Íslandsbanki

Consolidated Financial Statements

2022

Contents

Factsheet 4Q22

Íslandsbanki

Our profile

With a history that dates from 1875, Íslandsbanki is an Icelandic universal bank with a strong customer focus. The Bank believes in moving Iceland forward by empowering its customers to succeed – reflecting a commitment to run a solid business that is a force for good in society.

Driven by the ambition to be #1 for service, Íslandsbanki's banking model is led by three business divisions that build and manage relationships with its customers. Íslandsbanki maintains a strong market share with the most efficient branch network in the country, supporting at the same time its customers' move to more digital services.

The Bank operates in a highly attractive market and, with its technically strong foundations and robust balance sheet, is well positioned for the opportunities that lie ahead.

Íslandsbanki has a BBB/A-2 rating from S&P Global Ratings.

The Bank's shares are listed on the Nasdaq Iceland Main Market.

The Bank

12 branches

700 number of FTEs at Íslandsbanki at year-end

Sustainability 4Q22

- The ratio of ESG risk-assessed credit risk has increased from 34% to 76% during 2022
- Published Road to net-zero emissions report and sector-specific reduction targets
- Íslandsbanki awarded ISK 40m in grants to 15 innovation projects

Digital milestones 4Q22

- 95% of new private pension savings registrations done digitally
- Increase in personalised targeting of relevant products and services for customers
- Car lending process streamlined with electronic notarisation now available

Market share[1]

31% retail customers

36% SMEs

35% large companies

Ratings and certifications

S&P Global Ratings

BBB/A-2

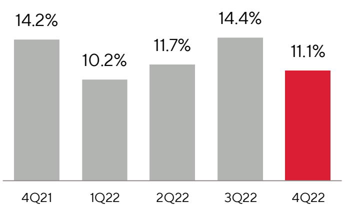
Stable outlook

EUROMONEY AWARDS FOR EXCELLENCE ICELAND BEST BANK 2022

EQUAL PAY CERTIFICATE

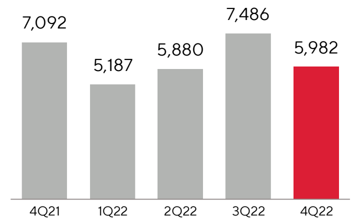
JAFNVÆGISVOG FKA 2022 VIÐURKENNING

Return on equity

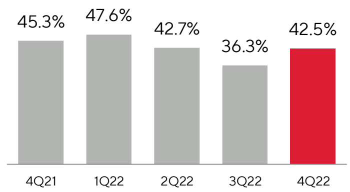


Profit after tax

(ISKm)

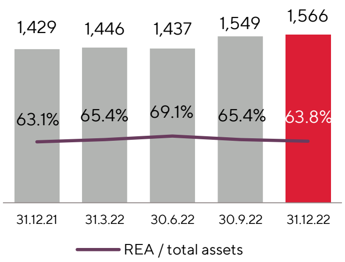


Cost-to-income ratio



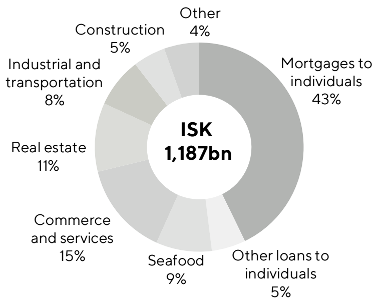
Total assets

(ISKbn)



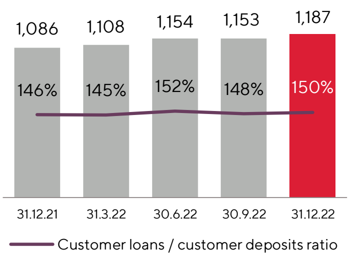
Loans to customers

(Sector split as of 31.12.22)

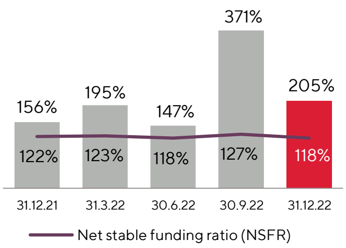


Loans to customers

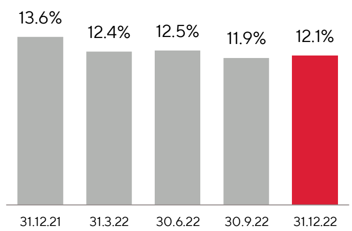
(ISKbn)



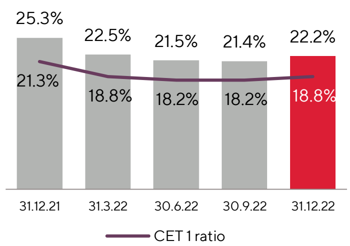
Total liquidity coverage ratio



Leverage ratio[2]



Total capital ratio[2]



The information above has not been reviewed or audited by the Group's auditor.
1. Based on Gallup surveys regarding primary bank. 6 months rolling average for retail customers, December 2022 survey for SMEs and 2022 average for large companies.
2. Including first quarter profit for 31.3.22 and third quarter profit for 30.9.22.

Directors' Report

The Board of Directors and the CEO of Íslandsbanki hf. ("the Bank" or "Íslandsbanki") present this report together with the audited Consolidated Financial Statements of Íslandsbanki hf. and its subsidiaries (together referred to as "the Group") for the year 2022. Íslandsbanki is a universal bank offering comprehensive financial services to households, corporations, and institutional investors in Iceland. The Group is one of Iceland's largest banking and financial services groups, with a strong domestic market share.

Operations in 2022

The Group's profit from operations for the year 2022 amounted to ISK 24,535 million and the return on equity was 11.8%, surpassing the Bank's target of over 10% ROE. At year-end, the Group employed 739 full-time members of staff, including 700 within the Bank itself, 57% female and 43% male, and operated 12 branches.

Operations in 2022 were impacted by the substantial volatility in the global economy and capital markets, growing inflation and rising interest rates, both domestically and internationally. This volatility has however so far had limited observable impact on delinquency rates and at the same time, the tourism industry has been recovering steadily from the COVID-19 pandemic and earnings and the financial standing in that industry have improved considerably.

The Government's sale of a 22.5% stake in the Bank in March 2022 has come under considerable public scrutiny. At year-end 2022, the Bank received the preliminary findings from the Financial Supervisory Authority of the Central Bank of Iceland (FSA), resulting from its inspection of the Bank's execution of the sale. In its findings, the FSA states, subject to the Bank's response, that the Bank may have violated certain laws and regulations applicable to the Bank's operations. The management of the Bank takes the FSA findings seriously and has already made relevant changes to its internal rules and procedures and will, subject to the outcome of its internal review and discussions with the FSA, continue to make appropriate changes. The amount of the potential administrative fine has not been decided and is therefore uncertain. The Bank has, however, recognised a provision based on its own internal estimate. For further information on this matter see Note 43.

Net interest income rose by 26.7% from the previous year, supported by balance sheet growth and a rising interest rate environment. As a result, the net interest margin increased from 2.4% to 2.9%. Net fee and commission income rose by 9.4%, with a strong performance in Allianz Ísland hf. and good growth in fees from cards and payment processing. Net financial income was adversely affected by the rising rates environment and a drop in the equities markets and was negative by ISK 1,257 million. Salaries and related expenses increased by only 0.4% between years due to a 2.7% reduction in the number of FTEs. Other operating expenses increased by 6.8%. The Group's cost-to-income ratio fell from 46.2% to 42.1% between years and was well below the 45% target. Net impairment reversals amounted to ISK 1,576 million, of which approximately ISK 750 million was a result of a favourable court ruling regarding a fully impaired loan, coupled with the outlook for the tourism sector continuing to improve and outweighing the negative impact from increased inflation and international economic volatility.

The Group's loan book grew by 9.2% during the year due to continued strong growth in mortgages and loans to SMEs. At the same time, growth in loans to larger corporates was kept at a more moderate pace of 2.3%. The Group's ratio of non-performing loans decreased from 2.0% at year-end 2021 to 1.8% at the end of 2022. Stage 2 loans under IFRS 9 have come down to 2.5% of the loan book, compared with 9.6% at year-end 2021, as the credit risk relating to loans to the tourism industry and related industries has come down substantially.

Capital and funding

Deposits from customers remain the Bank's largest source of funding and rose by 6.2% during the year. The largest increase came from deposits in Corporate and Investment Banking, while deposits in Personal Banking increased at a healthy 5.0% pace. The Bank was quite active in debt issuance during the year, although turbulence in the international funding markets had a considerable impact on the pricing and availability of funding. In the foreign markets the Bank issued its second sustainable note in the first quarter, followed by its inaugural FX Covered Bond transaction in September in the amount of EUR 300 million, which was successfully placed with investors in quite turbulent markets. In early October, the Bank issued ISK 10,520 million of Tier 2 bonds, the Bank's first of its kind in the domestic market. The liquidity position of the Bank remains robust with all liquidity ratios well above both internal targets and regulatory requirements.

The Bank paid ISK 11.9 billion in dividends to its shareholders in March 2022 in line with its dividend policy of 50% of the previous year earnings. The Group is well capitalised, with a total capital ratio of 22.2% and is well above the regulatory requirement of 19.9%, which increased from 17.8% during the year, mainly as a result of the countercyclical buffer increasing from zero to 2.0%. The CET1 capital ratio was 18.8% at the end of 2022, which is well above the Bank's financial target of approximately 16.5%. The capital ratios take into account the previously planned share buyback of ISK 15 billion. Due to volatility in the global economy and capital markets, the Central Bank of Iceland has asked the Icelandic banks to be careful in terms of capital distributions in the near term. The Bank is therefore planning to start its share buybacks with a standard ISK 5 billion buyback program, to be conducted over the next few months. The remaining ISK 10 billion will be added back to the Bank's capital buffers. The Bank will seek a renewed approval for share buybacks from the Bank's annual general meeting in March and is planning to optimise its capital structure before year-end 2024, in line with its target of approximately 16.5% CET1 capital ratio.

Directors' Report

Outlook

The Icelandic economy has broadly recovered from the COVID-19 induced recession at the start of the decade. GDP growth measured 7.3% year-on-year in the third quarter of 2022 and the 7.4% average growth for the year to September is the strongest reading for this period since 2007. Growth in the third quarter of 2022 was led by private consumption and exports, the latter largely due to a robust high season in tourism.

Recent economic trends in the fourth quarter of 2022 and timely indicators point to a slower growth in consumption and investment than in previous quarters. Card turnover figures and other data indicate a slowdown in consumption growth in November and December in particular, most likely affected by a drop in real wages, higher interest rates and dwindling impact from pent-up travel demand during the pandemic. On the other hand, tourism continued its upward trajectory in the fourth quarter and arrivals in that quarter were broadly on par with 2019 numbers. At just under 1.7 million, foreign tourist arrivals in 2022 were equal to 85% of arrivals in 2019. For the year 2022, the Bank's Chief Economist estimates GDP growth at 7.0%.

The economy has proven more resilient than European peers to impact from the war in Ukraine, as domestic renewable energy supplies most of households' energy needs and rising seafood prices have partly offset an increase in import prices.

Inflation rose back to 9.9% in January 2023 following a decline from 9.9% in July 2022 to a temporary nadir of 9.3% in November 2022. Despite the temporary setback in headline inflation, some factors in the high inflation in recent quarters show signs of abating. This holds true for the residential real estate market, where prices fell modestly both in November and December among signs that supply is increasing while demand is cooling. The Central Bank increased its policy rate by a total of 50 basis points in the fourth quarter and thereby its main policy rate was 6.0% at the end of 2022.

For 2023, the Bank's Chief Economist expects GDP growth to measure 3.4%. Exports will remain the main catalyst of growth this year due to continued growth in tourism and a moderate increase in other exports. Domestic demand, on the other hand, looks likely to grow at a more moderate pace compared to the two previous years.

On balance, the outlook for the Bank's operations in 2023 is favourable. Unemployment remains low in Iceland, with a good outlook for economic growth and a strong recovery in the tourism industry. Inflation however remains a challenge, impacting both the Bank's own cost base and that of its customers. The Bank expects profitability to be in line with its 10% target in 2023, assuming normalised impairments and the cost-to-income ratio is expected to be in the range of 40-45%, below the Bank's target to be below 45%. Furthermore, the Bank plans to optimise its capital structure before year-end 2024, subject to market conditions and the economic environment.

Risk management

The Bank is exposed to various risks. The management of these risks is an integral part of the Bank's operations, and the Bank has focused on building up a responsible internal risk culture among the Bank's employees. The ultimate responsibility for ensuring an adequate risk management framework lies with the Board of Directors. The Board defines and communicates the acceptable level of risk through the Bank's risk management policies and the CEO is responsible for ensuring that risks are managed within those limits.

The Board and the CEO hereby declare that Íslandsbanki has an overall satisfactory risk management in relation to the Bank's profile and strategy.

The Bank's risk management framework and policies are discussed under Notes 45-60 to the consolidated financial statements and in the unaudited Pillar 3 Report.

Ownership

The shares of Íslandsbanki are listed on the Nasdaq Iceland stock exchange and the Bank has the second largest shareholder base of any listed company in Iceland. The Icelandic Government sold a 22.5% stake in the Bank in an accelerated book building process at the end of March 2022 and as a result, the Government has now become a minority shareholder with a 42.5% stake. Shares held by the Government are administered by the Icelandic State Financial Investments (ISFI) in accordance with Act no. 88/2009.

At the end of 2022 the Bank had over 13 thousand shareholders, 91% of the Bank's shares were owned by domestic parties and 9% by international investors. Apart from the Government, pension funds and insurance companies were the largest investor group, owning 35.0% of the outstanding shares, where the largest pension funds have been gradually increasing their shareholding. Fund companies owned 10.9% of the shares and individuals 6.8%. The global index provider FTSE Russell upgraded Iceland to Secondary Emerging Market status on 19 September 2022 and Íslandsbanki's securities are now eligible for the FTSE Total Cap Index.

The Bank's shares outperformed the domestic stock market and were down by 5.1% in 2022, while the OMX10 index was down by 26.5%. Taking into account the dividend paid, the shareholder return was -0.4% for the year.

For further information on the Bank's shareholders see Note 41.

Directors' Report

Sustainability

Íslandsbanki aims to be a leader in the area of sustainable development and a force for good. Alongside its vision of being a leader in service to customers, the Bank will focus on integrating sustainability considerations into its activities, in addition to its profit objectives. The Bank takes account of ESG criteria in its risk management and actively explores business opportunities related to sustainability. Íslandsbanki aims to increase the general public's financial knowledge and interest in the subject and, to this end, offers interesting and accessible seminars on finance and economics.

The Board of Directors approves the Sustainability Policy and sets the Bank's strategy and risk appetite in terms of sustainability risk. The Board is regularly updated on corporate sustainability matters and the usage of the Bank's Sustainable Financing Framework. The Corporate Governance and Human Resource subcommittee of the Board assists the Board in fulfilling its oversight responsibilities concerning sustainability.

The CEO is responsible for executing the strategy and has appointed a Sustainability Committee as a main building block of the governance structure. The Committee is the formal forum for discussions on all issues related to sustainability risk, sustainable procurement, and business opportunities. The Committee is independent from credit committees and needs to approve proposals for credit cases before they are included in the Sustainable Financing Framework. The Committee is chaired by the CEO and has senior representatives from the business units, Finance, Risk Management, and Strategy and Sustainability.

The Sustainability Policy creates a comprehensive framework for its activities in the area of environmental affairs, respect for human rights, responsible lending, investments, purchasing, and grants, as well as integrating with and supporting the Bank's other policies. In line with the Sustainability Policy, the Board of Directors has approved seven sustainability goals for its operations, to be completed by 2025. The goals are based on ESG criteria and supported by annual targets set by business units as part of their five-year planning process.

The Sustainability Report for the year 2022 includes key information on the environmental, social and governance criteria for Íslandsbanki in accordance with the Nasdaq ESG guidelines from 2019. The Bank puts emphasis on an increased flow of transparent information on sustainability. Auditing firm Ernst & Young was engaged to review and confirm with limited assurance the Bank's sustainability information disclosure in the Annual and Sustainability report for 2022.

Sustainability risk has been more effectively integrated into key processes relating to lending, investments, and product development during the year. At year-end, 76% of all credit risk exposure (excluding individual banking and small enterprises which are not in scope) has been assessed with respect to ESG risk related factors. More detailed coverage can be found in the Bank's Pillar 3 Report for 2022 which contains a separate chapter on sustainability risk and climate risk in compliance with TCDF (Task Force on Climate-related Financial Disclosures) criteria.

Collaboration with international and local partners with regards to sustainability is highly important. Over the years, Íslandsbanki has participated in international commitments and supported domestic cooperative efforts on sustainability. Being a part of international collaborations such as the UN Principles for Responsible Banking (UN PRB), the Nordic CEOs for a Sustainable Future and most recently being a founding member of the Net-Zero Banking Alliance (NZBA) is particularly valuable and informative for a relatively small bank. On the other hand, being one of the largest companies in Iceland means that the Bank can contribute significantly towards domestic partnerships such as Festa - Center for Sustainability, IcelandSif and the Green Building Council Iceland, to name a few.

Environment

Íslandsbanki is committed to supporting Iceland's ambitious Climate Action Plan and the Paris Agreement Goals. To that end, the Bank announced in April 2021 its commitment to become net zero on financed emissions by 2040. The Bank's own operations have been carbon neutral for the past three years, and with this decision, its commitment will also extend to financed emissions which includes the carbon footprint of Íslandsbanki's entire loan and asset portfolio.

In 2022 Íslandsbanki published its first carbon neutrality report, On the Road to Net-Zero, which outlines the Bank's financed emissions (in accordance with the Partnership for Carbon Accounting Financials (PCAF) standard), objectives and performance in connection with climate issues. Íslandsbanki published its targets for specific sectors in the report, which account for 61% of total lending and 71% of total emissions from the loan portfolio. The Bank expects its financed emissions to shrink by 60% by 2030 and 85% by 2040. Furthermore, the activities of Íslandssjóðir (Iceland Funds), the fund management company owned by Íslandsbanki, are included for the first time in measurements of financed emissions. The Bank's objective of having a net-zero loan portfolio by 2040 is an ambitious but achievable goal in most sectors, although it is clear that transitioning to clean energy in air transport and cargo shipping by sea will probably take longer.

Directors' Report

Social

Íslandsbanki strongly emphasises creating a constructive and healthy work environment with passion, professionalism, and collaboration as guideposts. Because its human resources are its biggest resource, the Bank places strong emphasis on fostering employees' growth and development and contributing to their health and well-being.

As before, equal rights are uppermost in our minds, and we want Íslandsbanki to be a desirable workplace for people from wide-ranging backgrounds. One of Íslandsbanki's most important sustainability targets is to ensure that no single gender accounts for more than 60% of the Bank's management team. This ratio is considered in the hiring of management-level employees. As in previous years, the Bank received equal pay certification and was awarded professional certification under the ÍST 85:2012 standard for 2022. According to the most recent equal pay appraisal, the unexplained pay gap for jobs of equal value is 0.2%.

Governance

The regulatory framework for corporate governance practices within Íslandsbanki consists of the law applicable to its operations, including those imposed by the Central Bank of Iceland and Nasdaq Iceland. The Bank's governance practices derive, inter alia, from the laws and regulations applicable to financial institutions and the financial market. The Bank complies with the Guidelines on Corporate Governance in accordance with paragraph 7 of article 54 of the Act on Financial Undertakings no. 161/2002. Each year the Bank conducts an appraisal to ensure that they remain consistent with the Guidelines. The Board of Directors follows the Corporate Governance Guidelines (6th ed.) issued by the Iceland Chamber of Commerce, Nasdaq Iceland, and SA-Business Iceland, available on www.corporategovernance.is. Moreover, the Bank's governance practices are based on the European Banking Authority's Guidelines on Internal Governance for Financial Undertakings (EBA/GL/2021/05), cf. article 16 of regulation (EC) no. 1093/2010, transposed into Icelandic law with Act no. 24/2017, on European Control Systems in the Financial Market.

Íslandsbanki has a Code of Conduct in place for employees and the Board of Directors which is available on the Bank's website. In addition, the Bank's Sustainability Policy emphasises these matters. The aim of the Code is to promote good operational practices, reporting of misconduct and actions to prevent conflict of interest. Employees confirm annually that they have read and understood the rules and commit their adherence to the rules. At the end of 2022, more than 99% of employees had confirmed the rules. The Bank emphasises respect for human rights and avoids business transactions where human rights are violated, including discrimination on the basis of gender, religion, or race according to the Sustainability Policy and the Suppliers' Code of Conduct. The Bank is committed to continue its active dialogue with suppliers on sustainability issues. In 2022, the Bank set up ten meetings with key suppliers to discuss enhancing sustainable and environmental business practices in the value chain.

The Bank makes every effort to combat bribery and corruption. For that purpose, the Bank has e.g. implemented a policy on conflict of interest and rules on measures against conflict of interest in which there is a chapter on gifts and complimentary trips. The rules are intended to ensure that the impartiality and credibility of employees cannot be brought into question with respect to the treatment and handling of individual matters. Moreover, the Bank has a policy in place on actions against money laundering and terrorist financing. The Bank's policy on anti-money laundering takes a clear stance against payments on bribery and corruption. In practice, the Bank emphasises on being compliant with Act no. 140/2018 on measures against money laundering and financing of terrorism which involves combating bribery and corruption.

The Board of Directors of Íslandsbanki is committed to excellence in its governance framework so that it complies with the best corporate governance practices in the financial market at all times.

At each Annual General Meeting (AGM) seven nonexecutive directors, and two alternate members, are elected to the Board for a term of one year. The Board undertakes the Bank's affairs and is responsible for setting the Bank's general strategy as well as instructing the CEO on its further implementation and execution. The Board has a supervisory role overseeing that the Bank's organisation and activities are at all times in accordance with relevant laws, regulations and good business practices. Furthermore, the Board shall monitor the execution of its policies, the sound control of accounting and financial management, and ensure that group internal audit, compliance, risk management and internal controls are effective at all times.

In accordance with the Bank's Articles of Association the Bank operates a Nomination Committee whose role is to nominate individuals to the Bank's Board of Directors at the AGM, or as the case may be at a shareholders' meeting where Board elections are on the agenda. The members of the Nomination Committee shall be three and they shall be elected for one year at a time by the Board of Directors. The Committee shall be independent in its work and the majority of the Committee's members shall be independent of the Bank and its management. Along with the Bank's Nomination Committee, the ISFI operates a special three-member Selection Committee which, on behalf of the State, nominates candidates for the supervisory boards or boards of directors of banks or undertakings that are managed by ISFI.

Directors' Report

The Board has approved a policy on the suitability of the Board of Directors, the CEO and key function holders. The objective of the policy is that the Bank's Board of Directors, CEO, and key employees meet the relevant suitability requirements at all times and the framework for their appointment and/or employment is in accordance with the applicable legal requirements for the Bank's operation. The policy states, among other things, that the composition of the Board shall at any time be diverse, with regard to educational and professional background, gender and age. Human Resources reports annually to the Board on the Bank's actions in implementing the policy. Currently the Board consists of seven members, four female and three male. Board members are of various ages, born in the years 1960-1982. Board members have a broad range of education, e.g. in the fields of economics, law, computer science, nursing, engineering, auditing, business administration, and securities trading. Board members also have extensive industry experience in the areas of operations, management, and consulting.

The Board appoints three subcommittees, each one comprising Board members and operating under the terms of a mandate letter from the Board as well as the Rules of Procedure of the Board. The mandate letters of Board subcommittees are available on the Bank's website.

The CEO is responsible for the day-to-day operations of the Bank and that the Bank's business is, at all times, in accordance with the Bank's Articles of Association, policies of the Board and the relevant law. The CEO engages the Bank's Compliance Officer and appoints members of the Executive Committee and other Senior Management Committees.

The Executive Committee, comprising seven members, including the CEO, is composed of three women and four men. Members of the Executive Committee were born in the years 1961-1976 and possess diverse education and extensive experience. The role of the Executive Committee is to maintain an overall view of the Bank's operations and to coordinate key aspects of its activities. The CEO ensures that the Board is regularly provided with accurate information on the Bank's finances, development, and operations.

The Bank's Finance division is responsible for the preparation of the consolidated financial statements which are prepared in accordance with the International Financial Reporting Standards (IFRS). The Board's Audit Committee reviews the Group's annual and interim consolidated financial statements before their submission for Board approval and endorsement. The Board's Audit Committee regularly discusses the Bank's financial statements and evaluates its internal control processes. Management reporting is generally presented to the Board 10 times a year. The external auditors review the second quarter interim consolidated financial statements and audit the annual consolidated financial statements.

A more detailed description of Íslandsbanki's governance framework and associated practices can be found in the Bank's Corporate Governance Statement enclosed in an unaudited appendix to the consolidated financial statements and on the Bank's website, www.islandsbanki.is.

Other matters

On 2 February 2023, Íslandsbanki received a letter from the Board of Directors of Kvika banki hf. requesting the Board of Directors of Íslandsbanki's position on commencing merger discussions between the two companies.

Directors' Report

Statement by the Board of Directors and the CEO

The audited consolidated financial statements for the year ended 31 December 2022 have been prepared on a going concern basis in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union and additional requirements in the Act on Annual Accounts, no. 3/2006; the Act on Financial Undertakings, no. 161/2002; and rules on accounting for credit institutions, where applicable.

To the best of our knowledge, these consolidated financial statements provide a true and fair view of the Group's operating profits and cash flows in 2022 and its financial position as of 31 December 2022. Furthermore, in our opinion the financial statements and the Directors' report give fair view of the main operational developments and achievements and describe the principal risks and uncertainties that the Group faces in its operations.

In our opinion, the Consolidated Financial Statements of Íslandsbanki hf. for the year 2022 identified as "549300PZMFIQR79Q0T97-2022-12-31-en.zip" are prepared in all material respects, in compliance with the European Single Electronic Format Regulation (ESEF).

The Board of Directors and the CEO have today discussed and approved the 2022 Consolidated Financial Statements of Íslandsbanki.

Kópavogur, 9 February 2023

Board of Directors:

Finnur Árnason, Chairman

Guðrún Þorgeirsdóttir, Vice-Chairman

Anna Þórðardóttir

Ari Daníelsson

Frosti Ólafsson

Herdís Gunnarsdóttir

Tanya Zharov

Chief Executive Officer:

Birna Einarsdóttir

Building a better working world

Independent Auditor's Report

To the Board of Directors and shareholders of Íslandsbanki hf.

Opinion

We have audited the consolidated financial statements of Íslandsbanki hf. and its subsidiaries (the Group) which comprise the consolidated statement of financial position as at 31 December 2022 and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flow for the year then ended and a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2022, and its consolidated financial performance and its consolidated cash flows for the year then ended, in accordance with the International Financial Reporting Standards, as adopted by the European Union and additional requirements in the Icelandic Act on Annual Accounts, Act on Financial Undertakings and rules on accounting for credit institutions, where applicable.

Our opinion in this report on the consolidated accounts are consistent with the content of the additional report that has been submitted to the parent company's audit committee in accordance with the Audit Regulation (537/2014) Article 11.

Basis for Opinion

We conducted our audit in accordance with the International Standards on Auditing (ISAs). Our responsibilities are further described in the Auditor's Responsibilities for the Audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in Iceland, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

To the best of our knowledge, we have not provided any prohibited non-audit services as described in article 5(1) of Regulation (EU) no. 537/2014.

Appointment of auditor

We were initially appointed as auditor of Íslandsbanki hf. on 25 March 2015 for the financial year 2015 and we have been reappointed every year since then.

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. We do not provide a separate opinion on these matters.

We have fulfilled our responsibilities described in the "Auditor's responsibilities for the audit of the financial statements" section, including in relation to the key audit matters below. Accordingly, our audit included the design and performance of procedures to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the financial statements.

Building a better working world

Why significant	How our audit addressed the Key Audit Matter

Provision for expected credit losses (ECL)

Loans to customers represent ISK 1,186,639 million or 76% of total assets at 31 December 2022, thereof expected credit losses (ECL) of ISK 11,132 million have been recorded.

The determination of the provision for credit impairment is based on estimates and judgement by management. Key areas of judgement include:

- the interpretation of the requirements to determine impairment under application of IFRS 9, which is reflected in the Group's expected credit loss model;
- the identification of loans with significant deterioration in credit quality;
- assumptions used in the expected credit loss model such as the financial condition of the counterparty, expected future cash flows and forward-looking macroeconomic factors.

Due to the use of judgement and estimates and the relative size of loans to customers on the balance sheet, we consider the provision for expected credit losses (ECL) a Key Audit Matter.

Our procedures focused on the following to respond to the Key Audit Matter, among others:

- Assessing the Group's expected credit loss model, focusing on the following areas:
  - alignment of the expected credit loss model and its underlying methodology with the requirements of IFRS 9;
  - approach to the incorporation of forward-looking macroeconomic factors;

- Testing the effectiveness of relevant controls relating, among others, to the:
  - data used to determine the provision for credit impairment, including transactional data captured at loan origination and ongoing internal credit quality assessment;
  - expected credit loss model, including model build and approval, ongoing monitoring/validation, model governance and mathematical accuracy;
  - review and approval of forward-looking macro-economic factors; and
  - registration and valuation of collateral used in the calculation of expected credit loss.

- Testing of a sample of loans and procedures to evaluate among others:
  - timely identification of loans with significant deterioration in credit quality;
  - expected loss calculation by re-performing and assessing the reasonableness of the ECL model calculations;
  - appropriateness of forward-looking macroeconomic factors; and
  - COVID-19 pandemic effects of a sample of borrowers in the tourism and related industries and impact on collateral.

In addition, we assessed the disclosures in the consolidated financial statements. Refer to Notes 3 and 61.4 for credit impairment.

Why significant	How our audit addressed the Key Audit Matter
Reliability of information from IT systems relevant to financial reporting	
The Group is highly dependent on IT systems due to the significant number of transactions that are processed daily and due to the complexity of the various systems needed to support the Group's operations. In the process of preparing the consolidated financial statements the Group uses data from many complex IT systems. To ensure complete and accurate processing and reporting of financial data it is important that controls over appropriate access rights and system changes are designed and operate effectively. Also, controls over transaction processing need to be designed and operate effectively. Because of the importance of the data from the IT systems supporting the financial reporting we consider their reliability a Key Audit Matter.	Our procedures focused on the following to respond to the Key Audit Matter, among others: • Obtained an understanding of the Group's IT systems and the IT-environment relevant for financial reporting. • Reviewed the design, implementation and effectiveness of control activities, as appropriate, related to change management, access management and computer operations for the systems considered important for the audit. EY IT specialists were involved in the audit.

Other information

This document also contains other information than the consolidated financial statements and our auditor's report thereon. The other information is: The unaudited highlights, Directors' Report, and unaudited Íslandsbanki's Corporate Governance Statement 2022 in appendix. Management and Board of Directors are responsible for the other information.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon except for confirmation regarding Directors' Report as stated below.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether it is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we, based on the work we have performed concerning this other information, 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.

Responsibilities of CEO and Board of Directors for the consolidated financial statements

The Chief Executive Officer (CEO) and Board of Directors are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards, as adopted by the European Union and additional requirements in the Icelandic Act on Annual Accounts, Act on Financial Undertakings and rules on accounting for credit institutions, where applicable.

The CEO and Board of Directors are responsible for such internal control that management determines is necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group'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 Group or to cease operations, or has no realistic alternative but to do so.

The Board of Directors is responsible for overseeing the Group's consolidated financial reporting process.

Auditor's 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 International Standards on Auditing (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 the International Standards on Auditing (ISAs), we exercise professional judgement and maintain professional skepticism 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 the Group'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 Group'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 Group 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 Group to express an opinion on the consolidated 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 those charged with governance 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 those charged with governance 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 those charged with governance, 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.

Report on other legal and regulatory requirements

Report on European single electronic format (ESEF Regulation)

As part of our audit of the consolidated financial statements of Íslandsbanki hf. we performed procedures to be able to issue an opinion on whether the consolidated financial statements of Íslandsbanki hf. for the year 2022 with the file name "549300PZMFIQR79Q0T97-2022-12-31-en.zip" is prepared, in all material respects, in compliance with act no. 20/2021 on disclosure obligation of issuers of securities and the obligation to flag relating to requirements regarding European single electronic format regulation EU 2019/815 which include requirements related to the preparation of the consolidated financial statements in XHTML format and iXBRL markup.

The Board of Directors and CEO are responsible for preparing the consolidated financial statements in compliance with act no. 20/2021 disclosure obligation of issuers of securities and the obligation to flag. This responsibility includes preparing the consolidated financial statements in a XHTML format in accordance with EU regulation 2019/815 on the ESEF regulation.

Our responsibility is to obtain reasonable assurance, based on evidence that we have obtained, on whether the consolidated financial statements is prepared in all material respects, in compliance with the ESEF Regulation, and to issue a report that includes our opinion. The nature, timing and extent of procedures selected depend on the auditor's judgement, including the assessment of the risks of material departures from the requirement set out in the ESEF regulation, whether due to fraud or error.

In our opinion, consolidated financial statements of Íslandsbanki hf. for the 2022 with the file name "549300PZMFIQR79Q0T97-2022-12-31-en.zip" is prepared, in all material respects, in compliance with the ESEF Regulation.

Report on the Board of Directors Report

Pursuant to the legal requirements of Article 104, Paragraph 2 of the Icelandic Financial Statement Act no. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the consolidated financial statements includes all information required by the Icelandic Financial Statement Act.

Reykjavík, 9 February 2023

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Geir Steindórsson
State Authorised Public Accountant

Ernst & Young ehf.
Borgartúni 30
105 Reykjavík

Consolidated Income Statement

	Notes	2022	2021
Interest income calculated using the effective interest rate method		87,671	56,220
Other interest income		6,342	2,405
Interest expense		(50,887)	(24,582)
Net interest income	6	43,126	34,043
Fee and commission income		17,630	15,167
Fee and commission expense		(3,577)	(2,318)
Net fee and commission income	7	14,053	12,849
Net financial income (expense)	8	(1,257)	2,499
Net foreign exchange gain	9	881	479
Other operating income	10	433	302
Other net operating income		57	3,280
Total operating income		57,236	50,172
Salaries and related expenses	11	(13,452)	(13,397)
Other operating expenses	12	(10,466)	(9,799)
Contribution to the Depositors' and Investors' Guarantee Fund		(165)	(688)
Bank tax		(1,858)	(1,683)
Total operating expenses		(25,941)	(25,567)
Profit before net impairment on financial assets		31,295	24,605
Net impairment on financial assets	13	1,576	3,018
Profit before tax		32,871	27,623
Income tax expense	14	(8,485)	(5,119)
Profit for the year from continuing operations		24,386	22,504
Discontinued operations held for sale, net of income tax	15	149	1,221
Profit for the year		24,535	23,725
Profit attributable to shareholders of Íslandsbanki hf.		24,535	23,732
Loss attributable to non-controlling interests		-	(7)
Profit for the year		24,535	23,725
Earnings per share from continuing operations			
Basic and diluted earnings per share attributable to shareholders of Íslandsbanki hf.	16	12.19	11.26

The notes on pages 20 to 87 are an integral part of these Consolidated Financial Statements.

Íslandsbanki hf. Consolidated Financial Statements 2022 14 Amounts are in ISK million

Consolidated Statement of Comprehensive Income

	2022	2021
Profit for the year	24,535	23,725
Net loss on financial assets	-	(39)
Net gain (loss) on financial liabilities	2,527	(816)
Items that will not be reclassified to the income statement	2,527	(855)
Foreign currency translation	2	329
Items that may subsequently be reclassified to the income statement	2	329
Other comprehensive income (expense) for the year, net of tax	2,529	(526)
Comprehensive income for the year	27,064	23,199
Comprehensive income attributable to shareholders of Íslandsbanki hf.	27,064	23,453
Comprehensive income (expense) attributable to non-controlling interests	-	(254)
Comprehensive income for the year	27,064	23,199

The notes on pages 20 to 87 are an integral part of these Consolidated Financial Statements.

Íslandsbanki hf. Consolidated Financial Statements 2022 15 Amounts are in ISK million

Consolidated Statement of Financial Position

	Notes	31.12.2022	31.12.2021
Assets			
Cash and balances with Central Bank	21	94,424	113,667
Loans to credit institutions	22	110,364	43,988
Bonds and debt instruments	17	130,804	132,289
Derivatives	23	7,461	2,445
Loans to customers	24	1,186,639	1,086,327
Shares and equity instruments	17	15,868	31,677
Investments in associates	26	3,844	939
Property and equipment	27	6,752	7,010
Intangible assets	28	3,279	3,351
Other assets	29	6,072	5,784
Non-current assets and disposal groups held for sale	30	728	1,344
Total Assets		1,566,235	1,428,821
Liabilities			
Deposits from Central Bank and credit institutions	31	15,269	13,384
Deposits from customers	32	789,897	744,036
Derivative instruments and short positions	23	10,804	9,467
Debt issued and other borrowed funds	34	468,270	402,226
Subordinated loans	35	34,392	35,762
Tax liabilities	37	12,128	6,432
Other liabilities	38	16,601	12,848
Non-current liabilities and disposal groups held for sale	30	-	956
Total Liabilities		1,347,361	1,225,111
Equity			
Share capital		10,000	10,000
Share premium		55,000	55,000
Reserves		9,158	6,086
Retained earnings		144,716	132,624
Total Equity		218,874	203,710
Total Liabilities and Equity		1,566,235	1,428,821

The notes on pages 20 to 87 are an integral part of these Consolidated Financial Statements.

Íslandsbanki hf. Consolidated Financial Statements 2022 16 Amounts are in ISK million

Consolidated Statement of Changes in Equity

	Share capital	Share premium	Statutory reserve	Restricted reserves	Fair value reserve	Liability credit reserve	Foreign currency translation reserve	Retained earnings	Total shareholders' equity	Non-controlling interests	Total equity
Equity as at 1 January 2021	10,000	55,000	2,500	3,556	572	(238)	(209)	113,529	184,710	1,494	186,204
Profit (loss) for the year								23,732	23,732	(7)	23,725
Net gain (loss) on financial assets					(572)			900	328	(367)	(39)
Net loss on financial liabilities						(816)			(816)		(816)
Foreign currency translation							209		209	120	329
Comprehensive income (expense) for the year	-	-	-	-	(572)	(816)	209	24,632	23,453	(254)	23,199
Dividends paid								(3,400)	(3,400)		(3,400)
Restricted due to capitalised development costs				(291)				291	-		-
Restricted due to fair value changes				1,318				(1,318)	-		-
Restricted due to associates				57				(57)	-		-
Dissolution of a subsidiary								(1,053)	(1,053)	(1,240)	(2,293)
Equity as at 31 December 2021	10,000	55,000	2,500	4,640	-	(1,054)	-	132,624	203,710	-	203,710
Equity as at 1 January 2022	10,000	55,000	2,500	4,640	-	(1,054)	-	132,624	203,710	-	203,710
Profit for the year								24,535	24,535		24,535
Net gain (loss) on financial liabilities						2,840		(313)	2,527		2,527
Foreign currency translation							2		2		2
Comprehensive income for the year	-	-	-	-	-	2,840	2	24,222	27,064	-	27,064
Dividends paid								(11,900)	(11,900)		(11,900)
Restricted due to capitalised development costs				(292)				292	-		-
Restricted due to fair value changes				424				(424)	-		-
Restricted due to associates				98				(98)	-		-
Equity as at 31 December 2022	10,000	55,000	2,500	4,870	-	1,786	2	144,716	218,874	-	218,874

Authorised and issued share capital of the Bank is 2,000 million ordinary shares of ISK 5 each. At 31 December 2022 paid up share capital totalled ISK 65,000 million which is the total stated share capital of the Bank. The Bank has one class of ordinary shares which carry no right to fixed income. The Annual General Meeting (AGM) for the operating year 2021 was held on 17 March 2022. At the AGM shareholders approved the Board's proposal to pay dividends to shareholders amounting to ISK 11,900 million which is equivalent to ISK 5.95 per share (2021: ISK 1.70 per share). The dividends were paid on 28 March 2022.

The notes on pages 20 to 87 are an integral part of these Consolidated Financial Statements.

Íslandsbanki hf. Consolidated Financial Statements 2022 17 Amounts are in ISK million

Consolidated Statement of Cash Flows

		2022	2021
Profit for the year		24,535	23,725
Non-cash items included in profit for the year*		(39,076)	(32,764)
Changes in operating assets and liabilities*		(57,031)	(38,778)
Interest received		78,521	58,936
Interest paid**		(42,172)	(18,691)
Dividends received		1,049	54
Paid bank tax		(1,683)	(1,588)
Paid income tax and special financial activities tax		(3,582)	(3,794)
Net cash used in operating activities		(39,439)	(12,900)
Net investment in subsidiaries and associates		(1,103)	2,727
Proceeds from sales of property and equipment		35	29
Purchase of property and equipment		(273)	(206)
Purchase of intangible assets		(470)	(442)
Net cash provided by (used in) investing activities		(1,811)	2,108
Proceeds from borrowings		191,503	86,048
Repayment and repurchases of borrowings		(129,448)	(55,332)
Repayment of lease liabilities		(472)	(425)
Dividends paid		(11,900)	(3,400)
Subsidiary's capital decrease and share buyback paid to non-controlling interests		-	(1,130)
Net cash provided by financing activities		49,683	25,761
Net increase in cash and cash equivalents		8,433	14,969
Effects of foreign exchange rate changes		5	(40)
Cash and cash equivalents at the beginning of the year		130,597	115,668
Cash and cash equivalents at year-end		139,035	130,597
Reconciliation of cash and cash equivalents	Notes		
Cash on hand	21	3,563	3,882
Unrestricted balances with Central Bank	21	80,866	100,528
Bank accounts	22	54,606	26,187
Cash and cash equivalents at year-end		139,035	130,597

*For further breakdown see the following page.

**Interest is defined as having been paid when it has been deposited into the customer account and is available for the customer's disposal.

The Group has prepared its consolidated statement of cash flows using the indirect method. The statement is based on the net profit after tax for the year and shows the cash flows from operating, investing and financing activities and the increase or decrease in cash and cash equivalents during the year.

Presentation of interest received and interest paid has been changed, comparative figures have therefore been restated.

The notes on pages 20 to 87 are an integral part of these Consolidated Financial Statements.

Íslandsbanki hf. Consolidated Financial Statements 2022 18 Amounts are in ISK million

Consolidated Statement of Cash Flows

Non-cash items included in profit for the year

	2022	2021
Net interest income	(43,126)	(34,032)
Depreciation, amortisation, and write-offs	1,400	1,395
Share of profit, gain from sale, and reversal of impairment of associates	(198)	(133)
Net impairment on financial assets	(1,430)	(2,723)
Foreign exchange gain	(881)	(479)
Net gain from sales of property and equipment	(19)	(18)
Unrealised fair value gain recognised in profit or loss	(5,115)	(2,371)
Discontinued operations held for sale, net of income tax	(149)	(1,221)
Bank tax	1,858	1,683
Income tax expense	8,485	5,119
Other changes	99	16
Total	(39,076)	(32,764)

Changes in operating assets and liabilities

	2022	2021
Mandatory reserve and pledged balances with Central Bank	(738)	292
Loans to credit institutions	(32,284)	25,827
Bonds and debt instruments	4,557	(7,914)
Loans to customers	(78,415)	(81,116)
Shares and equity instruments	13,313	(15,272)
Other assets	(293)	(2,411)
Non-current assets and liabilities held for sale	(182)	1,380
Deposits from Central Bank and credit institutions	1,546	(25,941)
Deposits from customers	41,048	66,551
Derivative instruments and short positions	(9,207)	(1,055)
Other liabilities	3,624	881
Total	(57,031)	(38,778)

Significant non-cash transactions

Significant non-cash transactions 2022

During the year the Group repurchased own debt securites amounting to ISK 8,094 million by issuing new debt.

Significant non-cash transactions 2021

During the year the Group repurchased own debt securites amounting to ISK 1,511 million by issuing new debt.

The notes on pages 20 to 87 are an integral part of these Consolidated Financial Statements.

Íslandsbanki hf. Consolidated Financial Statements 2022 19 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Notes to the Consolidated Financial Statements

1. Corporate information

Íslandsbanki hf., the parent company, was incorporated on 8 October 2008 and is a limited liability company domiciled in Iceland. The registered office is at Hagasmári 3, 201 Kópavogur, Iceland.

The consolidated financial statements for the year ended 31 December 2022 ("the consolidated financial statements") comprise the financial statements of Íslandsbanki hf. ("the Bank" or "Íslandsbanki") and its subsidiaries together referred to as "the Group". The Bank's main subsidiaries are Íslandssjóðir hf. (Iceland Funds) and Allianz Ísland hf., additionally Íslandsbanki has control over nine other non-significant subsidiaries. All of the Bank's subsidiaries are wholly-owned.

The Group provides a wide range of financial services such as retail banking, corporate banking, investment banking, wealth management and asset financing. The Group operates mainly in the Icelandic market.

The consolidated financial statements were written in English and approved and authorised for issue by the Board of Directors and the CEO of Íslandsbanki hf. on 9 February 2023. In case of discrepancy between the English version and the Icelandic translation, the English original will prevail.

2. Basis of preparation

The consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union and additional requirements in the Act on Annual Accounts no. 3/2006, the Act on Financial Undertakings no. 161/2002 and rules on accounting for credit institutions.

The consolidated financial statements are presented in Icelandic króna (ISK), which is the functional currency of Íslandsbanki hf. All amounts presented in ISK have been rounded to the nearest million, except where otherwise indicated. At 31 December 2022 the exchange rate of the ISK against the USD was 142.04 and for the EUR 151.50 (at year-end 2021: USD 130.38 and EUR 147.60).

The Group's management has made an assessment of the Group's ability to continue as a going concern and is satisfied that the Group has the resources to continue in business for the foreseeable future. Therefore, the consolidated financial statements have been prepared on a going concern basis.

Basis of measurement

The consolidated financial statements are prepared on a historical cost basis, except for the following assets and liabilities, which are measured at fair value: bonds and debt instruments, shares and equity instruments, short positions in listed bonds, derivative financial instruments, and certain bonds issued by the Group.

Recognised financial liabilities designated as hedged items in qualifying fair value hedge relationships are measured at amortised cost adjusted for changes in fair value attributable to the risk being hedged.

Non-current assets and disposal groups held for sale are measured at the lower of its carrying amount and fair value less costs to sell.

3. Significant accounting estimates and judgements

In preparing these consolidated financial statements management has made judgements, estimates, and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income, and expenses. Management bases its judgements on previous experience and other factors that are considered reasonable under the circumstances, but actual results may differ from those estimates.

Management continuously evaluates these judgements, estimates, and assumptions. Changes in accounting estimates are recognised when they occur.

Key sources of estimation uncertainty include the allowance for credit losses and the determination of fair value of financial instruments.

3. Significant accounting estimates and judgements (continued)

Impairment of financial assets

The main assumptions used for calculating the allowance for credit losses that are subject to significant judgement include the following:

- Probability of default (PD), loss given default (LGD) and exposure at default (EAD)
- Macroeconomic variables for multiple scenarios built on available information
- Assessment of significant increase in credit risk (SIRC)

The PD, LGD and EAD inputs used to estimate expected credit losses are modelled based on variables that are most closely related with credit losses in the relevant portfolio. This includes macroeconomic variables, demographic variables, variables related to past payment history among other variables. These variables are sourced both internally and externally. Significant judgements required for measuring expected credit loss (ECL) include the following:

- Determining criteria for assessing what constitutes a significant increase in credit risk
- Establishing the forward-looking scenarios and their relative weightings
- Choosing appropriate models and assumptions for the measurement of ECL

For the first half of 2022 the Group made temporary changes to the impairment model due to the COVID-19 pandemic. The Group's impairment process allows for temporary changes to the impairment model to account for circumstances when it becomes evident that existing or expected risk factors have not been appropriately considered in the credit risk rating or modelling process. The COVID-19 pandemic created such circumstances for the tourism industry and therefore an adjustment was warranted.

Due to the general uncertainty in the operating environment of companies in the tourism industry, exposures were transferred to Stage 2 where the increase was estimated to be significant. At the end of the third quarter, however, the Group found that the uncertainty with regards to the impact of the COVID-19 pandemic on the credit quality of the Group's credit exposures had greatly reduced following a strong tourist season. Now that three years have passed since the pandemic started, all of these companies have received an updated risk assessment and the general uncertainty no longer applies. It was therefore decided to remove the general overlay factor and the transfer to Stage 2 in cases where no other indicators had been activated. For significant exposures where an increase in ECL was deemed to be appropriate, the added impairment allowance is accounted for through individual assessment in a manual process.

The All Risk Committee has determined it to be appropriate to adjust the weights of the scenarios following the COVID-19 pandemic and more recently the unrest following the war in Ukraine. Generally the scenarios are weighted 25%-50%-25% (good, base, bad) but the current weights are 20%-50%-30%. When deciding on the appropriate weights for the three scenarios, management used sensitivity analysis that indicated that a shift of 5% weight from the baseline to the pessimistic scenario would increase the impairment allowance by ISK 300 million while a 5% shift from the baseline to the optimistic scenario would decrease the allowance by ISK 160 million.

The allowance for credit losses is further discussed in Notes 24-25, in Notes 46-50 on risk management and in Note 61.4.

Fair value of financial instruments

The objective of the fair value measurement is to arrive at the price at which an orderly transaction would take place between market participants at the measurement date under current market conditions. The best evidence of fair value is a quoted price for the instrument being measured in an actively traded market. Where an active market or quoted prices are not available the fair value of financial instruments are decided upon by using valuation techniques. Financial instruments measured at fair value are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. Level 3 financial assets are measured at fair value using valuation techniques based on significant unobservable inputs. The valuation of Level 3 financial assets is a subjective area as the assumption on which the valuation is based on is not easily observable and subject to management's assessment. Changes made to the evaluation criteria could have a significant impact on the Group's results and financial position. The valuation methods are discussed in Notes 18-19 and in Note 61.4.

4. Changes to accounting policies

Amendments to IFRS standards that became effective from 1 January 2022 did not have a material impact on the consolidated financial statements.

Changes to IFRS standards issued but not effective at the reporting date

A new IFRS standard and amendments to several IFRS standards have been issued but are not yet effective. The Group did not early adopt any of them and intends to adopt them when they become effective. The Group currently does not expect a material impact on its future consolidated financial statements as a result of these changes.

Notes to the Consolidated Financial Statements

5. Operating segments

Segment information is presented in accordance with the Group's management and internal reporting structure. The segments' operating results are reported to the Board of Directors and the Chief Executive Officer, who are responsible for allocating resources to the reportable segments and assessing their financial performance.

An operating segment is a distinguishable component of the Group, for which discrete financial information is available, that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. Each operating segment is engaged in providing products or services which are subject to risk and return that are different from those of other operating segments. The accounting policies for the reportable segments are in accordance with the Group's accounting policies. The Group operates mainly in the Icelandic market.

The Bank has three main business segments: Personal Banking, Business Banking, and Corporate & Investment Banking. Operating segments pay and receive interest to and from Treasury to reflect the allocation of capital, funding costs, and the relevant risk premium. Capital allocation to the business units is based on the Pillar 1 regulatory capital requirement, the Pillar 2-R capital requirement calculated according to the Bank's Internal Capital Adequacy Assessment Process (ICAAP) and the combined buffer requirement as stipulated in the Act on Financial Undertakings no. 161/2002. Income tax and bank tax with breakdown for each segment is according to the current tax rates.

The Group comprises the following operating segments:

Personal Banking

Personal Banking provides comprehensive financial services to individuals, such as lending, savings and payments. Íslandsbanki's customers are increasingly taking care of their day-to-day banking via digital solutions such as apps, the online bank and the secure web chat. Customers can also visit the Bank's efficient branch network for comprehensive consultancy services and contact the advisory centre.

Business Banking

Business Banking provides small and medium-sized enterprises (SMEs) with comprehensive financial services and Ergo, the Bank's asset financing service, is also part of the division. Business Banking serves customers in business centres and branches close to their business. Via online banking and the app, customers have full overview of their business and day-to-day operations are easy to manage.

Corporate & Investment Banking

Corporate & Investment Banking provides universal banking services to large companies, municipalities, institutional investors, and affluent individuals. Services include customised products and services to customers including lending and advisory, risk management, brokerage, and private banking services. The division is sector-focused, building and maintaining relationships with key customer segments within Iceland. Outside of Iceland, Íslandsbanki has a special focus on the North Atlantic seafood industry, leveraging its expertise in the domestic market and global contacts.

Treasury and Proprietary Trading

Treasury is responsible for funding the Bank's operations and for managing the internal pricing framework. It is also responsible for the Bank's balance sheet management and for relations with investors, financial institutions, stock exchanges, and rating agencies. Equity that is not allocated to business units sits within Treasury. Proprietary Trading includes equity and debt investments in the trading book and the banking book.

Cost centres

Cost centres comprise the CEO's office (Human Resources, Marketing & Communications, Strategy & Sustainability, and Legal), IT, Risk Management, Compliance, and Finance excluding Treasury and Proprietary Trading. Group Internal Audit is also included in cost centres, however, it is independent from the Bank and the Chief Audit Executive reports directly to the Bank's Board of Directors.

Subsidiaries, eliminations and adjustments

Subsidiaries include Íslandssjóðir hf. (Iceland Funds), Allianz Ísland hf. and other less significant subsidiaries. Assets and liabilities of subsidiaries, that are classified as non-current assets and disposal groups held for sale, are included in the column "Other subsidiaries". All inter-company eliminations are included in the column "Eliminations & adjustments".

Following is an overview showing the Group's performance with a breakdown by operating segments.

Notes to the Consolidated Financial Statements

5. Operating segments (continued)

2022	Personal Banking	Business Banking	Corporate & Investment Banking	Treasury & Proprietary Trading	Cost centres	The Bank total	Subsidiaries, eliminations & adjustments	The Group total
Net interest income (expense)	15,065	14,493	11,108	2,673	(260)	43,079	47	43,126
Net fee and commission income (expense)	4,334	2,174	4,557	(55)	(1)	11,009	3,044	14,053
Other net operating income	342	90	1,301	398	149	2,280	(2,223)	57
Total operating income	19,741	16,757	16,966	3,016	(112)	56,368	868	57,236
Salaries and related expenses	(2,355)	(1,900)	(1,819)	(289)	(6,253)	(12,616)	(836)	(13,452)
Other operating expenses	(2,446)	(1,072)	(971)	(467)	(4,898)	(9,854)	(612)	(10,466)
Contribution to the Depositors' and Investors' Guarantee Fund	(129)	(33)	(3)	-	-	(165)	-	(165)
Bank tax	(801)	(407)	(520)	(116)	(14)	(1,858)	-	(1,858)
Net impairment on financial assets	(300)	796	395	683	-	1,574	2	1,576
Cost allocation	(4,792)	(3,431)	(3,237)	551	10,909	-	-	-
Profit (loss) before tax	8,918	10,710	10,811	3,378	(368)	33,449	(578)	32,871
Income tax income (expense)	(2,528)	(2,891)	(2,946)	108	92	(8,165)	(320)	(8,485)
Profit (loss) for the year from continuing operations	6,390	7,819	7,865	3,486	(276)	25,284	(898)	24,386
Net segment revenue from external customers	33,261	18,158	23,790	(18,922)	81	56,368	868	57,236
Net segment revenue from other segments	(13,520)	(1,401)	(6,824)	21,938	(193)	-	-	-
Fee and commission income	7,282	2,223	4,709	367	-	14,581	3,049	17,630
Depreciation, amortisation, and write-offs	(172)	(57)	(1)	-	(1,155)	(1,385)	(15)	(1,400)
At 31 December 2022								
Loans to customers	552,181	278,823	354,787	848	-	1,186,639	-	1,186,639
Other assets	3,158	2,100	3,859	360,594	9,387	379,098	498	379,596
Total segment assets	555,339	280,923	358,646	361,442	9,387	1,565,737	498	1,566,235
Deposits from customers	361,994	244,645	164,390	21,529	-	792,558	(2,661)	789,897
Other liabilities	2,597	2,054	5,565	540,189	5,785	556,190	1,274	557,464
Total segment liabilities	364,591	246,699	169,955	561,718	5,785	1,348,748	(1,387)	1,347,361
Allocated equity	39,228	40,433	62,400	73,966	962	216,989	1,885	218,874
Risk exposure amount	255,938	263,011	404,917	67,970	6,107	997,943	1,548	999,491

The individual segment balance sheet positions are with external customers, and exclude internal transactions thus explaining the differences in total assets, and total liabilities and equity.

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5. Operating segments (continued)

2021	Personal Banking	Business Banking	Corporate & Investment Banking	Treasury & Proprietary Trading	Cost centres	The Bank total	Subsidiaries, eliminations & adjustments	The Group total
Net interest income (expense)	12,027	10,867	9,282	2,034	(178)	34,032	11	34,043
Net fee and commission income (expense)	3,850	2,111	4,384	(72)	(62)	10,211	2,638	12,849
Other net operating income	189	61	759	2,694	203	3,906	(626)	3,280
Total operating income	16,066	13,039	14,425	4,656	(37)	48,149	2,023	50,172
Salaries and related expenses	(2,388)	(1,815)	(1,689)	(256)	(6,465)	(12,613)	(784)	(13,397)
Other operating expenses	(2,354)	(1,037)	(797)	(235)	(4,854)	(9,277)	(522)	(9,799)
Contribution to the Depositors' and Investors' Guarantee Fund	(538)	(135)	(15)	-	-	(688)	-	(688)
Bank tax	(723)	(344)	(516)	(86)	(14)	(1,683)	-	(1,683)
Net impairment on financial assets	318	2,401	121	94	4	2,938	80	3,018
Cost allocation	(4,539)	(3,113)	(3,170)	320	10,502	-	-	-
Profit (loss) before tax	5,842	8,996	8,359	4,493	(864)	26,826	797	27,623
Income tax income (expense)	(1,707)	(2,428)	(2,308)	1,421	221	(4,801)	(318)	(5,119)
Profit (loss) for the year from continuing operations	4,135	6,568	6,051	5,914	(643)	22,025	479	22,504
Net segment revenue from external customers	26,175	14,806	19,843	(12,748)	73	48,149	2,023	50,172
Net segment revenue from other segments	(10,109)	(1,767)	(5,418)	17,404	(110)	-	-	-
Fee and commission income	5,669	2,136	4,486	231	2	12,524	2,643	15,167
Depreciation, amortisation, and write-offs	(166)	(58)	(15)	-	(1,145)	(1,384)	(11)	(1,395)
At 31 December 2021								
Loans to customers	502,354	237,388	346,835	59	-	1,086,636	(309)	1,086,327
Other assets	3,609	2,004	1,335	325,158	9,108	341,214	1,280	342,494
Total segment assets	505,963	239,392	348,170	325,217	9,108	1,427,850	971	1,428,821
Deposits from customers	344,776	239,871	141,204	21,477	-	747,328	(3,292)	744,036
Other liabilities	1,603	1,630	4,728	465,397	5,711	479,069	2,006	481,075
Total segment liabilities	346,379	241,501	145,932	486,874	5,711	1,226,397	(1,286)	1,225,111
Allocated equity	37,549	33,738	59,055	70,217	894	201,453	2,257	203,710
Risk exposure amount	247,970	211,814	376,896	56,983	5,903	899,566	2,080	901,646

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Notes to the Consolidated Financial Statements

5. Operating segments (continued)

Subsidiaries, eliminations & adjustments

2022	Íslands-sjóðir hf.	Allianz Ísland hf.	Other subsidiaries	Eliminations & adjustments	Total
Net interest income (expense)	9	34	52	(48)	47
Net fee and commission income (expense)	1,627	1,561	(30)	(114)	3,044
Other net operating income	(55)	11	270	(2,449)	(2,223)
Total operating income	1,581	1,606	292	(2,611)	868
Salaries and related expenses	(562)	(209)	(65)	-	(836)
Other operating expenses	(218)	(602)	(214)	422	(612)
Net impairment on financial assets	2	-	-	-	2
Profit (loss) before tax	803	795	13	(2,189)	(578)
Income tax expense	(178)	(142)	-	-	(320)
Profit (loss) for the year from continuing operations	625	653	13	(2,189)	(898)
Net segment revenue from external customers	1,855	1,479	11	(2,477)	868
Net segment revenue from other segments	(274)	127	281	(134)	-
Fee and commission income	2,171	1,561	-	(683)	3,049
Depreciation, amortisation, and write-offs	-	-	(6)	(9)	(15)
At 31 December 2022					
Total assets	2,472	1,926	5,469	(9,369)	498
Total liabilities	354	714	134	(2,589)	(1,387)
Total equity	2,118	1,212	5,335	(6,780)	1,885

2021	Íslands-sjóðir hf.	Allianz Ísland hf.	Other subsidiaries	Eliminations & adjustments	Total
Net interest income (expense)	1	6	15	(11)	11
Net fee and commission income (expense)	1,733	938	(30)	(3)	2,638
Other net operating income	338	16	38	(1,018)	(626)
Total operating income	2,072	960	23	(1,032)	2,023
Salaries and related expenses	(590)	(191)	(3)	-	(784)
Other operating expenses	(197)	(455)	(40)	170	(522)
Net impairment on financial assets	-	-	-	80	80
Profit (loss) before tax	1,285	314	(20)	(782)	797
Income tax expense	(256)	(62)	-	-	(318)
Profit (loss) for the year from continuing operations	1,029	252	(20)	(782)	479
Net segment revenue from external customers	2,332	952	-	(1,261)	2,023
Net segment revenue from other segments	(260)	8	23	229	-
Fee and commission income	2,226	938	-	(521)	2,643
Depreciation, amortisation, and write-offs	-	(1)	(1)	(9)	(11)
At 31 December 2021					
Total assets	2,926	1,333	7,285	(10,573)	971
Total liabilities	401	716	1,386	(3,789)	(1,286)
Total equity	2,525	617	5,899	(6,784)	2,257

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6. Net interest income

	2022	2021
Cash and balances with Central Bank	2,791	948
Loans to credit institutions	757	128
Loans to customers	84,123	55,144
Financial assets mandatorily at fair value through profit or loss	6,335	2,388
Other assets	7	17
Interest income	94,013	58,625
Deposits from Central Bank and credit institutions	(364)	(306)
Deposits from customers	(23,049)	(6,815)
Debt issued and other borrowed funds designated as at fair value through profit or loss	(578)	(729)
Debt issued and other borrowed funds at amortised cost	(21,709)	(14,104)
Subordinated loans	(1,538)	(829)
Lease liabilities	(82)	(84)
Other liabilities	(3,567)	(1,715)
Interest expense	(50,887)	(24,582)
Net interest income	43,126	34,043

Net interest margin on total assets 2.9% (2021: 2.4%)

7. Net fee and commission income

	2022	2021
Asset management	3,154	3,100
Investment banking and brokerage	3,627	3,544
Payment processing	6,774	4,979
Loans and guarantees	2,350	2,212
Other fee and commission income	1,725	1,332
Fee and commission income	17,630	15,167
Brokerage	(484)	(471)
Clearing and settlement	(2,999)	(1,834)
Other fee and commission expense	(94)	(13)
Fee and commission expense	(3,577)	(2,318)
Net fee and commission income	14,053	12,849

Fee and commission income by segment is disclosed in Note 5.

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8. Net financial income (expense)

	2022	2021
Net gain (loss) on financial assets and financial liabilities mandatorily at fair value through profit or loss	(6,121)	1,641
Net gain on financial liabilities designated as at fair value through profit or loss	4,512	845
Net gain (loss) on fair value hedges	(56)	13
Net gain on derecognition of financial liabilities measured at amortised cost	408	-
Net financial income (expense)	(1,257)	2,499

The following table shows the categorisation of the net financial income (expense) by type.

	2022	2021
Net gain (loss) on bonds and related derivatives	(2,735)	56
Net gain (loss) on shares and related derivatives	(1,051)	1,086
Dividend income	1,049	54
Net gain on debt issued and related derivatives	754	913
Net gain on other derivatives	726	390
Net financial income (expense)	(1,257)	2,499

9. Net foreign exchange gain

	2022	2021
Cash and balances with Central Bank	5	(40)
Loans at amortised cost	11,647	(6,515)
Financial assets mandatorily at fair value through profit or loss	(1,078)	(7,435)
Other assets	(11)	(8)
Net foreign exchange gain (loss) for assets	10,563	(13,998)
Deposits	(4,782)	2,273
Debt issued and other borrowed funds designated as at fair value through profit or loss	(1,317)	5,148
Debt issued and other borrowed funds at amortised cost	(5,677)	4,695
Subordinated loans	2,094	2,361
Net foreign exchange gain (loss) for liabilities	(9,682)	14,477
Net foreign exchange gain	881	479

10. Other operating income

	2022	2021
Net gain from sale of associates	158	-
Share of profit of associates, net of income tax	40	73
Reversal of impairment for an associate	-	60
Legal fees	45	69
Rental income	44	41
Other net operating income	146	59
Other operating income	433	302

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11. Personnel and salaries

	2022	2021
Salaries	10,332	10,307
Contributions to pension funds	1,594	1,605
Social security charges and financial activities tax*	1,423	1,382
Other salary-related expenses	103	103
Salaries and related expenses	13,452	13,397

*Financial activities tax calculated on salaries is 5.5% in 2022 (2021: 5.5%).

	2022		2021	
	The Bank	The Group	The Bank	The Group
Average number of employees	730	772	759	794
Positions at year-end	700	739	702	735

Total amount of compensation to the Board of Directors, the CEO, and Executive Board are specified as follows:

	2022	2021
Finnur Árnason, Chairman of the Board	9.5	-
Guðrún Þorgeirsdóttir, Vice-Chairman of the Board	8.9	8.0
Anna Þórðardóttir, member of the Board	9.0	8.5
Ari Daníelsson, member of the Board	6.4	-
Frosti Ólafsson, member of the Board	8.9	8.0
Herdís Gunnarsdóttir, member of the Board*	2.5	4.5
Tanya Sharov, member of the Board	6.4	-
Hallgrímur Snorrason, former Chairman of the Board	3.6	11.9
Heiðrún Jónsdóttir, former Vice-Chairman of the Board	7.6	9.8
Árni Stefánsson, former member of the Board	2.2	8.5
Jökull H. Úlfsson, former member of the Board	2.3	6.1
Alternate board members	0.6	0.6
Total salaries	67.9	65.9

Contribution to pension funds for the Board of Directors amounted to ISK 9.2 million in 2022 (2021: ISK 8.5 million).

*Member of the Board since October 2022 (2021: January - March).

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Notes to the Consolidated Financial Statements

11. Personnel and salaries (continued)

	2022		2021	
	Fixed salaries & benefits	Pension funds contrib.	Fixed salaries & benefits*	Pension funds contrib.
Birna Einarsdóttir, CEO	48.3	11.5	46.1	11.6
Ásmundur Tryggvason, Managing Director of Corporate & Investment Banking**	47.0	6.7	40.1	6.1
Guðmundur Kristinn Birgisson, Chief Risk Officer	39.8	5.6	36.7	5.3
Jón Guðni Ómarsson, Chief Financial Officer**	46.9	6.6	38.9	6.2
Riaan Dreyer, Managing Director of Information Technology	42.7	6.4	39.4	6.1
Sigríður Hrefna Hrafnkelsdóttir, Managing Director of Personal Banking	41.1	5.7	37.9	5.2
Una Steinsdóttir, Managing Director of Business Banking	42.9	6.1	39.5	5.5
Total	308.7	48.6	278.6	46.0

Benefits are non-monetary benefits such as the use of cars owned by the Group.

As of 1 January 2017, the Bank has not had an active remuneration policy in place as stated in the Bank's compensation policy. In 2022 there were no paid performance-based salaries (2021: none) and there were no unpaid performance-based salaries at year-end 2022. There were no share-based payments in the years 2022 and 2021.

*Many employees of the Bank were subject to additional workload during 2021 because of the Bank's IPO and listing of shares on Nasdaq Iceland. In total, the Bank paid ISK 110.3 million to employees for overtime, of which the Bank's CEO received a payment of ISK 10.9 million and other members of the executive board received ISK 30.3 million. Contributions to pension funds for overtime payments amounted to ISK 1.7 million for the Bank's CEO and ISK 3.4 million for other members of the executive board. The overtime payments are not included in the table above.

**Included in salaries for the year 2022 are employment anniversary payments. The payments are in accordance with the collective agreement of the Confederation of Icelandic Bank and Finance Employees (SSF).

12. Other operating expenses

	2022	2021
Professional services	1,986	2,153
Software and IT expenses	4,389	4,214
Real estate and office equipment	565	556
Depreciation, amortisation, and write-offs	1,400	1,395
Other administrative expenses	2,126	1,481
Other operating expenses	10,466	9,799

Auditors' fees

	2022	2021
Audit of the financial statements	81	95
Review of interim financial statements	20	31
Other services	7	8
Auditors' fees	108	134

13. Net impairment on financial assets

	2022	2021
Net change in expected credit losses, on-balance sheet items	1,837	2,964
Net change in expected credit losses, off-balance sheet items	(336)	54
Changes in provision due to court rulings	75	-
Net impairment on financial assets	1,576	3,018

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14. Income tax expense

Recognised income tax is based on applicable tax laws. The income tax rate for legal entities in 2022 is 20% (2021: 20%). Special financial activities tax is calculated as 6% of the Bank's taxable profit exceeding ISK 1 billion in accordance with the Act on Financial Activities Tax no. 165/2011. The effective income tax rate in the Group's income statement for the year 2022 is 25.8% (2021: 18.5%).

	2022	2021
Current tax expense excluding discontinued operations	5,659	3,339
Special financial activities tax	1,396	853
Adjustments in prior year's calculated income tax	(472)	24
Changes in deferred tax assets and deferred tax liabilities	1,902	903
Income tax recognised in the income statement	8,485	5,119
Income tax recognised in other comprehensive income	(110)	-

	2022		2021	
Profit before tax	32,871		27,623	
20% income tax calculated on the profit for the year	6,574	20.0%	5,525	20.0%
Special financial activities tax	1,396	4.2%	853	3.1%
Share in taxes of non-independent taxpayers	150	0.5%	-	0.0%
Adjustments in prior year's calculated income tax	(472)	(1.4%)	-	0.0%
Income not subject to tax	(386)	(1.2%)	(1,611)	(5.8%)
Non-deductible expenses	1,210	3.7%	338	1.2%
Other differences	13	0.0%	14	0.00%
Effective income tax expense	8,485	25.8%	5,119	18.5%

The Bank is taxed jointly with its subsidiary Íslandssjóðir hf. (Iceland Funds).

15. Discontinued operations held for sale, net of income tax

	2022	2021
Net gain from foreclosed assets	45	191
Net gain (loss) from disposal groups held for sale	(1)	473
Net gain from sale or dissolution of subsidiaries	114	687
Income tax expense	(9)	(130)
Discontinued operations held for sale, net of income tax	149	1,221

16. Earnings per share

	Continued operations		Discontinued operations		Profit for the year	
	2022	2021	2022	2021	2022	2021
Profit attributable to shareholders of the Bank	24,386	22,511	149	1,221	24,535	23,732
Weighted average number of outstanding shares	2,000	2,000	2,000	2,000	2,000	2,000
Basic earnings per share	12.19	11.26	0.07	0.61	12.27	11.87

The Group's basic and diluted earnings per share are equal as the Group has not issued any options, warrants, convertibles, or other financial instruments that dilute earnings per share (2021: none).

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17. Classification of financial assets and financial liabilities

At 31 December 2022	Mandatorily at FVTPL	Hedge accounting	Designated as at FVTPL	Amortised cost	Carrying amount
Cash and balances with Central Bank	-	-	-	94,424	94,424
Loans to credit institutions	-	-	-	110,364	110,364
Listed bonds and debt instruments	125,318	-	-	-	125,318
Listed bonds and debt instruments used for economic hedging	3,454	-	-	-	3,454
Unlisted bonds and debt instruments	2,032	-	-	-	2,032
Derivatives	7,461	-	-	-	7,461
Loans to customers	-	-	-	1,186,639	1,186,639
Listed shares and equity instruments	3,221	-	-	-	3,221
Listed shares and equity instruments used for economic hedging	10,401	-	-	-	10,401
Unlisted shares and equity instruments	2,246	-	-	-	2,246
Other financial assets	-	-	-	5,411	5,411
Total financial assets	154,133	-	-	1,396,838	1,550,971
Deposits from Central Bank and credit institutions	-	-	-	15,269	15,269
Deposits from customers	-	-	-	789,897	789,897
Derivative instruments and short positions	9,208	1,596	-	-	10,804
Debt issued and other borrowed funds	-	49,579	83,437	335,254	468,270
Subordinated loans	-	-	-	34,392	34,392
Other financial liabilities	-	-	-	11,329	11,329
Total financial liabilities	9,208	51,175	83,437	1,186,141	1,329,961

At 31 December 2021	Mandatorily at FVTPL	Hedge accounting	Designated as at FVTPL	Amortised cost	Carrying amount
Cash and balances with Central Bank	-	-	-	113,667	113,667
Loans to credit institutions	-	-	-	43,988	43,988
Listed bonds and debt instruments	96,343	-	-	-	96,343
Listed bonds and debt instruments used for economic hedging	35,896	-	-	-	35,896
Unlisted bonds and debt instruments	50	-	-	-	50
Derivatives	1,900	545	-	-	2,445
Loans to customers	-	-	-	1,086,327	1,086,327
Listed shares and equity instruments	3,246	-	-	-	3,246
Listed shares and equity instruments used for economic hedging	24,406	-	-	-	24,406
Unlisted shares and equity instruments	4,025	-	-	-	4,025
Other financial assets	-	-	-	5,241	5,241
Total financial assets	165,866	545	-	1,249,223	1,415,634
Deposits from Central Bank and credit institutions	-	-	-	13,384	13,384
Deposits from customers	-	-	-	744,036	744,036
Derivative instruments and short positions	9,467	-	-	-	9,467
Debt issued and other borrowed funds	-	45,036	89,460	267,730	402,226
Subordinated loans	-	-	-	35,762	35,762
Other financial liabilities	-	-	-	9,681	9,681
Total financial liabilities	9,467	45,036	89,460	1,070,593	1,214,556

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18. Fair value information for financial instruments

Financial instruments carried at fair value

The fair value of a financial instrument is the transaction 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. Where a market price is not readily available, the Group applies valuation techniques based on estimates and assumptions that are consistent with that which market participants would use in setting a price for the financial instrument.

The following table shows financial instruments carried at fair value at 31 December 2022 categorised into three levels of fair value hierarchy that reflect the type of inputs used in making the fair value measurements. The different levels have been defined as follows:

Level 1: Inputs that are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Group can access at the measurement date.

Level 2: Valuation techniques based on observable inputs other than the quoted prices included in Level 1, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Valuation techniques based on significant unobservable inputs, e.g. internal assumptions.

At 31 December 2022	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	128,772	-	2,032	130,804
Derivatives	-	7,461	-	7,461
Shares and equity instruments	13,623	-	2,245	15,868
Total financial assets	142,395	7,461	4,277	154,133
Short positions	285	-	-	285
Derivative instruments	-	10,519	-	10,519
Debt issued and other borrowed funds designated as at FVTPL	83,437	-	-	83,437
Total financial liabilities	83,722	10,519	-	94,241

At 31 December 2021	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	132,239	-	50	132,289
Derivatives	-	2,445	-	2,445
Shares and equity instruments	27,625	-	4,052	31,677
Total financial assets	159,864	2,445	4,102	166,411
Short positions	1,951	-	-	1,951
Derivative instruments	-	7,516	-	7,516
Debt issued and other borrowed funds designated as at FVTPL	89,460	-	-	89,460
Total financial liabilities	91,411	7,516	-	98,927

Changes in Level 3 assets measured at fair value	Bonds and debt instruments	Shares and equity instruments
Fair value at 1 January 2022	50	4,052
Purchases	2,000	38
Sales and share capital reduction	(22)	(454)
Net gain on financial instruments recognised in profit or loss	4	347
Transfers to Level 1 or 2	-	(27)
Transfers to associates*	-	(1,711)
Fair value at 31 December 2022	2,032	2,245

*For further information on investments in associates see Note 26.

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18. Fair value information for financial instruments (continued)

	Bonds and debt instruments	Shares and equity instruments	Non-current assets
Fair value at 1 January 2021	145	2,890	1,266
Purchases	32	178	-
Sales and share capital reduction	(116)	(186)	(1,201)
Net gain (loss) on financial instruments recognised in profit or loss	(11)	1,170	-
Net loss on financial instruments recognised in other comprehensive income	-	-	(65)
Fair value at 31 December 2021	50	4,052	-

At the end of each reporting period the Group determines whether transfers have occurred between levels in the hierarchy, by reassessing categorisation based on the lowest level input that is significant to the fair value measurement as a whole.

Valuation process

The responsibility for the valuation of the fair value of financial instruments lies with the relevant business units. Each quarter, the business units present a valuation report to the Investment Committee for approval. The report and its assumptions are reviewed by Risk Management.

Valuation techniques

Where applicable, fair values are determined using quoted prices in active markets for identical assets and liabilities. If a market for a financial instrument is not active, the Group establishes its fair value using valuation techniques. Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which observable market prices exist, net asset value (NAV) for investment fund units, expected recovery for distressed bonds, Black-Scholes option pricing model and other valuation models.

Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, and expected price volatilities and correlations. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group and the counterparty where appropriate. In some cases, where significant inputs into these models are not observable, expert judgement and estimation for these inputs are required.

Level 1: Fair value established from quoted market prices

Financial instruments at this level are financial assets and financial liabilities containing actively traded bonds and shares that are listed either domestically or abroad.

Level 2: Fair value established using valuation techniques with observable market information

Financial instruments at this level are assets and liabilities containing domestic bonds, shares as well as derivatives. For interest rate derivatives contracts such as interest rate swaps (IRS) and cross-currency interest rate swaps (CIRS) the Group calculates the net present value of estimated future cash flows based on yield curves with key inputs such as interest swap rates and forward-rate agreements (FRAs) rates. Foreign-currency forwards and foreign-currency swaps are valued using the FX spot rate adjusted for forward pricing points that can be obtained from market sources. These products are classified as Level 2. Bond forwards and equity forwards are also classified as Level 2 as they are valued using standard models with key inputs observed from stock prices, estimated dividend rates and funding rates.

Level 3: Fair value established using valuation techniques using significant unobservable market information

Financial instruments at this level contain primarily unlisted and illiquid shares and bonds. Unlisted shares and bonds are initially recorded at their transaction price but are revalued each quarter based on the models as described above.

At 31 December 2022 the Group's Level 3 shares amounted to ISK 2,245 million:

- These include shares in seven professional investment funds and investment companies investing in unlisted shares and specialised investments in Iceland totalling ISK 2,023 million. The Group receives information from fund managers who use valuation models for the valuation of these shares.

- Other Level 3 shares amount to ISK 222 million.

At 31 December 2022 the Group's Level 3 bonds amounted to ISK 2,032 million:

- The majority of the amount in Level 3 bonds is estimated by discounting cash flow where the yield is the contractual currency's base rate with a premium that is decided by expert judgement on projected risk and financing cost.

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18. Fair value information for financial instruments (continued)

Sensitivity analysis for Level 3 assets

The valuations of Level 3 assets are in general uncertain and subject to various factors. The favourable and unfavourable scenarios can be considered as being likely movements in valuation within a year. The very favourable and very unfavourable scenarios are considered less likely, but not impossible and are not worst-case scenarios for some of the assets.

The following table shows how profit before tax would have been affected if one or more of the inputs for the fair value measurement in Level 3 were changed.

At 31 December 2022 **Effect on profit:**	Carrying amount	Very favourable	Favourable	Unfavourable	Very unfavour-able
Level 3 bonds and debt instruments	2,032	14	4	(4)	(7)
Level 3 shares and equity instruments	2,245	1,936	1,119	(109)	(224)

At 31 December 2021 **Effect on profit:**	Carrying amount	Very favourable	Favourable	Unfavourable	Very unfavour-able
Level 3 bonds and debt instruments	50	89	24	(21)	(50)
Level 3 shares and equity instruments	4,052	3,415	1,475	(975)	(1,676)

19. Financial instruments not carried at fair value

Assets

The fair value of "Loans to customers" may differ from their net carrying amount because the interest rates they carry may not reflect the interest rates that similar new loans would carry. The fair value is estimated by subtracting from or adding to the net carrying amount of the loans the discounted interest rate difference calculated from the reporting date until the next interest reset or maturity, whichever comes first. Since the interest rate difference is estimated using internal models these assets are classified as Level 3.

For "Cash and balances with Central Bank", "Loans to credit institutions" and "Other financial assets" the fair value is adequately approximated by the carrying amount as they are short-term in nature. They are thus classified as Level 2.

Liabilities

The fair value of a financial liability with a demand feature, such as a demand deposit, is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. Most deposits are on demand or carry floating interest rates and as such their carrying amount is considered a good approximation of their fair value. The fair value for longer term fixed rate deposits is calculated with a duration approach, using the difference in each liability's current interest rate from the rate that a similar deposit would carry today. All deposits are classified as Level 2 based on the use of observable market interest rates to estimate the fair value.

Observed market value is used for the fair value of "Debt issued and other borrowed funds" where it is available. Issued bonds and bills with quoted market prices are classified as Level 1. If there is no quoted market price the fair value of the debt is valued in the same manner as deposits if it carries a fixed rate. If the debt carries a floating rate its fair value is estimated by comparing the margin with the Group's current funding premium on similar debt. These liabilities are classified as Level 2. The funding premium is based on the interest margin in the Group's issued papers including covered bonds, commercial papers as well as foreign currency denominated bonds.

Other financial liabilities mainly include unsettled securities transactions and payments due to leasing contracts and they are classified as Level 2 since their value is not observable from active market prices. Due to the short-term nature of these liabilities their carrying amount is considered a good approximation of their fair value.

The following table shows the fair value measurement and classification of the Group's assets and liabilities not carried at fair value. The different levels are defined in Note 18.

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19. Financial instruments not carried at fair value (continued)

At 31 December 2022	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Cash and balances with Central Bank	-	94,424	-	94,424	94,424
Loans to credit institutions	-	110,364	-	110,364	110,364
Loans to customers	-	-	1,171,380	1,171,380	1,186,639
Other financial assets	-	5,411	-	5,411	5,411
Total financial assets	-	210,199	1,171,380	1,381,579	1,396,838
Deposits from Central Bank and credit institutions	-	15,108	-	15,108	15,269
Deposits from customers	-	789,938	-	789,938	789,897
Debt issued and other borrowed funds	215,189	163,529	-	378,718	384,833
Subordinated loans	-	36,070	-	36,070	34,392
Other financial liabilities	-	11,329	-	11,329	11,329
Total financial liabilities	215,189	1,015,974	-	1,231,163	1,235,720

At 31 December 2021	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Cash and balances with Central Bank	-	113,667	-	113,667	113,667
Loans to credit institutions	-	43,988	-	43,988	43,988
Loans to customers	-	-	1,089,920	1,089,920	1,086,327
Other financial assets	-	5,241	-	5,241	5,241
Total financial assets	-	162,896	1,089,920	1,252,816	1,249,223
Deposits from Central Bank and credit institutions	-	13,441	-	13,441	13,384
Deposits from customers	-	744,098	-	744,098	744,036
Debt issued and other borrowed funds	225,763	97,311	-	323,074	312,766
Subordinated loans	-	37,581	-	37,581	35,762
Other financial liabilities	-	9,681	-	9,681	9,681
Total financial liabilities	225,763	902,112	-	1,127,875	1,115,629

20. Offsetting financial assets and financial liabilities

The following tables show reconciliation to the net amounts of financial assets and financial liabilities which are subject to offsetting, enforceable master netting agreements and similar agreements.

	Financial assets subject to netting arrangements			Amounts not set off but subject to master netting arrangements and similar agreements					
At 31 December 2022	Financial assets before netting	Netting with financial liabilities	Net financial assets	Financial liabilities	Cash collateral received	Financial instruments collateral received	Net amount after consideration of potential effect of netting arrangements	Assets outside the scope of offsetting disclosure requirements	Total financial assets recognised in the balance sheet
Derivatives	7,461	-	7,461	(856)	(4,962)	(564)	1,079	-	7,461

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20. Offsetting financial assets and financial liabilities (continued)

At 31 December 2021	Financial assets subject to netting arrangements: Financial assets before netting	Netting with financial liabilities	Net financial assets	Amounts not set off but subject to master netting arrangements and similar agreements: Financial liabilities	Cash collateral received	Financial instruments collateral received	Net amount after consideration of potential effect of netting arrangements	Assets outside the scope of offsetting disclosure requirements	Total financial assets recognised in the balance sheet
Reverse repurchase agreements ..	100	-	100	-	-	-	100	-	100
Derivatives	2,445	-	2,445	(927)	(885)	(73)	560	-	2,445
Total assets	2,545	-	2,545	(927)	(885)	(73)	660	-	2,545

At 31 December 2022	Financial liabilities subject to netting arrangements: Financial liabilities before netting	Netting with financial assets	Net financial liabilities	Amounts not set off but subject to master netting arrangements and similar agreements: Financial assets	Cash collateral pledged	Financial instruments collateral pledged	Net amount after consideration of potential effect of netting arrangements	Liabilities outside the scope of offsetting disclosure requirements	Total financial liabilities recognised in the balance sheet
Derivative instruments and short positions	10,804	-	10,804	(856)	(6,630)	-	3,318	-	10,804
At 31 December 2021									
Derivative instruments and short positions	9,467	-	9,467	(927)	(945)	-	7,595	-	9,467

21. Cash and balances with Central Bank

	31.12.2022	31.12.2021
Cash on hand	3,563	3,882
Unrestricted balances with Central Bank	80,866	100,528
Cash and unrestricted balances with Central Bank	84,429	104,410
Balances pledged as collateral to Central Bank	483	589
Mandatory reserve deposits with Central Bank	9,512	8,668
Cash and balances with Central Bank	94,424	113,667

22. Loans to credit institutions

	31.12.2022	31.12.2021
Money market loans	55,742	17,759
Bank accounts	54,606	26,187
Other loans	16	42
Loans to credit institutions	110,364	43,988

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23. Derivative instruments and short positions

At 31 December 2022	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	3,953	50,399	9,403	225,817
Cross-currency interest rate swaps	637	17,028	353	11,818
Equity forwards	765	8,389	130	3,486
Foreign exchange forwards	750	20,437	95	9,944
Foreign exchange swaps	1,221	38,733	537	46,487
Bond forwards	135	3,834	1	286
Derivatives	7,461	138,820	10,519	297,838
Short positions in listed bonds	-	-	285	332
Total	7,461	138,820	10,804	298,170

At 31 December 2021	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	1,253	131,732	3,182	88,920
Cross-currency interest rate swaps	157	14,392	473	16,587
Equity forwards	126	5,693	2,958	16,591
Foreign exchange forwards	97	15,719	278	12,674
Foreign exchange swaps	359	33,914	599	42,795
Bond forwards	453	34,594	26	7,043
Derivatives	2,445	236,044	7,516	184,610
Short positions in listed bonds	-	-	1,951	1,447
Total	2,445	236,044	9,467	186,057

The Group uses derivatives to hedge currency exposure, interest rate risk in the banking book as well as inflation risk. The Group carries relatively low indirect exposure due to margin trading with clients and the Group holds collaterals for possible losses. Other derivatives in the Group held for trading or for other purposes are insignificant.

Short positions are in Icelandic Government bonds and bonds issued by municipalities, banks, and public companies. As a primary dealer the Group has access to securities lending facilities provided by the Central Bank and other issuers. Majority of the securities lending facilities have a maturity of less than a year.

The Group applies hedge accounting only with respect to certain EUR denominated interest rate swaps, whereby the Group pays floating rate interest and receives fixed rate interest. The interest rate swaps are hedging the exposure of changes in the fair value of certain fixed-rate EUR denominated bonds (see Note 34) arising from changes in EURIBOR benchmark interest rates. The Group applies fair value hedge accounting to the hedging relationships and for the purpose of evaluating whether the hedging relationship is expected to be highly effective, the Group assumes that the benchmark interest rate is not altered as a result of IBOR reform. At 31 December 2022 the total fair value of the interest rate swaps was negative and amounted to ISK 1,596 million (2021: positive ISK 545 million) and their total notional amount was ISK 90,900 million (2021: ISK 44,280 million).

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24. Loans to customers

At 31 December 2022	Gross carrying amount			Expected credit losses			Net carrying
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	amount
Individuals	562,460	5,134	5,256	(1,607)	(175)	(546)	570,522
Commerce and services	154,413	17,491	3,836	(974)	(1,703)	(841)	172,222
Construction	57,885	2,285	402	(654)	(66)	(37)	59,815
Energy	10,456	-	-	(45)	-	-	10,411
Financial services	2,641	1	-	(20)	-	-	2,622
Industrial and transportation	84,369	670	8,885	(303)	(19)	(2,524)	91,078
Investment companies	38,712	1,577	732	(409)	(210)	(66)	40,336
Public sector and non-profit organisations	10,857	219	1	(29)	(2)	-	11,046
Real estate	123,589	1,544	1,948	(493)	(57)	(234)	126,297
Seafood	101,491	854	63	(102)	(3)	(13)	102,290
Loans to customers	1,146,873	29,775	21,123	(4,636)	(2,235)	(4,261)	1,186,639

At 31 December 2021	Gross carrying amount			Expected credit losses			Net carrying
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	amount
Individuals	510,024	7,197	5,704	(1,368)	(199)	(625)	520,733
Commerce and services	110,618	55,299	5,252	(844)	(2,696)	(2,407)	165,222
Construction	34,238	1,704	1,298	(341)	(72)	(54)	36,773
Energy	9,529	-	-	(36)	-	-	9,493
Financial services	1,980	1	-	(3)	-	-	1,978
Industrial and transportation	61,386	24,593	6,481	(281)	(292)	(2,260)	89,627
Investment companies	21,066	2,636	606	(295)	(297)	(39)	23,677
Public sector and non-profit organisations	9,862	144	1	(18)	(1)	(1)	9,987
Real estate	97,395	10,989	2,177	(485)	(225)	(537)	109,314
Seafood	116,451	3,204	57	(159)	(22)	(8)	119,523
Loans to customers	972,549	105,767	21,576	(3,830)	(3,804)	(5,931)	1,086,327

25. Expected credit losses

Total allowances for expected credit losses

	Stage 1	Stage 2	Stage 3	Total
Cash and balances with Central Bank	3	-	-	3
Loans to credit institutions	152	-	-	152
Loans to customers	4,636	2,235	4,261	11,132
Other financial assets	9	4	-	13
Off-balance sheet loan commitments and financial guarantees	869	242	227	1,338
At 31 December 2022	5,669	2,481	4,488	12,638
Cash and balances with Central Bank	3	-	-	3
Loans to credit institutions	89	-	-	89
Loans to customers	3,830	3,804	5,931	13,565
Other financial assets	18	6	-	24
Off-balance sheet loan commitments and financial guarantees	545	298	158	1,001
At 31 December 2021	4,485	4,108	6,089	14,682

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25. Expected credit losses (continued)

The following tables reconcile the opening and closing balances for accumulated expected credit losses for loans to customers, and off-balance sheet loan commitments and financial guarantees.

Loans to customers

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2022	3,830	3,804	5,931	13,565
Transfer to Stage 1	2,028	(1,743)	(285)	-
Transfer to Stage 2	(491)	936	(445)	-
Transfer to Stage 3	(117)	(460)	577	-
Net remeasurement of loss allowance	(3,196)	(308)	(1,436)	(4,940)
New financial assets originated or purchased	3,425	1,742	3,849	9,016
Derecognitions and maturities	(842)	(1,736)	(3,292)	(5,870)
Write-offs*	(1)	-	(1,079)	(1,080)
Recoveries of amounts previously written off	-	-	146	146
Foreign exchange	-	-	(115)	(115)
Unwinding of interest	-	-	410	410
At 31 December 2022	4,636	2,235	4,261	11,132

*During the year financial assets amounting to ISK 570 million were written off but are still subject to enforcement activity.

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2021	3,645	6,482	7,387	17,514
Transfer to Stage 1	1,995	(1,780)	(215)	-
Transfer to Stage 2	(476)	1,650	(1,174)	-
Transfer to Stage 3	(48)	(1,259)	1,307	-
Net remeasurement of loss allowance	(3,550)	(2,254)	(779)	(6,583)
New financial assets originated or purchased	2,759	1,497	3,645	7,901
Derecognitions and maturities	(495)	(529)	(3,695)	(4,719)
Write-offs*	-	(3)	(1,206)	(1,209)
Recoveries of amounts previously written off	-	-	293	293
Foreign exchange	-	-	(44)	(44)
Unwinding of interest	-	-	412	412
At 31 December 2021	3,830	3,804	5,931	13,565

*During the year financial assets amounting to ISK 759 million were written off but are still subject to enforcement activity.

Off-balance sheet loan commitments and financial guarantees

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2022	545	298	158	1,001
Transfer to Stage 1	207	(158)	(49)	-
Transfer to Stage 2	(21)	68	(47)	-
Transfer to Stage 3	(7)	(32)	39	-
Net remeasurement of loss allowance	(424)	(185)	(91)	(700)
New loan commitments and financial guarantees	702	288	282	1,272
Derecognitions and maturities	(133)	(37)	(65)	(235)
At 31 December 2022	869	242	227	1,338

At 1 January 2021	347	483	225	1,055
Transfer to Stage 1	132	(114)	(18)	-
Transfer to Stage 2	(28)	92	(64)	-
Transfer to Stage 3	(4)	(16)	20	-
Net remeasurement of loss allowance	(491)	(292)	2	(781)
New loan commitments and financial guarantees	673	242	29	944
Derecognitions and maturities	(84)	(97)	(36)	(217)
At 31 December 2021	545	298	158	1,001

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26. Investments in associates

		31.12.2022	31.12.2021
Reiknistofa bankanna hf., an IT service centre company, Katrínartún 2, 105 Reykjavík	Iceland	30.1%	30.1%
Norðurturninn hf., a rental company of commercial real estate, Borgartún 26, 105 Reykjavík	Iceland	43.3%	12.2%
Auðkenni ehf., an information security company, Borgartún 31, 105 Reykjavík	Iceland	0.0%	23.8%
JCC ehf., a cash centre service company, Sundaborg 15, 108 Reykjavík	Iceland	0.0%	33.3%

At year-end 2021 Íslandsbanki owned shares in Norðurturninn hf. which were classified as shares and equity instruments (see Note 18). During the year Íslandsbanki increased its share in Norðurturninn and subsequently obtained significant influence over the company. The company has since been classified as an associate. The company's shares are divided into two categories, Class A shares and Class B shares. Class B shares hold all the voting rights and receive all dividends up to ISK 3,327 million (CPI-linked, based on the CPI in December 2022). After Class B shareholders have received that amount the class is then suspended, and Class A shares receive all the voting rights and the rights to dividend payments. Íslandsbanki owns 43.3% of Class B shares and 65.0% of Class A shares. Norðurturninn owns the real estate Hagasmári 3, where the Bank is the principal lessee and rents over half the building for its headquarters.

	2022	2021
Investments in associates at the beginning of the year	939	775
Additions during the year	1,328	31
Transfer from shares and equity instruments to associates	1,711	-
Sales of shares in associates	(174)	-
Share of profit of associates	40	73
Reversal of impairment	-	60
Investments in associates at year-end	3,844	939

Summarised financial information in respect of the Group's associates is set out below:

	2022	2021
Revenue	7,088	5,661
Profit	360	286
Assets	16,921	5,522
Liabilities	(8,397)	(2,590)
Net assets	8,524	2,932
Group's share of net assets of associates	3,844	939

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27. Property and equipment

At 31 December 2022	Land and buildings	Right-of-use assets: Buildings	Fixtures, equipment & vehicles	Total
Balance at the beginning of the year	3,101	4,921	2,996	11,018
Additions during the year	112	8	161	281
Disposals and write-offs during the year	-	-	(45)	(45)
Remeasurement	-	334	-	334
Historical cost	3,213	5,263	3,112	11,588
Balance at the beginning of the year	(1,360)	(1,234)	(1,414)	(4,008)
Depreciation during the year	(18)	(478)	(362)	(858)
Disposals and write-offs during the year	-	-	30	30
Accumulated depreciation	(1,378)	(1,712)	(1,746)	(4,836)
Carrying amount	1,835	3,551	1,366	6,752
Annual depreciation rates	0-2%	8-26%	8-33%	
Official real estate value of land and buildings	1,884			
Insurance value of buildings	2,752			
Insurance value of fixtures, equipment and vehicles			2,038	

At 31 December 2021	Land and buildings	Right-of-use assets: Buildings	Fixtures, equipment & vehicles	Total
Balance at the beginning of the year	3,058	4,729	3,119	10,906
Additions during the year	43	133	163	339
Disposals and write-offs during the year	-	(110)	(286)	(396)
Remeasurement	-	169	-	169
Historical cost	3,101	4,921	2,996	11,018
Balance at the beginning of the year	(1,340)	(906)	(1,319)	(3,565)
Depreciation during the year	(20)	(438)	(370)	(828)
Disposals and write-offs during the year	-	110	275	385
Accumulated depreciation	(1,360)	(1,234)	(1,414)	(4,008)
Carrying amount	1,741	3,687	1,582	7,010
Annual depreciation rates	0-2%	8-32%	8-33%	
Official real estate value of land and buildings	1,589			
Insurance value of buildings	2,486			
Insurance value of fixtures, equipment and vehicles			1,985	

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28. Intangible assets

At 31 December 2022	Purchased software	Developed software	Total
Balance at the beginning of the year	1,579	3,383	4,962
Additions during the year	470	-	470
Historical cost	2,049	3,383	5,432
Balance at the beginning of the year	(359)	(1,252)	(1,611)
Amortisation during the year	(232)	(310)	(542)
Accumulated amortisation	(591)	(1,562)	(2,153)
Carrying amount	1,458	1,821	3,279
Amortisation rates	10-25%	10%	

At 31 December 2021	Purchased software	Developed software	Total
Balance at the beginning of the year	1,623	3,383	5,006
Additions during the year	442	-	442
Write-offs during the year	(486)	-	(486)
Historical cost	1,579	3,383	4,962
Balance at the beginning of the year	(636)	(892)	(1,528)
Amortisation during the year	(190)	(360)	(550)
Write-offs during the year	467	-	467
Accumulated amortisation	(359)	(1,252)	(1,611)
Carrying amount	1,220	2,131	3,351
Amortisation rates	10-25%	10%	

29. Other assets

	31.12.2022	31.12.2021
Receivables	1,682	1,582
Unsettled securities transactions	3,591	3,412
Accruals	166	252
Prepaid expenses	400	332
Deferred tax assets	116	94
Other assets	117	112
Other assets	6,072	5,784

30. Non-current assets and disposal groups held for sale

	31.12.2022	31.12.2021
Repossessed collateral:		
Land and buildings	723	269
Industrial equipment and vehicles	5	-
Assets of disposal groups held for sale	-	1,075
Non-current assets and disposal groups held for sale	728	1,344

At year-end 2021 the Group classified the assets and liabilities of Miðengi ehf. (100%) and Reykjavík DC hf. (100%) as assets and liabilities of disposal groups held for sale. In 2022 the group sold Reykjavík DC hf. and reclassified Miðengi ehf. as a subsidiary.

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31. Deposits from Central Bank and credit institutions

	31.12.2022	31.12.2021
Deposits from credit institutions	15,105	13,233
Repurchase agreements with Central Bank	164	151
Deposits from Central Bank and credit institutions	15,269	13,384

32. Deposits from customers

	31.12.2022	31.12.2021
Demand deposits and deposits with maturity up to 3 months	697,025	658,543
Term deposits with maturity of more than 3 months	92,872	85,493
Deposits from customers	789,897	744,036

	31.12.2022		31.12.2021	
Deposits from customers specified by owners	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	8,791	1%	10,750	1%
Municipalities	9,412	1%	7,125	1%
Companies	400,329	51%	371,893	50%
Individuals	371,365	47%	354,268	48%
Deposits from customers	789,897	100%	744,036	100%

33. Pledged assets

	31.12.2022	31.12.2021
Loans to customers	402,958	289,544
Financial assets pledged as collateral with Central Bank	5,723	7,440
Loans to credit institutions	7,813	1,861
Cash and balances pledged against Covered Bonds	19,477	2,200
Pledged assets against liabilities	435,971	301,045

The Group has pledged assets against the issuance of covered bonds under Icelandic law, which are pledged on a pool of consumer mortgage loans. The Group owns covered bonds for its own use which accounts for a portion of the pledged assets. The carrying amount of these bonds at 31 December 2022 was ISK 24,682 million (year-end 2021: ISK 23,650 million).

The Group has also pledged assets with the Central Bank to ensure the clearing of the Icelandic payment system as well as other contracts with the Central Bank. Moreover, it has pledged cash in foreign banks and financial institutions, mainly as collateral for trades under ISDA agreements to hedge market risk.

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34. Debt issued and other borrowed funds

	First issued	Maturity	Maturity type	Interest	31.12.2022	31.12.2021
Covered bonds in ISK	2015	2023	Bullet	Fixed rates	38,970	39,020
Covered bonds in ISK	2020	2027	Amortising	Fixed rates	26,992	25,750
Covered bonds in ISK	2022	2027	Bullet	Floating rates	3,311	-
Covered bonds in ISK - CPI-linked	2015	2022	Bullet	Fixed rates	-	18,722
Covered bonds in ISK - CPI-linked	2012	2024	Bullet	Fixed rates	41,346	38,231
Covered bonds in ISK - CPI-linked	2015	2026	Bullet	Fixed rates	32,555	29,833
Covered bonds in ISK - CPI-linked	2019	2028	Amortising	Fixed rates	33,456	25,902
Covered bonds in ISK - CPI-linked	2017	2030	Bullet	Fixed rates	29,812	27,363
Covered bonds in EUR*	2022	2027	Bullet	Fixed rates	43,875	-
Covered bonds					250,317	204,821
Senior unsecured bonds in NOK	2019	2022	Bullet	Floating rates	-	14,841
Senior unsecured bonds in EUR**	2019	2022	Bullet	Fixed rates	-	44,803
Senior unsecured bonds in EUR**	2020	2023	Bullet	Fixed rates	43,876	44,657
Senior unsecured bonds in EUR (callable 2023)*	2018	2024	Bullet	Fixed rates	5,704	45,036
Senior unsecured bonds in NOK	2019	2024	Bullet	Fixed rates	5,972	6,122
Senior unsecured bonds in ISK	2019	2024	Amortising	Floating rates	282	2,100
Senior unsecured bonds in NOK	2021	2024	Bullet	Floating rates	2,157	2,211
Senior unsecured bonds in SEK	2021	2024	Bullet	Floating rates	3,406	3,597
Senior unsecured bonds in NOK	2021	2024	Bullet	Floating rates	6,903	7,037
Senior unsecured bonds in SEK	2021	2024	Bullet	Floating rates	2,739	2,882
Senior unsecured bonds in SEK	2022	2024	Bullet	Floating rates	10,957	-
Senior unsecured bonds in ISK	2020	2025	Bullet	Fixed rates	1,228	6,603
Senior unsecured bonds in SEK	2021	2025	Bullet	Floating rates	6,130	6,472
Senior unsecured bonds in NOK	2021	2025	Bullet	Floating rates	10,778	11,044
Senior unsecured bonds in EUR**	2022	2025	Bullet	Fixed rates	39,561	-
Senior unsecured bonds in NOK	2022	2025	Bullet	Floating rates	20,318	-
Senior unsecured bonds in ISK	2022	2027	Amortising	Floating rates	3,763	-
Senior unsecured bonds in ISK	2022	2027	Bullet	Fixed rates	5,301	-
Unsecured bonds					169,075	197,405
Other secured loans					36,650	-
Other unsecured loans					12,228	-
Other borrowed funds					48,878	-
Debt issued and other borrowed funds					468,270	402,226

The Group repurchased own bonds during the year amounting to ISK 79,026 million (2021: ISK 16,384 million).

*The Group applies hedge accounting to these bond issuances and uses certain EUR denominated interest rate swaps as hedging instruments (see Note 23). The interest rate swaps are hedging the exposure of the Group's changes in the fair value of this fixed-rate EUR denominated bond arising from changes in EURIBOR benchmark interest rates. The Group applies fair value hedge accounting to the hedging relationships and for the purpose of evaluating whether the hedging relationship is expected to be highly effective, the Group assumes that the benchmark interest rate is not altered as a result of IBOR reform. At 31 December 2022 the total carrying amount of the bond issuance amounted to ISK 49,579 million and included in the amount are fair value changes amounting to ISK 1,810 million.

**These bond issuances are classified as being designated as at fair value through profit or loss. At 31 December 2022 the total carrying amount of the bonds amounted to ISK 83,437 million; included in the amount are negative fair value changes amounting to ISK 7,733 million. The carrying amount of the bonds at 31 December 2022 was ISK 8,031 million lower than the contractual amount due at maturity.

The Group has issued additional bonds for its own use, e.g. for the purpose of securities lending and repurchase agreements. These bond amounts are not included in the total.

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35. Subordinated loans

	Issued	Maturity	Callable	Interest	31.12.2022	31.12.2021
Subordinated loans in SEK	2017	2027	2022	Floating, STIBOR + 2.0%	-	10,786
Subordinated loans in SEK	2018	2028	2023	Floating, STIBOR + 2.5%	6,820	7,187
Subordinated loans in SEK	2019	2029	2024	Floating, STIBOR + 3.9%	6,785	7,163
Subordinated loans in ISK	2022	2033	2028	Fixed, 8,62%	1,526	-
Subordinated loans in ISK	2022	2033	2028	Fixed CPI, 4,86%	9,199	-
Tier 2 subordinated loans					24,330	25,136
Subordinated loans in SEK	2021	Perpetual	2026	Floating, STIBOR + 4.75%	10,062	10,626
Additional Tier 1 subordinated loans					10,062	10,626
Subordinated loans					34,392	35,762

36. Changes in liabilities arising from financing activities

			Non-cash changes			
	1.1.2022	Cash flows	Interest expense	Foreign exchange	Fair value changes	31.12.2022
Covered bonds in ISK	64,770	1,855	2,609	-	39	69,273
Covered bonds in ISK - CPI-linked	140,051	(19,021)	16,109	-	30	137,169
Senior unsecured bonds in ISK	8,703	1,950	398	-	(477)	10,574
Senior unsecured bonds FX	54,206	15,284	1,258	(1,388)	-	69,360
Senior unsecured bonds FX at fair value	89,460	(279)	578	1,317	(7,639)	83,437
Covered bonds in hedge accounting	-	42,125	370	3,184	(1,804)	43,875
Senior unsecured bonds in hedge accounting	45,036	(39,992)	515	504	(359)	5,704
Other borrowed funds	-	45,051	450	3,377	-	48,878
Subordinated loans	35,762	(814)	1,538	(2,094)	-	34,392
Total	437,988	46,159	23,825	4,900	(10,210)	502,662

			Non-cash changes			
	1.1.2021	Cash flows	Interest expense	Foreign exchange	Fair value changes	31.12.2021
Covered bonds in ISK	39,958	22,380	2,432	-	-	64,770
Covered bonds in ISK - CPI-linked	136,487	(6,467)	10,031	-	-	140,051
Senior unsecured bonds in ISK	5,373	3,202	128	-	-	8,703
Senior unsecured bonds FX	61,553	(6,158)	960	(2,149)	-	54,206
Senior unsecured bonds FX at fair value	94,438	(734)	729	(5,148)	175	89,460
Senior unsecured bonds in hedge accounting	48,032	(525)	545	(2,546)	(470)	45,036
Other borrowed funds	1,433	(1,441)	8	-	-	-
Subordinated loans	27,194	10,100	829	(2,361)	-	35,762
Total	414,468	20,357	15,662	(12,204)	(295)	437,988

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Notes to the Consolidated Financial Statements

37. Tax assets and tax liabilities

	31.12.2022		31.12.2021	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	9,042	-	5,896
Deferred tax assets and tax liabilities	116	3,086	94	536
Tax in the balance sheet	116	12,128	94	6,432

	Assets	Liabilities
Deferred tax assets and tax liabilities 1.1.2021	259	2
Calculated income tax for 2021	(165)	4,099
Income tax payable in 2022	-	(3,361)
Changes in deferred tax assets and deferred tax liabilities due to equity	-	(204)
Deferred tax assets and tax liabilities 31.12.2021	94	536
Calculated income tax for 2022	22	7,593
Income tax payable in 2023	-	(5,668)
- thereof income tax recognised in other comprehensive income	-	110
Changes in deferred tax assets and deferred tax liabilities due to equity	-	625
Deferred tax assets and tax liabilities 31.12.2022	116	3,086

				Balance at 31 December		
2022	Net balance at 1 January	Recognised in profit or (loss)	Recognised in equity	Net	Deferred tax assets	Deferred tax liabilities
Property and equipment	(930)	54	-	(876)	-	(876)
Intangible assets	(484)	28	-	(456)	-	(456)
Assets and liabilities in foreign currency	(376)	(103)	-	(479)	-	(479)
Deferred foreign exchange difference	(275)	(562)	-	(837)	-	(837)
Derivatives	595	155	-	750	750	-
Lease liabilities	758	(25)	-	733	733	-
Debt issued and other borrowed funds	176	(1,472)	(625)	(1,921)	-	(1,921)
Other items	94	22	-	116	116	-
	(442)	(1,903)	(625)	(2,970)	1,599	(4,569)
Set-off of deferred tax assets together with liabilities of the same taxable entities					(1,483)	1,483
Tax assets (liabilities)	(442)	(1,903)	(625)	(2,970)	116	(3,086)

				Balance at 31 December		
2021	Net balance at 1 January	Recognised in profit or (loss)	Recognised in equity	Net	Deferred tax assets	Deferred tax liabilities
Property and equipment	(978)	48	-	(930)	-	(930)
Intangible assets	(490)	6	-	(484)	-	(484)
Assets and liabilities in foreign currency	(420)	44	-	(376)	-	(376)
Deferred foreign exchange difference	1,105	(1,380)	-	(275)	-	(275)
Derivatives	(90)	685	-	595	595	-
Lease liabilities	797	(39)	-	758	758	-
Debt issued and other borrowed funds	240	(268)	204	176	176	-
Other items	93	1	-	94	94	-
	257	(903)	204	(442)	1,623	(2,065)
Set-off of deferred tax assets together with liabilities of the same taxable entities					(1,529)	1,529
Tax assets (liabilities)	257	(903)	204	(442)	94	(536)

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Notes to the Consolidated Financial Statements

38. Other liabilities

	31.12.2022	31.12.2021
Accruals	2,448	2,463
Lease liabilities	3,708	3,838
Expected credit losses for off-balance sheet loan commitments and financial guarantees	1,338	1,001
Withholding tax	2,921	1,288
Unsettled securities transactions	3,805	2,005
Sundry liabilities	2,381	2,253
Other liabilities	16,601	12,848

39. Custody assets

	31.12.2022	31.12.2021
Custody assets - not managed by the Group	3,278,816	3,411,059

40. Leases

The Group as a lessee

The Group's significant leases are leases for offices, branches, and storage. Most leases are CPI-linked real estate leases with duration of 5-10 years with extension options. Lease commitments are recognised on-balance sheet except for short-term leases and leases of low-value assets. During the year 2022 the total expense for leases of low-value assets and short-term leases amounted to ISK 36 million (2021: ISK 22 million), the total cash outflow for leases amounted to ISK 584 million (2021: ISK 536 million) and total interest expense from lease liabilities amounted to ISK 82 million (2021: ISK 84 million).

At year-end 2022 the Group recognised ISK 3,551 million in right-of-use assets which are presented in the line item "Property and equipment" and lease liabilities amounting to ISK 3,708 million which are presented in the line item "Other liabilities".

The Group as a lessor

Net investment in finance lease receivables

	31.12.2022	31.12.2021
Due within 1 year	20,263	14,680
Due in 1-5 years	43,929	32,954
Due in more than 5 years	2,636	2,512
Total gross investment in the lease	66,828	50,146
Due within 1 year	15,942	12,562
Due in 1-5 years	37,729	29,738
Due in more than 5 years	2,341	2,279
Total present value of lease payments*	56,012	44,579
Unearned interest income	10,816	5,567

*The Group presents finance lease receivables in the line item "Loans to customers".

Expected credit loss allowance	260	424
Interest income from finance lease receivables during the year	3,769	2,191

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41. Íslandsbanki's shareholders

The following table shows the largest shareholders of Íslandsbanki.		31.12.2022	31.12.2021
The Icelandic Government	Iceland	42.5%	65.0%
LSR Pension Fund	Iceland	7.5%	4.1%
Gildi Pension Fund	Iceland	6.8%	3.1%
Live Pension Fund	Iceland	6.3%	3.7%
Capital Group	USA	4.9%	4.4%
Brú Pension Fund	Iceland	3.1%	0.8%
Stapi Pension Fund	Iceland	2.4%	1.0%
Birta Pension Fund	Iceland	1.6%	0.6%
Íslandssjóðir hf. (Iceland Funds)	Iceland	1.3%	0.9%
Vanguard	USA	1.3%	0.0%
RWC Asset Management LLP	UK	1.2%	0.8%
Frjálsi Pension Fund	Iceland	1.2%	0.3%
Lífsverk Pension Fund	Iceland	1.2%	0.1%
Almenni Pension Fund	Iceland	1.0%	0.8%
Other shareholders		17.7%	14.4%
Total		100.0%	100.0%

At 31 December 2022 the number of shareholders of the Bank were 13,079 (year-end 2021: 15,676). At 31 December 2022, 91.0% of the Bank's shares were owned by domestic parties and 9.0% by international investors (year-end 2021: 92.2% domestic parties and 7.8% international investors).

At 31 December 2022 the Bank's employees and related parties of the employees, not including board members, held 0.18% of shares in the Bank (year-end 2021: 0.22%).

42. Related party

The Icelandic Government is the largest shareholder of Íslandsbanki and has significant influence over the Group. The shares are administered by the Icelandic State Financial Investments (ISFI). As a result, the Icelandic Government and the ISFI are defined as related parties. The Group has applied the partial exemption for government-related entities, as described in IAS 24.

The Board of Directors and key management personnel of the Bank, ISFI and subsidiaries of the Bank, close family members of individuals referred to herein and legal entities controlled by them, are defined as related parties.

The Group's associates are also defined as related parties.

The Group's products and services are offered to the Icelandic Government and government-related entities in competition with other vendors and under generally accepted commercial terms. In a similar manner the Group entities purchase products and services from government-related entities under generally accepted commercial terms. Transactions with related parties were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third party counterparties.

All loans to employees are provided on general business terms of the Group.

The following tables show the Group's balances and transactions with related parties.

At 31 December 2022	Right of use asset	Other assets	Liabilities	Net balance	Guarantees & loan commitments
Shareholders with significant influence over the Group	-	-	-	-	2
Board of Directors, key management personnel and other related parties	-	450	415	35	72
Associated companies	3,157	5,074	4,028	4,203	9
Balances with related parties	3,157	5,524	4,443	4,238	83

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Notes to the Consolidated Financial Statements

42. Related party (continued)

1 January - 31 December 2022	Interest income	Interest expense	Other income	Other expense
Board of Directors, key management personnel and other related parties	34	219	4	-
Associated companies	326	81	26	1,993
Transactions with related parties	360	300	30	1,993

At 31 December 2021	Assets	Liabilities	Net balance	Guarantees & loan com-mitments
Shareholders with control over the Group	-	-	-	2
Board of Directors, key management personnel and other related parties	356	413	(57)	57
Associated companies	3	478	(475)	206
Balances with related parties	359	891	(532)	265

1 January - 31 December 2021	Interest income	Interest expense	Other income	Other expense
Shareholders with control over the Group	-	-	281	-
Board of Directors, key management personnel and other related parties	23	10	2	7
Associated companies	1	-	2	1,468
Transactions with related parties	24	10	285	1,475

At 31 December 2022 a total of ISK 3 million (at year-end 2021: ISK 1 million) were recognised as Stage 1 expected credit losses of balances with related parties. No share option programmes were operated during the year. For related party remuneration see Note 11.

43. Provision and contingencies

Provision

Initial Findings of the Financial Supervisory Authority of the Central Bank of Iceland

On 9 January 2023 the Bank announced that it had received the preliminary findings from the Financial Supervisory Authority of the Central Bank of Iceland's (FSA) inspection into the Bank's execution of the offering by the Icelandic State of a 22.5% stake in the Bank's share capital that took place in March 2022 (the Offering). In the findings the FSA indicates its view that the Bank may have violated certain laws and regulations applicable to its operations. The FSA pointed out its powers to impose administrative fines and to conclude cases with a settlement. The Bank has requested that the case be concluded with a settlement. The management of the Bank takes the FSA's findings seriously. The Bank has responded to certain sections in the preliminary findings and will complete a response to the FSA by mid-February and expects the FSA's response in due course. Following the Offering, the Bank has made changes to its internal rules and procedures and will, subject to the outcome of its internal review and discussions with the FSA, continue to implement appropriate measures. The amount of the potential administrative fine has not been decided and is therefore uncertain. The Bank has, however, recognised an undisclosed provision based on its own internal estimate.

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43. Provision and contingencies (continued)

Contingent liabilities

Borgun hf. – Landsbankinn hf.

Borgun hf., (currently SaltPay IIB hf.) a former subsidiary of Íslandsbanki, is a payment acquirer and issuing processor. Landsbankinn hf. sold its 31.2% stake in Borgun hf. in late 2014. Landsbankinn claims that Borgun's management did not disclose all available information that might have affected the value of Borgun during the sales process, namely the value of its stake in Visa Europe which was sold to Visa International shortly after the Borgun sale. In order to reclaim the alleged loss, Landsbankinn filed a lawsuit against Borgun and others on 12 January 2017, claiming the right to damages for having been deprived of the true value of the stake involved in the sale. Landsbankinn does not quantify the claim, but its estimate of the lost profit from having sold its shares in Borgun is approximately ISK 1,930 million. Court appointed senior assessors presented their reassessment in April 2021 which corroborates the previous assessment of Borgun's obligation to disclose. Furthermore, the senior assessors estimated that Borgun's share in Visa as of 31 December 2013 would have amounted to at least ISK 387 million. The hearing of the case is scheduled in the first quarter of 2023.

On 11 March 2020, the Bank signed an agreement to sell its 63.47% stake in Borgun hf. to SaltPay Co Ltd. and concluded the sale on 7 July 2020. In the agreement the Bank undertook to reimburse 63.47% of losses incurred by Borgun or the buyer as a result of an unfavourable outcome in the Landsbankinn case, however such reimbursement was never to exceed the Bank's share in the purchase price. The Group has not recognised a provision in relation to this matter.

105 Miðborg slhf. – ÍAV hf.

In February 2021 the alternative investor fund 105 Miðborg slhf., operated by Íslandssjóðir hf. (Iceland Funds hf.), a wholly owned subsidiary of the Bank, terminated its contractor agreement with ÍAV hf., a contractor that had been retained for a real estate project at Kirkjusandur in the centre of Reykjavík. The main reason for the termination was the alleged non-performance and delays in the construction of one building on the premises. The contractor, ÍAV, has claimed approximately ISK 3,829 million in damages plus late payment interest and legal costs from 105 Miðborg and Iceland Funds for the alleged unlawful termination. The suit was filed on 11 May 2021 at the District Court of Reykjavík. Additionally, 105 Miðborg has filed a case against ÍAV claiming approximately ISK 3,878 million in damages plus late payment interest and legal costs due to alleged delays and significant breaches of contract. The Group owns an 8.25% stake in 105 Miðborg. The Group has not recognised a provision in relation to this matter.

The Consumers' Association of Iceland

In December 2021 three customers, sponsored by the Consumers' Association of Iceland, commenced litigation against the Bank, demanding that certain provisions of their residential mortgages, governing variable interest rates, be deemed illegal and unenforceable and demand the repayment of any overpaid interest.

Firstly, two of the cases were brought by customers owing CPI linked mortgages that contain a certain interest resetting provision that the Supreme Court found in its ruling on case no. 623/2016 could not be used by the Bank to reset interest rates. Following that judgement, the Bank repaid its customers any interest that the Bank had charged in excess of the originally agreed interest rate and returned the affected loans to their original interest rates. In the suits now filed the customers maintain that instead of the originally agreed interest rates, their loans should incur interest rates pursuant to article 4 of Act no. 38/2001 on Interest and Price Indexation. An unfavourable finding by the courts may have an influence on the Bank's portfolio of loans and fully paid loans that contained the resetting provision, disputed in case no. 623/2016. The Bank estimates that the financial impact of an unfavourable ruling in an adverse scenario could lie in the range of ISK 4 to 6 billion.

Secondly, a case has been brought against the Bank by a customer owing a non-index linked mortgage bearing variable interest rates. The plaintiff maintains that the terms governing the variable interest rates are invalid and may not be used by the Bank as basis for setting interest rates, and that therefore the originally agreed interest rate should remain fixed during the term of the loan. An unfavourable ruling in this case may affect all indexed and non-index linked mortgages bearing variable interest rates, as well as any loans bearing fixed interest rates to be reset on a predefined date.

In April 2022, the plaintiffs in two of the cases submitted claims that an advisory opinion by the EFTA Court should be requested on the interpretation of certain provisions in directives incorporated into the EEA Agreement. On 13 December 2022, the District Court issued its rulings. In the case involving a CPI linked mortgage, the Court rejected the plaintiff's request. In the case involving a non-indexed linked mortgage, the District Court decided to request an advisory opinion from the EFTA Court on part of the issues raised by the plaintiff. The timing of the EFTA Court's advisory opinion is uncertain, as well as its impact on the case.

It is disputed in the three cases whether the terms of the Bank's mortgages, and the method used by the Bank to set variable interest rates, is in compliance with the Act on Mortgage Lending to Consumers no. 118/2016. That act is in this respect similar to the terms of Act no. 33/2013 on Consumer Credit. An unfavourable finding could therefore affect other loans to consumers bearing variable interest rates. Furthermore, the Bank has received information requests from a legal firm representing over 1,200 customers of Icelandic commercial banks and loan institutions, they deem to have a comparable right.

43. Provision and contingencies (continued)

In the event of an unfavourable ruling and a subsequent finding that the affected loans should bear a fixed rate of interest instead of a variable interest rate, the Bank's interest rate risk would rise significantly which could lead to a significant financial loss in the event of adverse developments of interest rates in the capital markets. The Bank believes that this is a very unlikely scenario. The Bank has reviewed the terms of its mortgages, other loan contracts and the methods used for the setting and resetting of variable interest rates in light of the above claims. The Bank believes that the claims of the plaintiffs are unfounded and has not recognised a provision in relation to this matter.

EC Clear ehf.

In August 2021 EC Clear ehf., a former owner of a payment processing company, filed a suit jointly against the Bank and four other financial institutions claiming damages in the amount of ISK 923 million plus interest from June 2013, resulting from a breach of competition law that allegedly took place during the period from 2003 to 2013. This was the sixth time the case had been brought before the courts for this purpose, after previous cases had been dismissed. On 30 September 2022 the District Court of Reykjavík dismissed the case. On 10 January 2023 the Court of Appeal partly reversed the dismissal and ordered the District Court to hear the case in substance. The hearing of the case has not been decided. The Group has not recognised a provision in relation to this matter.

44. Events after the reporting period

On 2 February 2023, Íslandsbanki received a letter from the Board of Directors of Kvika banki hf. requesting the Board of Directors of Íslandsbanki's position on commencing merger discussions between the two companies.

45. Risk management

Risk governance

The Group is exposed to various risk factors and managing these risks is an integral part of its operations. The Bank emphasises sound governance principles. The risk management and internal control framework of the Group is based on a three lines of defence model, as referred to in the European Banking Authority Guidelines on Internal Governance, and aims for informed decision-making and strong risk awareness. The framework is intended to ensure effective and efficient operations, adequate control of risks, prudent conduct of business, reliability of financial and non-financial information reported internally and externally, and compliance with laws, regulations, supervisory requirements and the Group’s internal rules.

The first line of defence consists of the Bank's business and support units; the second line of defence comprises the Bank's internal control units, Risk management and Compliance; and the third line of defence is Internal Audit which gives the Board an independent assessment of the quality of corporate governance, risk management and internal controls.

The Group's management body has a dual structure. The Board of Directors of the Bank has a supervising role in setting and monitoring the execution of set policies, the sound control of accounting and financial management and ensuring that Group Internal audit, Compliance and Risk management are effective. The Chief Executive Officer (CEO), the Chief Risk Officer (CRO), other members of the senior management and the senior management committees are responsible for implementing risk management practises and internal monitoring in accordance with Board authorisation.

The ultimate responsibility for ensuring an adequate risk management and internal control framework at the Group lies with the Board of Directors. The Board defines and communicates the risk governance framework and the acceptable level of risk through risk management policies and the Risk Appetite Statement. To assist the Board in fulfilling its oversight responsibilities, the Board has appointed three board subcommittees.

The CEO is responsible for the day-to-day operations of the Bank, pursuant to set policies and resolutions of the Board. Moreover, it is the task of the CEO to ensure that the Group's operations are consistent with applicable legislation and the Group's Articles of Association which includes maintaining adequate and effective risk management and internal control functions. The CEO appoints the Chief Risk Officer, the Compliance Officer as well as other members of the Executive Board. The CEO also engages the members of the senior management committees.

The CRO heads the Risk management function and is responsible for defining the daily tasks of the department and to assess the adequacy of its professional skills. In addition, the CRO is responsible for monitoring the risk management framework at the Group and for verifying that the Bank has the right resources and an appropriate organisation to manage its risks efficiently.

The CRO is selected and appointed by the CEO, subject to Board confirmation. The CRO reports directly to the Board and the Board Risk Committee on the overall risk profile of the Group and cannot be removed without the Board's prior approval.

45. Risk management (continued)

The CRO is independent from the business units, is a member of the Executive Board and reports directly to the CEO. The CRO provides an independent view on the Group's exposure to risk. The CRO has the right but not the responsibility to veto certain risk-taking decisions of the senior management committees if an internal control unit considers the proposal inconsistent with the Bank's risk appetite, policies or procedures.

Risk management is mandated to identify, understand, measure and monitor the risks that the Group is exposed to. It provides independent information, analyses and expert judgement on risk exposures, and advice on proposals and risk decisions made by the management and business or support units as to whether they are consistent with the risk appetite and risk polices set by the Board.

Where necessary, Risk management makes recommendations to senior management and the Board to improve or clarify risk policies, procedures and limits.

Risk Management provides a holistic view on risk, and compliance to limits to internal and external stakeholders, and ensures an appropriate escalation in the event of limit breaches.

Business and support units are, however, responsible for maintaining their independent view on the risks inherent in their operations and reporting to senior management any foreseeable breaches from limits, policies or strategic direction.

Risk management provides the senior management and the Board with all relevant risk related information to enable it to define the Bank's risk appetite.

The General Counsel is appointed by and reports directly to the CEO. The General Counsel provides legal advice to the Bank's senior management, including the Board of Directors, and manages the Bank's legal department which provides comprehensive legal advice to the Bank's business segments and support units.

The Chief Audit Executive (CAE) is appointed by the Board, reports directly to Board and directs Group Internal Audit with a mandate from the Board. The CAE is responsible for internal audit matters within the Group, including internal audit tasks which have been outsourced.

The Compliance Officer heads the compliance function and is responsible for defining the daily tasks of the department and assessing the adequacy of its professional skills. The Compliance Officer is responsible for monitoring the compliance risk management framework for the Bank and maintaining oversight for compliance risk throughout the Bank.

The Bank's Compliance Officer is selected and engaged by the CEO, subject to Board confirmation. The Compliance Officer cannot be removed without the Board's prior approval. The Financial Supervisory Authority of the Central Bank and Chief Audit Executive shall be notified of the dismissal or departure of the Compliance Officer. The Compliance Officer reports directly to the Board on the overall compliance risk profile of the Bank.

Each employee is responsible for understanding the risk related to their day-to-day work, for knowing and understanding the respective internal and external rules and procedures, for using the alert procedures in the event of possible fraudulent activities and for conducting business in accordance with the Bank's code of conduct.

The Bank's senior management committee structure is twofold. Firstly the two executive committees, the Executive Board and the All Risk Committee, that are responsible for the implementation of the Board approved business strategy, risk appetite and policies. Secondly the six business committees, the Asset and Liability Committee (ALCO), the Senior Credit Committee (SCC), the Investment Committee (IC), the Operational and Security Committee (OSC), the Sustainability Committee (SC), and the Digital Product Committee (DPC), which are responsible for the approval of business or operational proposals subject to internal rules and guidelines issued by the executive committees and the Board.

The members of the senior management committees are appointed by the CEO, and their mandate and rules of procedure are documented in a charter issued by the CEO.

More information about the Group's risk management and risk assessment processes is available in the unaudited Pillar 3 2022 Report, which is available on the Bank's website: www.islandsbanki.is.

46. Credit risk

Credit risk is defined as current or prospective risk to earnings and capital arising from an obligor's potential failure to meet the terms of any financial contract with the Group.

Credit concentration risk is the significantly increased risk that is driven by common underlying factors, e.g. industrial sector, economy, geographical location, type of financial instrument, or due to connections or relations among counterparties. This includes exposures to parties under common control and significant exposures to groups of counterparties whose likelihood of default is driven by common underlying factors. Credit risk arises principally from loans and advances to customers and other banks but also from balances with the Central Bank and off-balance sheet items such as financial guarantees, loan commitments and derivatives.

The Group has policies and procedures dedicated to accepting, measuring, and managing credit risk. The objective of the Group's credit risk management is to achieve an appropriate balance between risk and return and to minimise potential adverse effects of credit risk on the Group's financial performance.

A thorough analysis of the counterparty's financial standing, analysis of past and estimated future cash flows as well as the borrower's general ability to repay its obligations forms the basis for all credit decisions. The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, groups of borrowers, countries and industry segments. The Group measures and consolidates its credit risk for each counterparty or group of connected clients in accordance with internal and external criteria of connection between parties.

The Group employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security in borrower's assets. The principal collateral types for loans are properties, vehicles, equipment, vessels and securities. When applicable, other credit risk mitigants are employed.

47. Maximum credit exposure and collateral

The Group's credit risk exposure comprises both on-balance sheet and off-balance sheet items. Maximum exposure to credit risk for on-balance sheet assets is the net carrying amount as reported in the statement of financial position. The maximum exposure for off-balance sheet items is the amount that the Group might have to pay out against financial guarantees and credit commitments, less provisions that have been made because of these items. The maximum credit exposure for a derivative contract is calculated according to the original exposure method as described in CRR II.

Collateral and other credit mitigants vary between types of obligors and credit facilities. For loans to individuals the principal collateral taken is residential property against mortgages. In the case of corporate entities the Group takes a charge over assets such as real estate, vessels, cash, and securities as well as other collateral including accounts receivables, inventory, vehicles, and equipment. Loans to government entities and to municipalities are more often than not unsecured. Derivative exposures are generally made under ISDA master agreements with Credit Support Annex or corresponding terms with pledged collateral in the form of cash and government bonds.

In some cases the Group uses guarantees as a credit enhancement but since guarantees effectively transfer credit risk from one counterparty to another they do not represent a reduction in maximum exposure to credit risk. Exempt from this are Government guarantees issued in response to the COVID-19 pandemic which are shown under other collateral. Of these, ISK 1,838 million are subject to 100% Government guarantee, ISK 901 million to 85% Government guarantee and ISK 376 million to 70% Government guarantee. Covenants in loan agreements are also an important credit enhancement but do not reduce maximum credit exposure.

Valuation of collateral is based on market price, official valuation for tax purposes or expert opinion of the Group's employees, depending on availability. In the case of fishing vessels the associated fishing quota is included in the valuation. The total value of pledged assets can thus be higher than the cover indicates. For capital leases the Group remains the owner of the leased object.

The industry breakdown under loans to customers shows the credit exposure by industry classification. The breakdown follows an internal industry classification which is based on the Icelandic ISAT2008 that derives from the European NACE Rev. 2 classification standard.

The following table shows the maximum exposure to credit risk by collateral held against those exposures.

47. Maximum credit exposure and collateral (continued)

At 31 December 2022 **Collateral held against credit exposure**	Maximum exposure to credit risk	Residential real estate	Commercial real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral	Total credit exposure not covered by collateral	Associated ECL
Cash and balances with Central Bank	94,424	-	-	-	-	-	-	-	94,424	3
Loans to credit institutions	110,364	-	-	-	-	-	-	-	110,364	152
Bonds and debt instruments	130,804	-	-	-	-	-	-	-	130,804	-
Derivatives	25,264	-	-	-	11,733	-	-	11,733	13,531	-
Loans to customers:	1,186,639	557,263	306,469	82,645	20,744	63,889	69,383	1,100,393	86,246	11,132
Individuals	570,522	509,638	9,988	3	177	15,767	170	535,743	34,779	2,328
- Thereof mortgages	507,969	504,654	2,514	-	168	-	-	507,336	633	894
Commerce and services	172,222	8,356	76,739	788	2,932	37,908	32,473	159,196	13,026	3,518
Construction	59,815	14,395	35,787	1	186	2,911	2,298	55,578	4,237	757
Energy	10,411	57	8,862	-	9	5	25	8,958	1,453	45
Financial services	2,622	-	595	-	-	-	1,149	1,744	878	20
Industrial and transportation	91,078	1,954	48,834	2,203	109	6,660	13,147	72,907	18,171	2,846
Investment companies	40,336	3,006	10,432	-	16,975	102	9,226	39,741	595	685
Public sector and non-profit organisations	11,046	49	740	-	-	31	19	839	10,207	31
Real estate	126,297	19,349	103,126	-	265	427	671	123,838	2,459	784
Seafood	102,290	459	11,366	79,650	91	78	10,205	101,849	441	118
Other financial assets	5,411	-	-	-	-	-	-	-	5,411	13
Off-balance sheet items:	203,145	8,303	32,714	13,136	2,318	-	24,344	80,815	122,330	1,338
Financial guarantees	18,385	-	6,556	104	1,403	-	1,837	9,900	8,485	413
Loan commitments	184,760	8,303	26,158	13,032	915	-	22,507	70,915	113,845	925
Total	1,756,051	565,566	339,183	95,781	34,795	63,889	93,727	1,192,941	563,110	12,638

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47. Maximum credit exposure and collateral (continued)

At 31 December 2021 **Collateral held against credit exposure**	Maximum exposure to credit risk	Residential real estate	Commercial real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral	Total credit exposure not covered by collateral	Associated ECL
Cash and balances with Central Bank	113,667	-	-	-	-	-	-	-	113,667	3
Loans to credit institutions	43,988	-	-	-	-	-	-	-	43,988	89
Bonds and debt instruments	132,289	-	-	-	-	-	-	-	132,289	-
Derivatives	21,547	-	-	-	9,722	-	-	9,722	11,825	-
Loans to customers:	1,086,327	510,100	250,581	86,387	6,664	50,536	72,774	977,042	109,285	13,565
Individuals	520,733	460,898	9,317	21	205	15,756	198	486,395	34,338	2,192
- Thereof mortgages	457,800	454,684	1,417	-	194	-	-	456,295	1,505	1,023
Commerce and services	165,222	16,083	66,667	721	262	25,422	20,997	130,152	35,070	5,947
Construction	36,773	12,619	15,532	7	118	2,605	2,621	33,502	3,271	467
Energy	9,493	27	7,638	-	2	6	13	7,686	1,807	36
Financial services	1,978	-	475	-	-	-	1,472	1,947	31	3
Industrial and transportation	89,627	1,511	46,292	2,375	104	6,268	13,578	70,128	19,499	2,833
Investment companies	23,677	1,328	4,637	-	5,421	72	11,720	23,178	499	631
Public sector and non-profit organisations	9,987	85	738	-	-	45	3	871	9,116	20
Real estate	109,314	16,715	87,266	-	480	264	2,655	107,380	1,934	1,247
Seafood	119,523	834	12,019	83,263	72	98	19,517	115,803	3,720	189
Other financial assets	5,241	-	-	-	-	-	-	-	5,241	24
Off-balance sheet items:	164,262	4,230	32,611	12,306	1,902	-	20,515	71,564	92,698	1,001
Financial guarantees	18,830	-	6,614	370	1,434	-	1,503	9,921	8,909	453
Loan commitments	145,432	4,230	25,997	11,936	468	-	19,012	61,643	83,789	548
Total	1,567,321	514,330	283,192	98,693	18,288	50,536	93,289	1,058,328	508,993	14,682

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48. Credit quality of financial assets

The following tables provide the gross carrying amount of loans and credit risk exposure on loan commitments and financial guarantees. Amounts are broken down by risk class and the method by which their respective credit loss allowances (ECL) are calculated, i.e. Stage 1, 2 and 3.

The Group uses internal rating models to assess the default probability of corporate and retail customers. The models assign each customer to one of ten risk classes. One risk class is for customers in default (risk class 10), and nine risk classes are for performing customers (risk classes 1-9). Risk classes are assigned on customer level and not facility level.

The rating of corporate customers is based on a company's most recent financial statements, together with a qualitative assessment of its management, market position and industry sector.

For retail customers the Group uses two different statistical rating models. One model is for individuals and another is for small companies with a total exposure to the Group of less than ISK 150 million. These models are behavioural scoring models and use information about a customer's payment history, amount of debt and deposits, and demographic variables to assess the probability that a customer will default on any of his obligations within 12 months of the rating assessment.

Risk classes 1-4 represent low risk, risk classes 5-6 moderate risk, risk classes 7-8 increased risk, risk class 9 high risk, and risk class 10 represents customers that are in default. Unrated are loans that are yet to be rated.

Further information on the risk classes, including the mapping from risk classes to the probability of default, can be found in Section 4.2.2 of the unaudited Pillar 3 2022 Report.

The same customer can have loans and off-balance sheet commitments in Stages 1 and 2 simultaneously. However, if a customer has an exposure in Stage 3 then all other loans and commitments are classified as Stage 3 as well.

At 31 December 2022

Loans to customers:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	478,439	524	-	478,963
Risk class 5-6	473,451	14,804	-	488,255
Risk class 7-8	177,477	10,372	-	187,849
Risk class 9	17,425	4,035	-	21,460
Risk class 10	-	-	21,123	21,123
Unrated	81	40	-	121
	1,146,873	29,775	21,123	1,197,771
Expected credit losses	(4,636)	(2,235)	(4,261)	(11,132)
Net carrying amount	1,142,237	27,540	16,862	1,186,639

Off-balance sheet loan commitments and financial guarantees:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	99,648	2	-	99,650
Risk class 5-6	66,519	328	-	66,847
Risk class 7-8	28,039	5,464	-	33,503
Risk class 9	706	428	-	1,134
Risk class 10	-	-	1,640	1,640
Unrated	1,484	180	45	1,709
	196,396	6,402	1,685	204,483
Expected credit losses	(869)	(242)	(227)	(1,338)
Total	195,527	6,160	1,458	203,145

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48. Credit quality of financial assets (continued)

At 31 December 2021

Loans to customers:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	398,524	1,775	-	400,299
Risk class 5-6	377,063	42,650	-	419,713
Risk class 7-8	180,421	53,444	-	233,865
Risk class 9	16,445	7,889	-	24,334
Risk class 10	-	-	21,576	21,576
Unrated	96	9	-	105
	972,549	105,767	21,576	1,099,892
Expected credit losses	(3,830)	(3,804)	(5,931)	(13,565)
Net carrying amount	968,719	101,963	15,645	1,086,327

Off-balance sheet loan commitments and financial guarantees:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	77,769	1,065	-	78,834
Risk class 5-6	43,831	4,550	-	48,381
Risk class 7-8	21,854	14,446	-	36,300
Risk class 9	472	690	-	1,162
Risk class 10	-	-	544	544
Unrated	38	4	-	42
	143,964	20,755	544	165,263
Expected credit losses	(545)	(298)	(158)	(1,001)
Total	143,419	20,457	386	164,262

49. Forbearance

When restructuring or modification measures are believed to be more appropriate than collection procedures, the Group offers several debt relief measures and restructuring frameworks for customers in financial difficulties. These forbearance measures include temporary payment holidays, extension of loan terms, capitalisation of arrears, and waiving of covenants.

The relationship between forbearance and stages is discussed in Note 61.4.

Once an asset has been classified as forborne, it will remain forborne for a minimum 24-month probation period. In order for a loan to be reclassified out of the forborne category, the customer has to meet all of the following criteria:

- All of the customer's facilities have to be considered performing during the probation period; and
- The customer does not have any contract that is more than 30 days past due; and
- The probation period of two years has passed from the date of the forbearance event; and
- Regular payments of more than an insignificant amount of principal or interest have been made during at least half of the probation period.

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49. Forbearance (continued)

The following table provides a summary of the Group's forborne assets.

At 31 December 2022

Gross carrying amount	Stage 1	Stage 2	Stage 3	Total
Individuals	3,232	2,422	1,264	6,918
Companies	23,662	17,596	9,189	50,447
Total	26,894	20,018	10,453	57,365

Expected credit losses	Stage 1	Stage 2	Stage 3	Total
Individuals	(20)	(46)	(98)	(164)
Companies	(86)	(1,783)	(2,766)	(4,635)
Total	(106)	(1,829)	(2,864)	(4,799)

At 31 December 2021

Gross carrying amount	Stage 1	Stage 2	Stage 3	Total
Individuals	3,920	3,989	1,453	9,362
Companies	17,500	68,081	9,076	94,657
Total	21,420	72,070	10,529	104,019

Expected credit losses	Stage 1	Stage 2	Stage 3	Total
Individuals	(25)	(78)	(135)	(238)
Companies	(102)	(2,719)	(3,543)	(6,364)
Total	(127)	(2,797)	(3,678)	(6,602)

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50. Large exposures disclosure

When the Group's total exposure to a group of connected clients is 10% or higher of the Group's Tier 1 capital it is considered a large exposure. Both on-balance sheet and off-balance sheet items from all types of financial instruments are included in the exposure as defined by EU regulation no. 575/2013 on prudential requirements for financial undertakings. The Group has internal criteria that define connections between clients. These criteria reflect the Group's interpretation of article (1)(a) of the Act on Financial Undertakings no. 161/2002, where groups of connected clients are defined.

The exposure is evaluated both before and after credit risk mitigating effects according to the aforementioned regulation. After mitigating effects, the Group currently has five large exposures. No large exposure is above the maximum 25% large exposure limit set by the law.

The Group's largest exposure before eligible credit risk mitigating effects is the Icelandic Government. Biggest part of the exposure is due to Icelandic Government Bonds in the Group's liquidity portfolio.

At 31 December 2022

Groups of connected clients:	Before	After
Group 1	87%	9%
Group 2	13%	13%
Group 3	12%	12%
Group 4	11%	11%
Group 5	11%	11%
Group 6	11%	11%

At 31 December 2021

Group of connected clients:	Before	After
Group 1	100%	7%

51. Liquidity risk

The Group defines liquidity risk as the risk of not being able to fund its financial obligations or planned growth, or only being able to do so substantially above the prevailing market cost of funds.

The Group's main source of funding is customer deposits. Treasury is responsible for the Bank's funding and liquidity management in line with internal and regulatory limits and policies. Treasury manages the Bank's intraday liquidity. Risk Management, as the second line of defence, is responsible for independent reporting on the liquidity position to internal and external stakeholders and providing a holistic view on liquidity risk on a consolidated basis.

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52. Liquidity coverage and net stable funding ratio

Key measures for the assessment of liquidity risk are the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The Central Bank of Iceland, which is the main supervisory authority regarding liquidity risk, has incorporated the LCR and the NSFR based on the CRD IV standards into the rules on liquidity ratios and the rules on funding ratios. In addition, the Group complies with the Financial Supervisory Authority of the Central Bank's guidelines no. 2/2010 on best practices in liquidity management and liquidity coverage ratio rules no. 266/2017.

The minimum LCR ratio that the Group is required to maintain is 100% for the total LCR and LCR in foreign currencies. For LCR in ISK, the requirement is 40% in 2022 and 50% as of 2023. The Group is required to maintain a 100% minimum NSFR ratio.

The following tables show the NSFR and the LCR for the Group at 31 December 2022 and at year-end 2021.

Net stable funding ratio	31.12.2022	31.12.2021
For all currencies	118%	122%
Foreign currencies	198%	157%

Liquidity coverage ratio	31.12.2022	31.12.2021
For all currencies	205%	156%
ISK	109%	141%
Foreign currencies	492%	235%

	For all currencies		ISK		Foreign currencies	
At 31 December 2022	Unweighted	Weighted	Unweighted	Weighted	Unweighted	Weighted
Liquid assets level 1*	198,074	198,074	143,077	143,077	54,997	54,997
Liquid assets level 2	24,398	19,474	24,370	19,474	28	-
Total liquid assets	222,472	217,548	167,447	162,551	55,025	54,997
Deposits	656,669	180,302	561,212	142,739	95,457	37,563
Debt issued	6,157	6,157	294	294	5,863	5,863
Other outflows	64,880	35,224	59,652	33,932	5,228	1,292
Total outflows	727,706	221,683	621,158	176,965	106,548	44,718
Short-term deposits with other banks**	89,820	82,008	1,028	5	88,792	82,003
Other inflows	56,075	33,702	46,668	27,287	9,407	6,415
Restrictions on inflows	-	-	-	-	-	(54,878)
Total inflows	145,895	115,710	47,696	27,292	98,199	33,540
Liquidity coverage ratio		205%		109%		492%
At 31 December 2021						
Liquid assets level 1*	214,480	214,480	184,282	184,282	30,198	30,198
Liquid assets level 2	45,559	16,404	41,415	16,404	4,144	-
Total liquid assets	260,039	230,884	225,697	200,686	34,342	30,198
Deposits	618,940	173,789	542,616	145,478	76,324	28,311
Debt issued	15,464	15,464	66	66	15,398	15,398
Other outflows	99,162	37,587	69,796	29,940	29,366	7,647
Total outflows	733,566	226,840	612,478	175,484	121,088	51,356
Short-term deposits with other banks**	43,997	42,135	3,040	2,118	40,957	40,017
Other inflows	51,161	36,692	43,385	30,540	7,776	6,152
Restrictions on inflows	-	-	-	-	-	(7,653)
Total inflows	95,158	78,827	46,425	32,658	48,733	38,516
Liquidity coverage ratio		156%		141%		235%

*Level 1 liquid assets include cash and balances with the Central Bank, domestic bonds and foreign government bonds in accordance with rules no. 266/2017 on liquidity ratio.

**Short-term deposits with other banks with maturity less than 30 days.

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52. Liquidity coverage and net stable funding ratio (continued)

Deposits by liquidity coverage ratio category

The Group's deposits are categorised by counterparty according to the Liquidity Coverage Ratio (LCR) standard. The groups are listed in order of estimated stability and the respective LCR outflow weight. Deposits are also classified as stable if the customer has an established business relationship with the Bank and is covered by an effective insurance scheme.

	Deposits maturing within 30 days					
At 31 December 2022	Less stable	Weight (%)	Stable	Weight (%)	Term deposits	Total deposits
Individuals	86,621	13%	205,538	5%	79,206	371,365
Small and medium enterprises	59,495	13%	59,942	5%	8,614	128,051
Operational relationships	4,133	25%	-	5%	-	4,133
Corporations	140,039	40%	3,242	20%	30,526	173,807
Sovereigns, Central Bank, and public sector entities	10,805	40%	1,116	20%	777	12,698
Pension funds	35,662	100%	-	-	16,398	52,060
Domestic financial entities	41,830	100%	-	-	5,177	47,007
Foreign financial entities	8,246	100%	-	-	7,799	16,045
Total	386,831		269,838		148,497	805,166

	Deposits maturing within 30 days					
At 31 December 2021	Less stable	Weight (%)	Stable	Weight (%)	Term deposits	Total deposits
Individuals	78,319	13%	204,340	5%	66,643	349,302
Small and medium enterprises	58,774	12%	57,685	5%	6,185	122,644
Operational relationships	3,260	25%	-	5%	-	3,260
Corporations	110,682	40%	2,913	20%	29,279	142,874
Sovereigns, Central Bank, and public sector entities	8,168	40%	1,115	20%	559	9,842
Pension funds	45,346	100%	-	-	18,269	63,615
Domestic financial entities	41,894	100%	-	-	12,522	54,416
Foreign financial entities	6,444	100%	-	-	5,023	11,467
Total	352,887		266,053		138,480	757,420

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53. Maturity analysis of financial assets and financial liabilities

The following tables show the maturity profile of the Group's financial assets and the undiscounted cash flows of its financial liabilities. Maturity classification of assets is based on contractual maturity.

Bonds and debt instruments are based on contractual maturity and therefore do not represent the estimated liquidation time of the trading book.

The tables show undiscounted contractual payments of principal and interest for the Group's financial liabilities. Thus, the total figures for each liability class are higher than the respective balance sheet amount. Cash flows for payments of unknown nature, such as for floating rate, CPI-linked or foreign currency denominated instruments, are based on internal yield curves and forecasts.

For dated financial liabilities the amounts are grouped into maturity buckets according to contractual maturities of principal and estimated contractual payments of interest. For demand deposits or other non-dated liabilities, the figures are grouped according to the first possible required payment date.

The following tables also show the contractual cash flow of the Group's derivative liabilities, i.e. derivatives that have a negative and a positive carrying amount at the reporting date. For derivatives settled on a gross basis, the cash flow for both legs of the derivative is shown, since netting cannot be applied upon settlement.

At 31 December 2022	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Cash and balances with Central Bank	41,518	52,906	-	-	-	-	94,424	94,424
Loans to credit institutions	46,761	63,587	16	-	-	-	110,364	110,364
Bonds and debt instruments	-	50,429	46,570	28,940	4,865	-	130,804	130,804
Derivatives	-	3,062	1,619	2,260	-	-	6,941	7,461
- Net settled derivatives	-	897	-	-	-	-	897	897
- Inflow	-	41,940	24,587	29,827	-	-	96,354	81,324
- Outflow	-	(39,775)	(22,968)	(27,567)	-	-	(90,310)	(74,760)
Loans to customers	-	80,768	129,442	326,017	650,412	-	1,186,639	1,186,639
Shares and equity instruments	-	-	-	-	-	15,868	15,868	15,868
Other financial assets	4,968	288	155	-	-	-	5,411	5,411
Total financial assets	93,247	251,040	177,802	357,217	655,277	15,868	1,550,451	1,550,971
Deposits from CB and credit institutions	5,015	2,998	4,269	3,387	-	-	15,669	15,269
Deposits from customers	668,869	66,203	52,453	23,018	33,858	-	844,401	789,897
Derivatives instrument and short positions	-	1,366	4,220	4,504	509	-	10,599	10,804
- Net settled derivatives	-	134	-	-	-	-	134	134
- Inflow	-	(51,316)	(20,748)	(19,479)	-	-	(91,543)	(77,250)
- Outflow	-	52,533	24,968	23,923	-	-	101,424	87,635
- Short positions	-	15	-	60	509	-	584	285
Debt issued and other borrowed funds	-	12,384	111,618	465,372	50,404	-	639,778	468,270
Subordinated loans	-	529	1,427	20,516	35,530	-	58,002	34,392
Other financial liabilities	5,356	1,271	1,486	1,911	1,634	-	11,658	11,329
- Lease liabilities	-	141	396	1,866	1,634	-	4,037	3,708
- Other liabilities	5,356	1,130	1,090	45	-	-	7,621	7,621
Total financial liabilities	679,240	84,751	175,473	518,708	121,935	-	1,580,107	1,329,961
Total net financial assets and financial liab.	(585,993)	166,289	2,329	(161,491)	533,342	15,868	(29,656)	221,010

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53. Maturity analysis of financial assets and financial liabilities (continued)

At 31 December 2021	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total	Carrying amount
Cash and balances with Central Bank	39,278	74,389	-	-	-	-	113,667	113,667
Loans to credit institutions	24,327	19,661	-	-	-	-	43,988	43,988
Bonds and debt instruments	-	25,420	38,495	63,315	5,059	-	132,289	132,289
Derivatives	-	(1,737)	1,227	2,497	-	-	1,987	2,445
- Net settled derivatives	-	579	-	-	-	-	579	579
- Inflow	-	40,945	6,895	29,424	-	-	77,264	67,150
- Outflow	-	(43,261)	(5,668)	(26,927)	-	-	(75,856)	(65,284)
Loans to customers	1,153	89,452	114,436	304,623	576,663	-	1,086,327	1,086,327
Shares and equity instruments	-	-	-	-	-	31,677	31,677	31,677
Other financial assets	4,712	373	156	-	-	-	5,241	5,241
Total financial assets	69,470	207,558	154,314	370,435	581,722	31,677	1,415,176	1,415,634
Deposits from CB and credit institutions	5,403	4,022	-	4,101	-	-	13,526	13,384
Deposits from customers	621,391	62,356	43,950	25,254	28,357	-	781,308	744,036
Derivatives instrument and short positions	-	5,682	1,429	5,368	1,454	-	13,933	9,467
- Net settled derivatives	-	2,985	-	-	-	-	2,985	2,985
- Inflow	-	(55,405)	(18,216)	(33,280)	-	-	(106,901)	(85,961)
- Outflow	-	58,086	19,486	36,950	-	-	114,522	90,492
- Short positions	-	16	159	1,698	1,454	-	3,327	1,951
Debt issued and other borrowed funds	-	22,948	78,045	315,021	54,676	-	470,690	402,226
Subordinated loans	-	292	732	16,784	27,285	-	45,093	35,762
Other financial liabilities	3,434	1,739	1,157	1,858	2,047	-	10,235	9,681
- Lease liabilities	-	129	387	1,829	2,047	-	4,392	3,838
- Other liabilities	3,434	1,610	770	29	-	-	5,843	5,843
Total financial liabilities	630,228	97,039	125,313	368,386	113,819	-	1,334,785	1,214,556
Total net financial assets and financial liab.	(560,758)	110,519	29,001	2,049	467,903	31,677	80,391	201,078

Off-balance sheet liabilities

Note 47 Maximum Credit Exposure and Collateral shows the amount of contractual obligations of off-balance sheet liabilities that the Group has taken towards customers, either by committing to lend out money in the future or as third party guarantees. The amounts shown reflect the maximum amount, not taking into account the Group's ability to reduce overdraft or credit card limits before the current undrawn amount is fully utilised by the customer. These obligations are all categorised as on demand since contractually, on a case-by-case basis, the Group could be required to fulfil these obligations instantaneously.

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54. Market risk

The Group defines market risk as the current or prospective risk to earnings and capital arising from adverse movements in the level or volatility of prices of market instruments, such as those that arise from changes in interest rates, foreign exchange rates, equity prices, CPI-indexation, and commodity prices. Sources of market risk are imbalances in the Group's balance sheet and open positions in bonds, currencies, and equities. Derivative contracts are also potential sources of market risk (see Note 23).

Market risk within the Group can broadly be split into two categories, trading book and banking book. The trading book includes market risk exposures related, directly or indirectly, to the Group's short- and medium-term trading in securities, currencies and other capital market instruments and derivatives. All financial assets and liabilities in the trading portfolio are recognised at fair value and all resulting changes are immediately reflected in the income statement. The banking book includes market risk exposures related to securities held for long-term investment purposes, unlisted securities or holdings in subsidiaries or affiliates. A large part of the banking book market risk is due to mismatches in the composition of assets and liabilities, for example with respect to currencies, interest rates, CPI-indexation or other factors that can affect the Group's earnings or earnings volatility. These mismatches are reported to management and are subject to internal and regulatory limits.

55. Interest rate risk

Interest rate risk is defined as the current or prospective risk to earnings or capital arising from adverse movements in interest rates. Sensitivity measures like Basis Point Value (BPV) are used to measure and manage risk arising from its fixed income exposures. The BPV measures the effect of a 0.01 percentage point upward parallel shift in the yield curve on the fair value of these exposures.

Interest rate risk in the trading book

The fixed income trading unit invests mainly in government bonds, bonds issued by the Housing and Construction Authority which are guaranteed by the Icelandic Government, domestic municipality bonds, and covered bonds issued by other Icelandic banks. Bonds and bills in the Group's liquidity portfolio are also categorised in the trading book. In the following table the total market value (MV) of long and short positions may not be the same as reported in Note 17 since netting between short and long positions is not applied here.

	31.12.2022			31.12.2021		
Trading bonds and debt instruments, long positions	MV	Duration	BPV	MV	Duration	BPV
Indexed	3,446	6.39	(2.20)	548	6.59	(0.36)
Non-indexed	124,065	0.58	(7.17)	95,996	0.91	(8.75)
Total	127,511	0.74	(9.37)	96,544	0.94	(9.11)
Trading bonds and debt instruments, short positions						
Indexed	-	-	-	215	9.00	0.20
Non-indexed	282	5.04	0.14	148	1.00	0.02
Total	282	5.04	0.14	363	5.74	0.22
Net position of trading bonds and debt instruments	127,229	0.73	(9.23)	96,181	0.92	(8.89)

The following table shows the interest rate sensitivity of the Group's trading book from a parallel 100 basis points change in all yield curves.

Sensitivity analysis for trading bonds and debt instruments		31.12.2022		31.12.2021	
		Effect on profit or (loss)			
Currency	Parallel shift in yield curve (basis points)	Downward shift	Upward shift	Downward shift	Upward shift
ISK, indexed	100	222	(222)	57	(57)
ISK, non-indexed	100	601	(601)	781	(781)
EUR	100	87	(87)	35	(35)
USD	100	4	(4)	15	(15)
Other total	100	39	(39)	46	(46)
Total		953	(953)	934	(934)

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55. Interest rate risk (continued)

Interest rate risk in the banking book

Interest rate risk in the banking book arises from the Group's core banking activities. The main source of this type of interest rate risk is the risk of loss from fluctuations in future cash flows or fair value of financial instruments as interest rates change over time, reflecting the fact that the Group's assets and liabilities are of different maturities and are priced relative to different interest rates.

The following table shows the interest sensitivity of the Group's banking book from a parallel 100 basis points change in all yield curves, with all other variables held constant, categorised by the date of next interest rate reset.

Sensitivity analysis for interest rate risk in the banking book*

At 31 December 2022

Currency	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
ISK, indexed	12	(12)	220	(4,195)	2,860	(80)	(1,195)
ISK, non-indexed	23	232	(517)	(740)	1	46	(955)
EUR	103	218	(15)	(132)	-	-	174
SEK	51	-	-	-	-	-	51
USD	39	-	-	-	-	-	39
Other	79	-	3	(5)	-	-	77
Total	307	438	(309)	(5,072)	2,861	(34)	(1,809)

At 31 December 2021

Currency	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
ISK, indexed	6	121	(117)	(2,428)	2,858	(670)	(230)
ISK, non-indexed	(34)	2	502	(2,071)	745	-	(856)
EUR	(18)	25	(518)	582	-	-	71
SEK	64	-	-	-	-	-	64
USD	-	(10)	-	-	-	-	(10)
Other	39	(12)	-	(5)	-	-	22
Total	57	126	(133)	(3,922)	3,603	(670)	(939)

*Comparative figures have been changed with immaterial effects.

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56. Currency risk

Currency risk is the risk that earnings or capital may be negatively affected from the fluctuations of foreign exchange rates, due to transactions in foreign currencies or due to a mismatch in the currency composition of assets or liabilities.

The analysis of the Group's foreign currency exposure presented below is based on the contractual currency of the underlying balance sheet items. Additionally, there are off-balance sheet items that carry currency risk and are included in the total currency imbalance. The off-balance sheet amounts below represent the notional amounts of derivatives and unsettled spot agreements.

Debt issued is presented in the analysis of the Group's foreign currency exposure as the nominal amount plus accrued interest. Some debt issues are measured at fair value in the consolidated financial statements. Therefore, the net position presented below does not match the book value net position thus affecting the foreign exchange difference recognised in the consolidated income statement.

At 31 December 2022	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	CAD	Other foreign currencies	Total foreign currencies
Cash and balances with Central Bank	462	284	126	36	7	43	47	78	31	139	1,253
Loans to credit institutions	35,515	37,533	2,565	534	816	5,220	20,790	4,855	1,321	146	109,295
Bonds and debt instruments	34,693	5,666	7	-	-	3,393	9,996	-	-	-	53,755
Loans to customers	127,658	25,155	348	657	2,193	40	2,946	140	7,073	-	166,210
Shares and equity instruments	127	350	78	-	-	1,025	-	-	-	-	1,580
Other assets	344	243	7	-	-	46	-	1	-	-	641
Total assets	198,799	69,231	3,131	1,227	3,016	9,767	33,779	5,074	8,425	285	332,734
Deposits from credit institutions	8,657	1,869	17	-	-	-	7	-	-	-	10,550
Deposits from customers	35,002	42,694	4,988	641	683	910	3,891	10,011	322	12	99,154
Debt issued and other borrowed funds	179,456	12,228	-	-	-	23,231	46,128	-	-	-	261,043
Subordinated loans	-	-	-	-	-	23,667	-	-	-	-	23,667
Other liabilities	254	200	7	-	-	1	-	1	-	-	463
Total liabilities	223,369	56,991	5,012	641	683	47,809	50,026	10,012	322	12	394,877
Net on-balance sheet position	(24,570)	12,240	(1,881)	586	2,333	(38,042)	(16,247)	(4,938)	8,103	273	(62,143)
Net off-balance sheet position	22,616	(11,542)	1,766	(576)	(2,394)	38,117	16,233	4,953	(8,244)	(377)	60,552
Net position	(1,954)	698	(115)	10	(61)	75	(14)	15	(141)	(104)	(1,591)

Amounts are in ISK million

56. Currency risk (continued)

At 31 December 2021	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	CAD	Other foreign currencies	Total foreign currencies
Cash and balances with Central Bank	659	350	183	43	15	47	65	89	26	164	1,641
Loans to credit institutions	12,297	15,080	967	400	724	261	10,095	331	586	189	40,930
Bonds and debt instruments	9,612	3,910	32	-	-	5,040	10,320	-	-	-	28,914
Loans to customers	124,674	41,409	1,071	994	2,903	59	3,263	3,011	3,863	20	181,267
Shares and equity instruments	2,311	386	343	-	-	1,881	-	-	-	-	4,921
Other assets	13	390	-	-	-	4	-	1	-	-	408
Total assets	149,566	61,525	2,596	1,437	3,642	7,292	23,743	3,432	4,475	373	258,081
Deposits from credit institutions	7,802	336	15	-	-	-	8	2	-	-	8,163
Deposits from customers	38,846	29,637	3,763	442	708	831	2,813	2,258	340	29	79,667
Debt issued and other borrowed funds	133,709	-	-	-	-	12,951	41,255	-	-	-	187,915
Subordinated loans	-	-	-	-	-	35,762	-	-	-	-	35,762
Other liabilities	629	226	-	-	-	3	-	43	-	-	901
Total liabilities	180,986	30,199	3,778	442	708	49,547	44,076	2,303	340	29	312,408
Net on-balance sheet position	(31,420)	31,326	(1,182)	995	2,934	(42,255)	(20,333)	1,129	4,135	344	(54,327)
Net off-balance sheet position	31,200	(30,849)	893	(990)	(2,924)	42,157	20,148	(1,114)	(4,113)	(408)	54,000
Net position	(220)	477	(289)	5	10	(98)	(185)	15	22	(64)	(327)

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56. Currency risk (continued)

The following table shows the effect of a 10% depreciation or appreciation of foreign exchange rates where the Group had positions at year-end, with all other variables held constant.

Sensitivity analysis for currency risk	31.12.2022		31.12.2021	
	Effect on profit or (loss)			
Currency	-10%	10%	-10%	10%
EUR	195	(195)	22	(22)
USD	(70)	70	(48)	48
GBP	12	(12)	29	(29)
CHF	(1)	1	(1)	1
JPY	6	(6)	(1)	1
SEK	(8)	8	10	(10)
NOK	1	(1)	19	(19)
DKK	(2)	2	(2)	2
CAD	14	(14)	(2)	2
Other foreign currencies	10	(10)	6	(6)
Total	157	(157)	32	(32)

57. Shares and equity instruments

The Group's equity exposure in the trading book arises from flow trading and market making with shares listed on the Nasdaq Iceland Stock Exchange. Shares and equity instruments in the banking book are classified as mandatorily at fair value through profit or loss or are classified as held for sale.

The following table shows how a 10% shift in equity prices would affect the Group's equity and net financial income. Securities used for hedging are excluded.

Sensitivity analysis for shares and equity instruments		31.12.2022		31.12.2021	
		Effect on profit or (loss)			
Portfolio	Change in equity prices	Downward shift	Upward shift	Downward shift	Upward shift
Trading book	10%	(135)	135	(123)	123
Banking book	10%	(413)	413	(605)	605
Total		(548)	548	(728)	728

58. Inflation risk

The Group is exposed to inflation risk since the value of CPI-linked assets exceeds CPI-linked liabilities. The value of these assets and liabilities changes according to changes in the CPI at any given time and all changes in the CPI affect profit and loss. A 1% increase in the index would lead to an ISK 277 million increase in the balance sheet and a 1% decrease would lead to a corresponding decrease, other risk factors held constant.

	31.12.2022	31.12.2021
Bonds and debt instruments	4,148	1,169
Loans to customers	282,521	247,426
Total CPI-linked assets	286,669	248,595

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58. Inflation risk (continued)

	31.12.2022	31.12.2021
Deposits from customers	107,684	93,806
Debt issued and other borrowed funds	146,368	140,051
Off-balance sheet exposures	4,912	14,697
Total CPI-linked liabilities	258,964	248,554
CPI imbalance	27,705	41

59. Capital management

The following tables show the capital base, the risk exposure amount (REA), the resulting capital ratios, and the leverage ratio for the Group at 31 December 2022 and 31 December 2021.

The Group's regulatory capital requirement is calculated according to EU regulation no. 575/2013 as implemented through the Act on Financial Undertakings no. 161/2002. Capital requirement calculations for credit risk, market risk and operational risk are based on the standardised approach.

The Group aims at managing its capital position and the corresponding capital ratios above the overall regulatory capital requirement. According to the latest SREP report from the Financial Supervisory Authority of the Central Bank, the Bank shall as of 1 July 2022 maintain an additional capital requirement of 2.6% of risk exposure amount. In September 2022 a countercyclical capital buffer of 2% was reintroduced in Iceland. The Group's overall capital requirement, taking into account capital buffers, is 19.9%. The Group's capital target includes a 0.5-2.0% management buffer on top of the overall capital requirement.

The minimum leverage ratio for Icelandic financial institutions is 3%.

In December 2021, the Icelandic Resolution Authority published its MREL policy for Icelandic banks and in September 2022 the Resolution Authority announced that a resolution plan had been approved for Íslandsbanki and thereby the MREL requirement based on the MREL policy. Further information on MREL can be found in Section 3.7 of the unaudited Pillar 3 2022 Report.

	31.12.2022	31.12.2021
Own funds		
Ordinary share capital	10,000	10,000
Share premium	55,000	55,000
Reserves	9,158	6,086
Retained earnings	144,716	132,624
IFRS 9 reversal due to transitional rules	1,301	2,768
Fair value changes due to own credit standing	(1,786)	1,054
Foreseeable dividend payment and approved buyback*	(27,267)	(11,863)
Tax assets	(116)	(94)
Intangible assets	(3,279)	(3,351)
CET1 capital	187,727	192,224
Additional Tier 1 capital	10,062	10,626
Tier 1 capital	197,789	202,850
Tier 2 capital	24,330	25,136
Total capital base	222,119	227,986

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59. Capital management (continued)

	31.12.2022	31.12.2021
Risk exposure amount		
Due to credit risk	893,110	802,147
Due to market risk	15,417	17,100
Due to credit valuation adjustment	2,756	1,829
Due to operational risk	88,208	80,570
Total risk exposure amount	999,491	901,646
Capital ratios		
CET 1 ratio	18.8%	21.3%
Tier 1 ratio	19.8%	22.5%
Total capital ratio	22.2%	25.3%
Leverage ratio		
Exposure amount		
On-balance sheet exposures	1,541,738	1,422,930
Off-balance sheet exposures	68,702	49,220
Derivative exposures	30,596	21,615
Leverage ratio total exposure measure	1,641,036	1,493,765
Tier 1 capital	197,789	202,850
Leverage ratio	12.1%	13.6%

*The Annual General Meeting of Íslandsbanki hf. held on 17 March 2022 authorises the Board of Directors to acquire on behalf of the Bank up to 10% of issued share capital of the Bank. The Central Bank has furthermore granted a permission for the Bank to acquire, through buyback, share capital of the Bank equivalent to ISK 15 billion, which is within the 10% authorisation from the AGM. The approved amount of ISK 15 billion is subtracted from the capital base. The capital distribution is subject to market conditions. The target dividend payment amounting to 50% of the Group's profit for 2022 is also deducted.

60. Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The Group's definition of operational risk includes reputational risk, legal risk, model risk, conduct risk, and compliance risk among other risk factors.

The ultimate responsibility for ensuring an adequate operational risk management and internal control framework at Íslandsbanki lies with the Board of Directors. The Board has approved an Operational Risk Policy which outlines the Bank's framework for operational risk management. Risk Management is responsible for implementing the Bank's operational risk framework, for developing, maintaining the Operational Risk Policy, and for communicating the policy to the Bank's employees.

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Notes to the Consolidated Financial Statements

61. Significant accounting policies

The accounting policies set out below have been applied consistently by the Group for the periods presented in these consolidated financial statements.

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Notes to the Consolidated Financial Statements

61.1 Basis of consolidation

The consolidated financial statements of the Group comprise the financial statements of Íslandsbanki hf., as the parent company, and its subsidiaries.

Consolidation

The Group consolidates its subsidiaries on the basis of control. The consolidation begins when the Group obtains control of the subsidiary and ceases when the Group no longer has control of the subsidiary.

In preparing the consolidated financial statements, Íslandsbanki combines its financial statements with those of its subsidiaries, line by line, by adding together like items of assets, liabilities, equity, income, expenses, and cash flows. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with the Group's accounting policies. All intra-group balances, income and expenses relating to transactions between group entities are eliminated in full on consolidation. This also applies to subsidiaries classified as disposal groups held for sale (see Note 61.11).

A change in the Group's ownership interest in a subsidiary, without a loss of control, is accounted for as an equity transaction.

Control

Subsidiaries are defined as companies in which Íslandsbanki, directly or indirectly, has control. Control over an entity is evidenced by the Group's ability to exercise its power in order to affect any variable returns that the Group is exposed to through its involvement with the entity. When assessing whether to consolidate an entity the Group evaluates a range of control factors, including:

- The purpose and design of the entity
- The relevant activities and how these are determined
- Whether the Group's rights result in the ability to direct the relevant activities
- Whether the Group has exposure or right to variable returns, and
- Whether the Group has the ability to use its power to affect its return

Generally, there is a presumption that a majority of voting rights results in control. However, in individual circumstances, the Group may still exercise control with less than 50% shareholding, or may not be able to exercise control with over 50% of an entity's shares. When assessing whether the Group has power over the investment and therefore controls the variability of this return, the Group considers all relevant facts and circumstances, including the contractual arrangements with the other vote holders of the entity, rights arising from other contractual arrangements, the Group's voting rights and potential voting rights.

The Group reassesses its control over subsidiaries on a regular basis.

Business combinations

The Group accounts for each business combination by applying the acquisition method. Under the acquisition method, the Group identifies itself as the acquirer, determines the acquisition date, recognises and measures the identifiable assets acquired, the liabilities assumed and any non-controlling interests in the acquiree, and recognises and measures any goodwill or gain from a bargain purchase.

Non-controlling interests

Non-controlling interests represent equity in subsidiaries not attributable, directly or indirectly, to the Group.

For each business combination the Group measures non-controlling interests, at the acquisition date, at either fair value or their proportionate share of the acquiree's identifiable net assets.

The Group presents non-controlling interests within equity in the statement of financial position, separately from the equity attributable to equity holders of Íslandsbanki. Profit or loss and each component of other comprehensive income are attributed to equity holders of Íslandsbanki and to non-controlling interests even if this results in the non-controlling interests having a deficit balance. This also applies to subsidiaries classified as disposal groups held for sale.

Loss of control

If the Group loses control of a subsidiary, it derecognises the related assets, liabilities, non-controlling interests, and other components of equity, while any resultant gain or loss is recognised in profit or loss in the line item "Other operating income", or in the line item "Discontinued operations held for sale, net of income tax" if the subsidiary is classified as disposal group held for sale.

Any investment retained by the Group in the former subsidiary is recognised at its fair value at the date when control is lost.

Notes to the Consolidated Financial Statements

61.1 Basis of consolidation (continued)

Funds management

The Group acts as a manager for Undertakings for Collective Investment in Transferable Securities (UCITS) and investment funds as well as other funds for collective investment that accept capital from investors. Such funds are financed by issuing unit share certificates or shares. The Group does not have any contractual financial responsibility with respect to such custom units. The funds are not consolidated unless they are under the control of the Group.

The Group reviews all the facts and circumstances in order to decide if these funds should be consolidated. The Group is deemed to be a principal and hence controls and consolidates the funds, when it acts as fund manager and cannot be removed without cause, has variable returns through significant unit holdings and/or guarantees, and is able to influence the returns of the funds by exercising its power.

61.2 Investments in associates

Associates are entities over which the Group has significant influence to participate in the financial and operating policy decisions of an entity but does not have control over those policies. It is presumed that the Group has significant influence if the Group holds 20-50% of the voting power of an entity. Considerations made in determining significant influence are similar to those used to determine control over subsidiaries (see Note 61.1).

The Group accounts for its investments in associates using the equity method. Under the equity method, investments in associates are initially recognised at cost. After the acquisition date the carrying amount of each investment is adjusted to recognise changes in the Group's share of net assets. Distributions received from an associate reduce the carrying amount of the investment. If goodwill is in place related to acquisitions of associates then it is included in the carrying amount of the investments and is not tested for impairment separately.

The consolidated financial statements of the Group include the Group's share of the profit or loss and other comprehensive income of associates, from the date that significant influence commences until the date that significant influence ceases.

When the Group's share of losses of an associate exceeds its interest in the associate, the carrying amount of that associate is reduced to nil 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 profits only after its share of profits equals the share of losses not recognised.

After application of the equity method, the Group determines whether it is necessary to recognise an impairment loss on its investments in associates. At each reporting date, the Group determines whether there is objective evidence that individual investments in associates are impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying amount, and the impairment loss is recognised in profit or loss.

Upon loss of significant influence over an associate, the Group measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognised in profit or loss in the line item "Other operating income".

Income and expenses from investments in associates are recognised in profit or loss in the line item "Other operating income".

61.3 Foreign currencies

The financial statements of each of the Group's entities are measured using the functional currency of the respective entity.

Foreign currency transactions

On initial recognition transactions in foreign currencies are translated into functional currencies at the spot exchange rate at the date of the transactions. At the end of each reporting period monetary assets and liabilities denominated in foreign currencies are retranslated into functional currencies using the closing rate. 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 measured at fair value are translated into the functional currency using the exchange rate at the date when the fair value was determined.

All foreign currency differences arising on currency translation from one currency to another are recognised in profit or loss in the line item "Net foreign exchange gain (loss)".

Notes to the Consolidated Financial Statements

61.4 Financial assets and financial liabilities

Recognition

The Group recognises a financial asset and a financial liability in its statement of financial position on the trade date, which is the date on which the Group becomes party to the contractual provisions of the instrument, except for loans which are recognised on the date when cash is advanced by the Group to the borrowers. At initial recognition, the Group measures a financial asset or a financial liability at its fair value plus, in the case of a financial asset or a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or the financial liability.

Derecognition

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

The Group derecognises financial assets in the following circumstances:
• When the contractual rights to the cash flows from the financial assets expire, or
• When the Group transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which:
- The Group transfers substantially all the risks and rewards of ownership of the financial assets, or
- The Group neither transfers nor retains substantially all the risks and rewards of ownership of the financial assets and it does not retain control of the financial assets.

Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

The Group enters into transactions whereby it transfers assets recognised in its statement of financial position, but retains either all or substantially all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the statement of financial position of the Group. Transfers of assets with retention of all or substantially all risks and rewards include, for example, repurchase transactions and securities lending.

The Group does not derecognise from its statement of financial position securities which the Group sells under agreements to repurchase at a specified future date ("repos") at a fixed price or at the sale price plus a lender's return. The Group recognises the cash received as a liability in its statement of financial position. The difference between the sale and repurchase prices is recognised as interest expense over the life of the agreement using the effective interest method.

Securities lending and borrowing transactions are usually collateralised by securities or cash. The transfer of securities to counterparties is only reflected in the statement of financial position if the risks and rewards of ownership are also transferred. Cash advanced or received as collateral is recorded as an asset or liability.

In transactions in which the Group neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset and it retains control over the asset, the Group continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

Modifications

Substantial modifications of terms of existing financial assets, or replacements with new ones with significantly different terms, result in the Group derecognising the original financial assets and recognising new financial assets at fair value.

Classification and measurement of financial assets

For the purpose of measuring its financial assets, the Group classifies them at inception in one of the following categories:
• Financial assets at amortised cost
• Financial assets at fair value through other comprehensive income
• Financial assets at fair value through profit or loss
• Derivative assets in hedge accounting

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.

The business models

The business models are determined by the Group's key management personnel in the way that assets are managed and their performance is reported to them. The Group determines its business models at a level that reflects the way groups of financial assets are managed together to achieve a particular business objective. This condition is not an instrument-by-instrument approach to classification, but is determined at a higher level of aggregation. The Group's business models fall into the following three categories: Held to collect, Held to collect and for sale, and Other fair value business models, where assets are held for trading or managed on a fair value basis and are neither Held to collect nor Held to collect and for sale.

Notes to the Consolidated Financial Statements

61.4 Financial assets and financial liabilities (continued)

Solely payments of principal and interest (SPPI)
Financial assets held within the business models Held to collect and Held to collect and for sale, are assessed to evaluate if their contractual cash flows are comprised of solely payments of principal and interest. 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 changes over the life of the financial asset, for example if there are repayments of principal. Interest relates to basic lending returns, including compensation for the time value of money and credit risk associated with the principal amount outstanding over a period of time. Interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, servicing or administrative costs), as well as a profit margin that is consistent with a basic lending arrangement.

Where the contractual terms introduce exposure to 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.

Financial assets at amortised cost
A financial asset is classified as being subsequently measured at amortised cost if the contractual terms of the financial asset give rise to cash flows that are solely payments 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.

Financial assets at amortised cost are measured using the effective interest method. Amortised cost is calculated by taking into account the amount at which the assets are measured at initial recognition less principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount (such as due to discounts or premiums on acquisition and fees and costs that are an integral part of the effective interest rate), and minus any reduction for impairment. Accrued interest is included in the carrying amount of the financial asset in the statement of financial position. Impairment losses and reversals of impairment losses are recognised in profit or loss in the line item "Net impairment on financial assets".

Financial assets at fair value through other comprehensive income (FVOCI)
For shares and equity instruments that are not held for trading, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses, including any related foreign exchange component, in other comprehensive income rather than profit or loss. This election is made on an instrument-by-instrument basis. Shares and equity instruments at FVOCI are not subject to an impairment assessment. Dividends are to be presented in profit or loss, as long as they represent a return on investment. On derecognition there is no recycling of fair value gains and losses to profit or loss.

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 FVOCI. The Group designates financial assets as at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise. During the year the Group did not classify any financial assets as designated at fair value through profit or loss.

Financial assets at fair value through profit or loss are initially recognised and subsequently measured at fair value in the statement of financial position. Changes in fair value are recognised in profit or loss in the line item "Net financial income (expense)", except for interest earned, which is recognised in the line item "Net interest income" and foreign exchange gains and losses, which are included in the line item "Net foreign exchange gain (loss)".

Derivative assets in hedge accounting
Derivative assets in hedge accounting consist of derivatives with positive fair value which are designated and accounted for as hedging instruments (see Note 61.7)

Classification and measurement of financial liabilities

For the purpose of measuring its financial liabilities, the Group classifies them at inception in one of the following categories, except for loan commitments and financial guarantees (see Note 61.12):

- Financial liabilities at amortised cost
- Financial liabilities mandatorily at fair value through profit or loss
- Financial liabilities designated as at fair value through profit or loss
- Derivative liabilities in hedge accounting

Notes to the Consolidated Financial Statements

61.4 Financial assets and financial liabilities (continued)

Financial liabilities at amortised cost
Financial liabilities at amortised cost are non-derivative financial liabilities. Financial liabilities at amortised cost include deposits, debt issued and other borrowed funds, and subordinated loans.

Financial liabilities at amortised cost are recognised initially at fair value net of transaction costs incurred, and subsequently are carried at amortised cost using the effective interest method. Amortised cost is calculated by taking into account the amount at which the financial liabilities are measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount (such as due to discounts or premiums and fees and costs that are an integral part of the effective interest rate). Accrued interest is included in the carrying amount of the liabilities in the statement of financial position.

The amortised cost of certain bonds issued by the Group, which are designated as hedged items in qualifying fair value hedge relationships, is adjusted for changes in the fair value of the bonds attributable to interest rate risk (see Note 61.7).

Financial liabilities mandatorily at fair value through profit or loss
Financial liabilities mandatorily at fair value through profit or loss are financial liabilities incurred principally for the purpose of generating profits from short-term price fluctuations or from the dealer's margin. Financial liabilities mandatorily at fair value through profit or loss consist of short positions in listed bonds and derivatives with negative fair value which are not classified as financial guarantees or are not designated as hedging instruments.

Financial liabilities mandatorily at fair value through profit or loss are initially recognised and subsequently measured at fair value in the statement of financial position. Changes in fair value are recognised in profit or loss in the line item "Net financial income (expense)", except for interest incurred, which is recognised in the line item "Net interest income" on an accrual basis and foreign exchange gains and losses which are included in the line item "Net foreign exchange gain (loss)".

Financial liabilities designated as at fair value through profit or loss
Financial liabilities designated as at fair value through profit or loss are recognised at fair value and changes in fair value attributable to changes in the credit risk of those liabilities are recognised in other comprehensive income and are not subsequently reclassified to profit or loss. The remaining fair value changes are included in profit or loss in the line item "Net financial income (expense)", except for interest incurred, which is recognised in the line item "Net interest income" using the contractual interest rate and foreign exchange gains and losses which are included in the line item "Net foreign exchange gain (loss)".

The Group calculates the fair value attributable to changes in credit risk as the difference between the changes in fair value of the financial liability and the amount of changes in fair value attributable to changes in market interest rates. The change in fair value attributable to changes in market interest rates on financial liabilities is calculated by discounting contractual cash flows at the end of the period with the discount rate of the appropriate market interest rate.

Upon initial recognition, the Group determines if the recognition of gains and losses in other comprehensive income creates or enlarges an accounting mismatch in profit or loss, if applicable the whole fair value change is presented in profit or loss.

Derivative liabilities in hedge accounting
Derivative liabilities in hedge accounting consist of derivatives with negative fair value which are designated and accounted for as hedging instruments (see Note 61.7).

Reclassification
Financial assets are reclassified between measurement categories if the objective of the business model in which the financial assets are held changes after initial recognition and if the change is significant to the Group's operations.
Financial liabilities are not reclassified.

Determination of fair value
The fair value of a financial instrument is the transaction 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.

When available, the Group measures the fair value of financial assets and financial liabilities using quoted prices in an active market for that instrument. A market is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring transactions. The fair value is based on the most recent observed market prices at the reporting date.

61.4 Financial assets and financial liabilities (continued)

If a market for a financial instrument is not active, the Group establishes its fair value using valuation techniques. Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which observable market prices exist, Black-Scholes option pricing model and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, and expected price volatilities and correlations. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group and the counterparty where appropriate.

Periodically, the Group tests the valuation techniques and calibrates against historical data and using prices from observable current market transactions for the same instrument, or based on other available observable market data.

Changes in the fair value of financial assets and financial liabilities are recognised in profit or loss in the line item "Net financial income (expense)".

The Group has an established control framework with respect to the measurement of fair values. The business unit owning the positions is responsible for their valuations and for submitting the valuation to the Bank's Investment Committee for approval. Risk Management provides an independent review of the results, the valuation methods used and of the use of significant unobservable inputs. The final decision on the validity of the valuation is in the hands of the Bank's Investment Committee.

Impairment of financial assets

The impairment model of IFRS 9 is forward-looking and impairment under IFRS 9 should reflect a probability weighted average of possible outcomes. In addition, the expected credit loss model in IFRS 9 employs a dual measurement approach, under which the loss allowance for expected credit losses (ECL) is measured at each reporting date as either 12-month expected credit losses or lifetime expected credit losses, depending on whether there has been a significant increase in credit risk (SICR) of the financial instrument since initial recognition. To satisfy the provisions of the IFRS 9 standard, a significant amount of modelling must be involved. The models which the Group uses for the calculation of the impairment amount are developed according to the Group's modelling framework. This framework imposes structure on the initial model development work, the model documentation including educational material as needed for users, the approval process for models, the implementation of models and the lifetime support for models, including validation and back-testing. The Group's impairment process, which encompasses all the steps needed to derive the appropriate impairment allowance for each accounting period, is documented and approved by the All Risk Committee

Stage assignment

At each reporting date, all assets subject to the impairment methodology must be divided into three groups, termed "Stages", reflecting the extent of credit deterioration since initial recognition. This division then influences how the impairment is measured and how interest is recognised.

Stage 1

All assets that have not experienced a SICR are assigned to Stage 1. For these assets, an impairment allowance is recognised which is equal to the expected credit loss arising from credit events occurring within 12 months of the reporting date (12- month ECL). Interest is recognised on the gross carrying amount of the assets.

Stage 2

Assets that the Group determines to have experienced a SICR, but are not credit-impaired, are classified as Stage 2. For these assets, an impairment allowance is recognised which is equal to the expected credit loss arising from all credit events occurring within the expected lifetime of the assets (lifetime ECL). Interest is recognised on the gross carrying amount of the assets.

The Group's definition of a SICR is on the level of an individual asset. The Group assesses that there has been a significant increase in credit risk of an asset if the probability of a credit impairment event, i.e. transfer to Stage 3, occurring over the lifetime of the asset has increased significantly from the origination of the assets. For this purpose, origination does not refer to any modification events which have not resulted in derecognition of the asset. The assessment is based on a defined set of triggers. This includes, as a backstop, the trigger that the asset is more than thirty days past due. Other triggers are internal assessments of outlook, events such as forbearance events which are less severe than a credit event, external credit related information and a significant deterioration in risk assessment compared with the risk assessment done in relation to the origination of the asset. The definition of a SICR depends only on the probability of a credit event occurring, it does not take into account collateralisation, or any other information related to the expected loss arising from the event. As soon as all triggers for Stage 2 for a particular asset are no longer activated then the asset moves back to Stage 1. Additionally, assets are classified as forborne for two years after a forbearance event has occurred, but forbearance events only cause assets to be in Stage 2 for twelve months and then they migrate back to Stage 1 unless other triggers apply.

61.4 Financial assets and financial liabilities (continued)

The Group does not employ the low credit risk exemption in the Stage assignment process. In alignment with its operating procedures, the Group has chosen as its accounting policy to measure the impairment allowance for lease receivables at an amount equal to the lifetime ECL only for those assets which have a SICR or are credit impaired. For other lease receivables the impairment allowance is equal to the 12-month ECL.

Stage 3

This Stage is for assets which are credit-impaired according to the Group's assessment. These assets are therefore experiencing an ongoing credit event. Thus, the 12-month ECL and lifetime ECL are the same amount, and this amount is recognised as impairment allowance. For assets in this Stage, interest is recognised on the net carrying amount of assets, i.e., net of impairment allowance.

The Group's definition of being credit-impaired is on a customer level, rather than on the level of an individual asset. According to the definition, a customer is credit-impaired when either of the following holds:
a) The Group assesses that it is unlikely that the customer can service all of their commitments to the Group in accordance with the terms of the agreements without recourse to default provisions in the agreements, or
b) The customer has been more than 90 days past due on material credit commitments

The assessment in point a) is made based on a defined set of triggers, which includes serious breach of covenants, serious registrations on an internal watchlist, initiation of serious collection actions and serious external credit related information.

Furthermore, there is a defined set of conditions which must be satisfied so that customers that have been assessed as being credit-impaired are no longer subject to this assessment. This includes probation periods and a view to the future outlook of the customer.

Expected credit loss (ECL)

The ECL for each asset is calculated using models for the probability of a credit impairment event occurring (PD), the loss percentage expected in case of such an event (LGD) and the outstanding amount at the time of the event (EAD). In its simplest form the ECL can be calculated as the product of these factors, however, for several reasons, the actual formula must be more complicated than this.

The PD models are either fully automated statistical models, expert models or hybrid. For the models with a component involving expert input there is a process in place to ensure proper review of the model outcome and periodic reassessment of obligors. The inputs into the models include demographic variables, information from financial statements and past payment behaviour, among other variables.

The effect of the economy on the PD is accounted for with the use of scaling factors which map through-the-cycle PD values to point-in-time PD values. The Group has a model to predict these scaling factors based on an economic forecast. The economic forecast is provided by the Group's Chief Economist. The forecast predicts a range of macroeconomic indicators over a horizon of five years. The model is applied to a subset of these indicators and produces a set of scaling factors. The scaling factors are then reviewed by the All Risk Committee with respect to all of the indicators and any other relevant information available and the committee approves their use for the calculation of the impairment. This process is carried out at least quarterly.

The Group uses three economic scenarios. In addition to the base forecast, scaling factors are produced for a good and bad case. This is done in order to represent the whole range of possible future economic developments. The actual impairment allowance is the weighted average of the ECL in these different scenarios.

The All Risk Committee determined that it was appropriate to adjust the weights of the scenarios due to the COVID-19 pandemic and unrest following the war in Ukraine. Generally the scenarios are weighted 25%-50%-25% (good, base, bad) but it was determined appropriate to set the weights at 20%-50%-30%, as this would best represent the probability-weighted average over all possible scenarios.

The table below shows macroeconomic indicators of the Group's Chief Economist's macroeconomic forecast used in ECL calculations 31.12.2022.

Change in economic indicators %	Estimate 2022	Forecast 2023	Forecast 2024	Forecast 2025	Forecast 2026
Economic growth (YoY real GDP change)	7.3	2.2	2.4	2.0	2.1
Housing prices in Iceland (average YoY change)	21.1	8.1	2.9	3.5	3.5
Purchasing power (average YoY change)	-1.5	3.1	2.9	1.6	1.6
ISK exchange rate index (YoY change in average)	-3.1	3.3	-3.1	-0.3	0.0
Policy rate, Central Bank of Iceland (average per year)	4.2	5.9	5.0	4.5	4.0
Inflation (average per year)	8.3	6.3	3.9	3.3	2.8
Capital formation (YoY real change)	10.2	0.3	2.1	0.9	2.5
thereof capital formation in industry	14.6	-4.0	1.0	3.0	2.5

61.4 Financial assets and financial liabilities (continued)

The LGD model considers several scenarios for how a facility may develop once a credit event has occurred. One possibility is that the facility cures without a loss. If not, the recoveries may be based on the seizing of collateral and to estimate such recoveries, several scenarios for the development of the value of the collateral are considered. Finally, there may be recoveries even though a formal collateral is not in place. These different recovery scenarios are weighted differently depending on the economic scenario under consideration. This leads to a non-linear interaction and thus a difference between the probability weighted average ECL and the ECL in the most likely scenario.

For EAD it is necessary to account for expected prepayments on term loans and for the expected utilisation of commitments such as credit cards, overdrafts, financial guarantees, and credit lines. The expected lifetime of agreements may also extend beyond the contractual lifetime for contracts which are generally extended.

Temporary changes due to COVID-19 pandemic were suspended in the third quarter of 2022 as described in Note 3.

Write-off policy
When the Group has no reasonable expectations of recovering a credit exposure or when it is uneconomical to pursue legal collection, the financial asset is written off. A write-off does not change the debt obligation which is therefore still subject to enforcement activity. Any recoveries of amounts previously written off are credited to the income statement.

The impairment process
In the Group's impairment framework, the Stage assignment and ECL for each financial asset is calculated from the aforementioned models. The outcome is reviewed by the business units and they can propose changes if they provide sufficient supporting material. The impairment and any proposals for changes are reviewed by an Impairment Council appointed by the All Risk Committee and the impairment allowance is approved by the All Risk Committee on a quarterly basis.

The principle of materiality applies to the above discussion on impairment, whereby exceptions related to non-materiality and immaterial adjustments are not discussed.

61.5 Cash and cash equivalents

Cash and cash equivalents are carried at amortised cost in the statement of financial position and at the reporting date the expected credit loss is considered to be low. Impairment losses and reversals of impairment losses are recognised in profit or loss in the line item "Net impairment on financial assets".

Cash and cash equivalents in the statement of cash flows consist of cash on hand, unrestricted balances with the Central Bank, demand deposits with credit institutions, and short-term loans to credit institutions. Cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition.

61.6 Derivative financial instruments

Derivatives are primarily used in trading activities but are also used to manage the Group's exposure to various risks, such as interest rate risk, inflation risk, and currency risk. Derivatives are classified as financial assets or financial liabilities, measured at fair value and presented in the statement of financial position in separate line items as assets or liabilities, depending on whether their fair value at the reporting date is positive (assets) or negative (liabilities).

The Group applies hedge accounting. Accordingly, some of the Group's derivative financial assets and financial liabilities are accounted for as financial assets or financial liabilities mandatorily at fair value through profit or loss while others are accounted for as derivative assets or liabilities in hedge accounting (see Note 61.4 and Note 61.7).

When derivatives are embedded in other financial instruments or host contracts, such combinations are known as hybrid instruments with the effect that some of the cash flows of a hybrid instrument vary in a way similar to a stand-alone derivative. These embedded derivatives are measured and presented in the consolidated financial statements as if they were free-standing derivatives. The Group accounts for an embedded derivative separately from the host contract when, the host contract is not an asset in the scope of IFRS 9, is not carried at fair value through profit or loss, the terms of the embedded derivative would meet the definition of a derivative if they were contained in a separate contract, and the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract. When the Group is required to separate and account for embedded derivatives as if they were stand-alone contracts, the Group presents the fair value of the embedded derivatives in the statement of financial position in the same line items in which the Group presents the related host contracts.

61.7 Hedge accounting

The Group elected, as a policy choice permitted under IFRS 9, to continue to apply hedge accounting in accordance with IAS 39.

On initial designation of the hedges, the Group formally documented the relationship between the hedging instruments and hedged items, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationships. The Group makes an assessment, both at inception of the hedge relationships and on an ongoing basis, of whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value of the hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within the range of 80-125%. In the assessment the Group assumes that the benchmark interest rate is not altered as result of the transition to alternative benchmark interest rates.

The Group applies fair value hedge accounting with respect to designated hedging relationships consisting of certain fixed-rate euro denominated bonds issued by the Group as the hedged items and certain euro denominated interest rate swaps as the hedging instruments, whereby the Group pays floating rate interest and receives fixed rate interest. The hedging relationships are designated and accounted for as fair value hedges because the interest rate swaps are hedging the exposure of the Group to changes in the fair value of the bonds arising from changes in interest rates. The Group recognises the changes in the fair value of the interest rate swaps immediately in profit or loss together with the changes in the fair value of the bonds which are attributable to the interest rate risk. The changes in the clean fair value of the swaps and the bonds are included in the line item “Net financial income (expense)”, the accrued interest on the bonds and the swaps is included in the line item “Net interest income” and foreign exchange gains and losses on the bond are included in the line item "Net foreign exchange gain (loss)".

If a hedging derivative expires or is sold, terminated or exercised, or a hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, then hedge accounting for the corresponding hedging relationship is discontinued permanently. Any adjustment up to the point of discontinuation to a hedged item for which the effective interest method is used is amortised to profit or loss as part of the recalculated effective interest rate of the item over its remaining life.

61.8 Property and equipment

Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses (see Note 61.19). Where parts of an item of property and equipment have different useful lives, those components are accounted for and depreciated as separate items of property and equipment.

Subsequent costs

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 go to the Group and the cost of the item can be measured reliably. All other costs are recognised in profit or loss as incurred.

Depreciation

Items of property and equipment are depreciated from the date they are available for use, except for land, which is not depreciated. The depreciable amount of each item of property and equipment is determined after deducting its residual value. Depreciation is recognised in profit or loss in the line item "Other operating expenses" on a straight-line basis over the estimated useful lives of each part of an item of property and equipment.

The depreciation method, useful lives, and residual values are reviewed at each reporting date and adjusted if appropriate.

The estimated useful lives are as follows:

Buildings	50 years
Right-of-use-assets	1-10 years
Fixtures	6-12 years
Equipment	3-5 years
Vehicles	3 years

61.9 Intangible assets

Software

Software acquired by the Group is measured at cost less accumulated amortisation and impairment losses.

Expenditure on internally developed software is recognised as an asset when the Group is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits, and can reliably measure the costs to complete the development. The capitalised costs include all costs directly attributable to developing the software and capitalised borrowing costs. Internally developed software is carried at capitalised cost less accumulated amortisation and impairment losses.

Subsequent expenditure on software is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Software is amortised on a straight-line basis over its estimated useful life from the date that it is available for use. The amortisation is recognised in profit or loss in the line item "Other operating expenses". The estimated useful life of software is three to ten years.

61.10 Leases

At the inception of a contract, the Group assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The Group has elected not to separate non-lease components and account for lease and non-lease components of a contract as a single lease component.

The Group as a lessee

The Group applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The Group recognises a lease liability and a right-of-use asset at the lease commencement date. The Group has elected not to recognise right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The Group recognises lease payments associated with these leases as an expense on a straight-line basis over the lease term.

Lease liabilities

The lease liability is initially measured at the present value of the lease payments, both fixed and variable, discounted using the entity's incremental borrowing rate. The incremental borrowing rate is the rate of interest the Group would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The incremental borrowing rate is subject to estimation when no observable rates are available. The lease liability is measured at amortised cost using the effective interest method and remeasured when there is a change in future payments, e.g. arising from a change in an index or an assessment of whether extension or termination options will be exercised. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made.

The lease term is determined by the Group as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised. An assessment of whether the entity will exercise an extension or termination option is made by management annually. If the assessment of whether the Group will exercise an extension or termination option changes after the commencement date the lease liability is remeasured and a corresponding adjustment is made to the carrying amount of the right-of-use asset.

Right-of-use assets

The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred less any lease incentives received. For any remeasurement of the lease liability a corresponding adjustment is made to the carrying amount of the right-of-use asset or recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero. The right-of-use-asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. Right-of-use assets are subject to impairment.

If a lease modification increases the scope of the lease by adding a right to use of one or more underlying assets and the consideration for the lease increases by an amount commensurate with the stand-alone price for the increased scope and any adjustments to the price that reflects the circumstances of the particular contract, then the modification is accounted for as a separate lease. For lease modifications that are not accounted for as separate leases the lease term of the modified lease is redetermined and the lease liability remeasured using the revised lease payments and discounted using the incremental borrowing rate at the effective date of modification. Any adjustment of the lease liability is then correspondingly made to the right-of-use asset.

Notes to the Consolidated Financial Statements

61.10 Leases (continued)

The Group presents right-of-use assets in the line item "Property and equipment" and lease liabilities in the line item "Other liabilities" in the statement of financial position. Maturity analysis of lease liabilities is disclosed in Note 53. Interest on lease liabilities is recognised in profit or loss in the line item "Net interest income". Depreciation of right-of-use assets is recognised in profit or loss in the line item "Other operating expenses".

The Group as a lessor

The Group classifies leases based on the substance of the arrangements and the extent of the transfer of risks and rewards incidental to ownership of the leased asset. A lease is classified as an operating lease if the lessor does not transfer substantially all the risks and rewards incidental to ownership. A lease is classified as a finance lease if the lessor transfers substantially all the risks and rewards incidental to ownership.

When the Group is the lessor in a capital lease, the Group recognises a receivable equal to the net investment in the lease and presents it in the line item "Loans to customers" in the statement of financial position. The Group applies its accounting policies for derecognition and impairment of financial assets also to its capital lease receivables. The Group recognises the finance income from capital lease receivables in profit or loss in the line item "Net interest income" over the period of the capital lease so as to give a constant periodic rate of return on the net investment in the capital lease.

When the Group is a lessor in arrangements which involve the legal form of capital leases, but which in substance do not involve leases, the Group classifies them within loans at amortised cost.

61.11 Non-current assets and disposal groups held for sale

Non-current assets and disposal groups are either classified as held for sale when the Group expects to recover their carrying amount principally through a sale transaction rather than through continuing use or as held for distribution to owners when the Group is committed to distribute the asset, or disposal group, to the owners.

For this to be the case, the assets, or disposal groups, must be available for immediate sale, or distribution, in their present condition and their sale, or distribution, must be highly probable. The sale must only by subject to terms that are usual and customary for sales of such assets, or disposal groups.

Non-current assets and disposal groups are presented in a separate line in the statement of financial position. Non-controlling interests in a disposal group are presented within equity.

Immediately before the initial classification as held for sale or distribution the assets, or components of disposal groups, are remeasured in accordance with applicable accounting policies. Thereafter, the non-current assets, or disposal groups, are measured at the lower of their carrying amount and fair value less costs to sell or costs to distribute.

Income and expenses of non-current assets and disposal groups held for sale are recognised in profit or loss in the line item "Discontinued operations held for sale, net of income tax" (see Note 61.21).

61.12 Loan commitments and financial guarantees

Loan commitments are firm commitments of the Group to provide credit under a binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates. Expected credit loss of loan commitments (see Note 61.4) is recognised in the statement of financial position in the line item "Other liabilities". Loan commitment fees received by the Group are recognised in profit or loss in the line item "Fee and commission income".

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 payments when due, in accordance with the terms of a debt instrument. Financial guarantees are issued by the Group to credit institutions and other parties on behalf of its customers so that they can secure loans, overdrafts, and banking facilities.

Liabilities arising from financial guarantees issued by the Group are initially measured at their fair value, being the premium received. Subsequently the liabilities are carried at the higher of the amount representing the initial fair value of the guarantee and the expected credit loss allowance of the guarantee (see Note 61.4). Any changes in the liabilities arising from financial guarantees are recognised in profit or loss. The premium received is recognised in profit or loss in the line item "Fee and commission income" over the life of the guarantee.

Notes to the Consolidated Financial Statements

61.13 Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, if it is probable that the Group will be required to settle the obligation with an outflow of resources, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows. When management assesses that disclosing all information regarding certain matters can be expected to affect their outcome, then such detailed disclosures are not included in the consolidated financial statements.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that the reimbursement will be received and the amount of the receivable can be measured reliably.

61.14 Employee benefits

All Group entities are required to pay, on a mandatory and contractual basis, contributions to public and private pension funds. The Group has no further payment obligations once these contributions have been paid. The Group recognises these contributions as salary related expenses when they become due.

Short-term employee benefits include salaries, cash bonuses, non-monetary benefits and compensated absences. Short-term employee benefit obligations are expensed by the Group as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus 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.

The Group does not have a defined benefit pension plan or an active remuneration policy.

61.15 Equity

Share capital

The share capital disclosed in the consolidated financial statements represents the total nominal value of ordinary shares issued by the Bank. Incremental costs directly attributable to the issuance of ordinary shares are recognised as a deduction from equity, net of any tax effects.

Dividends on shares

Dividends payable to shareholders of the Bank are recognised as a liability and deducted from equity in the period in which the dividends are approved by the shareholders at the Bank's Annual General meeting. Dividends payable to non-controlling shareholders in subsidiaries are recognised as a liability and deducted from equity in the period in which the dividends are approved by the shareholders' meeting of the subsidiaries. Dividends declared after the reporting date are not recognised as a liability at the reporting date.

Statutory reserve

According to the Act on Public Limited Companies no. 2/1995 the statutory reserve shall amount to 25% of the share capital of the Bank.

Restricted reserves

The Group is to transfer, if applicable, certain amounts from retained earnings to restricted reserves which can therefore not be distributed as dividends to shareholders. These restricted reserves are specified as follows:

Restricted reserve due to capitalised development costs
When the Group capitalises development cost it transfers a corresponding amount from retained earnings to a restricted reserve. In the future the restricted amount is to be transferred back to retained earnings as the capitalised development cost is amortised in profit or loss.

Restricted reserve due to fair value changes of financial assets
The Group transfers fair value changes of financial assets at fair value through profit or loss, net of tax if applicable, from retained earnings to a restricted reserve. Amounts recognised in the reserve are transferred back to retained earnings upon sale of the financial asset.

Restricted reserve due to unrealised profit of associates
If share of profit of an associated company is in excess of dividend received or which can be claimed, the Group transfers the difference to a restricted reserve in equity. If the Group's shareholding in an associate is sold or written off the applicable amount recognised in the reserve is transferred to retained earnings.

Notes to the Consolidated Financial Statements

61.15 Equity (continued)

Fair value reserve

Fair value reserve comprises all unrealised gains or losses related to fair value changes of equity instruments classified at fair value through other comprehensive income. On derecognition of the equity instruments fair value changes are not reclassified to profit and loss.

Liability credit reserve

Changes in fair value attributable to changes in the credit risk of financial liabilities designated as at fair value through profit or loss are recognised in liability credit reserve. On derecognition the fair value changes are not reclassified to profit or loss.

Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign subsidiaries.

61.16 Interest income and interest expense

For all financial assets and financial liabilities measured at amortised cost, interest income and interest expense are recognised in profit or loss using the effective interest method.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, when appropriate, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows, considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation generally includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, as well as transaction costs and all other premiums or discounts.

The effective interest rate is established on initial recognition of financial assets and financial liabilities and their carrying amount is subsequently adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate. The change in carrying amount is recorded as interest income or interest expense. For floating rate instruments, interest income or interest expense is generally recognised based on the current market rate plus or minus amortisation or accretion of the discount or premium based on the original effective interest rate.

Interest on impaired financial assets is calculated by applying the original effective interest rate of the financial asset. For financial assets in Stage 1 and Stage 2 interest is recognised on the gross carrying amount of the assets and for financial assets in Stage 3 interest is recognised on the gross carrying amount of the assets, net of impairment allowance (see Note 61.4).

For financial assets and financial liabilities at fair value through profit and loss, interest income and interest expense are recognised through profit or loss on an accrual basis, except for financial liabilities designated as at fair value through profit or loss (see Note 61.4).

Accrued interest on interest rate swaps, which are designated and accounted for as hedging instruments in fair value hedges of the interest rate risk arising from certain fixed-rate euro denominated bonds issued by the Group (see Note 61.7), is recognised in profit or loss as an adjustment to the interest expense recognised for the bonds.

61.17 Net fee and commission income

Fees and commissions are recognised to reflect the transfer of services to customers at an amount that reflects the consideration that is expected to be received for such services. Fee and commission income and expenses that are integral to the effective interest rate on a financial asset or financial liability are included in the measurement of the effective interest rate.

Fees for loan commitments that are likely to be utilised are recognised as an adjustment to the effective interest rate of the loan. When a loan commitment is not expected to be utilised, fees are recognised in profit or loss on a straight-line basis over the commitment period.

Loan syndication fees are recognised as revenue in profit or loss when the syndication has been completed and the Group has retained no part of the loan package for itself or has retained a part at the same effective interest rate as the other participants.

Notes to the Consolidated Financial Statements

61.17 Net fee and commission income (continued)

Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as the arrangement of the acquisition of shares or other securities, or the purchase or sale of businesses, are recognised on completion of the underlying transaction.

Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportioned basis.

Asset management fees related to investment funds are recognised rateably over the period in which the service is provided. The same principle is applied for wealth management, financial planning, and custody services that are continuously provided over an extended period of time. Performance-linked fees or fee components are recognised when the performance criteria are fulfilled.

Where it is assessed that the Group is acting as an agent, the consideration is presented on a net basis.

61.18 Net financial income (expense)

Net financial income (expense) consists of net gain (loss) on financial assets and financial liabilities mandatorily at fair value through profit or loss, net gain (loss) on financial liabilities designated as at fair value through profit or loss, net gain (loss) on fair value hedges, and net gain (loss) on derecognition of financial liabilities measured at amortised cost.

Net gain (loss) on financial assets and financial liabilities mandatorily at fair value through profit or loss
Net gain (loss) on financial assets and financial liabilities mandatorily at fair value through profit or loss includes all realised and unrealised fair value changes of financial assets and financial liabilities classified by the Group as mandatorily at fair value through profit or loss, except for interest income and interest expense, which are included in the line item "Net interest income", and foreign exchange gains and losses, which are included in the line item "Net foreign exchange gain (loss)". Dividend income from financial assets is recognised in the income statement when the Group's right to receive payment is established.

Net gain (loss) on financial liabilities designated as at fair value through profit or loss
Net gain (loss) on financial liabilities designated as at fair value through profit or loss includes all realised and unrealised fair value changes of financial liabilities designated by the Group as at fair value through profit or loss, except for changes in fair value attributable to changes in credit risk which is recognised in other comprehensive income, interests incurred which are included in the line item "Net interest income", and foreign exchange gains and losses which are included in the line item "Net foreign exchange gain (loss)".

Net gain (loss) on fair value hedges
Net gain (loss) on fair value hedges includes the changes in the clean fair value of interest rate swaps which are accounted for as hedging instruments in fair value hedges and the changes in the fair value of certain bonds, which are attributable to the interest rate risk of the bonds, and are accounted for as the hedged items in fair value hedges (see Note 61.7).

Net gain (loss) on derecognition of financial liabilities measured at amortised cost
Net gain (loss) on derecognition of financial liabilities measured at amortised cost includes the difference between the buyback price and the carrying amount of debt issued measured at amortised cost at the derecognition date.

61.19 Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets, other than deferred tax assets and non-current assets and disposal groups held for sale, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the Group estimates the recoverable amount of the asset. If the carrying amount of an asset exceeds its estimated recoverable amount an impairment loss is recognised in profit or loss.

An impairment loss for non-financial assets is reversed if there has been a change in the estimates used to determine the recoverable amount. 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.

61.20 Taxes

Income tax expense

Income tax expense comprises special financial activities tax, current tax and deferred tax and is disclosed as a separate line item in the income statement. Income tax expense from discontinued operations is included in the income statement in the line item "Discontinued operations held for sale, net of income tax" (see Note 61.21). Income tax is recognised in profit or loss, except to the extent that it relates to items recognised directly in equity, consistent with the recognition of the underlying item to which it relates.

Bank tax

Bank tax is calculated as 0.145% (2021: 0.145%) of total liabilities at year-end as determined for tax purposes, in excess of ISK 50,000 million, excluding tax liabilities. The Bank tax is considered a non-deductible expense for the calculation of income tax. The Bank tax is shown in a separate line in the income statement and is included in the statement of financial position in the line item "Tax liabilities".

Special financial activities tax

Special financial activities tax is calculated as 6% of taxable profit exceeding ISK 1,000 million. Special financial activities tax is included in the statement of financial position in the line item "Tax liabilities".

Current tax

Current tax is the expected tax payable on the taxable income for the year using tax rates enacted at the reporting date. Current tax also includes any adjustment to tax payable in respect of previous years. Current tax assets and current tax liabilities are offset in the statement of financial position if the Group has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously. Current tax is included in the statement of financial position in the line item "Tax liabilities".

Deferred tax

Deferred tax is recognised based on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts. However, deferred taxes are not recognised if it arises from the initial recognition of an asset or liability, in a transaction other than a business combination, that at the time of the transaction affects neither the taxable profit nor the accounting profit. In addition, deferred taxes are not recognised if the temporary difference arises from the initial recognition of goodwill.

Deferred tax is measured using tax rates enacted at the reporting date.

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

Deferred tax liabilities are included in the statement of financial position in the line item "Tax liabilities" and deferred tax assets are included in the statement of financial position in the line item "Other assets". Deferred taxes that are part of discontinued operations (see Note 61.11) are included in the line items "Non-current assets and disposal groups held for sale" and " Non-current liabilities and disposal groups held for sale ", respectively, in the statement of financial position.

61.21 Discontinued operations held for sale, net of income tax

Discontinued operations held for sale, net of income tax, are disclosed as a separate line item in the income statement and consist of (i) profit or loss from foreclosed assets and disposal groups held for sale, (ii) gain or loss recognised on the measurement to fair value less costs to sell in excess of book value of foreclosed assets, (iii) profit or loss from sales of foreclosed assets and disposal groups held for sale, and (iv) income tax expense from discontinued operations.

61.22 Offsetting

Financial assets and financial liabilities are set off and the net amount reported in the statement of financial position when, and only when, the Group has a legal right to offset the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

The Group presents income and expenses on a net basis in the income statement only when required or permitted by the accounting standards.

61.23 Earnings per share

The Group presents basic and diluted earnings per share for its ordinary shares. Basic earnings per share are calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share are determined by adjusting the profit or loss attributable to ordinary shareholders of the Bank and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, if any.

Íslandsbanki's Corporate Governance Statement 2022
Unaudited

The regulatory framework for corporate governance practices within Íslandsbanki consists of the law applicable to entities subject to the supervision of the Financial Supervisory Authority of the Central Bank (FSA) as well as other applicable law and regulations, including those imposed by the FSA and Nasdaq Iceland, available at their respective websites, cb.is and nasdaqomxnordic.com. The applicable law includes, inter alia, the Act on Financial Undertakings no. 161/2002, the Act on Recovery and Resolution of Credit Institutions and Investment Firms no. 70/2020, the Act on Markets for Financial Instruments no. 115/2021, the Act on Payment Services no. 120/2011, the Act on Measures against Money Laundering and the Financing of Terrorist Activities no. 140/2018, the Act on Mortgage Credit to Consumers no. 118/2016, the Act on Consumer Credit no. 33/2013, the Act on Competition no. 44/2005 and the Act on Public Limited Companies no. 2/1995, which along with the Íslandsbanki's Articles of Association lay the foundation for the Bank's existence and activities. The relevant law are available on the Icelandic legislature's website, althingi.is.

The Board of Directors of Íslandsbanki is committed to excellence in corporate governance complying with the applicable regulatory standards and best international practices in the field of corporate governance.

The Bank's compliance with Corporate Governance Guidelines issued by the Iceland Chamber of Commerce, Nasdaq Iceland and SA Business Iceland (hereinafter the Guidelines) is reviewed annually. The Board of Directors follows the Guidelines in accordance with paragraph 7 of article 54 of the Act on Financial Undertakings no. 161/2002. The Guidelines are available on corporategovernance.is. Moreover, the Bank's governance practices are based on the European Banking Authority's Guidelines on Internal Governance for Financial Undertakings (EBA/GL/2021/05), cf. Article 16 of regulation (EC) No. 1093/2010, transposed into Icelandic law with Act No. 24/2017, on European Control Systems in the Financial Market.

The Bank's shares have been admitted to trading on the Nasdaq Main Market in Iceland. The Bank also regularly issues bonds on the regulated securities market in both Iceland and Ireland. The Bank is therefore subject to the disclosure obligation of issuers pursuant to the Act on the Disclosure and Information requirements of Issuers of Securities and Notifications on Major Holdings no. 20/2021 and the rules of the relevant stock exchange.

The Icelandic State Financial Investments (ISFI), on behalf of the Icelandic Government, is the largest shareholder of the Bank and holds 42.5% of the Bank's shares, in accordance with the Act on Icelandic State Financial Investments no. 88/2009 and the Icelandic State Ownership Policy for financial undertakings. The Icelandic State's objective as owner is that its management of the Bank's assets and operations promote confidence in, and credibility of, the financial market, to promote competition in the financial market, and maximise long-term value for the Icelandic State Treasury, considering risk.

Main Aspects of Risk Management and Internal Control

Internal Control

The risk management and internal control framework of the Bank is based on the three lines of defence model, as referred to in the European Banking Authority's Guidelines on Internal Governance and aims for informed decision making and strong risk awareness throughout the Bank. The framework is intended to ensure efficient operations, adequate control of risks, prudent conduct of business, reliability of financial and non-financial information reported internally and externally, and compliance with the applicable laws, regulations, supervisory requirements, and the Bank's internal rules.

The first line of defence consists of the Bank's business and support units; the second line of defence is comprised of the Bank's internal control units, Risk Management and Compliance; and the third line of defence is Group Internal Audit which keeps the Board informed of the quality of corporate governance, risk management and internal controls, including by performing independent and objective audits.

Risk Management

The Board of Directors approves the risk policy, risk appetite statement and procedure for risk management and ensures that internal procedures for risk management are revised at least annually.

The All Risk Committee, a Senior Management Committee, is comprised of the CEO, all the managing directors of the Bank and other members of management appointed by the CEO. The committee takes major decisions on implementation of the Bank's risk management and internal audit frameworks and conducts oversight to ensure that the Bank's risk profile is within the limits defined in the Board's risk appetite statement. The All Risk Committee issues guidelines for risk assessment and individual risk thresholds or limits.

Further information on the Bank's risk management structure and internal control can be found in the Bank's unaudited Pillar 3 Report which is available on the Bank's website.

Audit and Accounting

The CEO ensures that Directors of the Board are provided with accurate information on the Bank's finances, development and operations on a regular basis and the Board Audit Committee assists the Board in fulfilling its oversight responsibilities concerning the financial reporting process and the system of internal control.

The Bank's Finance division is responsible for the preparation of the Group's consolidated financial statements in line with the International Financial Reporting Standards (IFRS) as adopted by the European Union and additional requirements in the Act on Annual Accounts no. 3/2006, the Act on Financial Undertakings no. 161/2002, and rules on accounting for credit institutions. The Board's Audit Committee reviews annual and interim consolidated financial statements before their submission for Board approval and endorsement. The Board's Audit Committee regularly discusses the Group's financial statements and evaluates its internal control processes. Management reporting is generally presented to the Board 10 times a year. The external auditors review the half year consolidated financial statements and audit the consolidated financial statements.

The consolidated financial statements are published on an annual and quarterly basis.

The Annual General Meeting (AGM) elects an external audit firm in accordance with the Bank's Articles of Association. The Board's proposal to the AGM is based on the Audit Committee's recommendation on the selection of an audit firm. Ernst & Young ehf. has carried out the external audit of the Group in recent years.

Group Internal Audit

The Board appoints the Chief Audit Executive, who is responsible for internal audit of the Bank and its subsidiaries. Group Internal Audit reports directly to the Board and operates independently from other departments in accordance with article 16 of the Act on Financial Undertakings no. 161/2002. The department evaluates and promotes improvements to the effectiveness of governance, risk management, and control processes. The responsibilities and authorisations of the Chief Audit Executive and Group Internal Audit are further outlined in the Group Internal Audit Charter.

Compliance

The Bank's Compliance Officer is hired by the CEO, subject to Board confirmation. The Compliance Officer operates under the terms of a mandate letter approved by the Board. The Compliance Officer maintains an independent position within the Bank's organisation and is responsible for monitoring and assessing regularly whether the Bank's operations, regarding securities transactions, are in compliance with applicable law. Furthermore, the Compliance Officer is responsible for assessing and monitoring the Bank's compliance with the Act on Measures against Money Laundering and Terrorist Financing no. 140/2018 and is the Bank's responsible officer under the US Foreign Account Tax Compliance Act (FATCA) and the OECD Common Reporting Standard (CRS).

Íslandsbanki Values, Sustainability and Code of Conduct

The Bank's purpose is moving Iceland forward by empowering its customers to succeed. Íslandsbanki's values are the pillars of the Bank's corporate culture, shaping the conduct and attitudes of its employees. The values of Íslandsbanki are passion, professionalism, and collaboration.

The Board approves a Code of Conduct for the Bank's employees. The aim of the code is to promote good operational practices. The document is available on the Bank's website.

The Bank has in place a Sustainability Policy which is focused on making its operations exemplary in the Icelandic business environment based on established international ESG criteria. The Bank aspires to be a leader in sustainable development.

The Bank has decided to focus particularly on four of the UN Sustainable Development Goals (SDGs) in its course of business: quality education; gender equality; industry, innovation and infrastructure; and climate action. Annually the Bank publishes an Annual and Sustainability Report in accordance with the Nasdaq ESG guidelines, the applicable Global Reporting Initiative (GRI) metrics, the UN Principles for Responsible Banking (UN PRB), and the SDGs. For the last years Íslandsbanki has been a signatory to the UN Global Compact on social responsibility.

Board of Directors

At each AGM seven nonexecutive directors, and two alternate members, are elected to the Board for a term of one year. The Chairman of the Board is elected by the shareholders' meeting. There are no limitations on duration of Board membership.

The Board undertakes the Bank's affairs in between shareholders' meetings unless otherwise provided by law or the Bank's Articles of Association. The Board is responsible for setting the Bank's general strategy and instructs the CEO on its further implementation and execution. The Board has a supervisory role in that it oversees that the Bank's organisation and activities are at all times in accordance with the relevant law, regulations and good business practices. The CEO and Chief Audit Executive are hired by the Board.

The Rules of Procedure of the Board are adopted in accordance with article 70 of the Act on Public Limited Companies no. 2/1995 and article 54 of the Act on Financial Undertakings no. 161/2002. The Board's current Rules of Procedure are available on the Bank's website. According to its Rules of Procedure, at meetings of the Board the presence of at least five members of the Board is required to constitute a quorum. The Board met 17 times in 2022, each time constituting a quorum.

The Articles of Association of the Bank provide that the ratio of each gender on the Board of Directors shall not be lower than 40%, currently the Board is comprised of four women and three men. The Board has approved a policy on the suitability of the Board of Directors, CEO and key function holders. The policy states, among other things, that the composition of the Board shall at any time be diverse, with regard to educational and professional background, gender and age.

The Board Subcommittees

The Board subcommittees are three in total and they operate under the terms of a mandate letter from the Board as well as the Rules of Procedure of the Board. The mandate letters of the Board subcommittees are available on the Bank's website. The Board appoints the members of the subcommittees as well as their Chairman. When appointing the subcommittees, the Board shall take into account the expertise, skills and experience needed of a member to be appointed to the relevant subcommittee. All of the subcommittees are constituted of members of the Board.

The Board Audit Committee, comprising three Board members, assists the Board in fulfilling its oversight responsibilities concerning the financial reporting process, the system of internal control, the audit process and the Bank's process for monitoring compliance with the relevant laws and regulations and its Code of Conduct. The committee met six times in 2022, each time constituting a quorum.

The Board Risk Management Committee, comprising three Board members, assists the Board in providing oversight of senior management activities in managing risk relevant to the Bank's operations. The committee's responsibilities include the parent company, its subsidiaries, and the whole Group. The committee met eight times in 2022, each time constituting a quorum.

The Board Corporate Governance and Human Resource Committee, comprising three Board members, assists the Board in overseeing the development and the regular assessment of the Bank's approach to corporate governance issues and Board effectiveness. Furthermore, the committee assists the Board in fulfilling its oversight responsibilities concerning the Bank's Compensation Policy, implementation of the Bank's Sustainability Policy and issues concerning human resources. The committee met six times in 2022, each time constituting a quorum.

Structure and composition of Board subcommittees is illustrated below.

Members of the Board

Finnur Árnason

(b. 1961)

Joined the Board as a board member and Chairman of the Board in March 2022

Main occupation: Independent consultant.
Work experience: CEO of Hagar hf. (2005-2020). CEO of Hagkaup (2000-2005).
Other directorships: New Landspítali University Hospital construction project, NLSH ohf. (Chairman). Ormsson ehf. (Chairman).
Education: MBA from the University of Hartford in the US and Cand. oecon degree from the University of Iceland.
Shareholding and independence: Finnur holds 95,258 shares in Íslandsbanki as well as having an indirect holding of 12,658 shares through Rekavík ehf. Finnur's spouse holds 95,258 shares in Íslandsbanki. Finnur is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank.
Subcommittees: Member of the Board Audit Committee.

Anna Þórðardóttir

(b. 1960)

Joined the Board in April 2016

Main occupation: Professional director.
Work experience: Accountant at KPMG (1988-2015), partner from 1999.
Other directorships: The Icelandic Centre for Future Studies (Framtíðarsetur Íslands) (Board member). The Board Audit Committee of Hagar hf. (Chairman). The Board Audit Committee of Reginn hf. (Chairman).
Education: Cand. oecon. in Business Administration from the University of Iceland. Studied towards a cand. merc in Financial studies from Handelhøjskolen in Aarhus, Denmark. Chartered Accountant.
Shareholding and independence: Anna holds no shares in Íslandsbanki and is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank.
Subcommittees: Chairman of the Board Audit Committee.

Ari Daníelsson

(b. 1972)

Joined the Board in March 2022

Main occupation: Professional director and investor.
Work experience: Founder and CEO at Reviva Capital S.A., an international asset management company (2010-2022). General manager and board member at Glitnir Bank Luxemburg S.A. (2008-2010). Business development and asset financing at Glitnir Bank hf. (2006-2008). Software development for financial markets, Managing Director, and board member at Mentis hf. (1999-2006).
Other directorships: Origo hf. (Board member). Reviva Capital S.A. (Chairman). Menntaskóli í tónlist (MÍT Music College) (Board member).
Education: MBA from the University of Reykjavík. B.Sc. in Computer Science from Reykjavík University. The International Directors Programme (IDP) from INSEAD in France.
Shareholding and independence: Ari has an indirect holding of 469,005 shares in Íslandsbanki through R-Holdings 1 S.a.r.l. and 37,976 shares through the holding company MFT 1 ehf. He is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank.
Subcommittees: Member of the Board Risk Management Committee and the Board Audit Committee.

Frosti Ólafsson
(b. 1982)
Joined the Board in March 2020

Main occupation: CEO of Olís ehf.
Work experience: Independent consultant (2020-2021). CEO of ORF Genetics hf. (2017-2020). Managing Director of Iceland Chamber of Commerce (2013-2017). Strategic consultant for McKinsey & Company (2011-2013).
Other directorships: Controlant hf. (Board member). Garður ehf. (Board member).
Education: MBA from London Business School. B.Sc. in Economics from University of Iceland and Macquire University in Sydney, Australia.
Shareholding and independence: Frosti holds 12,659 shares in Íslandsbanki as well as having an indirect holding 12,659 shares through Óson ehf. Frosti's spouse holds 12,659 shares in Íslandsbanki. Frosti is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank.
Subcommittees: Chairman of the Board Corporate Governance and Human Resource Committee.

Guðrún Þorgeirsdóttir
(b. 1979)
Joined the Board in March 2020 and has been the Vice-Chairman of the Board since 2022

Main occupation: Chief Business Development Officer of PayAnalytics ehf. CEO of Tharsis ehf.
Work experience: Chief Financial Officer of Skeljungur hf. (2014-2016). Executive Director of Business Development at Skeljungur hf. (2013-2014). Investment manager at Klakki ehf. (2010-2013). Chief Risk Officer at Exista hf. (2006-2010).
Other directorships: Pavonis ehf. (alternate member).
Education: MBA from HEC School of Management in France. B.Sc. in Industrial Engineering from the University of Iceland. Securities broker licensed by the Icelandic Ministry of Finance and Economic Affairs.
Shareholding and independence: Guðrún holds no shares in Íslandsbanki and is considered independent of the Bank and major shareholders. Jón Þór Sigurvinsson, the spouse of Guðrún, is the head of corporate finance and one of the founders of Arctica Finance hf., one of the Bank's competitors. Otherwise there are no interest ties with main customers or competitors of the Bank.
Subcommittees: Chairman of the Board Risk Management Committee.

Herdís Gunnarsdóttir
(b. 1968)
Joined the Board in October 2022

Main occupation: Managing Director of The National Supervisory Authority for Welfare Services.
Work experience: Director of the Social Insurance Administration's rights division (2020-2022). CEO of the Health Care Institute of South Iceland (2014-2019). Nursing director and project manager at the National University Hospital of Iceland (2000-2014).
Other directorships: None.
Education: MBA, an M.Sc. in Paediatric Nursing, and a B.Sc. in Nursing from the University of Iceland.
Shareholding and independence: Herdís holds no shares in Íslandsbanki and has no connections with the Bank's key customers or competitors. Herdís is not considered independent of the Bank and its major shareholders on account of her employment with the Icelandic Government which is a large shareholder of the Bank.
Subcommittees: Member of the Board Corporate Governance and Human Resource Committee.

Tanya Zharov

(b. 1966)

Joined the Board in March 2022

Main occupation: Deputy CEO of Alvotech hf.
Work experience: Deputy CEO of deCODE Genetics ehf. (2016-2020). Instructor and examination proctor for the securities brokerage licensing programme of the Icelandic Ministry of Finance and Economic Affairs (2009-2015). General Counsel at Auður Capital hf., later Virðing hf. (2008-2015). VP of Corporate Governance and Administration at deCODE genetics ehf. (1999-2007). Partner and tax attorney at PwC (1996-1998).
Other directorships: Reykjavík University (Board member).
Education: Cand. jur. from the University of Iceland. European Patent Attorney.
Shareholding and independence: Tanya has an indirect holding of 4,408 shares in Íslandsbanki through the holding company Tölur ehf. She is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank.
Subcommittees: Member of the Board Risk Management Committee and Board Corporate Governance and Human Resource Committee.

Páll Grétar Steingrímsson is an alternate member of the Board since March 2022.

Composition of Board Subcommittees

	Audit Committee	Risk Managing Committee	Corporate Governance and HR Committee
Anna Þórðardóttir	Chair		
Ari Daníelsson	Member	Member	
Finnur Árnason	Member		
Frosti Ólafsson			Chair
Guðrún Þorgeirsdóttir		Chair	
Herdís Gunnarsdóttir			Member
Tanya Zharov		Member	Member

Chair Member

Íslandsbanki's Nomination Committee and the ISFI Selection Committee

In accordance with the Bank's Articles of Association the Bank operates a Nomination Committee whose role is to nominate individuals to the Bank's Board of Directors at the AGM, or as the case may be at a shareholders' meeting where Board elections are on the agenda. The members of the Nomination Committee shall be three, elected for one year at a time by the Board of Directors. The committee shall be independent in its work and the majority of the committee's members shall be independent of the Bank and its senior management.

The Nomination Committee consists of:
Helga Valfells, Chairman
Finnur Árnason, Chairman of the Board of Íslandsbanki
Tómas Már Sigurðsson

ISFI operates a special three-member Selection Committee which, on behalf of the State, nominates candidates for the supervisory boards or boards of directors of banks or undertakings that are managed by ISFI. According to the Relationship Agreement between the Bank and the ISFI the Bank's Nomination Committee and the ISFI Selection Committee shall ensure that when the Board of Directors is elected, the candidates for election to the Board of Directors meet the requirements on composition according to law, both as concerns breadth of experience as well as gender representation. The Rules of Procedure of the Bank's Nomination Committee are published on the Bank's website.

Board Performance and Suitability Assessment

At least once a year, as provided for in the Board's Rules of Procedure, the Board assesses its work, procedures and practices as well as each of its members. This performance assessment is intended to improve working methods and increase the efficiency of the Board. The assessment entails an evaluation of the strengths and weaknesses of the Board's work and practices. This is inter alia based on the necessary number of board directors, the board structure in relation to knowledge and experience, board procedure and practices. This assessment was last performed by the Board in December 2022.

Furthermore, the Board annually assesses the collective suitability of the Board and individual Board members in accordance with the Board's Rules of Procedure and the Bank's policy on the assessment of the suitability of the Board of Directors, the CEO and key function holders.

The Board assessed the collective suitability of the Board as well as the suitability of individual board members and concluded that the Board and individual board members possess sufficient experience and knowledge to fulfil the requirements of the Act on Financial Undertakings and the Bank's policy on the suitability of the Board of Directors, CEO, and key function holders.

The Chief Executive Officer

The Chief Executive Officer (CEO) is responsible for the day-to-day operations of the Bank and that the Bank's business is, at all times, in accordance with the Bank's Articles of Association, policies of the Board and the relevant law. The CEO engages the Bank's Compliance Officer and appoints members of the Executive Committee and other Senior Management Committees.

The Executive Committee

The Executive Committee consists of seven people, including the CEO: Birna Einarsdóttir, CEO since October 2008, Jón Guðni Ómarsson, Chief Financial Officer since October 2011, Sigríður Hrefna Hrafnkelsdóttir, Managing Director of Personal Banking since May 2017, Riaan Dreyer, Director of Information Technology since September 2019, Guðmundur Kristinn Birgisson, Chief Risk Officer since October 2018, Una Steinsdóttir, Managing Director of Business Banking since May 2017, and Ásmundur Tryggvason Managing Director of Corporate & Investment Banking since January 2019.

Senior Management Committees

Senior Management Committees are advisory committees appointed by the CEO. Senior Management Committees are divided into Policy-Setting Committees, which implement Board policies, and Business Committees, which take a position on specific business matters. The committees are appointed by the CEO, who also approves their letter of mandate.

Birna Einarsdóttir

(b. 1961)

Birna has been the CEO since 15 October 2008

Work experience: Managing director of sales and marketing and later retail banking at Íslandsbanki hf. (2004-2008). Senior Product Manager at the Royal Bank of Scotland (1998-2004). Branch manager in Seltjarnarnes, Executive director of sales and service at Íslandsbanki (1991-1997). Marketing manager for the Icelandic Broadcasting Company (1989-1991). Marketing manager at Iðnaðarbanki Íslands (1987-1989). General manager of Íslensk getspá (1985-1987).
Education: MBA from the University of Edinburgh, UK. Cand. oecon. from the University of Iceland.
Other directorships: None.
Shareholding and independence: The CEO holds 44,506 of the Bank's shares and is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank. No call-option agreements exist between the CEO and the Bank.

The Executive Committee and the **All Risk Committee** are considered Policy-Setting Committees and they take major decisions on the implementation of the policies set by the Board. Committee members include all of the Bank's Managing Directors, as well as other members of senior management appointed by the CEO.

The Executive Committee oversees and coordinates key aspects of the Bank's activities and has decision-making authority in matters assigned to it by the CEO, in accordance with policies, goals, and risk appetite as defined by the Board.

The All Risk Committee takes major decisions on implementation of the Bank's risk management and internal audit frameworks and conducts oversight to ensure that the Bank's risk profile is within the limits defined in the Board's risk appetite statement.

The Business Committees decide on individual business and operational matters in accordance with the rules and procedures issued by the Board, the Executive Committee and the All Risk Committee. The Bank's Business Committees are:

The Senior Credit Committee decides on proposals on lending and is the formal venue for discussion and review of individual loan proposals.

The Asset and Liability Committee decides on proposals regarding market risk, liquidity risk, funding, capital, and internal and external pricing.

The Investment Committee decides on proposals regarding the purchase, sale and valuation of equity stakes and other investments of the Bank.

The Operational and Security Committee decides on proposals regarding new products and services, continuous operation and material changes in systems and procedures.

The Sustainability Committee is a formal forum for reviewing and discussing issues related to sustainability risk, sustainable procurement, and business opportunities.

The Digital Product Committee is a formal forum for prioritisation of initiatives between product teams in line with the strategy and goals of the Bank.

Arrangement of Communications Between Shareholders and the Board

The Board communicates with shareholders in accordance with the relevant laws, the Bank's Articles of Association, and the Board's Rules of Procedure.

Shareholders' meetings, the supreme authority of the Bank, are the general forum for informing and communicating with shareholders. All information that is defined as sensitive market information is disclosed to the market through the relevant regulated market's announcement system in accordance with the Bank's Disclosure and Communication Policy. The Bank also organises quarterly meetings for market participants where the CEO, CFO and representatives of investor relations present the Bank's interim financial statements.

The Bank's Disclosure Committee assesses the Bank's event-specific disclosure obligations and decides on disclosure in accordance with the Bank's Rules on insider trading and management transactions. The Disclosure Committee consists of the CFO, the General Counsel, Executive Director of Treasury, and the Compliance Officer (without a vote).

Information on Infringements of Laws and Regulations Determined by the Appropriate Supervisory or Ruling Body

In the year 2022 the Financial Supervisory Authority of the Central Bank of Iceland imposed a fine in the amount of ISK 0.5 million for delivering an exposure report five days late. At the end of 2022 the Bank received the preliminary findings from the Financial Supervisory Authority of the Central Bank of Iceland's (FSA) inspection into the Bank's execution of the offering by the Icelandic State of a 22.5% stake in the Bank's share capital. For further information see Note 43. No other remarks were received from an appropriate supervisory or ruling body concerning violations of laws or regulations. Information on legal cases relating to Íslandsbanki can be found in the Notes to the consolidated financial statements.

This Corporate Governance Statement was approved by Íslandsbanki's Board of Directors on 9 February 2023.