	In our audit we have confirmed that the effective date of the acquisition was in compliance with IFRS 3 per inspection of the terms and conditions of the purchase agreement. Our examination included the following elements: • Reviewed the IFRS 3 acquisition date accounting treatment of the Gamma acquisition. • We confirmed that identifiable assets acquired and liabilities assumed were appropriately valued, in all material respects. • We have reviewed the valuation of the assets forming the majority of the contingent consideration and confirmed that the accounting treatment post acquisition is in accordance with IFRS 3. • We have reviewed the disclosures to the consolidated financial statement to confirm compliance with IFRS 3.

Other information

The Board of Directors and CEO are responsible for the other information. Other information comprises the endorsement and statement by the Board of Directors and the CEO, the Statement on the Corporate Governance of Kvika banki hf. and non- financial information.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon, except from our confirmation related to the endorsement and statement by the Board of Directors and the CEO as described below.

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

In accordance with Paragraph 2 article 104 of the Icelandic Financial Statement Act no. 3/2006, we confirm to the best of our knowledge that the accompanying endorsement and statement by the Board of Directors and the CEO contains all information required by the Icelandic Financial Statement Act that is not disclosed elsewhere in the consolidated financial statements.

Responsibilities of the Board of Directors and the CEO for the Consolidated Financial Statements

The Board of Directors and CEO are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional requirements in the Icelandic Financial Statement Act, and for such internal control as the Board of Directors and CEO determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

The Board of Directors and Audit Committee are responsible for overseeing the Kvika banki hf.'s consolidated financial reporting process.

Independent Auditors' Report

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Kvika banki hf.'s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Kvika banki hf. to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Kvika banki hf. to express an opinion on the consolidated and separate financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

Kópavogur, 27 February 2020.

Deloitte ehf.

Pálína Árnadóttir
State Authorized Public Accountant

Guðmundur Ingólfsson
State Authorized Public Accountant

Kvika Amounts are in ISK thousands

Consolidated Income Statement
For the year 2019

	Notes	2019	2018
Interest income		4,977,846	4,717,873
Interest expense		(3,201,925)	(3,017,016)
Net interest income	5	1,775,921	1,700,857
Fee and commission income		5,009,174	3,863,083
Fee and commission expense		(204,952)	(165,404)
Net fee and commission income	6	4,804,222	3,697,680
Net financial income	7	668,199	521,609
Share in profit (loss) of associates, net of income tax	25	31,982	(302,949)
Other operating income		145,313	87,305
Other operating income		845,494	305,965
Net operating income		7,425,637	5,704,502
Administrative expenses	9-12	(5,058,704)	(4,008,788)
Net impairment	13	(313,548)	(15,395)
Revaluation of contingent consideration		447,463	0
Revaluation on investment properties	26	0	114,582
Profit before taxes		2,500,848	1,794,900
Income tax	14	361,911	110,028
Special tax on financial activity	15	(57,141)	(62,436)
Special tax on financial institutions	16	(145,166)	(90,818)
Profit for the year		2,660,451	1,751,674

	Notes	2019	2018
Attributable to the shareholders of Kvika banki hf.		2,662,021	1,741,803
Attributable to non-controlling interest	24	(1,570)	9,871
Profit for the year		2,660,451	1,751,674
Earnings per share	17		
Basic earnings per share (ISK per share)		1.41	0.95
Diluted earnings per share (ISK per share)		1.27	0.86

The notes on pages 14 to 65 are an integral part of these Consolidated Financial Statements.

Kvika Amounts are in ISK thousands

Consolidated Statement of Comprehensive Income
For the year 2019

	Notes	2019	2018
Profit for the year		2,660,451	1,751,674
Translation of foreign operations			
Exchange difference on translation of foreign operations		17,609	9,698
Items that may be reclassified subsequently to profit and loss, net of tax		17,609	9,698
Total comprehensive income for the year		2,678,060	1,761,372

	Notes	2019	2018
Attributable to the shareholders of Kvika banki hf.		2,679,630	1,751,501
Attributable to non-controlling interest		(1,570)	9,871
Total comprehensive income for the year		2,678,060	1,761,372

The notes on pages 14 to 65 are an integral part of these Consolidated Financial Statements.

Kvika Amounts are in ISK thousands

Consolidated Statement of Financial Position
As at 31 December 2019

Assets	Notes	31.12.2019	31.12.2018
Cash and balances with Central Bank	18	26,818,231	21,339,185
Fixed income securities	19	8,097,169	5,127,335
Shares and other variable income securities	20	3,659,208	2,926,675
Securities used for hedging	21	24,274,769	21,526,794
Loans to customers	22	30,105,643	29,443,573
Derivatives	23	1,259,833	1,213,266
Investment in associates	25	776,490	774,832
Investment properties	26	1,016,553	950,000
Intangible assets	28	3,283,256	2,379,281
Property and equipment		596,336	42,894
Deferred tax assets	29	872,972	608,858
Other assets	30	4,823,577	1,941,070
Total assets		105,584,035	88,273,762

Liabilities	Notes	31.12.2019	31.12.2018
Deposits from customers	31	51,479,732	47,893,959
Borrowings	32	22,058,747	15,634,648
Issued bills	33	3,945,306	3,577,718
Issued bonds	34	4,261,308	3,160,215
Subordinated liabilities	35	1,999,530	1,947,511
Short positions held for trading	36	1,239,916	805,334
Derivatives	23	1,282,341	593,934
Current tax liabilities		136,395	3,140
Deferred tax liabilities	29	268,613	76,980
Other liabilities	37	3,396,965	1,610,323
Total liabilities		90,068,852	75,303,763

Equity	Notes	31.12.2019	31.12.2018
Share capital	38	1,945,366	1,844,996
Share premium		3,115,992	2,881,165
Option reserve		7,687	4,297
Warrants reserve	39	206,501	202,527
Deficit reduction reserve		3,103,697	3,103,697
Other reserves		5,586	(12,023)
Restricted retained earnings		778,191	506,896
Retained earnings		6,292,189	4,376,900
Total equity attributable to the shareholders of Kvika banki hf.		15,455,209	12,908,455
Non-controlling interest		59,974	61,544
Total equity		15,515,183	12,969,999
Total liabilities and equity		105,584,035	88,273,762

The notes on pages 14 to 65 are an integral part of these Consolidated Financial Statements.

Kvika Amounts are in ISK thousands

Consolidated Statement of Changes in Equity

For the year 2019

1 January 2019 to 31 December 2019	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 2019		1,844,996	2,881,165	4,297	202,527	3,103,697	(12,023)	506,896	4,376,900	12,908,454	61,544	12,969,998
Impact of adopting IFRS 16									(32,637)	(32,637)		(32,637)
Restated opening balance under IFRS 16		1,844,996	2,881,165	4,297	202,527	3,103,697	(12,023)	506,896	4,344,263	12,875,818	61,544	12,937,362
Profit for the year									2,662,021	2,662,021	(1,570)	2,660,451
Translation of foreign operations												
Exchange difference on translation of foreign operations							17,609			17,609		17,609
Total comprehensive income for the year		0	0	0	0	0	17,609	0	2,662,021	2,679,630	(1,570)	2,678,060
Restricted retained earnings								271,296	(271,296)	0		0
Transactions with owners of the Bank												
Capital increase		150,369	705,149							855,518		855,518
Transactions with own shares		(50,000)	(470,322)							(520,322)		(520,322)
Dividend paid to shareholders									(442,799)	(442,799)		(442,799)
Stock options				3,390						3,390		3,390
Warrants sold					43,424					43,424		43,424
Warrants exercised					(39,451)					(39,451)		(39,451)
Equity as at 31 December 2019		1,945,366	3,115,992	7,687	206,501	3,103,697	5,586	778,191	6,292,189	15,455,209	59,974	15,515,183

The notes on pages 14 to 65 are an integral part of these Consolidated Financial Statements

Kvika Amounts are in ISK thousands

Consolidated Statement of Changes in Equity
For the year 2018

1 January 2018 to 31 December 2018	Notes	Share capital	Share premium	Option reserve	Warrants reserve	Deficit reduction reserve	Trans-lation reserve	Restricted retained earnings	Retained earnings	Total share-holders' equity	Non-controlling interest	Total equity
Equity as at 1 January 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	10,982,277
Impact of adopting IFRS 9									28,709	28,709		28,709
Restated opening balance under IFRS 9		1,805,060	2,722,583	903	207,048	3,103,697	(21,722)	254,844	2,887,148	10,959,563	51,423	11,010,986
Profit for the year									1,741,803	1,741,803	9,871	1,751,674
Translation of foreign operations												
Exchange difference on translation of foreign operations							9,698			9,698		9,698
Total comprehensive income for the year		0	0	0	0	0	9,698	0	1,741,803	1,751,501	9,871	1,761,372
Restricted retained earnings								252,051	(252,051)	0		0
Transactions with owners of the Bank												
Capital increase		29,936	98,339		(4,521)					123,754		123,754
Transactions with own shares		10,000	60,242							70,242		70,242
Stock options				3,394						3,394		3,394
Other transactions												
Acquisition of a subsidiary with a non-controlling interest											250	250
Equity as at 31 December 2018		1,844,996	2,881,165	4,297	202,527	3,103,697	(12,023)	506,896	4,376,900	12,908,454	61,544	12,969,999

The notes on pages 14 to 65 are an integral part of these Consolidated Financial Statements

Amounts are in ISK thousands

Consolidated Statement of Cash Flows
For the year 2019

Cash flows from operating activities	Notes	2019	2018
Profit for the year		2,660,451	1,751,674
Adjustments for:			
Indexation and exchange rate difference		(12,337)	509,563
Share in (profit) loss of associates, net of income tax	25	(31,982)	302,949
Depreciation and amortisation		155,809	25,342
Net interest income	5	(1,775,921)	(1,700,857)
Net impairment		313,548	15,395
Income tax		(361,911)	(110,028)
Investment properties, fair value change		0	(114,582)
Other adjustments		(454,306)	1,500
		493,351	680,957
Changes in:			
Fixed income securities		(2,969,834)	216,074
Shares and other variable income securities		(337,231)	(89,300)
Securities used for hedging		(2,747,975)	(7,500,360)
Loans to customers		(585,063)	(4,114,031)
Derivatives - assets		(46,567)	(160,614)
Other assets		(430,794)	98,145
Deposits from customers		2,796,289	5,995,525
Short positions		434,582	435,171
Derivatives - liabilities		688,407	229,242
Other liabilities		613,927	(363,414)
		(2,584,258)	(5,253,563)
Interest received		4,731,940	4,561,814
Interest paid		(3,011,540)	(2,740,780)
Net cash to operating activities		(370,506)	(2,751,573)
Cash flows from investing activities			
Net proceeds from the sale of investment properties		0	128,456
Acquisition of intangible assets	28	(195,634)	(104,304)
Acquisition of property and equipment		(108,960)	0
Proceeds from the sale of property and equipment		0	2,394
Dividend from assoiciates		7,500	0
Acquisition of subsidiary, net of cash		(1,055,505)	0
Net investment in associates		0	7,750
Proceeds from the sale of assets classified as held for sale		0	11,700
Lease receivable payments		26,514	0
Net cash (to) from investing activities		(1,326,085)	45,996
Cash flows from financing activities			
Borrowings		6,365,359	3,623,081
Issued bills		367,588	(357,039)
Subordinated liabilities		0	800,000
Increase (decrease) in warrants		3,973	(4,521)
Dividend paid to shareholders		(442,799)	0
Treasury share transactions		335,197	70,242
Increase (reduction) of retained earnings		0	128,275
Lease payments		(84,119)	0
Net cash from financing activities		6,545,198	4,260,039
Net increase in cash and balances with Central Bank		4,848,607	1,554,462
Cash and balances with Central Bank at the beginning of the year	18	21,339,185	20,493,739
Change in cash and cash equivalents due to acquisition of subsidiary		20,538	0
Effects of exchange rate fluctuations on cash and balances with Central Bank		609,901	(709,016)
Cash and balances with Central Bank at the end of the year	18	26,818,231	21,339,185

The notes on pages 14 to 65 are an integral part of these Consolidated Financial Statements.

Notes to the Consolidated Financial Statements

Notes to the 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 Katrínartún 2, 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 Consolidated Financial Statements for the year ended 31 December 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 Consolidated Financial Statements were approved and authorised for issue by the Board of Directors and the CEO on 27 February 2020.

2. Basis of preparation

a. Statement of compliance
The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union and additional requirements in the Icelandic Financial Statement Act. The Consolidated Financial Statements are also prepared in accordance with Icelandic laws on financial statements.

b. Basis of measurement
The 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 Consolidated Financial Statements are prepared in Icelandic Krona (ISK), which is the Bank's functional currency. All financial information has been rounded to the nearest thousand, unless otherwise stated.
The Group's assets and liabilities which are denominated in other currency than ISK are translated to ISK using the exchange rate as at the end of day 31 December 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 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 Consolidated Financial Statements is provided in note 107.

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

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

3. 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. The adoption of IFRS 16 had little impact on the results of the Group and the presentation of its cash flows.

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 Consolidated Financial Statements.

4. 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 has been paid in 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 and the contingent consideration was estimated to amount to ISK 1,293 million. As at 31 December 2019 ISK 1,101 million have been paid in cash and ISK 499 million by delivering unit shares, and ISK 495 million have been recognised as a contingent consideration on the Group's Consolidated Statement of Financial Position. The amount of the contingent consideration is subject to change and fair value changes will be recognised through the Consolidated Income

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 which were expensed as operating expenses.

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

Other assets are mostly comprised of receivables, such as fund management fees. Out of the ISK 2,220 million which are recognised as other assets, ISK 1,612 million 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 is no indication that these receivables will not be collected in full. Certain assets that are owned by GAMMA form a part of the estimated book value of the contingent consideration as the purchase price will change if the book value of those assets changes. As a result, a large part of the economical risk of those assets lies with the former shareholders and not the Group.

The acquisition took place in early March. If the acquisition had occurred on 1 January 2019, it is estimated that the consolidated revenue would have been ISK 7,530 million and the consolidated profit for the year would have been ISK 2,577 million.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Income statement

5. Net interest income

Interest income is specified as follows:

	2019	2018
Cash and balances with Central Bank	817,716	945,278
Derivatives	1,488,360	1,140,160
Loans to customers	2,561,705	2,528,746
Other interest income	110,064	103,689
Total	4,977,846	4,717,873

Interest expense is specified as follows:

	2019	2018
Deposits from customers	1,496,257	1,440,430
Borrowings	1,068,823	1,024,390
Issued bills	189,208	175,598
Issued bonds	168,677	148,942
Subordinated liabilities	178,985	141,488
Derivatives	14,700	10,181
Other interest expense*	85,274	75,987
Total	3,201,925	3,017,016

* Thereof are lease liabilities' interest expense amounting to ISK 16 million

Total interest income recognised in respect of financial assets not carried at fair value through profit or loss amounts to ISK 3,304 million (2018: ISK 3,413 million). Total interest expense recognised in respect of financial liabilities not carried at fair value through profit or loss amounts to ISK 3,187 million (2018: ISK 3,007 million).

6. Net fee and commission income

Fee income and expenses are presented on a net fee basis, as presented in internal reporting to management for decision making purposes, and broken down by business segments. The business segments are representative of the nature and types of activity from which the Group generates fee income from. A description of each business segment is provided in note 61.

Net fee and commission income by business segment	2019	2018
Corporate Banking	598,836	622,501
Corporate Finance	462,903	579,018
Capital Markets	825,149	671,971
Proprietary trading and Treasury	120,504	73,711
Asset Management	2,925,112	1,919,013
Support functions and eliminations	(128,282)	(168,534)
Total	4,804,222	3,697,680

7. Net financial income

Net financial income is specified as follows:

	2019	2018
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss		
Fixed income securities	142,123	332,386
Shares and other variable income securities	509,755	57,497
Derivatives	(48,914)	20,707
Loans to customers	49,118	113,090
Foreign currency exchange difference	16,118	(2,072)
Total	668,199	521,609

8. Foreign currency exchange difference

Foreign currency exchange difference is specified as follows:

	2019	2018
Gain on financial instruments at fair value through profit and loss	325,719	491,349
Loss on other financial instruments	(309,602)	(493,421)
Total	16,118	(2,072)

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

9. Administrative expenses

Administrative expenses are specified as follows:	2019	2018
Salaries and related expenses	3,336,695	2,737,663
Other operating expenses	1,483,029	1,150,699
Depositors' and Investors' Guarantee Fund contributions	83,171	95,085
Depreciation and amortisation	138,138	25,342
Depreciation of right of use asset	17,671	0
Total	5,058,704	4,008,788

10. Salaries and related expenses

Salaries and related expenses are specified as follows:	2019	2018
Salaries	2,504,339	2,072,620
Performance based payments excluding share-based payments	96,755	24,198
Share-based payment expenses	3,390	3,394
Pension fund contributions	349,371	337,122
Tax on financial activity	177,827	127,491
Other salary related expenses	205,013	172,838
Total	3,336,695	2,737,663
Average number of full time employees during the year	130	110
Total number of full time employees at year-end	132	109

The figures for 2018 do not include employees of GAMMA Capital Management hf. ("GAMMA") and its subsidiaries, At the beginning of 2019, GAMMA had on 22 of full time employees and Kvika and its subsidiaries had 109, or 131 in total.

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%).

11. Employment terms of the Board of Directors and management

Salaries and benefits paid to the Board of Directors, the CEO and Managing Directors, including the Deputy CEO, of the Bank for their work for companies within the Group, and their shareholding in the Bank, are specified as follows:

			31.12.2019			31.12.2018
	Salaries and benefits	Number of shares	Warrants & options	Salaries and benefits	Number of shares	Warrants & options
Marinó Örn Tryggvason, CEO (from 01.06.2019)*	30,655	0	22,093	0	0	0
Ármann Þorvaldsson, former CEO (until 31.05.2019)*	17,438	0	0	41,850	2,082	22,040
Kristín Pétursdóttir, Chairman of the Board and member of the Risk and Remuneration committees**	18,545[1]	7,900	0	9,656	7,900	0
Guðmundur Þórðarson, Deputy Chairman of the Board and member of the Risk committee	8,986[2]	133,500	0	5,278	152,304	0
Inga Björg Hjaltadóttir, Board member and member of the Remuneration and Audit committees	12,616[3]	0	0	5,375	0	0
Hrönn Sveinsdóttir, Board member and member of the Audit committee	9,151[4]	500	0	5,375	0	0
Guðjón Karl Reynisson, Board member and chairperson of the Remuneration committee**	10,306[5]	10,166	0	4,097	10,411	0
Kristín Guðmundsdóttir, alternate Board member and chairperson of the Risk and Audit committees	5,049	419	0	6,405	419	0
Pétur Guðmundarson, alternate Board member	0	0	0	867	0	0
Þorsteinn Pálsson, former Board member	0	0	0	2,324	0	0
Jónas Hagan Guðmundsson, former Board member	0	0	0	639	0	0
Managing Directors (2019: 6 (on average: 5.3), 2018: 7 (on average: 6.9))	229,584	27,138	103,966	267,410	2,270	159,713
Former Managing Directors	59,130	0	0	0	0	0
Total	401,458	179,622	126,059	349,277	175,386	181,752

* *Figures for salaries and benefits relate to the period as CEO during the year.*

** *The respective Board member only served on the Board for a part of the year 2018.*

In January 2019, ISK 11 million in compensation for participation in Board committees for the year 2018 were expensed and paid which should have been included in the 2018 Consolidated Financial Statements. Due to the aforementioned the salaries and benefits figures for members of the Board of Director's for 2019 and 2018 are not directly comparable.

1) Of which, ISK 3,024 thousand relate to compensation for participation in Board committees for the year 2018, 2) of which ISK 1,458 thousand relate to compensation for participation in Board committees for the year 2018, 3) of which ISK 2,970 thousand relate to compensation for participation in Board committees for the year 2018, 4) of which ISK 1,458 thousand relate to compensation for participation in Board committees for the year 2018 and, 5) of which ISK 1,980 thousand relate to compensation for participation in Board committees for the year 2018.

Notes to the Consolidated Financial Statements

11. Employment terms of the Board of Directors and management (cont.)

Salaries and benefits are substantially all short-term employee benefits. Salaries and benefits paid to members of the Board of Directors include compensation for their participation in Board committees.

The CEO and the managing directors received performance based payments in 2019. In 2019 the following changes were made to the senior management of the Bank: i) In May, Marinó Örn Tryggvason took up the position of CEO of Kvika and at the same time Ármann Þorvaldsson took up the position of Deputy CEO of Kvika, ii) in September, Magnús Ingi Einarsson took up the position of Managing Director of Banking, iii) in September, Ragnar Páll Dyer took up the position of Managing Director of Finance and Operations and iv) in September, Hannes Frímann Hrólfsson was appointed as CEO of Júpíter rekstrarfélag hf. and at the same time left the position as Managing Director of Asset Management. No one was hired to take up the position of Managing Director of Asset Management and, as a result, the number of persons in the Management Committee reduced during the year. Due to the aforementioned the salaries and benefits figures for managing directors for 2019 and 2018 are not directly comparable.

Figures for shares, share options and warrants are in thousands and include shares held by companies owned by or under the control of the respective parties as at 31 December 2019 and 31 December 2018. If the holdings are held indirectly through companies, then the pro rata ownership of the aforementioned persons has been included.

The Bank has defined the Deputy CEO and two Managing Directors as Key Employees, as defined in Act No. 161/2002 on Financial Undertakings. Furthermore the Bank has approved and published internal rules covering the qualification requirements, evaluation process and conduct of Key Employees, in accordance with requirements set forth by the Icelandic Financial Supervisory Authority.

The Bank has adopted a remuneration policy at the proposal of the Remuneration Committee. The policy covers three remuneration components, base pay, performance based incentive scheme and other benefits, including pension fund contributions. Further information about the remuneration policy is provided in notes 64-66.

12. Auditor's fees

Remuneration to the Group's auditors is specified as follows:

	2019	2018
Audit of annual accounts	46,859	42,728
Review of interim accounts	12,659	7,854
Other audit related services	4,211	8,866
Total	63,729	59,448
Thereof to the auditors of the Bank	48,095	44,525

13. Net impairment

	2019	2018
Net change in impairment of loans	178,417	(15,742)
Net change in impairment of other assets	131,507	13,698
Net change in impairment of loan commitments, guarantees and unused credit facilities	3,625	17,439
Total	313,548	15,395

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

14. 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 2019, the tax loss carry forward of the Group amounted to ISK 7 billion. A substantial part of the tax loss carry forward is utilisable until end of year 2025. Management is of the opinion that the Group's operations in the years to come will result in taxable results which will be offset with the tax loss carry forward. The Group has therefore recognised a part of the tax loss carry forward as a deferred tax asset in the consolidated statement of financial position. The deferred tax asset is recognised only to the extent that it is probable to be utilisable against future taxable profits. The deferred tax asset is reviewed at each reporting date. Refer to note 29 for more information on the deferred tax asset.

Income tax is recognised based on the tax rates and tax laws enacted during the current year, according to which the domestic corporate income tax rate was 20.0% (2018: 20.0%)

Reconciliation of effective tax rate:

		2019		2018
Profit before tax		2,500,848		1,794,900
Income tax using the domestic corporation tax rate	20.0%	(500,170)	20.0%	(358,980)
Non-deductible expenses	0.1%	(1,604)	0.1%	(1,470)
Non-taxable income	(13.6%)	340,453	0.9%	(16,334)
Recognition of tax losses	(29.6%)	739,948	(28.1%)	505,203
Other changes	8.7%	(216,716)	1.0%	(18,391)
Effective income tax	(14.5%)	361,911	(6.1%)	110,028

Profit before tax amounts to ISK 2,501 million. Income tax amounts to ISK 362 million, resulting in an effective tax rate of -14.5%. This is substantially different from the Icelandic corporate tax rate of 20%, mainly due to non-taxable income from shares and revaluation of the deferred tax asset.

15. 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.

16. 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.

17. 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.

	2019	2018
Net earnings attributable to equity holders of the Bank	2,662,021	1,741,803
Weighted average number of outstanding shares	1,883,931	1,825,808
Adjustments for warrants and stock options	217,212	194,798
Total	2,101,142	2,020,607
Basic earnings per share (ISK)	1.41	0.95
Diluted earnings per share (ISK)	1.27	0.86

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Statement of Financial Position

18. Cash and balances with Central Bank

Cash and balances with Central Bank are specified as follows:

	31.12.2019	31.12.2018
Deposits with Central Bank	19,106,515	8,934,131
Cash on hand	6,845	9,114
Balances with banks	2,268,540	6,903,004
Foreign treasury bills	2,956,550	3,472,741
Included in cash and cash equivalents	24,338,450	19,318,990
Restricted balances with Central Bank - average maintenance level	853,192	708,656
Restricted balances with Central Bank - fixed reserve requirement	853,192	708,656
Receivables from Central Bank	773,398	602,882
Total	26,818,231	21,339,185

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.

19. Fixed income securities

Fixed income securities are specified as follows:

Mandatorily measured at fair value through profit or loss	31.12.2019	31.12.2018
Listed government bonds and bonds with government guarantees	3,434,851	1,841,982
Listed bonds	3,700,392	3,150,409
Unlisted bonds	961,925	134,944
Total	8,097,169	5,127,335

20. Shares and other variable income securities

Shares and other variable income securities are specified as follows:

Mandatorily measured at fair value through profit or loss	31.12.2019	31.12.2018
Listed shares	1,271,325	751,470
Unlisted shares	1,694,493	1,391,018
Unlisted unit shares	693,390	784,187
Total	3,659,208	2,926,675

21. Securities used for hedging

Securities used for hedging are specified as follows:

	31.12.2019	31.12.2018
Listed government bonds and bonds with government guarantees	8,006,643	7,625,469
Listed bonds	2,366,621	4,487,698
Listed shares	13,822,091	9,395,761
Unlisted unit shares	79,414	17,866
Total	24,274,769	21,526,794

22. Loans to customers

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

	Individuals		**Corporates**		**Total**	
31.12.2019	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
Loans to customers at amortised cost	4,790,146	4,780,053	23,365,514	22,978,928	28,155,660	27,758,981
Loans to customers at fair value through profit or loss	0	0	2,346,662	2,346,662	2,346,662	2,346,662
Total	4,790,146	4,780,053	25,712,176	25,325,590	30,502,322	30,105,643

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

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

23. Derivatives

Derivatives are specified as follows:

31.12.2019	Notional Assets	Notional Liabilities	Carrying value Assets	Carrying value Liabilities
Interest rate derivatives	3,342,934	3,103,868	239,066	0
Currency forwards	1,963,733	1,938,785	29,636	4,688
Bond and equity total return swaps	27,091,699	27,396,373	727,855	1,033,599
Equity options	326,762	11,760	263,275	244,054
Total	32,725,127	32,450,786	1,259,833	1,282,341

31.12.2018	Notional Assets	Notional Liabilities	Carrying value Assets	Carrying value Liabilities
Interest rate derivatives	4,803,789	4,607,104	196,684	0
Currency forwards	400,192	413,565		13,372
Bond and equity total return swaps	22,983,930	22,547,910	966,627	530,607
Equity options	7,900	7,900	49,955	49,955
Total	28,195,811	27,576,479	1,213,266	593,934

24. Group entities

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

Entity	Nature of operations	Domicile	Share 31.12.2019	Share 31.12.2018
FÍ Fasteignafélag GP ehf.	Real estate fund management	Iceland	100%	100%
GAMMA Capital Management hf.	Fund management	Iceland	100%	-
Júpíter rekstrarfélag hf.	Fund management	Iceland	100%	100%
M-Investments ehf.	Holding company	Iceland	100%	100%
Netgíró reikningar ehf.	Holding company	Iceland	100%	100%
Netgíró lán ehf.	Holding company	Iceland	100%	100%
Netgíró lán II ehf.	Holding company	Iceland	100%	100%
Rafklettur ehf.	Holding company	Iceland	100%	100%
Rekstrarfélag Virðingar hf.	Fund management	Iceland	-	100%
AC GP 3 ehf.	Fund management	Iceland	80%	80%
Kvika Securities ltd.	Business consultancy services	UK	100%	100%

During 2H 2019 the Group sold all its shareholding in Rekstrarfélag Virðingar hf.

25. Investment in associates

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

Entity	Nature of operations	Domicile	Share 31.12.2019	Share 31.12.2018
Akta sjóðir hf.	Fund management	Iceland	34%	49%
Kjölfesta GP ehf.	Holding company	Iceland	50%	50%
KORTA hf.	Payment Institution	Iceland	41%	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:

	31.12.2019	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	(7,500)	(7,500)
Disposal of shares in associates	(70,025)	0
Share in profit (loss) of associates, net of income tax	31,982	(302,949)
Total	776,490	774,832

26. Investment properties

Investment properties are specified as follows:	31.12.2019	31.12.2018
Balance at year beginning	950,000	953,874
Acquisitions	66,553	31,544
Disposal	0	(150,000)
Revaluation on investment properties	0	114,582
Total	1,016,553	950,000

In October 2017, the Group acquired investment properties through one of its subsidiaries, Rafklettur ehf. The intention is to either earn rental income or capital appreciation or both. The book value of investment properties is based on the most recent appraisal values by licensed real estate agents, current listing prices and/or recent transactions for comparable real estates or valuation models based on gross income multipliers. The Group received rental income amounting to ISK 73 million (2018:ISK 92 million) and incurred direct operating expenses of ISK 32 million (2018:ISK 14 million). In 2018 the Group sold one of its investment properties.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

27. Unconsolidated structured entities

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

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

	31.12.2019	31.12.2018
Investment funds	242,001,053	128,301,382

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

	Carrying amount	
	31.12.2019	31.12.2018
Investment funds	645,817	684,811

The Group received management fees during the year:	2019	2018
Investment funds	1,647,064	750,154

28. Intangible assets

a. Intangible assets are specified as follows:

31.12.2019	Goodwill	Software	Other	Total
Balance as at 1 January 2019	2,244,521	118,428	16,332	2,379,281
Acquisitions	0	76,467	119,167	195,634
Additions through a business combination	699,360	0	46,586	745,946
Disposals	0	(3,244)	(3,301)	(6,545)
Amortisation	0	(16,396)	(14,664)	(31,060)
Balance as at 31 December 2019	2,943,881	175,256	164,118	3,283,256
Gross carrying amount	2,943,881	227,805	216,603	3,388,289
Accumulated amortisation and impairment losses	0	(52,549)	(52,484)	(105,033)
Balance as at 31 December 2019	2,943,881	175,256	164,118	3,283,256

31.12.2018	Goodwill	Software	Other	Total
Balance as at 1 January 2018	2,244,521	23,959	15,860	2,284,340
Acquisitions	0	98,952	5,352	104,304
Amortisation	0	(4,482)	(4,880)	(9,362)
Balance as at 31 December 2018	2,244,521	118,428	16,332	2,379,281
Gross carrying amount	2,244,521	45,442	48,800	94,242
Accumulated amortisation and impairment losses	0	(21,484)	(32,940)	(54,424)
Balance as at 1 January 2018	2,244,521	23,959	15,860	2,284,340
Gross carrying amount	2,244,521	154,582	54,152	208,733
Accumulated amortisation and impairment losses	0	(36,153)	(37,820)	(73,973)
Balance as at 31 December 2018	2,244,521	118,428	16,332	2,379,281

Acquisitions by the Group in 2019 as a part of business combinations resulted in the recognition of goodwill. Preliminary purchase price allocation ("PPA") was prepared at the beginning of March 2019 at which time the fair value of the assets was determined.

b. Impairment testing

Assets with indefinite useful life, such as goodwill, are not amortised but are subject to annual impairment testing as described in note 89. Goodwill is allocated to cash generating units ("GCUs") for the purpose of impairment testing. The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the business combinations in which the goodwill arose. The goodwill was allocated to the Asset Management business segment as the acquistions in 2017 and 2019 were made to strengthen those operations of the Group and to realise synergies.

The purpose of impairment testing is to determine whether the recoverable amount exceeds the carrying amount of the above mentioned business segment. The recoverable amount of an operating segment is the higher of its value in use or fair value less costs to of sell. Value in use is determined as the present value of the future cash flows expected to be derived from a CGU, based on amongst others:

- the expected future cash flows from the GCU
- the time value of money, which is reflected by using a discount rate based on the current market risk-free rate of interest
- the price for the uncertainty inherent in the CGU

The estimated future cash flows are based on a budget for the CGU for the coming three years and a further four years using extrapolated figures based on estimated growth rates (3.5%) in assets under management. The time value of money and price of uncertainty, calculated as the weighted average cost of capital ("WACC"), are based on external market information about market risk, interest rates and CGU specific elements like country risk. The discount rate is calculated at CGU level and equals 9.4%.
The goodwill impairment test was performed at the end of 2019. Its results show that the recoverable value exceeds the carrying value of goodwill. In addition to the base case testing, additional scenarios were tested where some key inputs had been stressed. In all scenarios tested the results show that there is sufficient headroom and that there are no triggers indicating that impairment is necessary.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

29. Deferred tax assets and liabilities

Deferred tax assets	872,972	608,858
Deferred tax liabilities	(268,613)	(76,980)
Net	604,359	531,878

The Group's deferred tax assets (liabilities) are attributable to the following items:

	31.12.2019	**31.12.2018**
Property and equipment	(1,429)	4,414
Assets and liabilities denominated in foreign currencies	(5,390)	(3,795)
Other items	(266,109)	(73,367)
Tax losses carried forward	877,287	604,625
Total	604,359	531,878

At year end 2019, tax losses carried forward amount to ISK 7 billion, and are set to expire as follows:

	Tax losses
Tax losses 2010, expiring in 2020	66,358
Tax losses 2011, expiring in 2021	764,208
Tax losses 2012, expiring in 2022	640,623
Tax losses 2013, expiring in 2023	1,511,014
Tax losses 2014, expiring in 2024	781,928
Tax losses 2015, expiring in 2025	3,041,144
Total	6,805,275

30. Other assets

Other assets are specified as follows:

	31.12.2019	**31.12.2018**
Unsettled transactions	162,007	120,563
Accounts receivable	3,193,923	1,283,215
Right of use asset and lease receivables	622,415	0
Sundry assets	845,232	537,292
Total	4,823,577	1,941,070

Right of use asset and lease receivables are specified as follows:

	31.12.2019	**31.12.2018**
Adoption of IFRS 16 Leases 1 January 2019	353,811	0
Addition	541,118	0
Disposal	(189,692)	0
Indexation	3,254	0
Depreciation and lease receivable installment	(86,076)	0
Total	622,415	0

Right of use assets and lease receivables consist of real estates for the Group's own use, primarily the Bank's headquarters. The Bank has entered into sublease contracts for the parts of the real estates which it does not use for its operations.

31. Deposits from customers

Deposits from customers are specified as follows:

	31.12.2019	**31.12.2018**
Demand deposits	37,487,799	32,463,907
Time deposits	13,991,933	15,430,052
Total	51,479,732	47,893,959

32. Borrowings

Borrowings are specified as follows:

	31.12.2019	**31.12.2018**
Loans from credit institutions	803,052	1,215,343
Money market deposits	21,255,695	14,407,558
Other borrowings	0	11,747
Total	22,058,747	15,634,648

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

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

33. Issued bills

Issued bills are specified as follows:

	31.12.2019	**31.12.2018**
Issued bills	3,945,306	3,577,718
Total	3,945,306	3,577,718

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

34. Issued bonds

Issued bonds are specified as follows:

Currency, nominal value	First issued	Maturity	Maturity type	Terms of interest	31.12.2019	31.12.2018
KVB 19 01, ISK 1,520 million	2019	2024	Amortizing	Floating, 1 month REIBOR + 1.50%	1,522,432	0
KVB 17 02, ISK 2,160 million	2017	2020	At maturity	Floating, 1 month REIBOR + 1.25%	1,881,675	1,963,336
Total					3,404,107	1,963,336
Unlisted senior unsecured bonds, total					857,201	1,196,879
Total					4,261,308	3,160,215

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.

35. Subordinated liabilities

a. Subordinated liabilities:

Currency, nominal value	First issued	Maturity	Maturity type	Terms of interest	31.12.2019	31.12.2018
KVB 15 01, ISK 1,000 million	2015	2025	At maturity	CPI-Indexed, fixed 5.50%	1,122,360	1,093,162
KVB 18 02, ISK 800 million	2018	2028	At maturity	CPI-Indexed, fixed 7.50%	877,170	854,350
Total					1,999,530	1,947,511

At the interest payment date in the year 2020 for KVB 15 01, the annual interest rate increases from 5.50% p.a. to 7.50% p.a. At the same date, the Group has the right to repay the subordinated bond and on any subsequent interest payment dates until maturity.

At the interest payment date in the year 2023 for KVB 18 02, the Group has the right to repay the subordinated bond and on any subsequent interest payment dates until maturity.

Subordinated liabilities are financial liabilities in the form of subordinated capital which, in case of the Group's voluntary or compulsory winding-up, will not be repaid until after the claims of ordinary creditors have been met. In the calculation of the capital ratio, they are included within Tier 2 and are a part of the equity base. The amount eligible for Tier 2 capital treatment is amortised on a straight-line basis over the final 5 years to maturity or up to 20% a year. The Group may only retire subordinated liabilities with the permission of the Icelandic Financial Supervisory Authority.

b. Subordinated liabilities are specified as follows:

	31.12.2019	31.12.2018
Balance at the beginning of the year	1,947,511	1,058,741
Additional issuance	0	800,000
Paid interest	(115,000)	(47,458)
Paid interests due to indexation	(7,000)	(741)
Accrued interests and indexation	174,019	136,970
Total	1,999,530	1,947,511

36. Short positions held for trading

Short positions held for trading are specified as follows:

	31.12.2019	31.12.2018
Listed government bonds and bonds with government guarantees	632,124	569,471
Listed bonds	607,792	235,863
Total	1,239,916	805,334

Short positions held for trading are classified as mandatorily measured at fair value through profit or loss. Further discussion about the accounting classification of financial liabilites is provided in notes 58-60.

37. Other liabilities

Other liabilities are specified as follows:

	31.12.2019	31.12.2018
Unsettled transactions	487,683	186,794
Expected credit loss allowance for loan commitments, guarantees and unused credit facilities	21,092	17,439
Accounts payable and accrued expenses	401,230	250,522
Special taxes on financial institutions and financial activities	202,307	150,336
Withholding taxes	459,251	461,153
Salaries and salary related expenses	541,401	313,274
Lease liability	616,521	0
Contingent consideration	494,991	0
Other liabilities	172,489	230,806
Total	3,396,965	1,610,323

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

37. Other liabilities (cont.)

Lease liability is specified as follows:

	31.12.2019	31.12.2018
Adoption of IFRS 16 Leases 1 January 2019	386,455	0
Addition	541,118	0
Disposal	(217,535)	0
Installment	(98,493)	0
Indexation	4,976	0
Total	616,521	0

38. 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.

	31.12.2019	31.12.2018
Share capital according to the Bank's Articles of Association	1,995,366	1,844,996
Nominal amount of treasury shares	50,000	0
Authorised but not issued shares	742,117	838,635

b. Changes made to the nominal amount of share capital

The Bank's share capital was increased by ISK 150,369,458 in nominal value during the year 2019 in order to serve the exercising of issued warrants.

c. Share capital increase authorisations

According to the Bank's Articles of Association dated 18 December 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 54 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 388 million to serve issued warrants. According to section B of temporary provision IV the Board of Directors is furthermore granted a conditioned authorisation to increase the share capital by an additional amount of ISK 200 million to serve issued warrants. The authorisation under section B of temporary provision IV is directly linked to the Board of Directors' authorisation under section A of temporary provision I.

The aforementioned authorisation under section B of temporary provision IV currently stands at ISK 150 million. However, should the Board of Directors utilise its authorisation according to section A of temporary provision I and increase the Bank's share capital by ISK 100 million, the authorisation under section B of temporary provision IV will increase from ISK 150 million to ISK 200 million, as stipulated in the provision. The Board of Directors' authorisation under temporary provision IV to increase share capital thus currently totals ISK 538 million but can increase to ISK 588 million by the usage by the Board of Directors of its authorisation pursuant to section A of temporary provision I. This authorisation is valid until 31 December 2022.

A copy of the Bank's Articles of Association, including the temporary provisions, is available on the Bank's website, www.kvika.is, reference is made to them for more information.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

39. Warrants

The Bank has issued warrants for shares in the total nominal amount of ISK 583,616,682 as at 31 December 2019. The number of owners of these warrants is 116 and they purchased the warrants for a total consideration of ISK 206,500,620. 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 2,578,982,448, and the newly issued shares would represent 22.6% 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	109,450,016	32,944,454	7.5%	6.67	Sept. 2019 - Sept. 2020
September 2017	201,333,333	60,601,333	7.5%	7.74	Sept. 2020 - Sept. 2022
September 2017	201,333,333	60,601,333	7.5%	7.74	Sept. 2021 - Sept. 2022
December 2017	7,333,333	2,471,333	7.5%	7.59	Dec. 2019 - Dec. 2020
December 2017	7,333,333	2,471,333	7.5%	8.80	Dec. 2020 - Dec. 2022
December 2017	7,333,333	2,471,333	7.5%	8.80	Dec. 2021 - Dec. 2022
May 2018	1,166,667	505,167	7.5%	9.27	Dec. 2019 - Dec. 2020
May 2018	1,166,667	505,167	7.5%	10.75	Dec. 2020 - Dec. 2022
May 2018	1,166,667	505,167	7.5%	10.75	Dec. 2021 - Dec. 2022
April 2019	17,500,000	16,520,000	7.5%	15.36	Dec. 2020 - Dec. 2022
April 2019	17,500,000	16,520,000	7.5%	15.36	Dec. 2020 - Dec. 2022
August 2019	5,500,000	5,192,000	7.5%	15.36	Dec. 2020 - Dec. 2022
August 2019	5,500,000	5,192,000	7.5%	15.36	Dec. 2021 - Dec. 2022
Total	583,616,682	206,500,620			

40. Capital adequacy ratio (CAD)

Equity at the end of the year was ISK 15,515 million (31.12.2018: 12,970 million), equivalent to 14.7% 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 24.1% (31.12.2018: 25.1%). The minimum according to the Act is 8.0%. The ratio is calculated as follows:

Own funds	**31.12.2019**	**31.12.2018**
Total equity	15,515,183	12,969,999
Goodwill and intangibles	(3,283,256)	(2,379,281)
Shares in financial institutions	(146,401)	(171,272)
Subordinated fixed income securities	(102,999)	(54,595)
Deferred tax asset	(872,972)	(608,858)
Common equity Tier 1 capital (CET 1)	11,109,555	9,755,993
Tier 2 capital	1,941,695	1,886,506
Total own funds	13,051,251	11,642,499
Risk weighted assets		
Credit risk	37,614,747	31,948,930
Market risk	5,246,577	4,474,728
Operational risk	11,336,890	10,019,764
Total Capital requirements	54,198,213	46,443,422
Capital ratios		
Capital adequacy ratio (CAD)	24.1%	25.1%
CET1 ratio	20.5%	21.0%
Minimum Capital adequacy ratio requirement	15.1%	14.5%
Minimum Capital adequacy ratio requirement including supervisory buffers	22.4%	20.3%
Minimum CET 1 ratio requirement including supervisory buffers	15.7%	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 2019, is 15.1%. The minimum regulatory capital requirement including the additional capital buffers is 21.35% as at 31 December 2019 but increases to 22.35% from 1 January 2020.

Notes to the Consolidated Financial Statements

Risk management

41. Risk management framework

a. Board of Directors

The Bank's Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework and risk appetite setting. Risk management policies are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

b. Board of Directors sub-committees

The Bank's Board of Directors has established three sub-committees, the Risk Committee, Audit Committee and Remuneration Committee. In accordance with the Bank´s articles of association, three members have been appointed to each committee, thereof at least two Board members. It is not permitted to appoint employees of the Bank to any committee. Members shall have the necessary experience and knowledge for each committee´s tasks according to applicable laws and rules. Each committee has incorporated procedural rules which have been confirmed by the Board of Directors.

The Risk Committee is intended to perform a consultative and supervisory role for the Bank's Board of Directors, including for the formation of the Bank's risk policy and risk appetite. The Risk Committee supervises the arrangement and activity of risk management, credit risk, market risk, liquidity risk, operational risk, reputational risk and other risk as applicable.

The Audit Committee is intended to perform a consultative and supervisory role for the Bank's Board of Directors, including to ensure the quality of the annual accounts and other financial information of the Bank and the independence of the Bank's audit. The Audit Committee monitors the work process for the preparation of financial statements, the functioning of internal controls as well as internal and external auditing.

The Remuneration Committee is intended to perform a consultative and supervisory role for the Bank's Board of Directors in connection with the Bank's remuneration and that they support the objectives and interests of the Bank

c. CEO

The CEO is responsible for the effective implementation through the corporate governance structure and committees. The CEO has established three committees, which are responsible for developing and monitoring risk management policies in their specified areas.

d. Committees

The Bank operates three committees that are involved in risk management: an Asset and Liability Committee (ALCO), a Credit Committee and an Operations Committee.

The ALCO Committee meets regularly and each department reports on its operations and positions activity since the previous meeting. The committee addresses matters regarding the Bank's risk management, financing, capital management and proprietary trading.

The Credit Committee addresses matters regarding the Bank's loan activities. The committee is responsible for the approval of individual loans as well as deciding on credit limits for individual clients in derivative trades, and is the primary forum for the discussion of loan activity policy.

The Operations Committee is responsible for supervision and implementation of the Bank's security and quality policies. The security policy mainly addresses data security and operational security in IT systems, physical security for the personnel and proper access controls and monitoring in the Bank's premises. The quality work is aimed at upholding proper quality in work processes, IT systems and services to support performance and profitability, lower operational risk and increase the customer experience.

e. Risk management

The purpose of the Bank's risk management unit is to identify, quantify, control and report on the risks that the Group is exposed to in its daily activities. The unit also participates in drafting the overall risk policy and has representatives on the ALCO committee, Credit committee and the Operations committee. The unit's main activities include monitoring and managing credit risk, market risk, liquidity risk and operational risk. The Board of Directors sets the rules and guidelines regarding the Group's risk policy and the obligations of risk management and credit control. The division reports regularly on the Group's positions and exposure to risk to the Board of Directors, the CEO and to the ALCO committee.

f. Compliance Officer

The Compliance Unit is responsible for the supervision of securities transactions within the Bank, i.e. monitoring and assessing the adequacy and effectiveness of measures and procedures put in place to detect and minimise any risk of failure by the Bank to comply with its obligations under the Act on Securities Transactions. The compliance officer is also responsible for coordinating and monitoring the Bank's compliance with applicable anti-money laundering and terrorist financing laws and regulations. The Compliance Unit also assesses and manages the Bank´s compliance risk.

g. Internal Audit

Internal Audit is responsible for providing an objective opinion on the Group's operations, as well as advice which aims to increase the Group's value and to strengthen risk management and internal control. The Internal Audit's main task, is to estimate whether adequate processes and systems are in place, and whether they are relevant and efficient. The Internal Auditor is recruited by the Board of Directors and is located accordingly in the hierarchy. Its operations cover all units of operations, including the subsidiaries Júpiter Capital Management hf. and Gamma Capital Management hf., as well as the associate company Akta Capital Management hf.

42. Hedging

Securities held as a hedge against derivatives positions of customers make up a part of the Group's portfolio of assets. The Group hedges currency exposure between the Group's loan portfolio and debts to the extent possible, but does not apply hedge accounting.

Notes to the Consolidated Financial Statements

43. Credit risk - overview

a. Definition

One of the Group's primary sources of risk is counterparty credit risk. Credit risk is defined as the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

b. Management

The risk management unit is responsible for managing and reporting on credit risk. The Group uses a variety of tools and processes to manage credit risk, including collaterals, hedges and loan portfolio management.

c. Credit approval process

The originating department prepares a proposal for each loan or credit line which is presented to the credit committee for approval. The proposal consists of a basic description of the client, the purpose of the loan, a simple credit assessment and arguments for or against granting the loan. The committee decides whether there is need for further credit assessment and on what terms the loan may be granted.

A more thorough credit assessment may be conducted if considered appropriate and can include an assessment of a borrower's fundamental credit strength as well as the value of any collateral. To assess the borrower's capacity to meet his or her obligations the committee can request stress test analysis of the borrower's cash flow or call for third party assessments.

d. Collateral

Securing loans with collateral is a traditional method to reduce credit risk. The Group uses different methods to reduce credit risk by obtaining collateral from customers where appropriate. Such collateral gives the Group right to the collateralised assets for current and future obligations incurred by the customer.

The Group places emphasis on pricing loans according to the value and quality of pledged collateral. The Group applies appropriate haircuts on all collateral in order to ensure proper risk mitigation. For all collateral in listed securities, the Group maintains the right to liquidate collateral in case its market value falls below a predefined limit.

To a very large extent the Group's loan portfolio consists of senior loans, most of which are highly collateralised.

e. Credit rating, control and provisioning

The risk management unit is responsible for credit rating and reviewing the loan portfolio. In case of any significant delay of payments or defaults the unit carefully analyses the underlying assets and loan documents and organizes the process of collection.

The Group monitors the value of collateral by listed securities on a real time basis, and takes prompt action when necessary.

f. Loan portfolio management

To ensure an effective diversification of the loan portfolio the board has set a limit framework defining maximum exposure as a ratio of the Group’s equity and/or the total size of the loan portfolio. These limits include limitation on joint exposure to associated clients, exposure to individual and associated industries, single regions and countries etc. It is the responsibility of risk management to monitor that these limits are not being violated and to report discrepancies to the credit committee.

g. Impairment

Provisioning for loan impairments is estimated on the basis of expected loss models assessing the portfolio as a whole as well as individual lending. Risk management suggest a level of provisioning for the portfolio, based on the expected loss assessment. Risk management reassess impairments in the event of collateral decay, delayed payments, indication of increased risk, or other early warning signs. Provisions require approval from the credit committee. Refer to note 81 for more information on the Group's impairment policy.

h. Derivatives

The Group offers derivative contracts in the form of swap contracts on highly liquid securities. On the day when the contract is entered into, the Group purchases the underlying security and hedges its exposure to price changes. Collateral is in the form of cash or listed, highly liquid securities. The risk management sets rules about the level of collateralisation and monitors the compliance to these rules. Contracts are closed if required levels of collateralisation are not met.

i. Securities used for hedging

The Group hedges itself for market risk of derivative contracts by purchasing the underlying securities at the commencement of the contract. Since the contracts require delivery of the underlying securities to the customer on the settlement day, the credit risk towards the issuer is immaterial.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Risk management

44. 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:

31.12.2019 **On-balance sheet exposure**	**Public entities**	**Financial institutions**	**Corporate customers**	**Individuals**	**31.12.2019**
Cash and balances with Central Bank	24,549,691	2,268,540			26,818,231
Fixed income securities	4,306,557	2,782,322	1,008,289		8,097,169
Loans to customers		258,556	25,072,034	4,775,053	30,105,643
Derivatives		404,345	811,802	43,686	1,259,833
Other assets	67,451	230,117	3,903,594		4,201,162
	28,923,699	5,943,881	30,795,719	4,818,739	70,482,037
Off-balance sheet exposure					
Loan commitments		2,073,113	1,258,009	336,493	3,667,615
Financial guarantee contracts		197,415	642,515		839,930
Maximum exposure to credit risk	28,923,699	8,214,408	32,696,243	5,155,232	74,989,582

31.12.2018 **On-balance sheet exposure**	**Public entities**	**Financial institutions**	**Corporate customers**	**Individuals**	**31.12.2018**
Cash and balances with Central Bank	14,436,181	6,903,004			21,339,185
Fixed income securities	2,829,688	1,968,174	329,473		5,127,335
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
Off-balance sheet exposure					
Loan commitments		255,329	2,818,631	388,975	3,462,935
Financial guarantee contracts		100,000	823,074		923,074
Maximum exposure to credit risk	17,289,386	9,961,542	30,323,000	5,876,508	63,450,436

45. 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:

31.12.2019

Loans to customers:	**Stage 1**	**Stage 2**	**Stage 3**	**FVTPL**	**Total**
Credit quality band I	16,746,578	542,505	17,566	890,560	18,197,209
Credit quality band II	2,517,738	2			2,517,740
Credit quality band III	1,105,650	1,370,939		812,293	3,288,882
Credit quality band IV	1,793,786	1,137,340		643,809	3,574,935
In default	35,037	0	297,331		332,369
Non-rated	2,591,158	29			2,591,186
Gross carrying amount	24,789,948	3,050,814	314,898	2,346,662	30,502,322
Expected credit loss	(167,078)	(100,185)	(129,416)		(396,679)
Book value	24,622,870	2,950,629	185,482	2,346,662	30,105,643

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

45. Credit quality of financial assets (cont.)

Loan commitments, guarantees and unused credit facilities:	Stage 1	Stage 2	Stage 3	FVTPL	Total
Credit quality band I	2,140,892	6,283		11,215	2,158,389
Credit quality band II	484,628	0			484,628
Credit quality band III	38,059	176,503		149,929	364,491
Credit quality band IV	56,437	36,459			92,896
In default	100,000		9,739		109,739
Non-rated	1,297,403				1,297,403
Total off-balance sheet amount	4,117,418	219,245	9,739	161,143	4,507,545
Expected credit loss	(15,592)	(2,746)	(2,754)		(21,092)
Net off-balance sheet amount	4,101,826	216,499	6,985	161,143	4,486,453

31.12.2018

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

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

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

31.12.2019	Claim value	Expected credit loss	Carrying amount
Not past due	28,752,106	(297,606)	28,454,500
Past due 1-30 days	1,168,884	(2,705)	1,166,179
Past due 31-60 days	417,918	(95,485)	322,433
Past due 61-90 days	141,431	(543)	140,888
Past due 91-180 days	21,492	(95)	21,397
Past due 181-360 days	492	(246)	246
Past due more than 360 days			0
Total	30,502,322	(396,679)	30,105,643

31.12.2018	Claim value	Expected credit loss	Carrying amount
Not past due	28,900,493	(197,946)	28,702,547
Past due 1-30 days	570,167	(4,857)	565,309
Past due 31-60 days	158,379	(3,921)	154,458
Past due 61-90 days			0
Past due 91-180 days	11,158	(2)	11,156
Past due 181-360 days			0
Past due more than 360 days	24,353	(14,251)	10,102
Total	29,664,550	(220,977)	29,443,573

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

45. Credit quality of financial assets (cont.)

c. Breakdown of loans to customers by industry

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

31.12.2019	**Claim value**	**Expected credit loss**	**Carrying amount**	**%**
Financial institutions	258,665	(108)	258,556	0.9%
Corporate				
Services	7,522,777	(106,675)	7,416,102	24.6%
Holding companies	7,656,488	(47,285)	7,609,203	25.3%
Real estate, construction and industry	9,281,142	(207,116)	9,074,027	30.1%
Retail	449,783	(11,325)	438,458	1.5%
Other	543,322	(9,077)	534,245	1.8%
Individual	4,790,146	(15,093)	4,775,053	15.9%
Total	30,502,322	(396,679)	30,105,643	100.0%

31.12.2018	**Claim value**	**Expected credit loss**	**Carrying amount**	**%**
Financial institutions	3,988	(8)	3,979	0.0%
Corporate				
Services	11,393,477	(112,157)	11,281,320	38.3%
Holding companies	6,707,672	(18,015)	6,689,657	22.7%
Real estate, construction and industry	2,834,688	(33,759)	2,800,929	9.5%
Retail	1,034,244	(12,819)	1,021,424	3.5%
Other	2,283,070	(22,098)	2,260,972	7.7%
Individual	5,407,411	(22,120)	5,385,291	18.3%
Total	29,664,550	(220,977)	29,443,573	100.0%

d. Breakdown of loans to customers by seniority

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

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

The breakdown of loans to customers by categories is as follows:

	Senior I	**Senior II**	**Junior**	**Mezzanine**	**31.12.2019**
Amortised cost - Stage 1	6,626,169	10,425,165	2,495,466	4,986,905	24,533,705
Amortised cost - Stage 2	336,070	719,148	1,407,756	547,604	3,010,578
Amortised cost - Stage 3	30,781	11,435	100,921	71,561	214,698
Fair value through profit and loss	193,060	764,530	1,389,072		2,346,662
Total	7,186,080	11,920,278	5,393,215	5,606,070	30,105,643

	Senior I	**Senior II**	**Junior**	**Mezzanine**	**31.12.2018**
Amortised cost - Stage 1	6,030,827	8,442,103	4,316,905	6,143,591	24,933,426
Amortised cost - Stage 2	1,283,008	345,169	173,640	170,558	1,972,375
Amortised cost - Stage 3	163,415	65,451		148,383	377,250
Fair value through profit and loss	181,415	837,798	907,762	233,548	2,160,522
Total	7,658,665	9,690,522	5,398,306	6,696,080	29,443,573

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

45. Credit quality of financial assets (cont.)

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

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

31.12.2019

Expected credit loss allowance total

	Stage 1	Stage 2	Stage 3	Total
Transfers of financial assets:				
Balance as at 31 December 2018	176,146	28,614	33,657	238,416
Transfer to Stage 1 - (Initial recognition)	5,847	(438)	(5,410)	0
Transfer to Stage 2 - (significantly increased credit risk)	(22,672)	22,672		0
Transfer to Stage 3 - (credit impaired)	(2,701)	(19)	2,719	0
Net remeasurement of loss allowance	(13,866)	45,580	10,318	42,032
New financial assets, originated or purchased	127,749	26,700	113,056	267,505
Derecognitions and maturities	(86,640)	(20,178)	(19,922)	(126,739)
Write-offs	(1,194)		(2,249)	(3,443)
Balance as at 31 December 2019	182,670	102,932	132,170	417,771

Expected credit loss allowance for loans to customers

	Stage 1	Stage 2	Stage 3	Total
Transfers of financial assets:				
Balance as at 31 December 2018	160,684	27,930	32,363	220,977
Transfer to Stage 1 - (Initial recognition)	5,844	(434)	(5,410)	0
Transfer to Stage 2 - (significantly increased credit risk)	(22,404)	22,404		0
Transfer to Stage 3 - (credit impaired)	(2,677)	(19)	2,695	0
Net remeasurement of loss allowance	(13,575)	43,767	8,912	39,103
New financial assets, originated or purchased	120,333	26,468	112,592	259,393
Derecognitions and maturities	(79,932)	(19,931)	(19,488)	(119,351)
Balance as at 31 December 2019	167,078	100,185	129,416	396,679

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

	Stage 1	Stage 2	Stage 3	Total
Transfers of financial assets:				
Balance as at 31 December 2018	15,462	683	1,293	17,439
Transfer to Stage 1 - (Initial recognition)	4	(4)		0
Transfer to Stage 2 - (significantly increased credit risk)	(268)	268		0
Transfer to Stage 3 - (credit impaired)	(24)		24	0
Net remeasurement of loss allowance	(290)	1,813	1,407	2,929
New financial assets, originated or purchased	7,417	232	464	8,113
Derecognitions and maturities	(6,708)	(246)	(434)	(7,388)
Balance as at 31 December 2019	15,592	2,746	2,754	21,092

31.12.2018

Expected credit loss allowance total

	Stage 1	Stage 2	Stage 3	Total
General and specific loss provision at 31.12.2017	243,944	10,856	33,911	288,710
Net remeasurement	(91,791)	39,687	23,395	(28,709)
Opening expected credit loss balance at 1.1.2018	152,153	50,543	57,305	260,001
Transfers of financial assets:				
Transfer to Stage 1 - (Initial recognition)	2,673	(223)	(2,450)	0
Transfer to Stage 2 - (significantly increased credit risk)	(15,005)	15,032	(26)	0
Transfer to Stage 3 - (credit impaired)	(614)	(30,814)	31,429	0
Net remeasurement of loss allowance	(2,893)	(512)	(24,586)	(27,990)
New financial assets, originated or purchased	101,385	12,792	6,913	121,091
Derecognitions and maturities	(61,553)	(18,204)	(25,258)	(105,015)
Write-offs			(9,671)	(9,671)
Balance as at 31 December 2018	176,146	28,614	33,657	238,416

Expected credit loss allowance for loans to customers

	Stage 1	Stage 2	Stage 3	Total
General and specific loss provision at 31.12.2017	243,944	10,856	33,911	288,710
Net remeasurement	(106,713)	38,782	22,487	(45,444)
Opening expected credit loss balance at 1.1.2018	137,231	49,638	56,398	243,266

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

45. Credit quality of financial assets (cont.)

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

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

	Stage 1	Stage 2	Stage 3	Total
General and specific loss provision at 31.12.2017				0
Net remeasurement	14,922	905	908	16,735
Opening expected credit loss balance at 1.1.2018	14,922	905	908	16,735
Transfers of financial assets:				
Transfer to Stage 1 - (Initial recognition)	277	(8)	(269)	0
Transfer to Stage 2 - (significantly increased credit risk)	(134)	134		0
Transfer to Stage 3 - (credit impaired)	(46)		46	0
Net remeasurement of loss allowance	(895)	399	657	162
New financial assets, originated or purchased	8,416	46	26	8,488
Derecognitions and maturities	(7,078)	(793)	(75)	(7,945)
Write-offs				0
Balance as at 31 December 2018	15,462	683	1,293	17,439

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

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

b. Loans to customers

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2019
Financial institutions	382,137	15,159	773,001	887,268		193,049	2,250,614
Corporate customers	211,923	892,170	7,188,215	10,129,828	100,651	97,695	18,620,482
Individuals	26,351	10,033	724,757	937,911			1,699,052
Total	620,411	917,361	8,685,973	11,955,008	100,651	290,744	22,570,148

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

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

c. Derivatives

	Deposits	Fixed income securities	Variable income securities	Real estate	Other fixed assets	Other	31.12.2019
Financial institutions	776,901	469,180	709,118				1,955,199
Corporate customers	499,619	13,234	1,463,259				1,976,112
Individuals	81,341		72,169				153,510
Total	1,357,861	482,414	2,244,546	0	0	0	4,084,821

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

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

47. 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. Besides collateral included in the LTV ratios the bank uses other risk mitigation measures, such as guarantees, negative pledge, cross-collateral and collateralization of non-quantifiable assets.

b. Breakdown

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

	31.12.2019	%	31.12.2018	%
Less than 50%	12,784,235	42.5%	10,041,505	34.1%
51-70%	4,655,736	15.5%	6,286,414	21.4%
71-90%	2,440,778	8.1%	4,542,377	15.4%
91-100%	673,622	2.2%	525,403	1.8%
More than 100%	4,895,571	16.3%	3,216,506	10.9%
No collateral:				
Purchased short-term retail claims	2,763,804	9.2%	3,511,938	11.9%
Other loans with no collateral	1,891,896	6.3%	1,319,429	4.5%
Total	30,105,643	100.0%	29,443,573	100.0%

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

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

48. 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 40).

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

		31.12.2019		31.12.2018
Large exposures before risk adjusted mitigation	**Number**	**Amount**	**Number**	**Amount**
10-20% of capital base	7	10,931,359	5	6,740,154
20-25% of capital base	0	0	1	2,359,382
Exceeding 25% of capital base	0	0	1	3,472,741
Total	7	10,931,359	7	12,572,277
Thereof nostro accounts with foreign banks with a rating of investment grade or higher	0	0	1	2,359,382
Thereof foreign governments and central banks exposures	1	2,413,067	1	3,472,741
Large exposures net of risk adjusted mitigation	2	4,138,396	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.

49. 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 requirment 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 December 2019 the LCR was 246% and at year-end 2018 it was 277%.

Kvika Amounts are in ISK thousands

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49. Liquidity risk (cont.)

c. Maturity analysis of financial assets and financial liabilities

31.12.2019 **Financial assets by type**	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Gross inflow/ (outflow)**	**Carrying amount**
Non-derivative assets							
Cash and balances with Central Bank	25,773,296	968,800				26,742,096	26,818,231
Fixed income securities	7,902,293	102,999	91,876			8,097,169	8,097,169
Shares and other variable income securities	1,528,914		2,130,294			3,659,208	3,659,208
Securities used for hedging	24,274,769					24,274,769	24,274,769
Loans to customers	3,066,655	6,490,086	14,211,455	6,443,200	984,383	31,195,778	30,105,643
Other assets	1,629,388	535,529	517,497	2,141,163		4,823,577	4,823,577
	64,175,315	8,097,414	16,951,122	8,584,364	984,383	98,792,597	97,778,596
Derivative assets							
Inflow	10,272,921		205,885	37,050		10,515,855	
Outflow	(9,515,478)		(2,658)	(1,210)		(9,519,347)	
	757,442	0	203,226	35,840	0	996,508	1,259,833

Financial liabilities by type	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Gross inflow/ (outflow)**	**Carrying amount**
Non-derivative liabilities							
Deposits from customers	(38,047,222)	(8,851,313)	(2,813,005)	(1,905,846)	(122,169)	(51,739,556)	51,479,732
Borrowings	(2,419,498)	(7,505,617)	(12,417,607)			(22,342,722)	22,058,747
Issued bills		(2,000,000)	(2,000,000)			(4,000,000)	3,945,306
Issued bonds	(40,079)	(636,625)	(2,209,392)	(1,671,961)		(4,558,057)	4,261,308
Subordinated liabilities			(123,396)	(493,584)	(2,250,952)	(2,867,933)	1,999,530
Short positions held for trading	(1,239,916)					(1,239,916)	1,239,916
Short positions used for hedging						0	
Other liabilities	(955,774)	(917,995)	(973,396)	(549,800)		(3,396,965)	3,396,965
	(42,702,489)	(19,911,550)	(20,536,797)	(4,621,191)	(2,373,122)	(90,145,149)	88,381,503
Derivative liabilities							
Inflow	15,612,704		339,575			15,952,279	
Outflow	(16,645,233)		(349,300)			(16,994,533)	
	(1,032,529)	0	(9,725)	0	0	(1,042,254)	1,282,341
Unrecognised financial items							
Loan commitments							
Inflow	212,618	442,930	2,307,256	776,847		3,739,651	
Outflow	(3,667,615)					(3,667,615)	
Financial guarantee contracts							
Inflow	103,265	63,000	222,017	417,808	33,840	839,930	
Outflow	(839,930)					(839,930)	
	(4,191,662)	505,930	2,529,273	1,194,655	33,840	72,036	

Summary						
Non-derivative assets	64,175,315	8,097,414	16,951,122	8,584,364	984,383	98,792,597
Derivative assets	757,442		203,226	35,840		996,508
Non-derivative liabilities	(42,702,489)	(19,911,550)	(20,536,797)	(4,621,191)	(2,373,122)	(90,145,149)
Derivative liabilities	(1,032,529)		(9,725)			(1,042,254)
Net assets (liabilities) excluding unrecognised items	21,197,739	(11,814,136)	(3,392,173)	3,999,012	(1,388,739)	8,601,702
Net unrecognised items	(4,191,662)	505,930	2,529,273	1,194,655	33,840	72,036
Net assets (liabilities)	17,006,077	(11,308,207)	(862,901)	5,193,667	(1,354,899)	8,673,738

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

49. Liquidity risk (cont.)

31.12.2018 **Financial assets by type**	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Gross inflow/ (outflow)**	**Carrying amount**
Non-derivative assets							
Cash and balances with Central Bank	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
Derivative assets							
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

Financial liabilities by type	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Gross inflow/ (outflow)**	**Carrying amount**
Non-derivative liabilities							
Deposits from customers	(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
Derivative liabilities							
Inflow	12,213,045	510,776	399,690			13,123,511	
Outflow	(12,728,897)	(525,531)	(420,750)			(13,675,178)	
	(515,852)	(14,755)	(21,060)	0	0	(551,667)	593,934
Unrecognised financial items by type							
Loan commitments							
Inflow	505,137	1,014,347	1,417,147	601,431		3,538,062	
Outflow	(3,462,935)					(3,462,935)	
Financial guarantee contracts							
Inflow	923,074					923,074	
Outflow	(923,074)					(923,074)	
	(2,957,798)	1,014,347	1,417,147	601,431	0	75,127	
Summary							
Non-derivative assets	53,049,993	6,650,536	16,472,465	8,003,541	508,769	84,685,303	
Derivative assets	965,654	972	46,376	150,309		1,163,311	
Non-derivative liabilities	(35,475,008)	(22,484,990)	(10,665,961)	(5,464,964)	(2,514,219)	(76,605,142)	
Derivative liabilities	(515,852)	(14,755)	(21,060)			(551,667)	
Net assets (liabilities) excluding unrecognised items	18,024,787	(15,848,237)	5,831,820	2,688,886	(2,005,450)	8,691,805	
Net unrecognised items	(2,957,798)	1,014,347	1,417,147	601,431		75,127	
Net assets (liabilities)	15,066,989	(14,833,890)	7,248,967	3,290,317	(2,005,450)	8,766,933	

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

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

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

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

50. Market risk

a. Definition
Market risk constitutes risk due to changes in the market prices of financial instruments and comprises interest rate risk, currency risk and other price risk. Notes 51-56 relate to market risk exposure.

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

51. Interest rate risk

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

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

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

52. Interest rate risk associated with trading portfolios

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

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	31.12.2019
Fixed income securities		2,832,280	22,712	2,533,636	2,708,542	8,097,169
Short positions - fixed income securities				(1,137,103)	(102,813)	(1,239,916)
Net imbalance	0	2,832,280	22,712	1,396,533	2,605,729	6,857,253

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	31.12.2018
Fixed income securities		17,913	999,491	1,561,987	2,547,944	5,127,335
Short positions - fixed income securities				(755,454)	(49,880)	(805,334)
Net imbalance	0	17,913	999,491	806,534	2,498,063	4,322,001

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

	Shift in basis points		31.12.2019		31.12.2018
		Downward	Upward	Downward	Upward
Indexed	50	117,650	(117,650)	70,216	(70,216)
Non-indexed	100	64,121	(64,121)	69,481	(69,481)
Total		181,771	(181,771)	139,697	(139,697)

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

53. Interest rate risk associated with non-trading portfolios

a. Breakdown

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

31.12.2019

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	23,861,681	2,956,550				26,818,231
Loans to customers	23,951,507	1,148,549	3,010,619	647,975	1,346,993	30,105,643
Financial assets excluding derivatives	47,813,188	4,105,100	3,010,619	647,975	1,346,993	56,923,874
Effect of derivatives	27,334,633		2,500,000	600,000		30,434,633
Total	75,147,821	4,105,100	5,510,619	1,247,975	1,346,993	87,358,507

Financial liabilities	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Deposits from customers	51,479,732					51,479,732
Borrowings	2,417,672	7,463,302	12,177,773			22,058,747
Issued bills		1,982,430	1,962,876			3,945,306
Issued bonds	39,974	633,194	2,124,611	1,463,529		4,261,308
Subordinated liabilities			1,184,146	815,383		1,999,530
Financial liabilities excluding derivatives	53,937,378	10,078,925	17,449,406	2,278,912	0	83,744,622
Effect of derivatives	3,104,224					3,104,224
Total	57,041,603	10,078,925	17,449,406	2,278,912	0	86,848,846
Total interest repricing gap	18,106,219	(5,973,826)	(11,938,788)	(1,030,938)	1,346,993	509,660

31.12.2018

Financial assets	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Cash and balances with Central Bank	17,867,444	3,471,741				21,339,185
Loans to customers	23,872,709	1,432,779	2,821,790	1,158,425	157,870	29,443,573
Financial assets excluding derivatives	41,740,153	4,904,520	2,821,790	1,158,425	157,870	50,782,758
Effect of derivatives	22,590,158	597,560	1,500,000	3,100,000		27,787,718
Total	64,330,311	5,502,080	4,321,790	4,258,425	157,870	78,570,476

Financial liabilities	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Total**
Deposits from customers	47,893,959					47,893,959
Borrowings	1,437,087	8,610,188	5,587,373			15,634,648
Issued bills		1,779,152	1,798,565			3,577,718
Issued bonds	266,454		399,725	2,494,035		3,160,215
Subordinated liabilities					1,947,511	1,947,511
Financial liabilities excluding derivatives	49,597,500	10,389,341	7,785,664	2,494,035	1,947,511	72,214,051
Effect of derivatives	4,607,104					4,607,104
Total	54,204,604	10,389,341	7,785,664	2,494,035	1,947,511	76,821,155
Total interest repricing gap	10,125,707	(4,887,261)	(3,463,874)	1,764,389	(1,789,641)	1,749,321

b. Sensitivity analysis

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

	Shift in		**31.12.2019**		**31.12.2018**
Currency	**basis points**	**Downward**	**Upward**	**Downward**	**Upward**
ISK, indexed	50	26,255	(24,900)	11,837	(11,614)
ISK, non-indexed	100	(85,240)	78,636	(42,882)	41,861
Other currencies	20	(1,141)	175	(2,228)	1,157
Total		(60,126)	53,912	(33,273)	31,404

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

54. Exposure towards changes in the CPI

a. Definition

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

The Group is exposed to inflation indexation of assets and liabilities denominated in ISK. All indexed assets and liabilities are valued according to the CPI measure at any given time and changes in CPI are recognised in the income statement.

b. Management

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

c. Balance of CPI linked assets and liabilities

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

	31.12.2019	31.12.2018
Assets	10,676,860	7,180,237
Liabilities	(7,620,546)	(5,927,047)
Total	3,056,314	1,253,191

d. Sensitivity to changes in CPI

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

	31.12.2019		31.12.2018	
	-1%	1%	-1%	1%
Government bonds	(11,095)	11,095	(2,295)	2,295
Other fixed income securities	(25,248)	25,248	(20,049)	20,049
Loans to customers	(39,425)	39,425	(24,459)	24,459
Derivatives	(31,000)	31,000	(25,000)	25,000
Short positions	3,737	(3,737)	2,784	(2,784)
Deposits	54,469	(54,469)	46,487	(46,487)
Subordinated debt	18,000	(18,000)	10,000	(10,000)
	(30,563)	30,563	(12,532)	12,532

The effect on equity would be the same.

55. Currency risk

a. Definition

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

b. Management

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

The Group is subject to limits set by the Central Bank of Iceland regarding the maximum open currency position. At 31 December 2019 and 31 December 2018 the Group's position in foreign currencies was within those limits.

c. Exchange rates

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

	Closing 31.12.2019	Average 2019	Closing 31.12.2018	Average 2018
EUR/ISK	135.8	137.3	133.2	127.7
USD/ISK	121.1	122.7	116.3	108.4
GBP/ISK	159.4	156.5	148.3	144.4

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

55. Currency risk (cont.)

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

31.12.2019

Financial assets	**EUR**	**USD**	**GBP**	**CAD**	**Other currencies**	**Total**
Cash and balances with Central Bank	726,348	277,004	195,341	322,278	665,077	2,186,049
Fixed income securities	543,483	2,413,067			(0)	2,956,550
Shares and other variable income securities		181,624	1,020,161		1	1,201,786
Securities used for hedging	1,297,948					1,297,948
Loans to customers	444,945	106,074	863,985		16,616	1,431,619
Other assets	946,260	181,361	299,735		57,397	1,484,753
Financial assets excluding derivatives	3,958,984	3,159,129	2,379,222	322,278	739,091	10,558,704
Derivatives	1,319,461	888,608	19,221			2,227,290
Total	5,278,445	4,047,737	2,398,443	322,278	739,091	12,785,994

Financial liabilities	**EUR**	**USD**	**GBP**	**CAD**	**Other currencies**	**Total**
Deposits from customers	3,526,958	3,459,182	690,839	294,344	670,179	8,641,502
Borrowings	40,079					40,079
Issued bonds		301,738				301,738
Other liabilities	1,498,474	136,045	42,103		1,264	1,677,887
Financial liabilities excluding derivatives	5,065,512	3,896,965	732,942	294,344	671,443	10,661,206
Derivatives	165,895	78,811	1,594,200			1,838,907
Total	5,231,407	3,975,777	2,327,142	294,344	671,443	12,500,113

Net currency position	**EUR**	**USD**	**GBP**	**CAD**	**Other currencies**	**Total**
Financial assets	5,278,445	4,047,737	2,398,443	322,278	739,091	12,785,994
Financial liabilities	(5,231,407)	(3,975,777)	(2,327,142)	(294,344)	(671,443)	(12,500,113)
Financial guarantee contracts	67,915					67,915
Total	114,953	71,960	71,301	27,935	67,648	353,796

31.12.2018

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

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

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

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

55. 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.

	31.12.2019		31.12.2018	
Assets and liabilities denominated in foreign currencies	**-10%**	**+10%**	**-10%**	**+10%**
EUR	11,495	(11,495)	14,694	(14,694)
USD	7,196	(7,196)	10,028	(10,028)
GBP	7,130	(7,130)	1,401	(1,401)
CAD	2,793	(2,793)	760	(760)
NOK	2,651	(2,651)	(1,576)	1,576
Other currencies	4,114	(4,114)	10,293	(10,293)
Total	35,380	(35,380)	35,601	(35,601)

The effect on equity would be the same.

56. Other price risk

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

			31.12.2019			31.12.2018
	Average	**Max**	**Exposure**	**Average**	**Max**	**Exposure**
Listed shares	927,255	1,352,589	1,271,325	840,266	1,306,331	751,470
Unlisted shares	1,657,393	1,863,076	1,694,493	971,302	1,432,666	1,391,018
Unlisted unit shares	773,771	998,994	693,390	1,018,325	1,978,813	784,187
Total			3,659,208			2,926,675

57. Operational risk

a. Definition

Operational risk is the risk of direct or indirect loss from inadequate or failed internal processes or systems, from human error or external events that affect the Group's reputation and operational earnings.

b. Management

The individual business units within the Group are primarily responsible for managing their respective operational risk. The risk management unit is furthermore responsible for identifying, monitoring and reporting the Group's operational risk. Operational risk can be reduced through staff training, process re-design and enhancement of the control environment. The risk management unit monitors operational risk by tracking loss events, quality deficiencies, potential risk indicators and other early-warning signals. The unit takes an active role in internal control and quality management.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Financial assets and financial liabilities

58. Accounting classification of financial assets and financial liabilities

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

31.12.2019 **Financial assets**	**Amortised cost**	**Manda-torily at fair value through P/L**	**Total carrying amount**
Cash and balances with Central Bank	26,818,231		26,818,231
Fixed income securities		8,097,169	8,097,169
Shares and other variable income securities		3,659,208	3,659,208
Securities used for hedging		24,274,769	24,274,769
Loans to customers	27,758,981	2,346,662	30,105,643
Derivatives		1,259,833	1,259,833
Other assets	4,823,577		4,823,577
Total	59,400,789	39,637,640	99,038,429

Financial liabilities	**Amortised cost**	**Manda-torily at fair value through P/L**	**Total carrying amount**
Deposits from customers	51,479,732		51,479,732
Borrowings	22,058,747		22,058,747
Issued bills	3,945,306		3,945,306
Issued bonds	4,261,308		4,261,308
Subordinated liabilities	1,999,530		1,999,530
Short positions held for trading		1,239,916	1,239,916
Short positions used for hedging			0
Derivatives		1,282,341	1,282,341
Other liabilities	2,901,973	494,991	3,396,965
Total	86,646,596	3,017,248	89,663,844

31.12.2018 **Financial assets**	**Amortised cost**	**Manda-torily at fair value through P/L**	**Total carrying amount**
Cash and balances with Central Bank	21,339,185		21,339,185
Fixed income securities		5,127,335	5,127,335
Shares and other variable income securities		2,926,675	2,926,675
Securities used for hedging		21,526,794	21,526,794
Loans to customers	27,283,050	2,160,522	29,443,573
Derivatives		1,213,266	1,213,266
Other assets	1,941,070		1,941,070
Total	50,563,305	32,954,592	83,517,897

Financial liabilities	**Amortised cost**	**Manda-torily at fair value through P/L**	**Total carrying amount**
Deposits from customers	47,893,959		47,893,959
Borrowings	15,634,648		15,634,648
Issued bills	3,577,718		3,577,718
Issued bonds	3,160,215		3,160,215
Subordinated liabilities	1,947,511		1,947,511
Short positions held for trading		805,334	805,334
Derivatives		593,934	593,934
Other liabilities	1,610,323		1,610,323
Total	73,824,374	1,399,268	75,223,642

Notes to the Consolidated Financial Statements

59. 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.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

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

d. Fair value hierarchy classification

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

31.12.2019

Financial assets	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Mandatorily measured at fair value through profit and loss				
Fixed income securities	8,095,688		1,480	8,097,169
Shares and other variable income securities	1,665,665	227,472	1,766,071	3,659,208
Securities used for hedging	24,195,355	79,414		24,274,769
Loans to customers			2,346,662	2,346,662
Derivatives		1,259,833		1,259,833
Total	33,956,707	1,566,719	4,114,214	39,637,640

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Mandatorily measured at fair value through profit and loss				
Short positions held for trading	1,239,916			1,239,916
Short positions used for hedging				0
Derivatives		1,282,341		1,282,341
Other liabilities			494,991	494,991
Total	1,239,916	1,282,341	494,991	3,017,248

Transfers from Level 3 to Level 1 amounted to ISK 360 million during the year 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
Total	28,155,079	1,639,867	3,159,646	32,954,592

Financial liabilities	**Level 1**	**Level 2**	**Level 3**	**Carrying amount**
Mandatorily measured at fair value through profit and loss				
Short positions held for trading	805,334			805,334
Derivatives		593,934		593,934
Total	805,334	593,934	0	1,399,268

There were no transfers between levels during the year.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

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

e. Reconciliation of changes in Level 3 fair value measurements

31.12.2019	**Fixed income securities**	**Shares and other var. income securities**	**Loans to customers**	**Other liabilities**	**Total**
Balance as at 31 December 2018	134,944	864,180	2,160,522	0	3,159,646
Reclassification into Level 3 in accordance with IFRS 9			150,865		150,865
Total gains and losses in profit or loss	(133,463)	212,897	95,505	447,463	622,401
Purchases		1,652,385	592,385		2,244,770
Repayments			(652,615)	1,599,864	947,249
Acquisition of subsidiary		928,327		(2,542,318)	(1,613,991)
Sales		(1,531,253)			(1,531,253)
Transfers in (out) of Level 3		(360,466)			(360,466)
Balance as at 31 December 2019	1,480	1,766,071	2,346,662	(494,991)	3,619,222

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

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

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

Asset class	**Method**	**Significant unobservable input**	**Range**	**Book value 31.12.2019**
Unlisted bonds	Expected recovery	Value of assets	0-5%	1,480
Unlisted shares	Market price	Recent trades	-	1,766,071
Loans to customers	Expert model	Value of assets and collateral	-	2,346,662
Total				4,114,214

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

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

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	176,607	(176,607)
Loans to customers	234,666	(234,666)
Total	411,273	(411,273)

Notes to the Consolidated Financial Statements

60. Financial assets and financial liabilities not measured at fair value

The Group holds financial instruments which are not measured at fair value. Except for loans to customers, the Group believes that the best estimate of the fair value of these financial instruments is equal to the carrying amount at the reporting date and does therefore not report a fair value for these financial instruments. Loans to customers measured at amortised cost are classified as level 3, in the fair value hierarchy, and have a book value of ISK 27,759 million at end of December 2019. The estimated fair value of loans to customers measured at amortised cost at end of December 2019 is ISK 27,380 million.

Cash and balances with Central Bank includes several components as detailed in note 18. These assets are either balances available on-demand or on very short notice, or other assets easily converted to cash. Other financial assets consist primarily of short-term receivables. The carrying amount of these assets is therefore a reasonable approximation of their fair value.

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

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Segment information

61. Business segments

Segment reporting is based on the same principles and structure as internal reporting to senior management and the Board of Directors. Segment performance is evaluated on profit before cost allocation and tax.

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

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

Information about other divisions of the Bank, e.g. non-revenue generating divisions, is presented under the heading Support functions and eliminations.

2019	Corporate Banking	Corporate Finance	Capital Markets	Proprietary trading and Treasury	Asset Management	Support functions and eliminations	Total
Net interest income	1,581,631	(232)	242,195	36,511	(106,745)	22,561	1,775,921
Net fee and commission income	598,836	462,903	825,149	120,504	2,925,112	(128,282)	4,804,222
Net financial income	79,693	0	(11,276)	393,708	(16,283)	222,357	668,199
Share in profit of associates	(6,586)	0	0	0	38,568	0	31,982
Other operating income (expense)	90,720	0	187	2,521	202,429	(150,545)	145,313
Net operating income	2,344,294	462,671	1,056,254	553,244	3,043,082	(33,908)	7,425,637
Salaries and related expenses	(246,380)	(232,412)	(247,806)	(171,887)	(1,139,688)	(1,298,522)	(3,336,695)
Other operating expenses	(411,951)	(26,338)	(79,111)	(63,534)	(576,804)	(564,271)	(1,722,009)
Net impairment	(204,782)	(23,145)	(22)	0	(124,548)	38,948	(313,548)
Revaluation of investment properties	0	0	0	0	0	0	0
Revaluation of contingent consideration	0	0	0	0	447,463	0	447,463
Profit (loss) before cost allocation and tax	1,481,181	180,776	729,316	317,823	1,649,505	(1,857,753)	2,500,848
Net segment revenue from external customers	1,753,749	403,238	2,305,225	(76,473)	3,034,806	5,092	7,425,637
Net segment revenue from other segments	590,544	59,433	(1,248,971)	629,717	8,276	(39,000)	0

2018	Corporate Banking	Corporate Finance	Capital Markets	Proprietary trading and Treasury	Asset Management	Support functions and eliminations	Total
Net interest income	1,526,894	(4,010)	162,089	(15,676)	4,179	27,381	1,700,857
Net fee and commission income	622,501	579,018	671,971	73,711	1,919,013	(168,534)	3,697,680
Net financial income	224,551	212	1,365	285,490	10,278	(288)	521,609
Share in loss of discontinued operations	0	0	0	0	0	0	0
Share in profit of associates	(301,863)	0	0	0	(1,086)	0	(302,949)
Other operating income (expense)	91,351	26	79	2,039	30,130	(36,319)	87,305
Net operating income	2,163,434	575,246	835,503	345,564	1,962,514	(177,759)	5,704,502
Salaries and related expenses	(219,882)	(291,232)	(334,743)	(167,892)	(726,716)	(997,198)	(2,737,663)
Other operating expenses	(329,799)	(57,109)	(78,178)	(42,358)	(271,844)	(491,838)	(1,271,126)
Net impairment	19,303	(17,562)	(504)	0	(532)	(16,100)	(15,395)
Revaluation of investment properties	114,582	0	0	0	0	0	114,582
Profit (loss) before cost allocation and tax	1,747,637	209,343	422,078	135,314	963,423	(1,682,895)	1,794,900
Net segment revenue from external customers	1,662,509	545,246	1,808,166	(75,420)	1,936,760	(172,759)	5,704,502
Net segment revenue from other segments	500,924	30,000	(972,663)	420,984	25,754	(5,000)	(0)

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

Other information

62. Pledged assets

The Group has pledged assets, in the ordinary course of banking business, to the Central Bank of Iceland to the amount of ISK 2.7 billion as at 31 December 2019 (2018: ISK 2.7 billion) to secure settlement in the Icelandic clearing systems. Further pledges have been placed in the ordinary course of banking business for netting and set-off arrangements in the total amount of ISK 0.7 billion as at 31 December 2019 (2018: ISK 0.9 billion).

63. 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 25, 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

31.12.2019	**Loans & receivables**	**Deposits & payables**
Management	354	40,296
Associates	208,278	2,995,554
Total	208,632	3,035,851

31.12.2018	**Loans & receivables**	**Deposits & payables**
Management	79,231	212,291
Associates	7,450	3,004,717
Total	86,681	3,217,008

d. Effects on income statement

2019	**Interest income**	**Interest expense**	**Fees received**	**Fees paid**
Management	4,095	2,784	2,712	15,705
Associates	1,972	53,424	53,480	0
Total	6,067	56,208	56,192	15,705

2018	**Interest income**	**Interest expense**	**Fees received**	**Fees paid**
Management	6,770	3,608	3,070	10,603
Associates	9,842	103,908	43,527	0
Total	16,612	107,517	46,597	10,603

Further information about salaries and benefits paid to the Board of Directors, the CEO and Managing Directors is provided in note 11.

64. Remuneration policy

The Board of Directors has adopted a remuneration policy at the proposal of the Remuneration Committee. The Bank's Annual General Meeting approved the Bank's current remuneration policy in March 2019. The Board of Directors will submit an updated remuneration policy to the Bank's Annual General Meeting for approval in March 2020.

The remuneration policy conforms to Article 57 of Act No. 161/2002 on Financial Undertakings, Act No. 2/1995 on Public Limited Companies and the Icelandic FSA's rules No. 388/2016 on Incentive Schemes. A more detailed description of the policy can be found on the Bank's website, www.kvika.is.

Notes to the Consolidated Financial Statements

65. Incentive scheme

The Board of Directors has approved a performance based incentive scheme at the proposal of the Remuneration Committee. The scheme forms a part of the remuneration policy adopted by the Bank.

a. Description

The incentive scheme conforms to the Icelandic FSA's directive No. 388/2016 on Incentive Schemes. Payments according to the scheme are based on key performance indicators (KPIs) that reflect the goals of the Bank, the division and the employee. The basis for performance based pay reflects sound risk management and does not induce excessive risk taking. Performance based pay to individual employees shall not exceed 25% of their annual salary and 40% of the performance based pay shall be deferred for three years. Performance based pay that does not exceed 10% of annual salary is not subject to deferral. A more detailed description of the scheme can be found in the Bank's remuneration policy on it's website, www.kvika.is.

b. Performance based payments through profit and loss

	2019 Cash	2018 Cash
Non-deferred	92,635	18,875
Deferred	4,120	10,950
Salary related expenses	26,986	9,281
Cancelled deferred performance based payments	0	(5,627)
Total	123,741	33,479

c. On-balance sheet deferred performance based payments

	31.12.2019	31.12.2018
Deferred cash payments	24,652	19,348
Deferred cash payments, acquired via business combinations	68,743	35,461
Total	93,395	54,809

66. Share-based payments

During 2017, in accordance with a remuneration policy from that year, the Bank granted stock options based on a stock options plan which was set up in accordance with article 10 in law 90/2003 on income tax. The Board of Directors is authorised to increase the share capital of the Bank, in accordance with the Articles of Association, to fulfil any obligations arising from the scheme. No further stock options have been granted based on the aforementioned plan and the current remuneration policy does not include provision for such stock options.

a. Description

The average weighted exercise price is equal to 5.58 per share with a per annum increase of 5%. The options were issued to most employees, taking into consideration the conditions set out in the Bank's remuneration policy at the time, and the total nominal amount issued amounts to 8,543,799 shares. The options do not allow for cash settlement and vest evenly over 36 months following signing. The options are conditional on the employee remaining employed by the Bank and various other conditions which meet demands set by the Financial Supervisory Authority.

b. Movements in the number of stock options outstanding and their related weighted average exercise prices

The grant date fair value of the options granted through the scheme was as follows:

	Average exercise price per share	Stock options (thousands)
At 1 January 2018	5.58	8,544
Granted in 2018	0.00	0
Exercised in 2018	0.00	0
At 31 December 2018	5.94	8,544
Granted in 2019	0.00	0
Exercised in 2019	0.00	0
At 31 December 2019	6.24	8,544
Exercisable stock options at 31 December 2019	0.00	0

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

67. Shareholders of the Bank

Shareholder	Country	31.12.2019 %	31.12.2018 %	Beneficial owners
Lífeyrissjóður verzlunarmanna	Iceland	8.77%	9.49%	
K2B fjárfestingar ehf.	Iceland	6.69%	7.70%	Svanhildur Nanna Vigfúsdóttir (100%)
Arion banki hf.	Iceland	6.40%	4.91%	
Íslandsbanki hf.	Iceland	5.22%	4.26%	
Vátryggingafélag Íslands hf.	Iceland	4.71%	8.66%	
Landsbankinn hf.	Iceland	3.78%	0.00%	
Lífsverk lífeyrissjóður	Iceland	3.11%	3.58%	
Sindrandi ehf.	Iceland	3.10%	2.48%	Bogi Þór Siguroddsson (50%), Linda Björk Ólafsdóttir (50%)
Almenni lífeyrissjóðurinn	Iceland	2.54%	0.12%	
Lífeyrissj.starfsm.rík. A-deild	Iceland	2.19%	0.64%	
Frjálsi lífeyrissjóðurinn	Iceland	2.02%	1.43%	
Eignarhaldsfélagið VGJ ehf.	Iceland	1.66%	1.45%	Eiríkur Vignisson (90%), Sigríður Eiríksdóttir (10%)
Landsbréf - Úrvalsbréf	Iceland	1.56%	1.27%	Investement fund managed by Landsbréf hf.
MK 4 ehf.	Iceland	1.55%	1.68%	Sigfinna Lóa Skarphéðinsdóttir (36%), Elfa Ágústa Magnúsdóttir (16%), Héðinn Karl Magnússon (16%), Magnús Berg Magnússon (16%), Þóra Magnúsdóttir (16%)
Titania ehf.	Iceland	1.49%	1.79%	Berglind Björk Jónsdóttir (100%)
Birta lífeyrissjóður	Iceland	1.48%	1.01%	
A.C.S safnreikningur I	Iceland	1.43%	-	
Miðeind ehf	Iceland	1.25%	1.36%	Vilhjálmur Þorsteinsson (100%)
Fagfjárfestasjóðurinn TRF	Iceland	1.25%	0.38%	
Stekkur fjárfestingarfélag ehf	Iceland	1.03%	1.12%	Kristinn Aðalsteinsson (100%)
Júpíter - Innlend hlutabréf	Iceland	1.03%	-	Investement fund managed by Júpíter rekstrarfélag hf.
Others, each less than 1%		35.22%	46.68%	2019: 804, 2018: 714
		97.49%	100.00%	
Treasury shares		2.51%	0.00%	
Issued share capital		100.00%	100.00%	

Beneficial owners are defined as owners holding a share of 10% or greater, directly or indirectly. The information presented is, among other things, based on publicly available information.

68. Events after the reporting date

There are no material events after the reporting date.

Notes to the Consolidated Financial Statements

Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these Consolidated Financial Statements, and have been applied consistently by Group entities.

69. Basis of consolidation

a. Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Group reassesses its relationship with an entity when there is a change in one or more of the elements of control.

b. Business combinations

The Group uses the acquisition method to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value, at the date of exchange, of the assets given, liabilities incurred or assumed and equity instruments issued. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest.

The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recognised as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised immediately in the income statement.

Any contingent consideration is measured at fair value at the date of acquisition. If an obligation to pay contingent consideration that meets the definition of a financial instrument is classified as equity, then it is not remeasured and settlement is account for within equity. Otherwise, other contingent consideration is remeasured at fair value at each reporting date and subsequent changes in the fair value of the contingent consideration are recognised in profit and loss.

c. Non-controlling interest

Non-controlling interest represent the portion of profit or loss and equity not owned, directly or indirectly, by the Bank. Non-controlling interest is presented separately in the income statement and is included in equity in the statement of financial position, separately from equity attributable to owners of the Bank.

The Group chooses on an acquisition-by-acquisition basis whether to measure non-controlling interest in an acquiree at fair value or according to the proportion of non-controlling interests in the acquiree's net assets. Changes in the Bank's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions. In such circumstances the carrying amounts of the controlling and non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interest is adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Bank.

d. Fiduciary services

The Group provides custody services, fund management and discretionary and advisory investment management services which require the Group to make decisions on the handling, acquisition or disposal of financial instruments on behalf of its clients.

The financial statements of managed funds and investment portfolios managed by the Group on behalf of customers are not included in the financial statements, as they do not constitute assets or liabilities of the Group.

e. Transactions eliminated on consolidation

Intra-bank balances, income and expenses, and unrealised gains and losses arising from intra-bank transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates are eliminated against the investment to the extent of the Group's interest in the associate. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

f. Structured entities

Structured entities are entities that have been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

The Group acts as investment manager or investment advisor, for example, to a number of investment funds operated by the fund management companies Júpíter rekstrarfélag hf. and Rekstrarfélag Virðingar hf. The purpose of these fund management companies is to generate fees from managing assets on behalf of third-party investors by providing investment strategies. These investment funds are financed through the issue of units to investors. The Group has no contractual obligation to provide financial support to these structured entities.

From time to time, the Group makes seed capital investments in certain fund products in order to establish track records for new products, to test new investment strategies or to launch new products at a viable minimum size.

The Group has set up a formal procedure to assess whether or not to consolidate investment funds managed and administered by the Group on behalf of its customers and other investors in the consolidated financial statements. As part of this assessment, the Group reviews all facts and circumstances including the purpose and design of the investment fund, to determine whether the Group, as fund manager, is acting as agent or principal. The Group is deemed to be a principal when the Group acts as fund manager and cannot be removed without cause, has variable returns through significant holdings and is able to influence the returns of the funds by exercising its power.

Notes to the Consolidated Financial Statements

70. Foreign currency

a. Foreign currency transactions
Transactions in foreign currencies are translated into the functional currency of the respective Group's entity using the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to the functional currency using the exchange rate at the reporting date. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated using the exchange rate at the date the fair value was determined.

Foreign currency differences are posted as a separate line item under net financial income as disclosed in notes 7 and 73.

b. Foreign operations
The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into the functional currency at spot exchange rate current at the reporting date. The income and expenses of foreign operations are translated into the functional currency at the spot exchange rates at the dates of the transactions.

Translation differences on foreign operations are presented as a separate category in the statement of changes in equity.

71. Interest income and expense

Effective interest rate
Interest income and expense are recognised in the income statement using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial instrument to the gross carrying amount of the financial asset or the amortised cost of the financial liability. When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Group estimates future cash flows considering all contractual terms of the financial instrument but not ECL. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including ECL.

Amortised cost and gross carrying amount
The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance. The gross carrying amount of a financial asset is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

Presentation
Interest income and expense presented in the income statement includes interest on:
- financial assets measured at amortised cost
- financial liabilities measured at amortised cost
- derivatives

72. Fee and commission income and expense

The Group earns income from providing various services to its customers. This includes fees for managing assets on behalf of customers, commissions received for equity and bond transactions and fees and commissions for various other financial services. Fee and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.
Fee and commission income and expense are recognised in the income statement when an agreement with a customer meets all of the following criteria:
- the parties to the contract have approved the contract and are committed to perform their respective obligations
- performance obligations have been established for services to be transferred
- the payment terms have been established for the services to be transferred
- the transaction price can be allocated to each individual service in the agreement
- it is probable that a consideration will be collected in exchange for the services that will be transferred to the customer

The following applies to recognition of income for various types of fees and charges:
- Fees that are earned gradually as the services are performed, such as management fees in asset management, are recognised as income at the rate these services are delivered. In practice, these are on a straight line basis
- Fees attributable to a specific service or action are recognised as income when the service has been performed. Examples of such fees are brokerage and payment commissions

Notes to the Consolidated Financial Statements

73. Net financial income

Net financial income comprises the following:
- Realised and unrealised gains or losses from price changes of fixed income securities measured at fair value
- Realised and unrealised gains or losses from price changes of variable income securities
- Interest income from fixed income securities carried at fair value through profit or loss
- Dividends
- Fair value changes in derivatives
- Foreign exchange difference

74. Dividend income

Dividend income is recognised when the right to receive income is established. Usually this is the ex-dividend date for equity securities. Dividends are presented as a component of net financial income.

75. Administrative expenses

Administrative expenses comprise expenses other than interest expenses, fee and commission expenses and expenses related to fair value changes. A breakdown of administrative expenses is provided in note 9.

76. Employee benefits

a. Short-term employee benefits
Short-term employee benefits obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

b. Defined contribution plans
Obligations for contributions to defined contribution plans are expensed in profit or loss as the related service is provided. The Group has no further obligations once those contributions have been paid.

c. Share-based payments
Equity-settled share-based payments to employees are measured at the fair value of the equity instruments at grant date. The grant date fair value of equity-settled share-based payment awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market performance conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that meet the related service and non-market performance conditions at the vesting date.

77. Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, except to the extent that it relates to items recognised directly in other comprehensive income or equity, in which case it is recognised there.

Current tax liabilities include the estimated tax payable next year on current year's profit according to the tax rates prevailing at reporting date, in addition to corrections on tax from previous years.

The deferred income tax asset and/or liability has been calculated and recognised in the statement of financial position. The calculation is based on the difference between assets and liabilities as presented in the tax return on the one hand, and in the consolidated financial statements on the other, taking into consideration tax losses carried forward. This difference is due to the fact that the tax assessment is based on premises that differ from those governing the financial statements, mostly due to temporary differences arising from the recognition of revenue and expense in the tax returns and in the financial statements.

Deferred tax assets and tax liabilities are offset in the statement of financial position when there is a legal right to settle on a net basis and they are levied by the same taxing authority on the same entity or on different entities subject to joint taxation.

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

Notes to the Consolidated Financial Statements

78. Financial assets and financial liabilities

a. Recognition

The Group initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated. All other financial assets and liabilities are initially recognised on the trade date, which is the date when the Group becomes a party to the contractual provisions of the instrument.

b. Classification

Financial assets

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

Financial assets at amortised cost

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

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

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

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

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

Business model assessment

The Group makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way

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

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

Cash flow characteristics assessment

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

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

Reclassifications

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

Notes to the Consolidated Financial Statements

78. Financial assets and financial liabilities (cont.)

Financial liabilities
The Group's financial liabilities are classified into one of two measurement categories, i.e. at amortised cost or at fair value through profit or loss. Financial liabilities held for trading are measured at fair value through profit or loss, all other financial liabilities are measured at amortised cost. Financial liabilities measured at amortised cost are initially recognised at fair value, which is typically equal to cost, i.e. cash advanced less any transaction costs. They are subsequently measured at amortised cost using the effective interest method. Accrued interest, in the case of interest bearing liabilities is included in the carrying amount. Interest expense is recognised in net interest income.

Derecognition

Financial assets
A financial asset is derecognised when the contractual rights to the cash flows from the asset expire, or when the Group enters into a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

The Group enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised. Examples of such transactions are securities lending and sale and repurchase agreements.

Financial liabilities
Financial liabilities are derecognised when the obligation of the Group is discharged, cancelled or expires.

79. Offsetting

Financial assets and liabilities are offset, and the net amount reported in the statement of financial position, when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis for gains and losses arising from a group of similar transactions, such as in the Group's trading activity, or other circumstances permitted by International Financial Reporting Standards.

80. Determination of fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk. When available, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction. For further information on valuation techniques, refer to notes 59 - 60.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Group determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

Notes to the Consolidated Financial Statements

81. Impairment

Expected Credit Loss

The Group recognises loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

- debt instruments measured at amortised cost;
- contract assets;
- loan commitments issued; and
- financial guarantee contracts issued.

The Group estimates an ECL for each of these types of assets or exposures. However, IFRS 9 specifies three different approaches depending on the type of asset or exposure:

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

The general approach

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

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

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

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

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

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

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

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

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

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

Notes to the Consolidated Financial Statements

81. Impairment (cont.)

Expected credit losses

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

12 month expected credit losses

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

Lifetime expected credit losses

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

Definition of default

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

The Risk Management department can manually override automatic default triggers if the following applies:
- the reason for reported default triggers is known to the Bank and not considered to be lack of willingness or ability to pay.
- re-financing of borrower’s exposures is expected and has been confirmed.

Probability of default and credit risk rating

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

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

Notes to the Consolidated Financial Statements

81. Impairment (cont.)

Significant increase in credit risk

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

Quantitative SICR assessment

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

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

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

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

Qualitative SICR assessment

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

Exposure at default

Lifetime definition

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

Committed facilities

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

Expected credit loss measurement

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

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

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

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

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

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

81. Impairment (cont.)

Forward looking probability weighted scenarios

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

The following table shows key macroeconomic variables used in modelling the allowance for credit losses. Projections for the base case scenario, upside and downside scenarios are averages for the next 12 months.

		Scenarios	
2020	**Base case**	**Upside**	**Downside**
GDP growth	1.5%	4.1%	0.6%
Inflation rate	2.5%	3.5%	3.0%
Unemployment rate	4.0%	3.2%	4.5%

82. Cash and balances with Central Bank

Cash and balances with Central Bank include notes and coins on hand, balances held with the Central Bank and other financial institutions, and highly liquid financial assets with original maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their fair value, and are used by the Group in the management of its short-term commitments.

Cash and balances with Central Bank are carried at amortised cost in the statement of financial position.

83. Fixed income securities

Fixed income securities are initially measured at fair value and subsequently accounted for depending on their classification as discussed in note 78.

84. Shares and other variable income securities

Shares and other variable income securities consist of equity investments and unit shares in mutual funds. Shares and other variable income securities are initially measured at fair value and subsequently accounted for depending on their classification as discussed in note 78.

85. Securities used for hedging

Securities used for hedging consist of non-derivative financial assets that are used to hedge the Group's exposure arising from derivative contracts with customers. Securities used for hedging are measured at fair value as discussed in note 78.

86. Loans to customers

Loans are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and include loans provided by the Group to its customers, participation in loans from other lenders and purchased loans that are not quoted in an active market and which the Group has no intention of selling immediately or in the near future.

Loans are initially recognised at fair value, which is the cash advanced, plus any transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the loans and advances. The carrying amount of impaired loans is reduced through the use of an allowance account.

When the Group purchases a financial asset and simultaneously enters into an agreement to resell the asset, or a substantially similar asset, at a fixed price at a future date ("reverse repo" or "stock borrowing"), the arrangement is accounted for as a loan and the underlying asset is not recognised in the Group's statement of financial position.

Notes to the Consolidated Financial Statements

87. Derivatives

A derivative is a financial instrument or another contract that falls under the scope of IFRS 9 and generally has the following three characteristics:

- Its value changes due to changes in an underlying variable, such as bond price, share price, security or price index (including CPI), foreign currency exchange rate or interest rate
- The contract requires no initial investment or an initial investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors
- Settlement takes place at a future date

The Group uses derivatives for trading purposes and to hedge its exposure to market price risk, foreign exchange risk and inflation and interest risk arising from operating, financing and investing activities. The Group does not apply hedge accounting.

Derivative assets and liabilities are initially recognised and subsequently measured at fair value in the statement of financial position. Derivatives with positive fair values are classified as financial assets and derivatives with negative fair values as financial liabilities. Revenue from derivatives is split into interest income and net income from financial instruments at fair value and presented in the corresponding line items in the income statement.

88. Investment properties

An investment property is an asset which is specified for leasing to third parties, for returns or for both purposes. Investment properties are initially recognised at cost and subsequently measured at fair value. Changes in fair value are recognised as gains or loss in the income statement.

89. Intangible assets

a. Asset categories
The Group groups intangible assets into three categories:

- Software
  Software comprise acquired software licences and external costs associated with the development of bespoke applications.
- Goodwill
  Goodwill arises in business combinations. It is recognised as of the acquisition date and measured as the aggregate of (a) the fair value of the consideration transferred, (b) the recognised amount of any non-controlling interest in the acquiree, and (c) the fair value of any previously held equity interest in the acquiree, less the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as at the acquisition date. The consideration transferred includes the fair value of assets transferred, liabilities incurred and equity interests issued by the Group. In addition, consideration transferred includes the fair value of any contingent consideration.
- Other intangible assets
  Other intangible assets comprise licences and acquired trademarks used in the operation of the Group.

The Group has not defined any internally generated intangible assets.

b. Initial recognition
Intangible assets are initially recognised at cost.

c. Subsequent measurement
The Group uses the cost model for measurement after recognition and intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Intangible assets are reviewed for indications of impairment or changes in estimated future economic benefits at each reporting date. If such indications exist, then the asset's recoverable amount is estimated. Goodwill is tested annually for impairment.

For impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that is largely independent of the cash inflows of other assets or cash generating units (CGUs). Goodwill arising from a business combination is allocated to CGUs or groups of CGUs that are expected to benefit from the synergies of the combination.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. Value in use is based on the estimated future cash flows, discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

An impairment loss is recognised if the carrying amount of an asset or CGU exceeds its recoverable amount.

Impairment losses are recognised in profit or loss. They are allocated first to reduce the carrying amount of any goodwill allocated to the CGU, and then to reduce the carrying amounts of the other assets in the CGU on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. For other assets, an impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Kvika Amounts are in ISK thousands

Notes to the Consolidated Financial Statements

89. Intangible assets (cont.)

d. Amortisation

Intangible assets with finite useful life are amortised using the straight-line method over their estimated useful economic life, with the amortisation recognised in the income statement. The estimated useful life of intangible assets is as follows:

Software	5-10 years
Other intangible assets with finite useful life	10 years

Depreciation of property and equipment and amortisation of intangible assets are presented together as a separate line item in administrative expenses as disclosed in note 9. Further breakdown on depreciation of intangible assets is provided in note 28.

90. Property and equipment

a. Asset categories

The Group groups tangible assets into two categories:

- Real estate, which includes office and residential buildings, land and building rights
- Other property and equipment, which includes automobiles, furniture and fixtures, computers and other office equipment

b. Initial recognition

Property and equipment is initially recognised at cost, which includes direct expenses related to the purchase.

c. Subsequent measurement

The Group uses the cost model for the measurement after recognition and property and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses. Property and equipment is reviewed for indications of impairment or changes in estimated future economic benefits at each reporting date. If such indications exist, the assets are analysed to assess whether their carrying amount is fully recoverable.

d. Subsequent cost

The Group recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. The decision, if subsequent costs are added to the acquisition cost of property and equipment, is based on whether an identified component, or part of such component, has been replaced or not, or if the nature of the subsequent cost means a contribution of a new component. All other costs are expensed in the income statement when incurred.

e. Depreciation

Depreciation is recognised in the income statement on a straight-line basis over the estimated useful lives of each component of an item of property and equipment. The estimated useful lives are as follows:

Real estate	15-50 years
Other property and equipment	3-5 years

Where parts of an item of property and equipment have different useful lives, those components are accounted for separately.

91. Investments in associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence generally exists when the Group holds between 20% and 50% of the voting power, including potential voting rights, if any. Investments in associates are initially recognised at cost.

The Group's share of the total recognised gains and losses of associates is included in the financial statements of the Group on an equity accounted basis, from the date the significant influence commences until the date it ceases.

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

Notes to the Consolidated Financial Statements

92. Other assets

Other assets are measured at amortised cost.

93. Assets classified as held for sale

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets are remeasured in accordance with the Group's accounting policies. Thereafter the assets are measured at the lower of their carrying amount and fair value less cost to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

94. Deposits from customers

Deposits consist of time deposits and demand deposits. Money market deposits are included in borrowings. Deposits are recognised at amortised cost, including accrued interest.

95. Borrowings

Borrowings are mostly comprised of money market deposits. They are initially recognised at fair value less attributable transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in their carrying amount.

When the Group sells a financial asset and simultaneously enters into an agreement to repurchase the asset, or a substantially similar asset, at a fixed price at a future date ("repo" or "stock lending"), the arrangement is accounted for as a borrowing and the underlying asset continues to be recognised in the Group’s statement of financial position.

96. Issued bills

Issued bills are initially recognised at fair value less attributable transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in their carrying amount.

97. Issued bonds

Issued bonds are initially recognised at fair value less attributable transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in their carrying amount.

98. Subordinated liabilities

Subordinated liabilities are initially recognised at fair value less attributable transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in their carrying amount.

99. Short positions held for trading

Short positions are obligations of the Group to deliver financial assets borrowed by the Group and sold to third parties. Short positions are carried at fair value through profit or loss with all fair value changes recognised in the income statement under net financial income.

100. Other liabilities

Other liabilities are measured at amortised cost.

101. Right of use asset and lease liability

The Group assesses whether a contract is or contains a lease, at inception of the contract. The Group recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases and leases of low value assets. For these leases, the Group recognises the lease payments as an operating expense on a straight-line basis over the term of the lease. The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by using the Group's incremental borrowing rate. The right-of-use assets comprise the initial measurement of the corresponding lease liability. They are subsequently measured at cost less accumulated depreciation.

102. Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value. The guarantee liability is subsequently measured at the higher of the loss allowance determined in accordance with IFRS 9 and the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15. Liabilities arising from financial guarantees are included with provisions.

Notes to the Consolidated Financial Statements

103. Share capital

a. Treasury shares
Acquired own shares and other equity instruments (treasury shares) are deducted from equity. No gain or loss is recognised in income statement on the purchase, sale, issue or cancellation of treasury shares. Consideration paid or received is recognised directly in equity. Incremental transaction costs of treasury share transactions are accounted for as a deduction from equity, net of any related income tax benefit.

b. Share premium
Share premium represents excess of payment above nominal value (ISK 1 per share) that shareholders have paid for shares sold by the Group.

c. Dividends on share capital
Dividends on share capital are deducted from equity in the period in which they are approved by the Group's shareholders meetings.

104. Nature and purpose of equity reserves

a. Option reserve
The option reserve represents the cumulative charge to the income statement for options to purchase shares in the Bank granted under the Bank's Remuneration policy, which is discussed in notes 64-66.

b. Warrants reserve
The warrants reserve represents the consideration received for outstanding warrants, as disclosed in note 39.

c. Deficit reduction reserve
The deficit reduction reserve was created as a part of a share capital reduction approved by the Bank's Annual General Meeting in April 2014. The reserve has no specified purpose and can only be used with the approval of a shareholders' meeting.

d. Translation reserve
The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations, until the operations are sold, dissolved or abandoned.

e. Restricted retained earnings
According to the Financial Statements Act No. 3/2006 the difference between share of profit of subsidiary or associate in excess of dividend payment or dividend payment pending, shall be transferred to a restricted retained earnings reserve, net of tax, which is not subject to dividend payments. When shareholding in subsidiary or associate is sold or written off the restricted retained earnings reserve shall be released and the amount transferred to retained earnings.

f. Accumulated deficit - retained earnings
Accumulated deficit (retained earnings if positive) consists of undistributed profits and losses accumulated, less transfers to other reserves.

105. Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss that is attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares, which comprise share options granted to employees and issued warrants.

106. New standards and interpretations

The Group has adopted amendments to existing standards which became effective for the first time in 2019. The amendments did not have a material effect on these financial statements.

A number of new standards, amendments to standards and interpretations were not yet effective for the year ended 31 December 2019 and have not been applied in the preparation of these financial statements. Early adoption of new standards and amendments is not planned.

No new standards, amendments or implementations with significant relevance to the Group will become effective during the next financial year.

Notes to the Consolidated Financial Statements

107. Use of estimates and judgements

In the process of applying the Group's accounting policies, management makes use of judgements and estimates which are based on various assumptions. These judgements and estimates can affect the reported amounts of assets and liabilities, income and expense.

Assumptions and estimates are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances, and are reviewed on an on-going basis. The estimates form the basis for judgements about the carrying value of assets and liabilities that are not readily available from other sources and actual results may differ. Judgement may also be required in circumstances not involving estimates, e.g. when determining the substance of a particular transaction, contract or relationship.

The areas where the use of judgements and estimates has the most significant effect on the amounts recognised in the statement of financial position or the income statement are disclosed in this note.

a. Fair value of financial instruments
The fair value of financial instruments that are not quoted in active markets is determined using valuation techniques which are reviewed regularly as discussed in note 59.

b. Impairment of financial assets
As outlined in note 81, the use of estimates and judgement is an important component of the calculation of impairment losses. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. Unforeseen events could, however, result in further impairment losses which would have a material effect on the income statement and statement of financial position.

c. Impairment of intangible assets
The carrying amount of intangible assets are reviewed annually to determine whether there is indication of impairment as disclosed in note 89. If any such indication exists the asset's recoverable amount is estimated. An impairment loss is recognised if the carrying amount of an asset exceeds its recoverable amount.

d. Deferred tax assets
Judgement is required to determine the extent to which deferred tax assets are recognised in the statement of financial position, based on the likely timing and level of future taxable profits.

KVIKA

Appendixes:

1. Statement on the Corporate Governance of Kvika banki hf. 2019
2. Non-Financial Information regarding Kvika banki hf. 2019

Unaudited

Statement on the Corporate Governance of Kvika banki hf. 2019

Business strategy and values

Kvika banki hf. (hereinafter referred as “Kvika” or “the bank”) is a specialised bank focusing on asset management and investment services. Kvika’s values are based on long-term thinking and in accordance with that the objectives of Kvika’s business strategy are to develop solid business relationships and long-term results. The bank operates for a specific target group and places an emphasis on serving its customers well. The bank’s size enables it to adapt to its environment with the aim of maintaining profitability and customer service. The bank strives to develop and maintain a powerful infrastructure that can be used to generate income.

The Banking division finances enterprises and the investments of the bank’s clients. The Banking division also makes use of the bank's infrastructure to broker loans to other institutional investors.

The Asset and Fund Management division emphasises offering clients a broad range of services for investing in Iceland as well as on foreign markets. The goal is to provide the best asset and fund management services, guided by clients’ long-term interests.

The Capital Markets division offers clients comprehensive securities brokerage and FX market services.

The Corporate Finance division provides various types of advisory services in connection with investments and financing. The emphasis is placed on corporate acquisitions and divestments, as well as initial public offerings.

The return on equity is determined by the decisions that are made in accordance with the risk appetite, which reflects the profitability targets, since an emphasis is placed on utilising the equity as efficiently as possible with regard to risk. Decisions regarding the composition of the balance sheet take into account the best utilisation of equity to generate income, but are restricted by risk appetite and funding at any given time. An emphasis is placed on Kvika’s activities being profitable and the bank’s objective is to achieve a return on equity of at least 15% before taxes.

Kvika’s objective is for its shareholders to receive an annual dividend of a minimum of 25% of profits, whether it be in the form of dividend payments or through the acquisition of own shares, in accordance with a formal buy-back programme, all pursuant to laws and the decisions made at shareholders’ meetings. When deciding on the amount of the dividend payments or, as the case may be, the amount allocated to buying own shares, care shall be taken to maintain the bank’s strong financial position and also to take into account the risks of the internal and external environment, growth prospects, and ensure that the company maintains a solid capital ratio and liquidity for the future. However, dividend payments are subject to assessments of the opportunities offered by reinvesting profits in the bank's operations and growth.

Corporate Social Responsibility and ethics

Kvika has a established a CSR policy which promotes sustainability, particularly in the areas in which the bank operates, in the community and environment. In accordance with the values of the bank, an emphasis is placed on long-term decisions, whether they concern the internal matters of the bank or customers.

In this manner Kvika places an emphasis on good corporate governance, corporate social responsibility and sustainable development through, among other things, significant influence investments in Kvika’s equity funds. The bank also endeavours to have a positive impact on the development and functionality of the Icelandic financial market. In Kvika’s opinion, education is one of the best long-term investments for the community and individuals, and it therefore places a particular emphasis on education issues. Kvika places an emphasis on minimising the negative effects which the operations of the bank may have on the environment.

In accordance with the above, the Board of Directors has established codes of conduct and conflicts of interest rules to support good working and business practices. Kvika also offers its employees a healthy, reliable and positive working environment, founded on equal opportunities. An emphasis is placed on ensuring the staff’s professionalism and that their decisions take into account the values of the bank regarding long-term thinking.

Compliance with corporate governance guidelines

Kvika is obliged to observe recognised corporate governance guidelines, pursuant to Par. 7 of Article 54 of Act no. 161/2002 on Financial Undertakings. Kvika complies with the Guidelines on Corporate Governance, 5th edition, published in May 2015 by the Chamber of Commerce, Nasdaq OMX Iceland and the Confederation of Icelandic Employees in most respects. The Guidelines are available on the website of the Chamber of Commerce www.vi.is. Kvika’s only deviation from the guidelines is that it has not appointed a nomination committee or decided on how it should be appointed. During the year, the Board of Directors has evaluated the pros and cons of the bank appointing a nomination committee and it will present its conclusions at the next Annual General Meeting and ask shareholders to take a position on the matter. In its work, Kvika also complies with the recognised standards and rules of the European Banking Authority (EBA) regarding the internal governance of financial undertakings (hereinafter referred to as the EBA guidelines).

Regulatory framework

Kvika is a financial undertaking which operates according to, among other things, Act no. 161/2002 on Financial Undertakings, Act No. 108/2007 on Securities Transactions, Act no.2/1995 on Limited Liability Companies, Competition Act no. 44/2005, Act no. 120/2011 on Payment Services, Annual Accounts Act no. 3/2006 and Act no.140/2018 on Measures against Money Laundering and Terrorist Financing. Moreover, Kvika guarantees the safety of the personal data it works with in its activities, in accordance with Act no. 90/2018 on Data Protection and the Handling of Personal Information. Kvika has an operating licence from the Financial Supervisory Authority of the Central Bank of Iceland (“FME“), which supervises the activities of the bank. Kvika’s activities are therefore governed by the rules and instructions of the FME and Central Bank of Iceland as well as other legal provisions regarding the financial market. More details about FME and an overview of the principal legislation and rules that apply to the bank at any given time can be found on the website of FME www.fme.is.

Statement on the Corporate Governance of Kvika banki hf. 2019

Description of the main elements of internal control, risk management and accounting of Kvika

The Board of Directors is responsible for ensuring that an active system of internal controls is in place within the bank and it is based on three lines of defence: The first line of defence comprises the management and the employees of business and principal units, who are in charge of the daily management and organization of the bank. Their main responsibility is to ensure the functionality and implementation of internal control measures in daily operations. The second line of defence comprises the internal control units of the bank, principally the Compliance Officer, who is in charge of ensuring that laws and regulations are observed, and Risk Management, which measures and assesses risk in relation to the bank's criteria. Other units may also be given control functions. The third line of defence comprises of internal auditors and sub-committees, which ensure internal auditing is in place and functioning. Among other things, independent surveys and reports are made for the Board of Directors and Audit Committee.

The implementation and execution of internal controls is the responsibility of the management of the bank and its control units. The internal control of the bank is founded on risk assessment and control measures which should reduce risk factors in the operations of the bank. Part of the internal control is a documented and formal procedure which bank employees follow in their daily work and is examined by the control units.

The Board of Directors determines the risk policy and risk appetite of the bank. It annually defines the risk factors, which the bank has to address, including their nature and extent. Furthermore, the Board also defines responses to the risk in question. The Board hires an Internal Auditor, signs his/her formal statement of duties and annually approves the audit plan. The CEO appoints the Compliance Officer with the approval of the Board and signs his/her formal statement of duties. The reports and findings of the Internal Auditor and Compliance Officer are presented directly to the Board.

The Board has established rules regarding Kvika's risk management and risk policy. The purpose of the risk policy is to ensure the risk management of the bank is systematic and effective and geared to enhance transparency in the bank´s risk taking at all levels of management, from the Board to the operating units and individuals who directly participate in the daily management and decision making regarding risk.

The Finance division of Kvika prepares annual accounts in accordance with international financial reporting standards (IFRS) and additional requirements in the Icelandic Financial Statement Act. The Consolidated Financial Statement is audited by the bank´s external auditors, Deloitte.

The CEO reports to the Board when verifying the effectiveness of internal controls and risk management regarding the Consolidated Financial Statement. Internal controls and risk management in connection with the Consolidated Financial Statements are organised with a view to preventing any substantial deficiencies in the accounting process.

Kvika's Board of Directors and control units regularly verify the effectiveness of internal controls and risk management.

Composition and activities of the Board of Directors, Executive Committee and sub-committees

Kvika's Board of Directors comprises of five board members and two alternates.

Board members come from broad backgrounds and possess extensive experience and expertise. In accordance with the bank´s gender equality policy and the Act on Limited Liability Companies, care is taken to ensure at least 40% representation of each gender among board members and the Board currently comprises three women and two men. The Annual General Meeting elects the Board of Directors and alternate members for a period of one year at a time. The CEO is appointed by the Board of Directors. Board meetings are generally held once a month. In 2019, 24 board meetings were held and were well attended by members.

The Board of Directors is the supreme authority in the affairs of the bank between shareholders' meetings. Its main duties are to supervise all the operations of the bank and ensure that they are in good order at all times. The Board is responsible for Kvika's policy making. The Board shall ensure that the book-keeping and handling of bank's funds are properly supervised. The Board shall establish plans for Kvika in line with the purpose of the bank and in accordance with the Articles of Association and determine the strategies to be followed to achieve set objectives. The Board supervises the CEO´s work. The Board also represents the bank before courts and government authorities and decides on who has power of attorney to commit the bank.

The Board of Directors has three sub-committees, the Audit Committee, Risk Committee and Remuneration Committee.

The members of the Audit Committee are Kristín Guðmundsdóttir, as chairperson, Hrönn Sveinsdóttir and Inga Björg Hjaltadóttir. The committee is intended to play an advisory and supervisory role for the Board of Directors of the bank by, among other things, ensuring the quality of financial statements and other financial information from the bank and the independence of its auditors. The committee supervises accounting procedures and the effectiveness of internal controls in addition to internal and external auditing. The committee met eleven times in 2019.

The members of the Risk Committee are Kristín Guðmundsdóttir, who is chairperson, Guðmundur Þórðarson and Kristín Pétursdóttir. The committee is intended to play an advisory and supervisory role for the Board of Directors of the bank by, among other things, determining its risk policy and risk appetite. The committee also monitors the organisation and effectiveness of risk management, credit risk management, market risk, liquidity risk, operating risk, reputational risk and other risks, as the case may be. The committee met seven times in 2019.

The members of the Remuneration Committee are Guðjón Reynisson, who is chairman, Inga Björg Hjaltadóttir and Kristín Pétursdóttir. The committee is intended to play an advisory and supervisory role for the Board of Directors of the bank in connection with remuneration terms in the company and ensuring they support its objectives and interests. The committee met eight times in 2019.

All the Board's sub-committees have established rules of procedure prescribing the implementation of their tasks in detail and they are endorsed by the Board of the bank. The Board appoints sub-committee members by majority from its own ranks and nominates their chairpersons. Because of the nature of the committees, neither the CEO nor other employees can sit on them. The rules of procedure of the committees and the Board are accessible on Kvika's website www.kvika.is.

The members of Kvika's Executive Committee, in addition to the CEO are the following employees: Ármann Þorvaldsson, Deputy-CEO, Ragnar Páll Dyer, Managing Director of Finance and Operations, Magnús Ingi Einarsson, Managing Director of Banking, Bjarni Eyvinds, Managing Director of Capital Markets, Lilja Jensen, General Counsel, and Baldur Stefánsson, Managing Director of Corporate Finance. More details about the Executive Committee are accessible on Kvika's website www.kvika.is.

The CEO provides more detailed information on the rules of procedure and the operations of the board and sub-committees.

Statement on the Corporate Governance of Kvika banki hf. 2019

Information on Board members

Kristín Pétursdóttir is the chairperson of the Board of Directors. She was appointed to the bank's Board of Directors in March 2018. She was born in 1965 and graduated with a Cand. Oecon degree from the University of Iceland in 1991 and an MBA degree from Handelshöyskolen in Bergen in 1993. Kristín is an independent executive coach and owner of the company The Inner and Outer Game. Kristín was one of the founders of Auður Capital hf. and served as its CEO from 2007 to 2013 and as its executive chairperson from 2013 to 2017 (later Virðing hf.). She was the CEO of Mentor hf. from 2015 to 2017, worked as Managing Director of Treasury in Kaupthing from 1997 to 2005 and Deputy CEO of Kaupthing Singer & Friedlander from 2005 to 2007. From 1993 to 1997, she worked for Statoil, Íslandsbanki and Skeljungur. Kristín has sat on the boards of Ölgerðin, Tal, Yggdrasill ehf., Kaupthing Singer & Friedlander Ltd., the Icelandic Chamber of Commerce, Confederation of Icelandic Employers and the Financial Services Association. She currently sits on the board of directors of GRID ehf. Kristín is a shareholder in Kvika through her private limited company, KP Capital ehf., which holds a 0.39% stake in the bank and controls 7,900,000 shares. She does not have interest links with major clients, competitors or big shareholders in the sense of the Guidelines of Corporate Governance.

Guðmundur Þórðarson is the deputy chairperson of the Board. He was appointed to the bank's Board of Directors in March 2017. Guðmundur was born in 1972. He graduated from the University of Iceland with a Cand. Oecon business degree in 1997. He has also completed a securities brokerage and asset management exam in the UK. Guðmundur's main focus is on managing his own investments. From 1997 to 2000 he worked in Asset Management at Landsbréf hf. From 2000 to 2003, he worked as a specialist in the development and corporate advisory division of Íslandsbanki hf. From 2003 to 2007 he worked as Managing Director of Corporate Finance at Straumur fjárfestingarbanki hf. Guðmundur also sits on the boards of Hedda eignarhaldsfélag ehf., Bergstaðastræti 27 ehf., K2B fjárfestingar ehf. and BBL II ehf. Guðmundur and his wife, Svanhildur Nanna Vigfúsdóttir, jointly own the company K2B fjárfestingar ehf. which owns a 6.64% stake in Kvika and controls 133,500,000 shares. Furthermore, Svanhildur Nanna serves as the Chairperson of the Board of Vátryggingafélag Íslands hf. which owns a 4.67% stake in Kvika and controls 94,000,000 shares.

Inga Björg Hjaltadóttir, the Managing Director, consultant and co-owner of Attentus Human Resources and attorney and co-owner of the Reykjavik Law Firm, was appointed to the Board of Directors in April 2013. Inga Björg was born in 1970. She graduated from the University of Iceland in 1995 with a law degree, and obtained a licence to plead cases before the District Courts of Iceland in 2003. She is one of the founders of Attentus Human Resources and has worked there since 2007, while also working as an attorney at the Reykjavik Law Firm from 2016 and previously at the Acta Law Firm from 2006 to 2016, as well as at DP Lögmenn between 2003-2006 and was Department Manager at Eimskipafélag Íslands hf. from 1999 to 2003. From 1996 to 1999 she was a lawyer and later Deputy Head of Human Resources for the City of Reykjavik. She has previously served on the boards of Límtré Vírnet hf., E-Farice ehf., eignarhaldsfélagið Smellinn hf. and the audit committee of the City of Reykjavík, Reykjavík Energy, Strætó BS, Malbikunarstöðinn Höfði, the Associated Icelandic Ports network, Sorpa BS., Reykjavík Social Housing and the Reykjavík Fire Department. She also serves as a judge on the Labour Court, and chairs the Remuneration Committee of the City of Reykjavík. Inga does not own shares in the bank and she does not have interest links with major clients, competitors or big shareholders in the sense of the Corporate Governance Guidelines.

Hrönn Sveinsdóttir was appointed to the Board of Directors of the bank in March 2017. Hrönn was born in 1967. She graduated from the University of Iceland with a Cand. Oecon business degree in 1992. Hrönn works independently as co-owner and board member of Smart Finance ehf. and co-owner of Íslandskróna ehf. She previously served as Managing Director of Finance and Operations of Sýn hf. Hrönn joined Sýn hf. in 2005 as Managing Director of Finance. Prior to that she worked for P. Samúelsson hf. where she was also the director of human resources. Hrönn has served on the boards of various firms such as Almenni lífeyrissjóðurinn, Húsasmiðjan hf., Farice ehf., P/F Kall in the Faroe Islands, ISNIC, Mamma ehf., Ódýra símafélagið and P. Samúelsson hf. Hrönn holds a 0.02% stake in the bank and controls 500,000 shares in Kvika, but does not have interest links with major clients, competitors or big shareholders in the sense of the Corporate Governance Guidelines.

Guðjón Reynisson was appointed to the bank's Board of Directors in March 2018. He was born in 1963 and works as an independent investor and board member. Between 2008 and 2017 he served as CEO of Hamleys of London. From 2003 to 2008, he served as managing director of the 10-11 stores. From 1998 to 2003 he was the managing director of the sales division of Tal, an Icelandic phone company. He graduated with an MBA degree from the University of Iceland in 2002. He graduated with an Operations and Business degree from the Continuing Education Study of the University of Iceland in 1999 and also graduated with a degree as a licensed physical education teacher from the University of Iceland in 1986. Guðjón has been on the board of directors of Festi hf. since 2014 and Securitas hf. from 2018. He holds a 0.52% stake in the bank and controls 10,410,789 shares in Kvika through his private limited company, Hakk ehf., but does not have interest links with major clients, competitors or big shareholders in the sense of the

The Board of Directors considers that Kristín, Guðjón, Inga and Hrönn are independent members of the Board in the sense of the Guidelines of Corporate Governance.

The alternate members of Kvika's board of directors are Kristín Guðmundsdóttir and Albert Þór Jónsson. In the opinion of the Board, both alternate members are independent of the bank.

Main factors in the Board's performance evaluation

The Board of Kvika annually evaluates its performance. It evaluates the performance of tasks and work of the Board for the previous year. The focus of the assessment is on strategic planning, disclosure and future vision, the size and composition of the Board, performance of Board members, the work of sub-committees and performance of the CEO. The development of the bank is examined with a view to assessing whether it is line with its objectives. Following the annual performance assessment, the Board defines tasks in areas where improvements are needed. The Board's last performance assessment was conducted in January 2020. The Board also regularly conducts special self-assessments on its composition in accordance with the guidelines of the European Banking Authority (EBA), and last did so in January 2020.

Statement on the Corporate Governance of Kvika banki hf. 2019

Information on the CEO of Kvika and his main duties

Marinó Örn Tryggvason became the CEO of Kvika in May 2019. Marinó was born in 1978 and from August 2017 acted as Kvika's Deputy CEO. Prior to this, Marinó worked in asset management at Arion banki and the bank's forerunner from 2002. Between 2014-2017, Marinó was the Deputy Managing Director of Asset Management at Arion banki and between 2007 and 2014 was the head of institutional asset management. Marinó sat on the board of the Vörður insurance company between 2016-2017. Marinó holds a BSc in business studies from the University of Iceland and possesses a diploma in securities trading. Marinó owns no shares in Kvika, although he has call options and subscription rights for shares in the bank. He does not have interest links with major clients, competitors or big shareholders in the sense of the Guidelines of Corporate Governance.

The CEO oversees the daily operations of Kvika and shall in that respect follow the policy and instructions which have been laid down by the bank's Board of Directors. Daily operations do not extend to unusual or major arrangements. The CEO shall ensure that the bank's books are kept in accordance with laws and customs and that the bank's assets are handled in a secure manner. The CEO appoints and dismisses employees of the bank. Furthermore he is obliged to follow all of the Board's instructions. The CEO shall provide the bank´s external auditors with all requested information.

Information on violations of laws and regulations, determined by the relevant supervisory body or adjudicating entity

Kvika has not been subject to withdrawal, revocation or dismissal of registration, authorization, membership or permissions to perform certain trades, operations or work. On 19 September 2019, the Financial Supervisory Authority and Kvika concluded an agreement with a settlement for a violation of Par. 2 of Article 21 of Act no. 161/2002 on Financial Undertakings. Information on court cases that may be in progress in relation to Kvika can be found in the notes to the Consolidated Financial Statements of the bank.

Communications between the shareholders and the Board

Information is provided to shareholders on a non-discriminatory basis and is mainly limited to shareholders' meetings or delivery of uniform information to all shareholders simultaneously. News of the bank's operations is posted on the bank's website and press releases are sent out when newsworthy events in the bank's operations take place. A detailed presentation of the bank's operations over the past year also takes place at the Annual General Meeting of the bank and information on the bank's operations is published in the bank's annual accounts and financial statements.

This statement on the corporate governance practices of Kvika banki hf. was reviewed and agreed upon by the Board on 27 February 2020.

Non-Financial Information regarding Kvika banki hf.

Kvika banki is a specialised bank focusing on asset management and investment activities. The bank operates for a specific target group and places an emphasis on serving its customers well. The bank's size enables it to adapt to its environment with the aim of maintaining profitability and customer service. The bank is ready to use its infrastructure and balance sheet to procure revenue by, for example, utilising lending procedures to lend in conjunction with others.

Kvika also operates two companies in the UK which are regulated by the British Financial Conduct Authority and have operating licences to manage specialised funds, asset management and corporate advisory. The objective of Kvika having offices in both Iceland and the UK is to bridge the gap between Iceland and Europe and connect Iceland with global markets by providing Icelandic investors with advice on investing abroad and international investors with advice on investing in Iceland.

Kvika has a number of subsidiaries in addition to the above and places a great deal of emphasis on their independence both in their management and daily operations. At the same time, Kvika places an emphasis on harmonised and professional work procedures within the group, maintaining a tight work force and ensuring that Kvika's values of long-term thinking and having a positive long-term effect on the community are followed within the group.

Long-term thinking is important since solid business relationships develop over a long period. Kvika places an emphasis on providing comprehensive services to its current customers and prioritising their interests. The bank's size enables it to adapt to its environment with the aim of maintaining profitability and customer service.

Kvika's return on equity is determined by the decisions that are made and decisions have to be in line with the risk appetite. Risk appetite reflects the target returns since an emphasis is placed on utilising the equity as efficiently as possible with regard to risk. The bank's objective is to achieve a return on equity of at least 15% before taxes. Return on equity comprises income related to the balance sheet together with commission income from activities that commit little equity. The bank's policy is for its shareholders to receive an annual dividend of a minimum of 25% of profits, whether it be in the form of dividend payments or through the acquisition of own shares, in accordance with a formal buy-back programme, all pursuant to laws and the decisions made at shareholders' meetings. Dividend payments are however subject to assessments of the opportunities offered by reinvesting profits in the bank's operations and growth, as well as the requirements of supervisory authorities at any given time. Decisions regarding the composition of the balance sheet take into account the best utilisation of equity to generate income, but are restricted by risk appetite and funding, at any given time.

Community

Kvika's policy is to have a positive long-term impact on the community, with a particular emphasis on education. With a view to strengthening the educational system, Kvika has set up two incentive funds, one for vocational training students and the other for student teachers. Future prosperity is founded on solid education and education is therefore increasingly considered as one of the best investments countries can make in the world. Societies that are driven by ingenuity and innovation are expected to play a leading role in the coming years. Education is also considered a fundamental element in women's pursuit for equal rights, protecting children from slavery and sexual abuse, promoting human rights and democracy and supporting the protection of the environment.

Kvika realises that it can have the greatest impact on the community by focusing on the areas that relate to the group's activities. In Kvika's corporate social responsibility policy, a particular emphasis is placed on having a positive impact on the development and functionality of financial markets. In this context the group strives to find ways to better mobilise investors in Iceland, by developing more diversified investment options, both for those who are already involved in the securities market as well as new investors. This emphasis is very much in line with Kvika's long-term thinking value, which serves as a guiding principle in the group's decision making going forward.

Kvika is the main partner of UNICEF in Iceland in the field of banking services and the Global Parents programme. Kvika also runs a charity fund, the main purpose of which is to encourage young women to show initiative and take action. In addition to the above, Kvika also supports various causes which promote more positive social development through small grants. Kvika is also a founding member of the Iceland Sustainable Investment Forum (IcelandSIF) and a member of the Icelandic Centre for Corporate Social Responsibility (Festa).

Because of the nature of Kvika's focus on the above social issues, no measurable criteria have been set regarding the group's corporate social responsibility.

Environment

Kvika's value is long-term thinking and this entails having a positive long-term impact on the community. Kvika therefore places an emphasis on minimising the negative effects which operations may have on the environment and applies numerous remedies to save energy in its offices, and to limit unnecessary printing and recycling.

The biggest factors in Kvika's activities which can have an impact on the environment are the air travel of employees and driving to and from work. To offset this, employees are encouraged to use eco-friendly modes of transport and to use teleconferencing equipment instead of travelling as much as possible. Kvika offsets the carbon emissions of all the air travel of its employees undertaken on behalf of the group and has established a transport policy to promote the use of eco-friendly, cost-effective and healthy modes of transport for its employees by, among other things, issuing transport grants. Kvika has however not set itself any measurable criteria in this field.

Non-Financial Information regarding Kvika banki hf.

Human resources and human rights

Kvika's aim is to be an attractive workplace where all employees are given equal opportunities. Kvika's value is long-term thinking and an emphasis is placed on guaranteeing professionalism in all our dealings and ensuring that all decisions take into account the values of the bank.

To support the above, Kvika has established, among other things, a human resources policy, non-discrimination policy, rules regarding counter contributions for parental leave and a policy and response plan for cases of harassment, bullying and violence. Moreover, Kvika supports its staff in further education and regular physical exercise through, among other things, sport grants and annual health check-ups for those who want them. Kvika is at a very advanced stage in its gender pay equity certification, which is expected to be completed in the second quarter of 2020.

Opinion polls are conducted annually among our staff to evaluate, among other things, job satisfaction, stress, equal rights, the balance between working and private life, harassment, bullying and violence. These surveys enable Kvika to evaluate the above factors and monitor changes between years. In the wake of the surveys, results are examined and an action plan is established if needed.

Corruption and bribery

Because Kvika is a financial undertaking, as are a number of its subsidiaries, there is a considerable risk that attempts may be made to use the companies within the group for money laundering and the funding of terrorism. Kvika has established rules regarding measures against money laundering and terrorist financing, which fulfil the requirements placed on financial undertakings in this field, both domestically and globally. The Compliance Officer monitors customers on a regular and case-by-case basis and keeps track of their transfers, money withdrawals etc. with a view to detecting any unnatural behaviour and thus prevent any money laundering and terrorist financing, if it is taking place. Kvika recently purchased the Lucinity Intelligent AML solution with a view to strengthening the above protection of the bank, particularly in connection with a risk-based approach to supervision in accordance with new legal requirements.

Kvika employees are not permitted to accept or give any gifts, incentive payments or any kind of recompense, which could undermine the credibility of the bank and could lead to conflicts of interest. Kvika has set itself rules regarding gifts, incentive payments and recompenses, which stipulate that an authorisation must be sought from the managing director or CEO before accepting any benefits of this kind and which impose an obligation to notify the Compliance Officer. The Compliance Officer keeps a record of all notifications. A breach of the rules can result in a warning being issued or, as the case may be, dismissal from work.

Kvika banki's ESG report can be found at www.kvika.is