Arion Bank

Condensed Consolidated **Interim Financial Statements** 1 January - 31 March 2022

Contents

page

Arion Bank in brief

31.03.2022

12.7%
Return on equity

42.7%
Cost-to-income

19.1%
CET1 ratio

Rating from S&P

Long term: BBB

Short term: A-2

Outlook: Stable

The Banker
Bank of the Year 2021
ICELAND

UNEP FINANCE INITIATIVE
PRINCIPLES FOR RESPONSIBLE BANKING

Equal Pay Certification

PRI Principles for Responsible Investment

Arion Bank

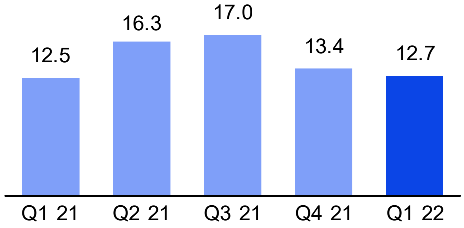
- Arion Bank provides services to households, corporates, institutions and investors. The Bank has three business segments: Retail Banking, Corporate & Investment Banking (CIB), and Markets. The service offering is further augmented by the subsidiaries Stefnir and Vördur. Stefnir is an Icelandic fund management company, and Vördur is an insurance company providing non-life and life insurance with sales channels through CIB and Retal Banking.
- Arion Bank plays an important role in the community through financing of progressive and sustainable initiatives in the community and sustainability is an integral part of the Bank's day-to-day activities, its decision-making and processes
- The diverse service offering at Arion Bank means that the revenue base is broad and the loan portfolio is well diversified between retail and corporate customers. The high percentage of mortgages and the healthy distribution of loans across different sectors reduces credit risk
- The Bank is a market leader in digital solutions and innovation. Numerous new digital solutions have been launched in the past few years, enhancing service to customers and making the Bank's operations more efficient, which in the long term reduces operating expenses across the Bank
- The Bank is emphazising customer experience in all aspects of the Bank
- At 31.03.2022 Arion Bank has ISK 18.6bn in excess capital and will continue to manage towards 17% CET1 target. Further capital distribution considered in parallel with business growth opportunities and will be related to completion of sale of Valitor

Key figures

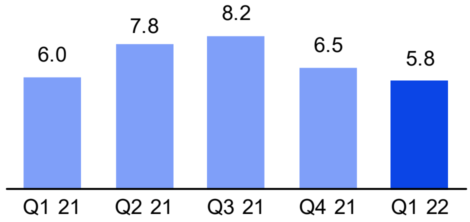
(ISK million)

	Q1 2022	Q1 2021
Net earnings	5,818	6,039
ROE	12.7%	12.5%
Net interest margin	3.1%	2.7%
Cost to income ratio	42.7%	46.2%
Operating income / REA	6.9%	7.0%
	31.03.2022	**31.12.2021**
Total assets	1,341,015	1,313,864
Loans to customers	976,383	936,237
Deposits	679,925	655,476
Borrowings	370,026	356,637
Stage 3 gross	1.6%	1.9%
Leverage ratio	12.5%	12.6%
Number of employees	753	751
EUR/ISK	142.00	147.60

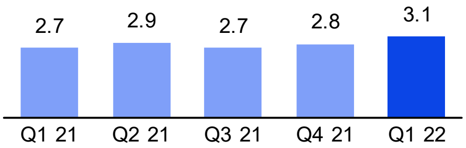
Return on equity (%)



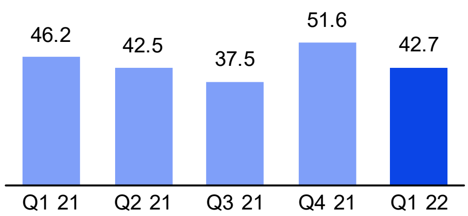
Net earnings (ISK billion)



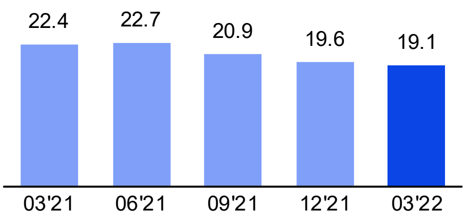
Net interest margin (%)



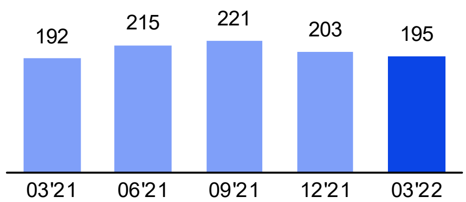
Cost-to-income ratio (%)



CET 1 ratio (%)



LCR ratio (%)



Endorsement and statement
by the Board of Directors and the CEO

The Condensed Consolidated Interim Financial Statements of Arion Bank for the period from 1 January to 31 March 2022 include the Condensed Consolidated Interim Financial Statements of Arion Bank ("the Bank") and its subsidiaries, together referred to as "the Group".

Operations during the period

Income Statement

Net earnings amounted to ISK 5,818 million, return on equity was 12.7% and earnings per share were ISK 3.67. Core income, defined as net interest income, net commission income and net insurance income, increased by 15.9% YoY. There was very strong growth in net interest income, both due to the increased base rate and 16.6% growth in the loan book from the first quarter 2021. Net commission income continued to grow strongly, while the quarter was weak in terms of net insurance income due to very high claim rates as a result of challenging weather conditions during the quarter.

Balance Sheet

The Bank's balance sheet grew by 2.1% from year-end 2021. Loans to customers increased by 4.3% from year-end 2021 and 16.6% from the same period the previous year. The increase is primarily in corporate lending, or an 8% increase from year-end 2021. Total equity amounted to ISK 173,013 million at the end of March. The Group's capital ratio was 22.9% and the CET1 ratio 19.1%. The ratios are determined on the basis of the unaudited net earnings in the quarter, with a deduction of 50% of net earnings as foreseeable dividends in accordance with the Bank's dividend policy. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 22.5% and the CET1 ratio was 18.8%. These ratios comfortably exceed the requirements made by the Financial Supervisory Authority of the Central Bank of Iceland (FSA) and Icelandic law. The liquidity position was also strong at period end and well above the regulatory minimum.

On 1 July 2021 Arion Bank and Rapyd entered into a definitive agreement regarding the sale of Valitor hf. The transaction is subject to regulatory approval and the parties had agreed on a deadline for obtaining this approval of 1 May 2022. Should the sale not be finalized due to the failure to obtain regulatory approval, the risk shall be borne by the buyer, a condition valid for two years. As conditions in the agreement to acquire Valitor have not yet been met, the parties have agreed to extend the agreement until 1 June 2022. According to the original agreement the purchase price to be paid by Rapyd for Valitor is USD 100 million. Due to the delays in completing the transaction Rapyd has paid Arion Bank an additional USD 10 million. Additionally, Rapyd will pay Arion Bank 10% annualized interest on the original purchase price from 1 April 2022 until closing. The estimated profit on the sale, minus costs, increases accordingly and is estimated at ISK 5 billion at the exchange rate at the end of March 2022. The sale agreement for Valitor hf. does not affect the Consolidated Interim Financial Statements for the period, in accordance with IFRS.

Arion Bank's financial targets compared with the operational results for the period.

	Q1 2022	Target
Return on equity	12.7%	Exceed 13%
Operating income / REA	6.9%	Exceed 7.3%
Insurance premium growth (YoY)	9.8%	Premium growth (net of reinsurance) to exceed the growth of the domestic market by more than 3% (Premium growth in the domestic insurance market was 7.2% in 2021)
Loan growth (from YE 2021)	4.3%	In line with nominal economic growth (Arion Bank forecasts economic growth of 12.5% in 2022)
Cost-to-income ratio	42.7%	Below 45%
CET1 ratio	19.1%	~17%
Dividend payout ratio	-	50%

Economic outlook

The Icelandic economy is well on its way to full recovery. According to preliminary figures from Statistics Iceland, GDP increased by 4.3% in 2021, a much stronger economic growth rate than forecast at the beginning of the year. Since the onset of the pandemic, analysts have repeatedly underestimated the resilience of domestic demand, especially private consumption and business investment, which have been the main drivers behind economic growth. For example, in Q4 private consumption increased by a massive 13%, the highest growth rate in a single quarter since 2005, exceeding expectations by a considerable margin.

At the end of February all public restrictions due to the pandemic were lifted, both domestically and at the border. This positive development was overshadowed, however, by Russia's invasion of Ukraine. So far, the direct effects of the war on the Icelandic economy have been limited, mostly confined to the seafood industry. Even though the affected market areas are important for exports of pelagic fish, the impact is small in the grand scheme of things, amounting to 3% of the country's total exports of goods in 2021. The indirect effects of the war, for example on people's willingness to travel, travel expenses and tourist income, could have a greater impact on the economy. Nevertheless, Arion Bank's Chief Economist is optimistic, forecasting 1.6 million tourist arrivals this year. The latest numbers, in addition to the data on hotel and airlines bookings, support this forecast, even indicating stronger growth.

Falling unemployment, rising wages, accumulated savings and greatly improved equity position are likely to support continued private consumption growth, even if inflation might undermine purchasing power for a short time. Unlike in the past, high inflation is not a uniquely Icelandic concern. Inflation is expected to continue to climb, fuelled by soaring housing prices and rising inflation among Iceland's main trading partners. Although the Central Bank has already raised rates by 2 percentage points over the past ten months, analysts expect further rate hikes ahead given the short-term inflation outlook and tight labour market.

Endorsement and statement
by the Board of Directors and the CEO

Outlook for the Bank

During the first quarter of the year, our thoughts are first and foremost with the people of Ukraine. The challenges faced in the country over the last few months put anything else we face in our operations in a new perspective.

Arion Bank is relatively isolated from the impact of the war in Ukraine, although it is inevitable that risks across our business are being reassessed. The primary impact on the Icelandic economy, and therefore most of our clients, is limited. The secondary impact relating to, for example, energy prices and global inflation expectations, will affect our clients over time, but in general the position is relatively robust.

The Icelandic economy, being self-sustainable in terms of green energy and with its relatively balanced economic pillars, has demonstrated its strength during this period. The importance of the Arctic region when it comes to green energy and raw minerals is also likely to be further enhanced as regions reassess their supply of energy and resources.

With regard to operations more generally, we are starting to see the impact this quarter of the sharp increase in policy rates in recent months. Over time the ongoing normalization in the rate environment will support the operations of the Group. The positive outlook is also underpinned by the strategic direction of the Group, with a focus on enhancing return on REA. This strategy focuses on increasing non-interest income, including fee and commission and insurance income, and using our strong distribution channels to provide holistic financial services to our clients.

During the quarter there were several management changes within the Group. It is a testament to the strong bench of talent that all the positions were filled with internal promotions. In many cases these involved employees moving between divisions of the Group which is expected to enhance synergy within the Group, thus supporting the strategy of providing holistic financial services to our clients.

The position of the Group remains strong. While there continue to be uncertainties in the external environment, there is strong overall optimism. The operations across the business segments are robust and the pipeline is strong which should allow for a profitable growth plan in the near term, supporting the recovery of the economy. A key focus for the year will continue to be to manage these growth opportunities with the capital release plans to optimize shareholder returns.

Funding and liquidity

In terms of funding and liquidity management the Groups liquidity position is strong. The Bank’s liquidity position was well above the regulatory minimum of 100%, with a liquidity coverage ratio of 195% at the end of March 2022.

Arion Bank continued to issue green and covered bonds in the domestic market. Total issuance in the domestic market was ISK 9.2 billion during the first three months of 2022.

In March 2022 Arion Bank tapped the existing EUR 300 million covered bond for a total of EUR 200 million, bringing the issue size to EUR 500 million. The covered bonds were sold at a rate corresponding to 0.37% margin over interbank rates.

Capital adequacy and dividends

Arion Bank’s dividend policy states that the Bank shall pay 50% of net earnings in dividends and that additional dividends or share buybacks can be considered when the Bank’s capital levels exceed the minimum regulatory requirements together with the Bank’s management buffer. The Bank aims to maintain a 17% Common Equity Tier 1 ratio. The corresponding capital requirement is 13.5% of the total risk-weighted exposure amount (REA). The Bank has released equity through dividend payments and purchase of own shares to meet this objective. In March 2022, the Bank paid dividends of ISK 22.5 billion, or ISK 15 per share, based on the authority given by the Annual General Meeting.

The Board of Directors has the authority to propose that the Bank pay dividends or other disbursement of equity and may convene a special shareholders' meeting later in the year to propose a payment.

The Group’s capital adequacy ratio on 31 March 2022 was 22.9% and the CET1 ratio 19.1%, when the unaudited interim net earnings for Q1 2022 are included. The ratios account for a deduction due to foreseeable dividends that represent 50% of net earnings in line with the Bank’s dividend policy. The capital position of Arion Bank is very strong and will remain so for the foreseeable future. This underpins the Bank’s ability to support its customers and the Icelandic economy as it completes the recovery from the Covid-19 phase and enters a new growth period.

The Bank’s REA increased by ISK 58 billion in Q1 2022. The carrying amount of loans to customers increased by ISK 40 billion, of which non-mortgage loans grew by ISK 29 billion. Thus, loans to customers contributed ISK 34 billion to REA growth. Other credit risk items contributed ISK 10 billion and market risk items ISK 14 billion to the growth in REA.

The Central Bank of Iceland’s resolution authority approved the resolution plan of Arion Bank on 26 April 2022. With the approval of the resolution plan, the resolution authority made a decision on the minimum required own funds and eligible liabilities (MREL), in accordance with the Act on Resolution of Credit Institutions and Investment Firms, no. 70/2020. Arion Bank’s MREL requirement as a percentage of REA is 22.4%, the Bank is in full compliance with this requirement. The MREL requirement will be updated later this year, based on data submitted to the Authority in respect of the Bank’s balance sheet at the end of 2021. It is estimated that the decision on MREL will be updated in the third quarter of 2022.

As part of the Icelandic government’s economic measures in response to Covid-19, the Financial Stability Committee decided to vacate the 2% countercyclical capital buffer in March 2020. In September 2021, the Committee announced that the countercyclical capital buffer would again be set at 2% as of 29 September 2022. This will increase the Group’s total capital requirement from 18.5% to 20.4%. However, these measures have had a limited impact on Arion Bank given its strong capital position throughout the pandemic.

Endorsement and statement
by the Board of Directors and the CEO

Group ownership

At the AGM in March 2022 a motion was passed to reduce the company's share capital by ISK 150 million at nominal value, by cancelling the company's own shares. The reduction took place 4 April 2022. Prior to the reduction Arion Bank's shareholding was 9.79% whereas after the reduction the Banks shareholding was down to 0.65%. The largest shareholder in Arion Bank after the reduction was Lífeyrissjódur starfsmanna ríkisins with a 9.79% shareholding. The number of shareholders has grown from around 11,300 at the beginning of the year to 12,500 at the end of March. Further information on Arion Bank's shareholders can be found in Note 35.

Governance

At the Bank's AGM on 16 March 2022, five members were elected to serve on the Board of Directors until the next AGM, two women and three men. Additionally, two Alternate Directors (one woman and one man) were elected. The five Directors and two Alternates are independent of Arion Bank, its management and major shareholders.

In April 2022 Ásgeir H. Reykfjörd Gylfason, Deputy CEO of Arion Bank and the managing director of Corporate & Investment Banking, resigned. Ida Brá Benediktsdóttir, the managing director of Retail Banking has been appointed deputy CEO. Jóhann Möller, who has been managing director of Stefnir for the last couple of years, has been appointed managing director of Markets, as Margrét Sveinsdóttir is leaving the Bank after having served as managing director of Asset Management, later Markets, since 2009.

Endorsement of the Board of Directors and the Chief Executive Officer

The Condensed Consolidated Interim Financial Statements of Arion Bank for the period ended 31 March 2022 have been prepared in accordance with International Financial Reporting Standard IAS 34 Interim Financial Reporting as adopted by the European Union and additional requirements in the Icelandic Financial Statements Act, Financial Undertakings Act and Rules on Accounting for Credit Institutions.

It is our opinion that the Condensed Consolidated Interim Financial Statements give a true and fair view of the financial performance and cash flow of the Group for the period ended 31 March 2022 and its financial position as at 31 March 2022. Furthermore, in our opinion the Condensed Consolidated Interim Financial Statements and the Endorsement of the Board of Directors and the CEO give a fair view of the development and performance of the Group's operations and its position and describe the principal risks and uncertainties faced by the Group.

The Board of Directors and the CEO have today discussed the Condensed Consolidated Interim Financial Statements of Arion Bank for the period ended 31 March 2022 and confirm them by means of their signatures.

Reykjavík, 4 May 2022

Board of Directors

Brynjólfur Bjarnason, Chairman

Paul Richard Horner, Vice Chairman

Gunnar Sturluson

Liv Fiksdahl

Steinunn Kristín Thórdardóttir

Chief Executive Officer

Benedikt Gíslason

Consolidated Interim Income Statement

	Notes	2022 1.1.-31.3.	2021 1.1.-31.3.
Interest income		17,526	11,779
Interest expense		(7,998)	(4,437)
Net interest income	6	**9,528**	**7,342**
Fee and commission income		4,068	3,726
Fee and commission expense		(516)	(449)
Net fee and commission income	7	**3,552**	**3,277**
Net insurance income	8	5	671
Net financial income	9	991	1,500
Share of profit of associates	25	203	1
Other operating income	10	235	306
Other net operating income		**1,434**	**2,478**
Operating income		**14,514**	**13,097**
Salaries and related expenses	11	(3,540)	(3,271)
Other operating expenses	12	(2,661)	(2,777)
Operating expenses		**(6,201)**	**(6,048)**
Bank levy	13	(393)	(330)
Net impairment	14	(495)	1,080
Earnings before income tax		**7,425**	**7,799**
Income tax expense	15	(1,703)	(1,866)
Net earnings from continuing operations		**5,722**	**5,933**
Discontinued operations held for sale, net of income tax	16	96	106
Net earnings		**5,818**	**6,039**

Attributable to

Shareholders of Arion Bank hf.		5,812	6,038
Non-controlling interest		6	1
Net earnings		**5,818**	**6,039**

Earnings per share

	Notes		
	17		
Basic earnings per share attributable to the shareholders of Arion Bank (ISK)		3.67	3.61
Diluted earnings per share attributable to the shareholders of Arion Bank (ISK)		3.50	3.46

The accompanying Notes are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK millions

Consolidated Interim Statement of Comprehensive Income

	Notes	2022 1.1.-31.3.	2021 1.1.-31.3.
Net earnings		**5,818**	**6,039**
Net change in fair value of debt investments carried at fair value through OCI, net of tax		(1,136)	(481)
Realized net loss (gain) on debt investments carried at fair value through OCI, net of tax, transferred to the Income Statement	9	21	(35)
Changes to reserve for financial instruments at fair value through OCI		**(1,115)**	**(516)**
Exchange difference on translating foreign subsidiaries		(81)	6
Other comprehensive loss that is or may be reclassified subsequently to the Income Statement		**(1,196)**	**(510)**
Total comprehensive income		**4,622**	**5,529**

Attributable to

Shareholders of Arion Bank		4,616	5,528
Non-controlling interest		6	1
Total comprehensive income		**4,622**	**5,529**

The accompanying Notes are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK millions

Consolidated Interim Statement of Financial Position

Assets	Notes	31.3.2022	31.12.2021
Cash and balances with Central Bank	18	64,395	69,057
Loans to credit institutions	19	35,868	30,272
Loans to customers	20	976,383	936,237
Financial instruments	21-23	185,680	225,657
Investment property	23	6,586	6,560
Investments in associates	25	700	668
Intangible assets	26	9,239	9,463
Tax assets	27	754	2
Assets and disposal groups held for sale	28	14,706	16,047
Other assets	29	46,704	19,901
Total Assets		**1,341,015**	**1,313,864**

Liabilities			
Due to credit institutions and Central Bank	22	4,270	5,000
Deposits	22	679,925	655,476
Financial liabilities at fair value	22	12,323	5,877
Tax liabilities	27	8,080	7,102
Liabilities associated with disposal groups held for sale	28	15,122	16,935
Other liabilities	30	44,582	37,151
Borrowings	22,31	370,026	356,637
Subordinated liabilities	22,32	33,674	35,088
Total Liabilities		**1,168,002**	**1,119,266**

Equity	34		
Share capital and share premium		18,955	22,684
Other reserves		11,631	12,838
Retained earnings		141,747	158,403
Total Shareholders' Equity		**172,333**	**193,925**
Non-controlling interest		680	673
Total Equity		**173,013**	**194,598**
Total Liabilities and Equity		**1,341,015**	**1,313,864**

The accompanying Notes are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK millions

Consolidated Interim Statement of Changes in Equity

			Restricted reserves											
	Share capital	Share premium	Share option	Warrants reserve	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Debt invest-ments at fair value thr. OCI, unrealized	Statutory reserve	Foreign currency trans-lation reserve	Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
Equity 1 January 2022	1,518	21,166	99	828	7,245	3,166	1,124	(1,937)	1,637	676	158,403	**193,925**	673	**194,598**
Net earnings											5,812	**5,812**	6	**5,818**
Net change in fair value								(1,136)				**(1,136)**		**(1,136)**
Realized net loss transferred to P/L								21				**21**		**21**
Translation difference										(81)		**(81)**		**(81)**
Total comprehensive income	-	-	-	-	-	-	-	(1,115)	-	(81)	5,812	**4,616**	6	**4,622**
Transactions with owners														
Dividend paid											(22,489)	**(22,489)**		**(22,489)**
Purchase of treasury shares	(23)	(4,246)										**(4,269)**		**(4,269)**
Share option charge			49									**49**		**49**
Share option vested	3	349	(38)									**314**		**314**
Incentive scheme	1	186										**187**		**187**
Changes in reserves					319	(310)	(31)				22	**-**		**-**
Equity 31 March 2022	1,499	17,455	110	828	7,564	2,856	1,093	(3,052)	1,637	595	141,747	**172,333**	680	**173,013**

The accompanying Notes are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK millions

Consolidated Interim Statement of Changes in Equity

			Restricted reserves											
	Share capital	Share premium	Share option	Warrants reserve	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Debt invest-ments at fair value thr. OCI, unrealized	Statutory reserve	Foreign currency trans-lation reserve	Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
Equity 1 January 2021	1,718	49,613	-	-	7,421	694	1,054	(141)	1,637	655	135,021	**197,672**	173	**197,845**
Net earnings											6,038	**6,038**	1	**6,039**
Net change in fair value								(481)				**(481)**		**(481)**
Realized net gain transferred to P/L ...								(35)				**(35)**		**(35)**
Translation difference										6		**6**		**6**
Total comprehensive income	-	-	-	-	-	-	-	(516)	-	6	6,038	**5,528**	1	**5,529**
Transactions with owners														
Dividend paid											(2,857)	**(2,857)**		**(2,857)**
Purchase of treasury shares	(98)	(11,846)										**(11,944)**		**(11,944)**
Share option charge			18									**18**		**18**
Warrants sold				828								**828**		**828**
Changes in reserves					398	571	132				(1,101)	**-**		**-**
Equity 31 March 2021	1,620	37,767	18	828	7,819	1,265	1,186	(657)	1,637	661	137,101	**189,245**	174	**189,419**

The accompanying Notes are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK millions

Consolidated Interim Statement of Cash flows

	2022 1.1.-31.3.	2021 1.1.-31.3.
Operating activities		
Net earnings	5,818	6,039
Non-cash items included in net earnings	(6,917)	(3,027)
Changes in operating assets and liabilities		
Loans to credit institutions, excluding bank accounts	(264)	(1,410)
Loans to customers	(41,142)	(19,170)
Financial instruments and financial liabilities at fair value	42,585	22,071
Deposits	23,406	24,749
Borrowings	(8,496)	422
Other changes in operating assets and liabilities	3,459	(5,067)
Interest received	14,234	11,501
Interest paid	(3,657)	(3,913)
Dividend received	57	42
Income tax paid	(1,477)	(685)
Net cash from operating activities	**27,606**	**31,552**
Investing activities		
Proceeds from sale of associates	241	-
Acquisition of associates	(70)	-
Acquisition of intangible assets	(53)	(396)
Proceeds from sale of property and equipment	238	67
Acquisition of property and equipment	(51)	(171)
Net cash from (to) investing activities	**305**	**(500)**
Financing activities		
Proceeds from issued warrants	-	828
Proceeds from vested share options	352	-
Purchase of treasury stock	(4,269)	(11,944)
Dividend paid to shareholders of Arion Bank	(22,489)	(2,857)
Net cash used in financing activities	**(26,406)**	**(13,973)**
Net increase in cash and cash equivalents	1,505	17,079
Cash and cash equivalents at beginning of the year	90,678	58,284
Effect of exchange rate changes on cash and cash equivalents	(833)	1,229
Cash and cash equivalents	**91,350**	**76,592**
Cash and cash equivalents		
Cash and balances with Central Bank	64,395	60,479
Bank accounts	33,550	21,997
Mandatory reserve deposit with Central Bank	(6,595)	(5,884)
Cash and cash equivalents	**91,350**	**76,592**

The accompanying Notes are an integral part of these Condensed Consolidated Interim Financial Statements

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements
Contents

Notes to the Condensed Consolidated Interim Financial Statements

General information

Arion Bank hf., the Parent Company, was established on 18 October 2008 and is incorporated and domiciled in Iceland. The registered office of Arion Bank hf. is located at Borgartún 19, Reykjavík. The Condensed Consolidated Interim Financial Statements for the period ended 31 March 2022 comprise the Parent Company and its subsidiaries (together referred to as "the Group").

1. Basis of preparation

The Condensed Consolidated Interim Financial Statements were approved and authorized for publication by the Board of Directors of Arion Bank on 4 May 2022.

The Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Financial Reporting Standard, IAS 34 Interim Financial Reporting, as adopted by the European Union and additional requirements in the Icelandic Financial Statements Act, Financial Undertakings Act and Rules on Accounting for Credit Institutions. The Condensed Consolidated Interim Financial Statements do not include all the information and disclosures required in the Annual Financial Statements, and should be read in conjunction with Arion Bank's Annual Consolidated Financial Statements for the year ended 31 December 2021. The Annual Consolidated Financial Statements are available on Arion Bank's website www.arionbanki.is.

Statement of compliance

The Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union and additional requirements in the Icelandic Financial Statements Act, Financial Undertakings Act and rules on Accounting for Credit Institutions.

The same accounting policies, presentation and methods of computation are followed in these Condensed Consolidated Interim Financial Statements as were applied in the Consolidated Financial Statements for the year ended 31 December 2021.

Basis of measurement

The Condensed Consolidated Interim Financial Statements have been prepared on a historical cost basis except for the following:

- bonds and debt instruments, shares and equity instruments, short positions in listed bonds and equities and derivatives. For details on the accounting policy, see Note 56 in the Consolidated Financial Statements 2021;
- investment properties are measured at fair value; and
- non-current assets and disposal groups held for sale are stated at the lower of their carrying amounts and fair value, less cost to sell.

Functional and presentation currency

The Condensed Consolidated Interim Financial Statements are presented in Icelandic krona (ISK), which is the Parent Company's functional currency, rounded to the nearest million, unless otherwise stated. At the end of the period the exchange rate of the ISK against USD was 128.13 and 142.00 for EUR (31.12.2021: USD 129.75 and EUR 147.60).

2. Going concern assumption

The Group's management has made an assessment of the ability to continue as a going concern and is satisfied that the Group has the resources to continue. In making this assessment, management has taken into consideration the risk exposures facing the Group, which are further described in the Risk Management Disclosures. The Condensed Consolidated Interim Financial Statements are prepared on a going concern basis.

3. Significant accounting estimates and judgments in applying accounting policies

The preparation of the Condensed Consolidated Interim Financial Statements requires management to make judgments, estimates and assumptions that affect the reported amount of revenues, expenses, assets and liabilities, and the accompanying disclosures, as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

Estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. The Group based its assumptions and estimates on parameters available when the Condensed Consolidated Interim Financial Statement were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising that are beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

Notes to the Condensed Consolidated Interim Financial Statements

3. Significant accounting estimates and judgements in applying accounting policies, continued

Impairment of financial assets

The book value of financial assets which fall under the impairment requirements of IFRS 9 are presented net of expected credit losses in the statement of financial position. On a monthly basis expected credit losses are recalculated for each asset, the calculations being derived from PD, LGD and EAD models. In addition to the model outcomes, the assessment of expected credit losses is based on three key factors: management's assumptions regarding the development of macroeconomic factors over the next three years, how those factors affect each model and how to estimate a significant increase in credit risk. The assumptions for macroeconomic development are incorporated into each model for three scenarios: a base case, an optimistic case and a pessimistic case. Management estimates the probability weight for each scenario used for calculations of the probability weighted expected credit losses. The amount of expected credit losses to be recognized is dependent on the Bank's definition of significant increase in credit risk, which controls the impairment stage each asset is allocated to. Management has estimated factors to measure significant increase in credit risk from origination, by comparison of changes in PD values, annualized lifetime PD values, days past due and watch list. For further information see Note 56 in the Annual Financial Statements 2021.

Macroeconomic outlook

The Omicron wave of Covid-19 has subsided in Iceland and all public health restrictions have been lifted. As a consequence, the outlook for the tourism industry for the summer 2022 and the coming years is very good with 1.6m tourists expected in 2022 and the pre-Covid peak of 2.2m tourists being reached in 2024. In line with this, it is expected that the unemployment rate will continue to decrease in the coming years and that GDP growth will be strong. Private consumption grew very strongly in 2021, by 7.6%, and a slower growth is expected in the coming years, also due to the persistence of inflation. The growth in housing prices is also expected to slow down in the second half of 2022 and in the coming years due to increased supply although demand is also expected to remain strong from demographic considerations.

The war in Ukraine is neither expected to have a substantial effect on the Icelandic economy nor on the Group in the base economic forecast. However, it is clear that several types of risks have increased due to the war. Thus, the probability of a negative economic scenario being realized has increased.

Assets and disposal groups held for sale

Legal entities acquired exclusively with a view to resale, and discontinued operations held for sale are measured at the lower of carrying amount and fair value, less cost to sell. For the most part, fair value at the date of classification of these legal entities and discontinued operations was calculated using valuation models based on discontinued future cash flows that incorporated significant non-market observable inputs and assumptions. The use of reasonably possible alternative inputs and assumptions to these models, in particular changes to the discount rate employed (representing the required rate of return on equity), could have an impact on the value of these disposal groups. For further information on assets and disposal groups held for sale, see Note 29.

Real estates acquired exclusively with a view to resale are measured at the lower of carrying amount and fair value, less cost to sell. Fair value at the date of classification is based on independent property values or management valuation. As the fair value measurement of real estates is based on valuation techniques, there is some uncertainty about the actual fair value of assets.

Impairment of intangible assets

The carrying amounts of goodwill, infrastructure and customer relationship and related agreements are reviewed annually to determine whether there is any indication of impairment. If any such indication exists the asset's recoverable amount is estimated. An impairment loss is recognized if the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognized in the Consolidated Income Statement. The recoverable amount of an asset is the greater of its value in use and its fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Revaluation of investment properties

The Group carries its investment properties at fair value, with changes in fair value being recognized in the statement of profit or loss. For investment properties, either a valuation methodology based on present value calculations is used, as there is a lack of comparable market data because of the nature of the properties, or the investment properties are valued by reference to transactions involving properties of a similar nature, location and condition.

4. The Group

Shares in the main subsidiaries in which Arion Bank holds a direct interest

			Equity interest	
	Operating activity	Currency	31.03.2022	31.12.2021
Eignabjarg ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Leiguskjól ehf., Bjargargata 1, Reykjavík, Iceland	Rental guarantee	ISK	51.0%	51.0%
SRL slhf., Borgartún 19, Reykjavík, Iceland	Real estate	ISK	100.0%	100.0%
Stefnir hf., Borgartún 19, Reykjavík, Iceland	Asset management	ISK	100.0%	100.0%
Valitor hf., Dalshraun 3, Hafnarfjördur, Iceland	Payment solutions	ISK	100.0%	100.0%
VISA Ísland ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Vördur tryggingar hf., Borgartún 19, Reykjavík, Iceland	Insurance	ISK	100.0%	100.0%

The subsidiaries Eignabjarg ehf. (holding company of Stakksberg ehf. and Sólbjarg ehf.) and Valitor hf. are classified as held for sale in accordance with IFRS 5, see Note 29 for further information.

SRL slhf. holds a 51% shareholding in its subsidiary Arnarland ehf. and recognizes minority interest accordingly.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Operating segment reporting

Segment information is presented in respect of the Group's operating segments and is based on the Group's management and internal reporting structure. The business units are segmented according to customers, products and services characteristics. Segment performance is evaluated based on earnings before tax.

Inter segment pricing is determined on an arm's length basis. Operating segments pay and receive interest to and from Treasury on an arm's length basis to reflect the allocation of capital, funding cost and relevant risk premium.

5. Operating segments

In line with the Group’s progression focuses on holistic customer journey optimization introduced a key part of the vision is to bring Vördur insurance company closer to the Bank for a more focused bancassurance offering. In 2022 the operation of Vördur has been split into individuals and corporates and is presented as such as part of Corporate & Investment Banking and Retail banking, respectively.

Markets & Stefnir

Markets & Stefnir comprise Asset Management and Capital Markets. Asset Management manages financial assets on behalf of its customers according to a pre-determined investment strategy. Asset Management also administers pension funds. Asset management comprises Institutional Asset Management, Private Banking and Pension Fund Administration. The operation of Stefnir hf. is presented under the segment. Stefnir hf. is an independently operating financial company owned by Arion Bank and manages a broad range of mutual funds, investment funds and institutional investor funds. Arion Bank also offers comprehensive selection off funds from some of the leading international fund management companies. Capital Markets is a securities brokerage and brokers listed securities transactions for the Bank’s international and domestic clients on all the world’s major securities exchanges.

Corporate & Investment Banking (CIB)

Corporate & Investment Banking provides companies and investors with comprehensive financial services that meet the needs of each client, both in Iceland and internationally. The division is divided into Corporate Banking and Corporate Finance.

Corporate Banking's experienced account managers specialize in key economic sectors such as retail and services, seafood, energy and real estate. The division serves companies ranging from SMEs to large cap companies and provides a full range of lending and insurance products, including guarantees, deposit accounts, payment solutions, and, a variety of value-added digital solutions. The Corporate Banking portfolio includes several larger international transactions, partly in syndicates with other Icelandic or international banks.

Arion Bank‘s Corporate Finance works closely with Corporate Banking and provides the Bank’s clients with financial advisory services, with a key focus on M&A advisory, private placements of equity and IPOs and other offerings of securities.

Retail Banking

Retail Banking provides a diverse range of financial services in 15 branches and service points across Iceland and offers digital solutions both in the Arion app and online banking. These services include deposits and loans, savings, payment cards, pensions, insurance, securities and funds. In order to improve efficiency the branch network is split into four regions, and smaller branches can therefore benefit from the strength of larger units within each region. Retail Banking has more than 100,000 customers.

Treasury

Treasury is responsible for the Bank's liquidity, currency and interest rate management. Treasury is a market maker in Iceland in domestic securities and FX. Treasury is responsible for funds' transfer pricing and hedging and pricing of financial products. FX brokerage is part of the Treasury unit. Treasury also handles all debt issuance both in the domestic and foreign markets and maintaining the Banks credit ratings.

Other subsidiaries

Subsidiaries include the subsidiaries SRL slhf., which holds the main part of investment property of the Group and the holding companies VISA Ísland ehf. and other smaller entities of the Group. The subsidiaries Valitor, Stakksberg and Sólbjarg (both subsidiaries of Eignabjarg) are classified as disposal groups held for sale in accordance with IFRS 5.

Supporting units

Supporting units include the Bank's headquarters which carry out support functions such as the CEO office, Risk Management, Finance (excluding Treasury), IT and Customer Experience. The information presented relating to the supporting units does not represent an operating segment. A significant proportion of expenses from support functions is allocated to operating segments in a separate line in the operating segment overview.

Notes to the Condensed Consolidated Interim Financial Statements

5. Operating segments, continued

1.1.-31.3.2022	Markets and Stefnir	CIB including insurance	Retail Banking including insurance	Treasury	Subsidi- aries excl. Stefnir and Vördur	Supporting units and elimi- nations	Total
Income Statement							
Net interest income	477	4,419	4,560	96	3	(27)	9,528
Net fee and commission income	1,521	1,133	923	150	24	(199)	3,552
Net insurance income	-	(61)	127	-	-	(61)	5
Net financial income	(35)	95	332	611	19	(31)	991
Share of profit of associates	-	-	-	-	-	203	203
Other operating income	-	-	34	(1)	5	197	235
Operating income	1,963	5,586	5,976	856	51	82	14,514
Operating expenses	(513)	(632)	(1,297)	(152)	(33)	(3,574)	(6,201)
Allocated expenses	(483)	(846)	(1,750)	(284)	(1)	3,364	-
Bank levy	(16)	(120)	(185)	(72)	-	-	(393)
Net impairment	(1)	(418)	(78)	(2)	-	4	(495)
Earnings (loss) before income tax	950	3,570	2,666	346	17	(124)	7,425
Net seg. rev. from ext. customers	810	5,962	10,237	(2,947)	340	112	14,514
Net seg. rev. from other segments	1,153	(376)	(4,261)	3,803	(289)	(30)	-
Operating income	1,963	5,586	5,976	856	51	82	14,514
Balance Sheet							
Loans to customers	56	397,458	579,620	61	3	(815)	976,383
Financial instruments	51,791	7,672	19,294	106,658	2,829	(2,564)	185,680
Other external assets	6,661	5,141	9,322	104,851	34,183	18,794	178,952
Internal assets	29,726	-	-	325,939	-	(355,665)	-
Total assets	88,234	410,271	608,236	537,509	37,015	(340,250)	1,341,015
Deposits	68,124	235,378	303,719	61,112	-	11,592	679,925
Other external liabilities	12,667	21,099	23,589	415,010	11,889	3,823	488,077
Internal liabilities	-	116,134	223,739	9,211	6,581	(355,665)	-
Total liabilities	80,791	372,611	551,047	485,333	18,470	(340,250)	1,168,002
Allocated equity	7,443	37,660	57,189	52,176	18,545	-	173,013

Amounts are in ISK millions

5. Operating segments, continued

1.1.-31.3.2021 *Income Statement*	Markets and Stefnir	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other sub-sidiaries	Supporting units and elimi-nations	Total
Net interest income	139	2,585	3,932	709	26	(41)	(8)	7,342
Net fee and commission income	1,191	1,107	940	165	(72)	(140)	86	3,277
Net insurance income	-	-	-	-	717	-	(46)	671
Net financial income	65	216	-	1,019	316	(116)	-	1,500
Share of profit of associates	-	-	-	-	-	-	1	1
Other operating income	-	1	211	(2)	8	(15)	103	306
Operating income	1,395	3,909	5,083	1,891	995	(312)	136	13,097
Operating expenses	(439)	(325)	(1,311)	(143)	(630)	(85)	(3,115)	(6,048)
Allocated expenses	(467)	(642)	(1,629)	(236)	(8)	(1)	2,983	-
Bank levy	(13)	(94)	(155)	(68)	-	-	-	(330)
Net impairment	-	841	414	2	-	(85)	(92)	1,080
Earnings (loss) before income tax	476	3,689	2,402	1,446	357	(483)	(88)	7,799
Net seg. rev. from ext. customers	1,033	4,988	7,779	(1,606)	915	(105)	93	13,097
Net seg. rev. from other segments	362	(1,079)	(2,696)	3,497	80	(207)	43	-
Operating income	1,395	3,909	5,083	1,891	995	(312)	136	13,097
Balance Sheet								
Loans to customers	3	307,733	530,153	115	-	4	(846)	837,162
Financial instruments	48,175	1,267	-	123,608	23,538	2,804	(2,176)	197,216
Other external assets	5,154	8,023	4,179	74,057	8,463	31,635	15,204	146,715
Internal assets	24,595	-	-	248,093	-	-	(272,688)	-
Total assets	77,927	317,023	534,332	445,873	32,001	34,443	(260,506)	1,181,093
Deposits	64,525	107,254	361,077	63,671	-	-	(3,987)	592,540
Other external liabilities	5,285	1,775	5,436	337,375	21,205	11,889	16,169	399,134
Internal liabilities	-	148,674	124,014	-	-	-	(272,688)	-
Total liabilities	69,810	257,703	490,527	401,046	21,205	11,889	(260,506)	991,674
Allocated equity	8,117	59,320	43,805	44,827	10,796	22,554	-	189,419

Comparative figures have not been restated based on new approach in disclosing Vördur as part of Corporate & Investment Banking and Retail Banking instead of a separate segment.

Income taxes and discontinued operations held for sale are excluded from the profit and loss segment information.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Consolidated Income Statement

6. Net interest income

1.1.-31.3.2022	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	392	-	-	392
Loans to credit institutions	8	15	-	23
Loans to customers	15,997	-	-	15,997
Securities	-	240	814	1,054
Other	60	-	-	60
Interest income	16,457	255	814	17,526
Interest expense				
Deposits	(3,478)	-	-	(3,478)
Borrowings	(3,957)	-	-	(3,957)
Subordinated liabilities	(520)	-	-	(520)
Other	(43)	-	-	(43)
Interest expense	(7,998)	-	-	(7,998)
Net interest income	8,459	255	814	9,528

1.1.-31.3.2021	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	88	-	-	88
Loans to credit institutions	25	7	-	32
Loans to customers	10,676	-	-	10,676
Securities	-	320	619	939
Other	44	-	-	44
Interest income	10,833	327	619	11,779
Interest expense				
Deposits	(1,181)	-	-	(1,181)
Borrowings	(2,774)	-	-	(2,774)
Subordinated liabilities	(453)	-	-	(453)
Other	(29)	-	-	(29)
Interest expense	(4,437)	-	-	(4,437)
Net interest income	6,396	327	619	7,342

Net interest income calculated using the effective interest rate method were ISK 16,412 million during the period (3M 2021: ISK 10,796 million).

	2022	2021
Interest spread	1.1.-31.3.	1.1.-31.3.
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	3.1%	2.7%

Amounts are in ISK millions

7. Net fee and commission income

	1.1.-31.3.2022			1.1.-31.3.2021		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	1,396	(159)	1,237	1,139	(113)	1,026
Capital markets and corporate finance	695	(9)	686	584	(9)	575
Lending and financial guarantees	1,046	-	1,046	1,161	-	1,161
Collection and payment services	340	(26)	314	291	(34)	257
Cards and payment solution	430	(144)	286	414	(89)	325
Other	161	(178)	(17)	137	(204)	(67)
Net fee and commission income	4,068	(516)	3,552	3,726	(449)	3,277

Asset management fees are earned by the Group for trust and fiduciary activities where the Group holds or invests assets on behalf of the customers.

Fee and commission income from capital markets and corporate finance includes miscellaneous corporate finance services plus commission from capital markets relating to sales of shares, bonds, FX and derivatives.

Fee and commission income from lending and financial guarantees is mainly related to lending activities, extension fees, advisory services and documentation, notification and payment fees plus fees from the issuing of guarantees on behalf of customers.

Fee and commission income on collection and payment services is generated billing services, such as issuing invoices and payment collection notices, wire transfer services and other payment services.

Commission from cards and payment solutions is mainly from the Bank's issuance of credit and debit cards and other card related commission, e.g. yearly fee on cards and transaction fees.

Other fee and commission income is mainly fees relating to sale, custody and market making on the Icelandic stock exchange.

8. Net insurance income

	2022 1.1.-31.3.	2021 1.1.-31.3.
Earned premiums, net of reinsurers' share		
Premiums written	4,675	4,330
Premiums written, reinsurers' shares	(148)	(115)
Change in provision for unearned premiums	(1,176)	(1,161)
Earned premiums, net of reinsurers' share	3,351	3,054
Claims incurred, net of reinsurers' share		
Claims paid	(2,577)	(2,074)
Claims paid, reinsurers' share	92	16
Change in provision for claims	(864)	(362)
Changes in provision for claims, reinsurers' share	3	37
Claims incurred, net of reinsurers' share	(3,346)	(2,383)
Net insurance income	5	671
Combined ratio		
Combined ratio	115.5%	98.5%

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

9. Net financial income

	2022 1.1.-31.3.	2021 1.1.-31.3.
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	1,112	1,463
Loss on prepayments of borrowings	(35)	-
Net loss on fair value hedge of interest rate swap	(125)	(1)
Realized (loss) gain on financial assets carried at fair value through OCI	(28)	47
Net foreign exchange gain (loss)	67	(9)
Net financial income	991	1,500

Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss

Equity instruments	624	1,194
Debt instruments	268	366
Derivatives	220	(97)
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	1,112	1,463

Net loss on fair value hedge of interest rate swap

Fair value change of interest rate swaps designated as hedging instruments	(4,483)	(523)
Fair value change on bonds issued by the Group attributable to interest rate risk	4,358	522
Net loss on fair value hedge of interest rate swap	(125)	(1)

10. Other operating income

Net gain on disposal of assets	174	49
Net gain on assets held for sale	10	109
Other income	51	148
Other operating income	235	306

Net gain on assets held for sale

Income from real estates and other assets	13	118
Expense related to real estates and other assets	(3)	(9)
Net gain on assets held for sale	10	109

Real estates and other assets classified as assets held for sale are generally the result of foreclosures on companies and individuals.

11. Personnel and salaries

	2022 1.1.-31.3.	2021 1.1.-31.3.
Number of employees		
Average number of full-time equivalent positions during the period	749	768
Full-time equivalent positions at the end of the period	753	772

Salaries and related expenses

Salaries	2,666	2,615
Incentive scheme	14	14
Share-based payment expenses	50	18
Defined contribution pension plans	398	389
Salary-related expenses	412	368
Capitalization of salaries due to implementation of core systems	-	(133)
Salaries and related expenses	3,540	3,271

Amounts are in ISK millions

11. Personnel and salaries, continued

Incentive schemes

During the period the Group made a provision of ISK 19 million (Q1 2021: ISK 19 million) for the incentive scheme, including salary-related expenses. At the end of the period the Group's accrual for the incentive scheme payments amounted to ISK 470 million (31.12.2021: ISK 1,638 million).

Revised incentive scheme for Arion Bank hf. and Vördur came into effect in 2021. The scheme is in compliance with the FSA’s rules on remuneration policy for financial institutions. The scheme is split into two parts. Firstly, employees can receive up to 10% of their fixed salary for each fiscal year in the form of a cash payment. Secondly, a limited group can receive up to 25% of their fixed salary as a payment in the form of shares in the Bank which will be subject to a three-year lock-up period. The key metric used to determine whether incentive scheme payments will be paid by the Bank, in part or in full, is whether the Bank’s return on equity is higher than the weighted ROE of the Bank’s main competitors. Other supporting metrics are for example ROE and cost-to-income ratio vs target, compliance, staff NPS etc. Corresponding metrics are for incentive scheme payment at Vördur, i.e. higher ROE than the Icelandic competitors and other internal measures. Stefnir hf. has a special incentive scheme where other criteria are used as a basis.

Share-based payment expense

Arion Bank has in place a share option plan for all employees of the Bank, approved at the Banks annual general meeting, under which employees may be granted options to purchase ordinary shares at an exercise price determined by the Bank’s average share price 10 days prior to issue date. The employee must remain continuously employed with Arion Bank until the expiring date. The options carry neither rights to dividends nor voting rights and are valued using the Black-Scholes pricing model. A total expense of ISK 50 million was recognised in the Income Statement during the period (2021: ISK 18 million). Estimated remaining expenses due the share option contracts are ISK 543 million and will be expensed over the next four years. For further information on the share option program, see Note 34.

12. Other operating expenses

	2022 1.1.-31.3.	2021 1.1.-31.3.
IT expenses	1,100	1,250
Professional services	225	232
Housing expenses	150	157
Other administration expenses	612	632
Depositors' and Investors' Guarantee Fund	135	143
Depreciation of property and equipment	128	137
Depreciation of right of use asset	34	33
Amortization of intangible assets	277	193
Other operating expenses	2,661	2,777

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

13. Bank levy

The Bank levy is 0.145% on total debts excluding tax liabilities, in excess of ISK 50 billion. The tax is assessed on Financial Undertakings but non-financial subsidiaries are exempt from this tax.

14. Net impairment

Net impairment on financial instruments and value changes on loans	2022 1.1.-31.3.	2021 1.1.-31.3.
Net impairment on loans to customers and financial institutions	(522)	955
Net impairment on other financial instruments at FVOCI	1	1
Other value changes of loans - corporates	5	9
Other value changes of loans - individuals	21	115
Net impairment	(495)	1,080

Net impairment by customer type		
Financial institutions	-	(43)
Individuals	34	124
Corporates	(529)	999
Net impairment	(495)	1,080

Other value changes of loans to individuals and corporates is mainly due to release of discount from loans acquired with discount during the years 2008 to 2013, both due to impairments and other discount rate than reflected in the interest rates of the loans. The discount release was primarily related to loans that were paid up or sold during the year.

15. Income tax expense

	2022 1.1.-31.3.	2021 1.1.-31.3.
Current tax expense	2,995	2,330
Deferred tax expense (income)	(1,292)	(464)
Income tax expense	1,703	1,866

Reconciliation of effective tax rate	2022 1.1.-31.3.		2021 1.1.-31.3.	
Earnings before income tax		7,425		7,799
Income tax using the Icelandic corporate tax rate	20.0%	1,485	20.0%	1,560
Additional 6% tax on Financial Undertakings	9.1%	678	6.6%	514
Non-deductible expenses	0.1%	11	0.0%	1
Tax exempt revenues / loss	(3.9%)	(293)	(2.1%)	(166)
Non-deductible taxes (Bank levy)	1.1%	79	0.8%	66
Tax incentives not recognized in the Income Statement	(3.7%)	(273)	(1.4%)	(111)
Other changes	0.2%	16	0.0%	2
Effective tax rate	22.9%	1,703	23.9%	1,866

Financial undertakings pay 6% additional tax on taxable profit exceeding ISK 1 billion.

Tax exempt revenues / loss consist mainly of profit / loss from equity positions.

Amounts are in ISK millions

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

	2022 1.1.-31.3.	2021 1.1.-31.3.
Net gain from discontinued operations held for sale	109	103
Income tax expense	(13)	3
Discontinued operations held for sale, net of income tax	96	106
Valitor hf.	288	120
Stakksberg ehf.	(215)	(34)
Sólbjarg ehf.	23	20
Discontinued operations held for sale, net of income tax	96	106

The net profit from Valitor's operation was ISK 59 million during the period whereas Valitor's positive contribution to the Group, after taking into account the Group's eliminations, was ISK 288 million. Operating income of Valitor was ISK 1,377 million, or ISK 1,610 million after taking into account the Group's eliminations.

Operating effects of Sólbjarg are mainly due to a binding offer of sale of assets held by the company.

For further information about Valitor hf., Stakksberg ehf. and Sólbjarg ehf., see Note 28.

17. Earnings per share

Basic earnings per share is based on net earnings attritutable to the shareholders of Arion Bank and the weighted average number of shares outstanding during the period. Diluted earnings per share is calculated by adjusting the weighted average number of outstanding shares to assume conversion of all dilutive potential ordinary shares. Arion Bank has issued warrants and stock options that have dilutive effects.

	Continued operations		Discontinued operations		Net Earnings	
	2022 1.1.-31.3.	2021 1.1.-31.3.	2022 1.1.-31.3.	2021 1.1.-31.3.	2022 1.1.-31.3.	2021 1.1.-31.3.
Net earnings attributable to the shareholders of Arion Bank	5,716	5,932	96	106	5,812	6,038
Weighted average number of outstanding shares (millions)	1,583	1,673	1,583	1,673	1,583	1,673
Weighted average number of outstanding shares including warrants and options (millions)	1,661	1,747	1,661	1,747	1,661	1,747
Basic earnings per share (ISK)	3.61	3.55	0.06	0.06	3.67	3.61
Diluted earnings per share ISK)	3.44	3.40	0.06	0.06	3.50	3.46

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Consolidated Statement of Financial Position

18. Cash and balances with Central Bank

	31.3.2022	31.12.2021
Cash on hand	3,342	3,556
Cash with Central Bank	54,458	58,966
Mandatory reserve deposit with Central Bank	6,595	6,535
Cash and balances with Central Bank	64,395	69,057

The mandatory reserve deposit with the Central Bank is not available for the Group to use in its daily operations. Minimum reserve requirements of the Central Bank falls into two categories: a fixed reserve requirement and an average maintenance requirement. The fixed reserve requirement is 1%.

19. Loans to credit institutions

	31.3.2022	31.12.2021
Bank accounts	33,550	28,156
Other loans	2,318	2,116
Loans to credit institutions	35,868	30,272

20. Loans to customers

	Individuals		Corporates		Total	
31.3.2022	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
Overdrafts	15,262	14,716	20,371	19,766	35,633	34,482
Credit cards	13,270	13,115	1,526	1,485	14,796	14,600
Mortgage loans	469,877	469,417	46,508	46,343	516,385	515,760
Construction loans	-	-	16,064	16,003	16,064	16,003
Capital lease	4,611	4,594	3,847	3,820	8,458	8,414
Other loans	33,245	32,553	359,774	354,571	393,019	387,124
Loans to customers	536,265	534,395	448,090	441,988	984,355	976,383
31.12.2021						
Overdrafts	14,255	13,691	18,301	17,785	32,556	31,476
Credit cards	13,192	13,037	1,449	1,409	14,641	14,446
Mortgage loans	463,895	463,457	41,588	41,420	505,483	504,877
Construction loans	-	-	17,798	17,775	17,798	17,775
Capital lease	4,471	4,451	3,882	3,843	8,353	8,294
Other loans	32,573	31,862	332,433	327,507	365,006	359,369
Loans to customers	528,386	526,498	415,451	409,739	943,837	936,237

The total book value of pledged loans that were pledged against amounts borrowed was ISK 305 billion at the end of the period (31.12.2021: ISK 267 billion). Pledged loans comprised mortgage loans to individuals.

Further analysis of loans is provided in Risk management disclosures.

21. Financial instruments

	31.3.2022	31.12.2021
Bonds and debt instruments	106,022	151,852
Shares and equity instruments with variable income	26,712	25,063
Derivatives	2,693	2,905
Securities used for economic hedging	50,253	45,837
Financial instruments	185,680	225,657

Amounts are in ISK millions

22. Financial assets and financial liabilities

31.3.2022	Amortized cost	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	64,395	-	-	64,395
Loans to credit institutions	33,838	-	2,030	35,868
Loans to customers	976,383	-	-	976,383
Loans	1,074,616	-	2,030	1,076,646
Bonds and debt instruments				
Listed	-	83,428	21,905	105,333
Unlisted	-	-	689	689
Bonds and debt instruments	-	83,428	22,594	106,022
Shares and equity instruments with variable income				
Listed	-	-	11,593	11,593
Unlisted	-	-	11,350	11,350
Bond funds with variable income, unlisted	-	-	3,769	3,769
Shares and equity instruments with variable income	-	-	26,712	26,712
Derivatives				
OTC derivatives	-	-	2,486	2,486
Derivatives used for hedge accounting	-	-	207	207
Derivatives	-	-	2,693	2,693
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	13,007	13,007
Shares and equity instruments with variable income, listed	-	-	37,246	37,246
Securities used for economic hedging	-	-	50,253	50,253
Other financial assets				
Accounts receivable	5,638	-	-	5,638
Other financial assets	33,770	-	-	33,770
Other financial assets	39,408	-	-	39,408
Financial assets	1,114,024	83,428	104,282	1,301,734
Financial liabilities				
Due to credit institutions and Central Bank	4,270	-	-	4,270
Deposits	679,925	-	-	679,925
Borrowings	370,026	-	-	370,026
Subordinated liabilities	33,674	-	-	33,674
Short position in bonds	-	-	412	412
Derivatives	-	-	7,080	7,080
Derivatives used for hedge accounting	-	-	4,831	4,831
Other financial liabilities	14,132	-	-	14,132
Financial liabilities	1,102,027	-	12,323	1,114,350

Amounts are in ISK millions

22. Financial assets and financial liabilities, continued

31.12.2021	Amortized cost	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	69,057	-	-	69,057
Loans to credit institutions	28,156	-	2,116	30,272
Loans to customers	936,237	-	-	936,237
Loans	1,033,450	-	2,116	1,035,566
Bonds and debt instruments				
Listed	-	133,825	17,344	151,169
Unlisted	-	-	683	683
Bonds and debt instruments	-	133,825	18,027	151,852
Shares and equity instruments with variable income				
Listed	-	-	7,707	7,707
Unlisted	-	-	13,079	13,079
Bond funds with variable income, unlisted	-	-	4,277	4,277
Shares and equity instruments with variable income	-	-	25,063	25,063
Derivatives				
OTC derivatives	-	-	1,805	1,805
Derivatives used for hedge accounting	-	-	1,100	1,100
Derivatives	-	-	2,905	2,905
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	14,044	14,044
Shares and equity instruments with variable income, listed	-	-	31,793	31,793
Securities used for economic hedging	-	-	45,837	45,837
Other financial assets				
Accounts receivable	5,104	-	-	5,104
Other financial assets	7,617	-	-	7,617
Other financial assets	12,721	-	-	12,721
Financial assets	1,046,171	133,825	93,948	1,273,944
Financial liabilities				
Due to credit institutions and Central Bank	5,000	-	-	5,000
Deposits	655,476	-	-	655,476
Borrowings	356,637	-	-	356,637
Subordinated liabilities	35,088	-	-	35,088
Derivatives	-	-	4,974	4,974
Derivatives used for hedge accounting	-	-	903	903
Other financial liabilities	8,685	-	-	8,685
Financial liabilities	1,060,886	-	5,877	1,066,763

Amounts are in ISK millions

22. Financial assets and financial liabilities, continued

Bonds and debt instruments measured at fair value, specified by issuer

31.3.2022	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial and insurance activities	20,187	10,046	30,233
Public sector	63,241	10,281	73,522
Corporates	-	2,267	2,267
Bonds and debt instruments at fair value	83,428	22,594	106,022
31.12.2021			
Financial and insurance activities	21,001	7,561	28,562
Public sector	112,824	8,325	121,149
Corporates	-	2,141	2,141
Bonds and debt instruments at fair value	133,825	18,027	151,852

The total amount of pledged bonds was ISK 8.4 billion at the end of the period (31.12.2021: ISK 8.6 billion). Pledged bonds comprised Icelandic Government Bonds and Financial Institutions Bonds that were pledged against funding received and included in Due to credit institutions and Central Bank as well as short positions included in Financial liabilities at fair value.

23. Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of assets and liabilities by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
Level 2: valuation techniques for which all significant inputs are market observable, either directly or indirectly; and
Level 3: valuation techniques which include significant inputs that are not based on observable market data.

For assets and liabilities that are recognized at fair value on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Assets and liabilities recorded at fair value by level of the fair value hierarchy

31.3.2022

Assets at fair value	Level 1	Level 2	Level 3	Total
Loans to credit institutions	-	2,030	-	2,030
Bonds and debt instruments	104,794	1,130	98	106,022
Shares and equity instruments with variable income	9,397	13,765	3,550	26,712
Derivatives	-	2,486	-	2,486
Derivatives used for hedge accounting	-	207	-	207
Securities used for economic hedging	50,253	-	-	50,253
Investment property	-	-	6,586	6,586
Assets at fair value	164,444	19,618	10,234	194,296
Liabilities at fair value				
Short position in bonds	412	-	-	412
Derivatives	-	7,080	-	7,080
Derivatives used for hedge accounting	-	4,831	-	4,831
Liabilities at fair value	412	11,911	-	12,323

Amounts are in ISK millions

23. Fair value hierarchy, continued

31.12.2021

Assets at fair value	Level 1	Level 2	Level 3	Total
Loans to credit institutions	-	2,116	-	2,116
Bonds and debt instruments	150,723	1,032	97	151,852
Shares and equity instruments with variable income	5,519	15,736	3,808	25,063
Derivatives	-	1,805	-	1,805
Derivatives used for hedge accounting	-	1,100	-	1,100
Securities used for economic hedging	45,829	8	-	45,837
Investment property	-	-	6,560	6,560
Assets at fair value	202,071	21,797	10,465	234,333
Liabilities at fair value				
Derivatives	-	4,974	-	4,974
Derivatives used for hedge accounting	-	903	-	903
Liabilities at fair value	-	5,877	-	5,877

There was no transfer between Level 1 and Level 2 during the period (2021: Transfers from Level 1 to Level 2 ISK 172 million and transfers from Level 2 to Level 1 ISK 122 million).

Fair value of assets and liabilities

The fair value of asset and liabilities is the amount at which the asset and liability could be exchanged in a current transaction between willing parties, i.e. not during a forced sale or liquidation. The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used by the Group to measure assets and liabilities. If quoted prices for an asset fail to represent actual and regularly occurring transactions in active market transactions or if quoted prices are not available at all, fair value is established by using an appropriate valuation technique.

Methods for establishing fair value

The best evidence of the fair value of an asset and liability at initial recognition is the transaction price, unless the fair value can be evidenced by comparison with other observable current market transactions, or is based on a valuation technique whose variables include only data from observable markets.

In some cases, the carrying value of an asset in Note 22 is used as an approximation for the fair value of the asset. This is straight forward for cash and cash equivalents but is also used for short term investments and borrowings to highly rated counterparties, such as credit institutions, on contracts that feature interest close to or equal to market rates and expose the Group to little or no credit risk.

Level 1: Fair value established from quoted market prices

For listed and liquid stocks and bonds, certain financial derivatives and other market traded securities, the fair value is derived directly from quoted market prices. These instruments are disclosed under Financial instruments and Financial liabilities at fair value in the Statement of Financial Position.

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

For assets and liabilities, for which the market is not active, the Group applies valuation techniques to attain a fair value using as much market information as available. Valuation techniques include using recent market transactions between knowledgeable and willing parties, if available, reference to current fair value of another instrument that is substantially the same, discounted cash flow analysis, option pricing models or other commonly accepted valuation techniques used by market participants to price the instrument.

For assets and liabilities for which quoted prices on active markets are not available, the fair value is derived using various valuation techniques. This applies in particular to OTC derivatives such as options, swaps, futures and unlisted equities but also some other assets and liabilities.

In most cases the valuation is based on theoretical financial models, such as the Black Scholes model or variations thereof. These techniques also include forward pricing and swap models using present value calculations.

Level 2 instruments include unlisted shares, unlisted funds with underlying bonds and equity holdings (share certificates), unlisted and less liquid listed bonds and all OTC derivatives.

Amounts are in ISK millions

23. Fair value hierarchy, continued

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

In some cases there is little or no market data to rely on for fair value calculations. The most common valuation technique is present value calculations. Such calculations involve the estimation of future cash flow and the assessment of appropriate discount rate. The discount rate should both reflect current market rates and the uncertainty in the future cash flow. In such cases internal models and methods are used to calculate the fair value. The models may be statistical in nature, based on internal or external history of assets with similar characteristics and/or based on internal knowledge and experience. For example, the credit margin on most loans to customers which, is added to the current and suitable interest rate to arrive at an appropriate discount rate, is estimated using credit rating and loss parameters in case of default that have been derived from internal models.

Equity instruments that do not have a quoted market price are evaluated using methods and guidelines from pertinent international organizations. In most cases intrinsic value is the basis for the assessment but other factors, such as cash flow analysis, can also modify the results.

The Group applies management valuation for determining fair value of investment properties. Management valuation is either based on recent transactions and offers for similar assets or present value calculations which involve estimation of future cash flow and the assessment of appropriate discount rate.

Movements in Level 3 assets measured at fair value

	Investment	Financial assets		
31.3.2022	property	Bonds	Shares	Total
Balance at the beginning of the year	6,560	97	3,808	10,465
Net fair value changes	-	-	252	252
Additions	26	-	4	30
Disposals	-	1	(514)	(513)
Balance at the end of the period	6,586	98	3,550	10,234
31.12.2021				
Balance at the beginning of the year	6,132	358	1,685	8,175
Net fair value changes	545	12	664	1,221
Additions	15	301	1,655	1,971
Disposal	(132)	(574)	(196)	(902)
Balance at the end of the period	6,560	97	3,808	10,465

Line items where effects of Level 3 assets are recognized in the Income Statement

1.1.-31.3.2022				
Net financial income	-	-	252	252
Effects recognized in the Income Statement	-	-	252	252
1.1.-31.3.2021				
Net financial income	-	4	365	369
Other operating income	3	-	-	3
Effects recognized in the Income Statement	3	4	365	372

Amounts are in ISK millions

23. Fair value hierarchy, continued

Carrying values and fair values of financial assets and financial liabilities not carried at fair value

31.3.2021	Carrying	Fair	Unrealized
Financial assets not carried at fair value	value	value	gain (loss)
Cash and balances with Central Bank	64,395	64,395	-
Loans to credit institutions	35,868	35,868	-
Loans to customers	976,383	977,922	1,539
Other financial assets	39,408	39,408	-
Financial assets not carried at fair value	1,116,054	1,117,593	1,539
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	4,270	4,270	-
Deposits	679,925	679,925	-
Borrowings	370,026	376,465	(6,439)
Subordinated liabilities	33,674	36,419	(2,745)
Other financial liabilities	14,132	14,132	-
Financial liabilities not carried at fair value	1,102,027	1,111,211	(9,184)
31.12.2021			
Financial assets not carried at fair value			
Cash and balances with Central Bank	69,057	69,057	-
Loans to credit institutions	30,272	30,272	-
Loans to customers	936,237	937,179	942
Other financial assets	12,721	12,721	-
Financial assets not carried at fair value	1,048,287	1,049,229	942
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	5,000	5,000	-
Deposits	655,476	655,476	-
Borrowings	356,637	367,470	(10,833)
Subordinated liabilities	35,088	35,590	(502)
Other financial liabilities	8,685	8,685	-
Financial liabilities not carried at fair value	1,060,886	1,072,221	(11,335)

Loans to customers largely bear variable interest rates. Those loans, including corporate loans, are presented at book value as they generally have a short duration and very limited interest rate risk. Loans with fixed interest rates, mainly long-term retail mortgages, are estimated by using the discount cash flow method with the interest rates offered on new loans, taking into account loan to value. Defaulted loans are presented at book value as no future cash flow is expected on them. Instead they are written down according to their estimated potential recovery value.

Derivatives	Notional	Fair value	
31.3.2021	value	Assets	Liabilities
Forward exchange rate agreements	112,000	763	1,146
Fair value hedge of interest rate swap	183,213	207	4,831
Interest rate and exchange rate agreements	50,171	196	1,320
Bond swap agreements	15,898	362	57
Share swap agreements	35,481	985	4,539
Options - purchased agreements, unlisted	21	180	18
Derivatives	396,784	2,693	11,911
31.12.2021			
Forward exchange rate agreements	59,089	229	444
Fair value hedge of interest rate swap	190,095	1,100	903
Interest rate and exchange rate agreements	51,426	692	874
Bond swap agreements	10,947	359	20
Share swap agreements	31,029	348	3,530
Options - purchased agreements, unlisted	22	177	106
Options - purchased agreements, listed	16	-	-
Derivatives	342,624	2,905	5,877

Amounts are in ISK millions

23. Fair value hierarchy, continued

Fair value hedge of interest rate swap

The Group applies fair value hedge accounting only with respect to interest rate swaps, whereby the Group pays floating rate interest and receives fixed rate interest, with identical cash flows to the borrowings. The interest rate swaps are hedging the exposure of changes in the fair value of certain fixed-rate euro bonds, see Note 31, arising from changes in interest rates. On 1 January 2018 the Group adopted IFRS 9, but has elected to continue to apply the hedge accounting principles under IAS 39. For further information about the Group's hedge accounting policy, see Note 57 in the Annual Financial Statements 2021.

	Notional	Maturity date	Fair value		Gain (loss) on FV changes
31.3.2022			Assets	Liabilities	
Interest rates swaps - EUR	42,600	6-12 mth	207	-	(246)
Interest rates swaps - EUR	42,600	1-5 years	-	761	(692)
Interest rates swaps - USD	12,813	1-5 years	-	474	(579)
Interest rates swaps - EUR	42,600	1-5 years	-	2,041	(1,738)
Interest rates swaps - EUR	42,600	1-5 years	-	1,554	(1,228)
			207	4,830	(4,483)
31.12.2021					
Interest rates swaps - EUR	44,280	1-5 years	802	-	(463)
Interest rates swaps - EUR	-	-	-	-	(122)
Interest rates swaps - EUR	44,280	1-5 years	-	151	(301)
Interest rates swaps - USD	12,975	1-5 years	298	-	(526)
Interest rates swaps - EUR	44,280	1-5 years	-	350	(388)
Interest rates swaps - EUR	44,280	1-5 years	-	402	(462)
			1,100	903	(2,262)

Hedged borrowings and subordinated liabilities

	Book value	Accumulated fair value		Gain (loss) on FV changes
31.3.2022		Assets	Liabilities	
EUR 300 million - issued 2018 - 3 years	39,386	364	-	250
EUR 300 million - issued 2020 - 4 years	41,752	960	-	679
USD 100 million - issued 2020 - Perpetual	12,315	470	-	549
EUR 300 million - issued 2021 - 4 years	40,904	1,613	-	1,178
EUR 300 million - issued 2021 - 5 years	66,960	2,066	-	1,702
Hedged borrowings and subordinated liabilities	201,317	5,473	-	4,358
31.12.2021				
EUR 500 million - issued 2017/18 - 5 years	-	-	-	(106)
EUR 300 million - issued 2018 - 3 years	41,491	119	-	461
EUR 300 million - issued 2020 - 4 years	44,021	293	-	306
USD 100 million - issued 2020 - Perpetual	13,224	-	82	526
EUR 300 million - issued 2021 - 4 years	43,681	455	-	468
EUR 300 million - issued 2021 - 5 years	43,624	382	-	391
Hedged borrowings and subordinated liabilities	186,041	1,249	82	2,046

The effectiveness of each hedge is measured regularly with linear regression. The relationship between fair value changes of an interest rate swap on the one hand and a borrowing on the other hand is examined. In all cases the effectiveness is within limits, or between 93-105%.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

24. Offsetting financial assets and financial liabilities

Financial assets subject to enforceable master netting arrangements and similar arrangements

	Assets subject to netting arrangements			Netting potential not recognized in the Balance Sheet				
31.3.2022	Gross assets before nettings	Nettings with gross liabilities	Assets recognized on Balance Sheet, net	Financial liabilities	Collateral received	Assets after consideration of netting potential	Assets not subject to enforceable netting arr- angements	Total assets recognized on Balance Sheet, net
Reverse repurchase agreements	8,748	(577)	8,171	318	-	8,489	-	8,171
Derivatives	501	-	501	(346)	-	155	2,192	2,693
Total assets	9,249	(577)	8,672	(28)	-	8,644	2,192	10,864
31.12.2021								
Reverse repurchase agreements	8,560	(720)	7,840	720	-	8,560	-	7,840
Derivatives	1,689	-	1,689	(830)	-	859	1,216	2,905
Total assets	10,249	(720)	9,529	(110)	-	9,419	1,216	10,745

Financial liabilities subject to enforceable master netting arrangements and similar arrangements

	Liabilities subject to netting arrangements			Netting potential not recognized in the Balance Sheet				
31.3.2022	Gross liabilities before nettings	Nettings with gross assets	Liabilities recognized on Balance Sheet, net	Financial assets	Collateral pledged	Liabilities after consideration of netting potential	Liabilities not subject to enforceable netting arr- angements	Total liabilities recognized on balance sheet
Repurchase agreements	259	(577)	(318)	318	-	-	-	(318)
Derivatives	6,535	-	6,535	(346)	-	6,189	5,376	11,911
Total liabilities	6,794	(577)	6,217	(28)	-	6,189	5,376	11,593
31.12.2021								
Repurchase agreements	-	(720)	(720)	720	-	-	-	(720)
Derivatives	2,000	-	2,000	(830)	-	1,170	3,877	5,877
Total liabilities	2,000	(720)	1,280	(110)	-	1,170	3,877	5,157

Reverse repurchase agreements and repurchase agreements are recognized within the line items Financial instruments and Due to credit institutions and Central Bank respectively.

25. Investments in associates

	31.3.2022	31.12.2021
Carrying amount at the beginning of the year	668	891
Acquisitions / increased share capital	70	111
Disposals	(241)	(356)
Share of profit of associates and profit from sale	203	22
Investment in associates	700	668

The Group's interest in its principal associates

Bílafrágangur ehf., Hlídasmára 13, Kópavogur, Iceland	33.4%	-
Reiknistofa bankanna hf., Katrínartún 2, Reykjavík, Iceland	23.0%	23.0%
SER eignarhaldsfélag ehf., Borgartún 19, Reykjavík	35.3%	35.3%
Audkenni hf., Borgartún 31, Reykjavík, Iceland	-	25.4%

Arion Bank sold its entire shareholding in Audkenni hf. The sale generated a profit of ISK 150 million and is recognized in the Income Statement. In March Arion Bank invested in Bílafrágangur ehf. and holds a 33.4% shareholding.

Amounts are in ISK millions

26. Intangible assets

Intangible assets comprise the following categories: Goodwill, which arises on business combinations; Infrastructure, Customer relationships and related agreements which are identified during the acquisition of subsidiaries and related to the activities of the businesses being acquired; and Software, which is acquired (i.e. software licenses) and expenses of implementation.

Infrastructure, which is capitalized as an intangible asset, is related to the asset management operation and branding of the insurance operation. The business activity is based on years of developing expertise and systems, during which a valuable platform has been created for future growth. An impairment test is performed annually.

Customer relationships and related agreements are connected to business relationships and agreements which the Bank acquired in subsidiaries. The asset is based on the assumption that business relationships and agreements generate regular payments and earnings to the relevant business segments. The lifetime of these agreements is based on the experience of the Group and the industry. As a result, these agreements are assessed as having an identified useful lifetime.

Acquired software and internally developed software is capitalized on the basis of the cost of acquiring and bringing the software into service. Expenditure on internally developed software is recognized 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 when it can reliably measure the costs to complete the development. The capitalized costs of internally developed software include external expenses directly attributable to developing the software and salary and salary related expenses of implementation of core systems. Capitalized costs of software are amortized over its useful life. Computer software licenses and internally developed software recognized as intangible assets are amortized over their useful life, which is estimated to be 3-10 years.

Policies applied to the Group's intangible assets	Goodwill and infrastructure	Customer relationship and related agreements	Software
Useful lives	Undefined	Finite 6-15 years and undefined	Finite 3-10 years
Amortization method	Impairment test	Straight-line basis over 6-15 years and impairment test	Straight-line basis over 3-10 years
Internally generated or acquired	Acquired	Acquired	Acquired and internally generated

31.3.2022	Goodwill	Infra-structure	Customer relationship and related agreements	Software	Total
Balance at the beginning of the year	669	2,383	607	5,804	9,463
Additions	-	-	-	53	53
Amortization	-	-	(15)	(262)	(277)
Intangible assets	669	2,383	592	5,595	9,239

31.12.2021	Goodwill	Infra-structure	Customer relationship and related agreements	Software	Total
Balance at the beginning of the year	669	2,383	667	5,970	9,689
Additions	-	-	-	844	844
Additions, capitalized salaries	-	-	-	161	161
Amortization	-	-	(60)	(1,171)	(1,231)
Intangible assets	669	2,383	607	5,804	9,463

Goodwill related to the insurance operation is recognized among assets in the operating segments Corporate & Investment Banking and Retail Banking, see Note 5 (2021: recognized in the operating segment Vördur).

27. Tax assets and tax liabilities

	31.3.2022		31.12.2021	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	8,061	-	6,543
Deferred tax	754	19	2	559
Tax assets and tax liabilities	754	8,080	2	7,102

Amounts are in ISK millions

28. Assets and disposal groups held for sale and associated liabilities

Assets and disposal groups held for sale	31.3.2022	31.12.2022
Valitor hf.	11,171	12,294
Stakksberg ehf.	1,371	1,548
Sólbjarg ehf.	1,681	1,671
Disposal groups held for sale	14,223	15,513
Real estate	455	500
Other assets	28	34
Assets and disposal groups held for sale	14,706	16,047

Liabilities associated with disposal groups held for sale		
Valitor hf.	13,622	15,564
Sólbjarg ehf.	1,500	1,371
Liabilities associated with disposal groups held for sale	15,122	16,935

Real estates and other assets classified as assets held for sale are generally the result of foreclosures on companies and individuals.

Valitor hf.

Arion Bank's shareholding in the subsidiary Valitor hf. is 100%. In accordance with IFRS 5 Non-current assets and disposal groups held for sale, Valitor is classified as asset held for sale in these Consolidated Financial Statements.

On 1 July 2021 Arion Bank and Rapyd entered into a definitive agreement regarding the sale of Valitor hf. The transaction is subject to regulatory approval and the parties had agreed on a deadline for obtaining this approval of 1 May 2022. Should the sale not be finalized due to failure to obtain regulatory approval, the risk shall be borne by the buyer, valid for two years. As conditions in the agreement to acquire Valitor have not yet been met, the parties have agreed to extend the agreement until 1 June 2022. According to the original agreement the purchase price to be paid by Rapyd for Valitor is USD 100 million. Due to the delays in completing the transaction Rapyd has paid Arion Bank an additional USD 10 million. Additionally, Rapyd will pay Arion Bank 10% annualized interest on the original purchase price from 1 April 2022 and until closing. The estimated profit on the sale, minus costs, increases accordingly and is estimated at ISK 5 billion at the exchange rate at the end of March 2022. The sale agreement for Valitor hf. does not affect the Consolidated Financial Statements for the period, in accordance with IFRS.

	31.3.2022	31.12.2021
Loans to credit institutions	13,030	14,842
Loans to customers	1,840	1,885
Financial instruments	74	16
Intangible assets	4,144	4,261
Tax assets	403	407
Other assets	2,834	2,805
Assets	22,325	24,216
Elimination within Arion Bank Group	(11,154)	(11,922)
Valitor's contribution to the Group	11,171	12,294
Other liabilities	13,688	15,569
Liabilities	13,688	15,569
Elimination within Arion Bank Group	(66)	(5)
Valitor's contribution to the Group	13,622	15,564
Book value of Valitor	8,637	8,647

Sólbjarg ehf., a subsidiary of Eignabjarg ehf.

Sólbjarg ehf. is a holding company of the former TravelCo hf. tour operator group which included Terra Nova Sól ehf., Heimsferdir ehf. and TravelCo Nordic/Bravo Tours. In the first quarter of 2020 Sólbjarg completed the sale of Terra Nova Sól ehf. Sólbjarg ehf. completed the sale of its 59.4% share in the Danish operator Bravo Tours 1998 A/S in the fourth quarter of 2021.

A sales and purchase agreement was signed with Ferdaskrifstofa Íslands ehf. in December 2020 for the sale of all operations, brand, and domain of Heimsferdir ehf. The sale was subject to the approval of the Icelandic Competition Authorities which approved the sale with conditions 26 April 2022. The parties involved will work on concluding the conditions and the process in the second quarter of 2022. Sólbjarg will be a 27.5% shareholder in Ferdaskrifstofa Íslands ehf. The sale will have minor effects on the Consolidated Income Statement.

Amounts are in ISK millions

28. Assets and disposal groups held for sale and associated liabilities, continued

Stakksberg ehf., a subsidiary of Eignabjarg ehf.

In January 2018 United Silicon was declared bankrupt following severe technical issues at the plant which ended with the temporary suspension of operations. Following the bankruptcy of United Silicon in 2018, an agreement was reached between the liquidator of the estate and Arion Bank, under which the Bank acquired all the company's main assets. The assets of the silicon plant are currently under the supervision of Stakksberg ehf., which is owned by the Bank, via the subsidiary Eignabjarg ehf. After the assets of United Silicon were transferred to Stakksberg, the company has sought to reduce uncertainty over the recommissioning of the plant, by taking measures such as transferring the operating license to the company, obtaining a new power agreement for the company and undertaking engineering designs for the necessary improvements at the plant before it can be reopened.

Stakksberg submitted a new EIA for the plant during the year, and the Environment Agency of Iceland and the National Planning Agency have both submitted their opinions which support the continued consideration of the project. The Bank's objective is to investigate the possibility of selling Stakkberg's infrastructure on the basis of work which has been carried out for this purpose and also to consider the sale of infrastructure for other uses. The fundamental aim is to maximize the utilization of this infrastructure and also to find a buyer which sees opportunities and has the experience and expertise to continue to use this infrastructure in harmony with the local community. Therefore the Bank's holding in Stakksberg ehf. has been classified as a disposal group held for sale under IFRS 5.

In January 2022 a letter of intent was signed with a potential buyer for this asset and due diligence is in progress which is expected to be completed in the third quarter 2022.

29. Other assets

	31.3.2022	31.12.2021
Property and equipment	4,157	4,298
Right of use asset	927	823
Accounts receivable	5,638	5,104
Unsettled securities trading	31,168	5,113
Investment for life assurance policyholders where risk is held by policyholder	1,186	1,281
Sundry assets	3,628	3,282
Other assets	**46,704**	**19,901**

30. Other liabilities

	31.3.2022	31.12.2021
Accounts payable	973	818
Unsettled securities trading	4,639	1,259
Depositors' and Investors' Guarantee Fund	136	138
Technical provision	20,211	18,170
Technical provision for life assurance policyholders were investment risk is held by policyholder	1,186	1,281
Withholding tax	1,020	810
Bank levy	1,909	1,516
Accrued expenses	3,385	4,200
Prepaid income	1,611	1,476
Impairment of off-balance items	760	711
Lease liability	989	878
Sundry liabilities	7,763	5,894
Other liabilities	**44,582**	**37,151**

Technical provision	Technical provision	Reinsurers' share	Total 31.3.2022	Technical provision	Reinsurers' share	Total 31.12.2021
Claims reported and loss adjustment expenses	10,278	(114)	10,164	9,473	(110)	9,363
Claims incurred but not reported	2,081	(64)	2,017	2,021	(64)	1,957
Claims outstanding	12,359	(178)	12,181	11,494	(174)	11,320
Provision for unearned premiums	7,852	(22)	7,830	6,676	(12)	6,664
Own technical provision	20,211	(200)	20,011	18,170	(186)	17,984

Insurance claim consists of claims outstanding and provision for unearned premiums. Claims outstanding present unsettled claims incurred. Claims outstanding is the total of claims reported and actuarial estimation of claims incurred but not reported. Provision for unearned premiums presents the current insurance risk that will be conditional on future fiscal years.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

31. Borrowings

Currency, original nominal value	First issued	Maturity	Maturity type	Terms of interest	31.3.2022	31.12.2021
ARION CB 22, ISK 31,720 million	2015	2022	At maturity	Fixed, 6.50%	27,116	31,508
ARION CB 24 ISK 28,900 million	2019	2024	At maturity	Fixed, 6.00%	26,294	26,004
ARION CBI 25, ISK 37,940 million	2017	2025	At maturity	Fixed, CPI linked, 3.00%	44,435	43,341
ARION CBI 26 ISK 17,080 million	2019	2026	At maturity	Fixed, CPI linked, 2.00%	18,149	17,747
ARION CBI 29, ISK 27,200 million	2014	2029	At maturity	Fixed, CPI linked, 3.50%	33,649	29,902
ARION CBI 48, ISK 11,680 million	2018	2048	Amortizing	Fixed, CPI linked, 2.50%	11,033	11,017
ARION CB EUR 500 million *	2021	2026	At maturity	Fixed, EUR 0.05%	66,959	43,624
Statutory covered bonds					227,635	203,143
NOK 750 million	2019	2022	At maturity	Floating, NIBOR +1.82%	-	11,096
SEK 150 million	2019	2022	At maturity	Floating, 3 month STIBOR +1.33%	2,060	2,159
NOK 250 million	2017	2023	At maturity	Fixed, 3.02%	3,757	3,757
EUR 300 million *	2018	2023	At maturity	Fixed, 1.00%	39,386	41,491
EUR 300 million *	2020	2024	At maturity	Fixed, 0.625 %	41,752	44,021
NOK 250 million	2017	2027	At maturity	Fixed, 3.40%	3,770	3,766
EUR 300 million *	2021	2025	At maturity	Fixed, 0.375%	40,904	43,680
ARION 26 1222 GB, ISK 4,860 million .	2021	2026	At maturity	Fixed, 4.70%	4,742	3,524
ARION 24 1020 GB, ISK 6,020 million .	2022	2024	At maturity	Floating, REIBOR 3M +0.70%	6,020	-
Senior unsecured bonds					142,391	153,494
Borrowings					370,026	356,637

* The Group applies fair value hedge accounting to these bond issuances and uses certain foreign currency denominated interest rate swaps as hedging instruments, see Note 23.

The book value of listed bonds was ISK 370 billion at the end of the period (31.12.2021: ISK 357 billion). The market value of those bonds was ISK 376 billion (31.12.2021: ISK 367 billion). The Group repurchased own debts amounting to ISK 4 billion during the period with a net loss of ISK 35 million recognized in the Income Statement (2021: nil).

32. Subordinated liabilities

Currency, original nominal value	Issued	Maturity	First call date	Terms of interest	31.3.2022	31.12.2021
SEK 500 million	2018	2028	22 Nov '23	Floating, 3 month STIBOR +3.10% .	6,846	7,174
NOK 300 million	2019	2029	9 Jul '24	Floating, NIBOR +3.65%	4,432	4,461
SEK 225 million	2019	2029	20 Dec '24	Floating, 3 month STIBOR +3.70% .	3,084	3,232
ARION T2I 30 ISK 4,800 million	2019	2030	4 Jan '25	Fixed, CPI linked, 3.875%	5,398	5,337
ARION T2 30 ISK 880 million	2019	2030	4 Jan '25	Fixed, 6.75%	893	907
EUR 5 million	2019	2031	6 Mar '26	Fixed, 3.24%	706	752
Tier 2 subordinated liabilities					21,359	21,863
ARION AT1 USD 100 million *	2020	Perpetual	26 Mar '26	Fixed, 6.25%	12,315	13,225
Additional Tier 1 subordinated liabilities					12,315	13,225
Subordinated liabilities					33,674	35,088

* The Group applies fair value hedge accounting to these bond issuances and uses certain foreign currency denominated interest rate swaps as hedging instruments, see Note 23.

Additional Tier 1 and Tier 2 subordinated liabilities are eligible as regulatory capital under the Icelandic Financial Undertakings Act No. 161/2002.

33. Pledged assets

Pledged assets against liabilities	31.3.2022	31.12.2021
Assets, pledged as collateral against borrowings	324,430	287,449
Assets, pledged as collateral against loans from credit institutions and short positions	8,394	8,560
Pledged assets against liabilities	332,824	296,009
Thereof pledged assets against issued covered bonds held by the Bank	(44,874)	(43,182)
Pledged assets against liabilities on balance	287,950	252,827

The Group has pledged assets against borrowings, both issued covered bonds and other issued bonds and loan agreements. Pledged loans comprised mortgage loans to individuals. The book value of the borrowings was ISK 228 billion at period end (31.12.2021: ISK 203 billion).

Amounts are in ISK millions

33. Pledged assets, continued

The Group has pledged bonds against short term lending from the Central Bank of Iceland and against short positions, related to swap agreements, to hedge market risk of those assets.

The Group has issued covered bonds amounting to ISK 37 billion that can be used for repo borrowings at the Central Bank of Iceland or sold if market conditions are favorable (31.12.2021: ISK 36 billion). Pledged assets against those covered bonds are ISK 45 billion (31.12.2021: ISK 43 billion).

34. Equity

Share capital and share premium

According to the Bank's Articles of Association, total share capital amounts to ISK 1,660 million, with par value of ISK 1 per share. The holders of ordinary shares are entitled to receive dividends as approved by the AGM and are entitled to one vote per share at shareholders' meetings.

	Share capital	Own shares	Share premium	Total 31.3.2022	Share capital	Own shares	Share premium	Total 31.12.2021
Balance at the beginning of the year ...	1,660	(142)	21,166	22,684	1,730	(11)	49,612	51,331
Share capital reduction	-	-	-	-	(70)	70	-	-
Purchase of treasury shares	-	(23)	(4,246)	(4,269)	-	(201)	(28,446)	(28,647)
Share option vested	-	3	349	353	-	-	-	-
Incentive scheme	-	1	186	187	-	-	-	-
Balance at the end of the period	1,660	(161)	17,455	18,955	1,660	(142)	21,166	22,684
Own shares / issued share capital		9.68%				8.54%		

Based on a share buyback program authorized by the Financial Supervisory Authority of the Central Bank of Iceland (FSA) and which was launched in October 2021, Arion Bank bought back own shares for ISK 4,269 million during the first quarter of 2022. In March 2022 the programme was concluded. Buybacks in 2021 were based on authorisation from the FSA from 2020 and 2021.

At the AGM in March 2021 a motion was passed to reduce the Bank’s share capital by ISK 70 million at nominal value, totalling 70 million shares, by cancelling the company’s own shares. The reduction was effective 20 April 2021. The company’s share capital was reduced from ISK 1,730 million to ISK 1,660 million at nominal value, divided into an equal number of shares and with one vote attached to each share.

Share options

The following share option contracts are in existence at period end.	Number of shares (in ths.)	Exercise year	Exercise price (ISK)
Issued in 2021 (ISK 600,000)	11,278	2023-2026	95.5
Issued in 2022 (ISK 900,000)	8,832	2023-2026	181.7
Issued in 2022 (ISK 1,500,000)	3,674	2023-2026	181.7
	23,783		

Movements in share options during the period.	31.3.2022		31.12.2021	
	Number of shares (in ths.)	Weighted average contract rate	Number of shares (in ths.)	Weighted average contract rate
Outstanding at the beginning of the year	11,278	95.5	-	-
Granted during the period	12,505	181.7	11,278	95.5
Forfeited during the period	(371)	95.5	-	-
Exercised during the period	(3,292)	95.5	-	-
Outstanding at the end of the period	20,120	140.8	11,278	95.5

Warrants

The warrants reserve represents the consideration received for outstanding warrants. Arion Bank issued 54 million warrants on 9 March 2021. The purchase price of the warrants amounted to ISK 15.6 per warrant, resulting in a total sale price of ISK 842.4 million. The warrant issuing represents approximately 3% of the Bank's total share capital and the Bank is obliged to issue new shares when the warrants are exercised. Approximately 48.5% of the total issue was sold to around 150 employees of the Group and 51.5% to professional investors. The exercise period runs from Q4 2023 to Q3 2024.

Amounts are in ISK millions

Other information

35. Shareholders of Arion Bank

	4.4.2022	31.3.2022	31.12.2021
Lífeyrissjódur starfsmanna ríkisins	9.79%	8.91%	9.10%
Lífeyrissjódur verzlunarmanna	9.68%	8.81%	8.81%
Gildi lífeyrissjódur	9.65%	8.78%	8.83%
Stoðir hf.	5.20%	4.73%	4.73%
Birta lífeyrissjódur	3.46%	3.15%	3.16%
Stefnir rekstrarfélag hf.	3.26%	2.92%	2.88%
Frjálsi lífeyrissjódurinn	3.17%	2.88%	2.88%
Stapi lífeyrissjódur	2.98%	2.71%	2.71%
Brú lífeyrissjódur	2.97%	2.70%	2.35%
Hvalur hf.	2.44%	2.22%	2.22%
Kvika banki hf.	2.30%	2.08%	2.20%
Landsbankinn hf.	2.30%	2.10%	0.70%
Íslandsbanki hf.	2.12%	2.00%	2.22%
Festa lífeyrissjódur	1.54%	1.41%	1.23%
Almenni lífeyrissjódur	1.47%	1.33%	1.33%
MainFirst Bank AG	1.31%	1.19%	1.19%
Lífsverk Pension fund	1.07%	0.97%	1.07%
Kvika eignastýring	0.84%	0.76%	1.31%
Arion banki hf.	0.65%	9.68%	8.54%
Bóksal ehf.	0.00%	0.00%	1.26%
Other shareholders with less than 1% shareholding	33.80%	30.67%	31.27%
	100.0%	100.0%	100.0%

At the AGM in March 2022 a motion was passed to reduce the company's share capital by ISK 150 million at nominal value, by cancelling the company's own shares. The reduction took place 4 April 2022. Shareholdings changed accordingly.

At the end of the period the Bank's employees held a shareholding of 0.78% in Arion Bank (31.12.2021: 0.51%). The Board of Directors and the members of the Bank's Executive Committee shareholding is as follows:

	31.03.2022		31.12.2021	
	Warrants / options	Number of shares	Warrants	Number of shares
Steinunn Kristín Thórdardóttir, Director	-	12,000	-	12,000
Alternate directors of the Board	-	13,000	-	13,000
Benedikt Gíslason, CEO	991,623	2,306,283	992,953	2,300,000
Seven members of the Executive Committee (31.12.2021: seven)	4,481,669	1,677,057	4,482,724	1,633,076

Other members of the Board of Directors do not hold shares or warrants in Arion Bank.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

36. Legal matters

The Group has formal controls and policies in place for managing legal claims. Once professional advice has been obtained and the likelihood and amount of loss reasonably estimated, the Group makes adjustments, if appropriate, to account for any adverse effects the claims may have on its financial standing. Should the Group conclude that it is to the detriment of the Group's case to disclose such potential amounts, relating to the legal claims raised, it elects not to do so. At the end of the year, the Group had several unresolved legal claims.

Contingent liabilities

Legal proceedings regarding damages

In a lawsuit brought in June 2013, Kortaþjónustan hf. claimed damages from Arion Bank hf., Íslandsbanki hf., Landsbankinn hf., Borgun hf. and Valitor hf. in the amount of ISK 1.2 billion plus interest. The lawsuit is a result of damage Kortaþjónustan hf. contended the five parties caused the company due to violations of the Competition Act. In June 2017 the Supreme Court dismissed the case on procedural grounds. Since then, Kortaþjónustan hf. and subsequently its largest shareholder EC-Clear have tried to initiate five lawsuits against the same defendants which have all been dismissed, the last one in March 2021. In September 2021 EC-Clear has once again brought the same matter of dispute, claiming damages in the amount of ISK 922 million plus interest, against the same defendants. Should the defendants be found liable for damages, they would be jointly responsible. Therefore, the Bank has not made any provision.

Consumer Association's class-action lawsuit

The Consumer Association of Iceland sent a letter to Arion Bank, Íslandsbanki and Landsbankinn in April 2020 urging the banks to review its contractual terms on variable rate mortgages to individuals. The letter called for revised terms and compensation to borrowers who, according to the Association, have suffered damage. The Association's argument is that standard contractual terms lack proper legal grounds, as parameters for interest rate decisions lack transparency and predictability, thus causing a contractual imbalance to the detriment of the consumer.

Arion Bank undertook a review of its contractual terms and processes for interest rate decisions in light of the letter, concluding that no changes were required and that the Association's arguments are unfounded. A reasoned response was sent to the Consumer Association in September 2020. According to information published on the Consumer Association's website, all three banks have rejected the Association's arguments.

The Consumer Association in May 2021 published an article on its website calling for participants in a class action lawsuit. The intention is to commence court proceedings against Icelandic credit institutions to provide court precedents for loans with variable rates. Arion Bank has received information requests from a legal firm representing approximately 1200 individuals and one case has been filed against the Bank. The Bank has commissioned an outside opinion on its legal position and believes it likely that it will be acquitted of the claims and has therefore not made any provision.

Administrative fine from Central Bank of Iceland

On 7 July 2020 the Financial Supervisory Authority of the Central Bank of Iceland (FSA) published its decision to impose an administrative fine on Arion Bank of ISK 87.7 million due to the Bank's alleged breach of an obligation to disclose insider information in a timely manner. The decision has been published on FSA´s website. Arion Bank paid the fine but filed a claim with the district court of Reykjavik in October 2020 demanding that FSA's decision be annulled. A statement by FSA was submitted in the case in November 2020. Principal proceedings in the case were held in March 2022 and with a judgment in April 2022 FSA was acquitted. The Bank will appeal the ruling.

Other legal proceedings

Since 2008 Arion Bank has formally been a party to proceedings in Luxembourg, commenced against the Luxembourg company R Capital S.á r.l. and its beneficial owner, Mr. Umberto Ronsisvalle, for the collection of EUR 6 million plus interest. During this time, Kaupthing ehf. has been the beneficial owner of the claim, with Arion Bank's involvement limited to being the formal party to the proceedings while enjoying indemnity from Kaupthing. The reason for the setup is a decision by the Icelandic Financial Supervisory Authority in 2009 during the split of Kaupthing to the "new" and "old" bank. In 2019, a counterclaim was made against Arion Bank in the proceedings, for the net sum of EUR 24 million plus interest, with the Bank continuing to enjoy full indemnity from Kaupthing. In September 2021, Kaupthing and Arion Bank agreed that all rights and liabilities in the Luxembourg proceedings would be transferred to Arion Bank. The Bank is still held harmless for any liabilities associated with the claims and has therefore not made any provision.

The estate of TravelCo Nordic has filed a case against TravelCo hf. and the Bank in Denmark claiming payment in solidum in the amount of DKK 58.1 million plus interest. The merits and arguments against the Bank are vague. The bankruptcy estate alleges that the Bank, as owner of Heimsferdir ehf. and Terra Nova Sól ehf., contrived the sale of the companies to its subsidiary, Sólbjarg ehf., without real payment. The transaction the bankruptcy estate is referring to is in fact the legal and lawful enforcement of security (i.e. share pledges) by the Bank over the shares in Heimsferdir hf. and Terra Nova Sól ehf. following a default on a facilities agreement to TravelCo hf. as borrower. Following the enforcement, the Bank moved the companies to its holding company, Sólbjarg ehf., and the Bank remained the beneficial owner of the companies. The Bank believes it likely that it will be acquitted of the estate's claim and has therefore not made any provision.

37. Events after the reporting period

No event has arisen after the reporting period and up to the approval of these Condensed Consolidated Interim Financial Statements that require additional disclosures.

Notes to the Condensed Consolidated Interim Financial Statements

Off balance sheet information

38. Commitments

Financial guarantees, unused credit facilities and undrawn loan commitments	31.3.2022	31.12.2021
Financial guarantees	21,304	15,858
Unused overdrafts	57,371	63,108
Undrawn loan commitments	113,019	108,691
Financial guarantees, unused credit facilities and undrawn loan commitments	191,694	187,657

39. Assets under management and under custody

Assets under management	1,349,740	1,351,573
Assets under custody	1,104,285	1,148,203

Assets under management represent the total market value of the financial assets which the Group manages on behalf of its customers.

The Group, acting as custodian, is responsible for safeguarding a firm's or individual's financial assets, hold in safekeeping securities such as stocks, bonds and securities funds, arrange the settlement of trades and movements of securities, process corporate actions such as income on bonds and dividends on shares; and pricing on securities.

Related party

40. Related party

At the end of the period no shareholder was defined as related party with an influence over the Group (31.12.2021: none).

The Board of Directors of Arion Bank, key management personnel of the Bank and the Group's associates are defined as related parties, as are close family members of the individuals referred to above and legal entities controlled by them.

Transactions with related parties have been conducted on an arm's length basis. There have been no further guarantees provided or received for related party receivables or payables.

Balances with related parties

31.3.2022	Assets	Liabilities	Net balance
Board of Directors and key Management personnel	63	(906)	(843)
Associates and other related parties	338	(180)	158
Balances with related parties	401	(1,086)	(685)
31.12.2021			
Board of Directors and key Management personnel	139	(284)	(145)
Associates and other related parties	530	(311)	219
Balances with related parties	669	(595)	74

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Risk management disclosures

The Group faces various risks arising from its day to day operations Managing risk is a core activity within the Group. The key to effective risk management is a process of on-going identification of significant risk, quantification of risk exposure, actions to limit risk and constant monitoring of risk. This process of risk management and the ability to evaluate, manage and correctly price the risk encountered is critical to the Group's continuing profitability and this process enables the Group to ensure that the exposure to risk remains within acceptable levels.

Further information on risk management and capital adequacy is provided in the Annual Financial Statements for 2021 and in the Pillar 3 Risk Disclosures for 2021, available on the Bank's website, www.arionbanki.is.

41. Credit risk

Credit risk is the risk that the Group will incur a loss because its customers or counterparties fail to discharge their contractual obligations.

Credit risk arises anytime the Group commits its funds, resulting in capital or earnings being dependent on counterparty, issuer or borrower performance. Loans to customers are the largest source of credit risk. Credit risk is also inherent in other types of assets, such as loans to credit institutions, bonds, derivatives and off-balance sheet items such as commitments and guarantees.

Managing and analyzing the Group's loan portfolio is of utmost importance. Great emphasis is placed on the quality of the credit portfolio, by maintaining a strict credit process, by critically inspecting loan applications, by actively monitoring the credit portfolio and by identifying and reacting to possible problem loans at an early stage as well as by restructuring impaired credits.

The Group grants credit based on well informed lending decisions and seeks to build business relationships with customers that have good repayment capacity and are backed by strong collateral. The risk level of each credit is considered in the pricing.

Credit risk is managed and controlled by setting limits on the amount of risk the Group is willing to accept for individual counterparties and group of connected clients, and by monitoring exposures in relation to such limits. The Group seeks to limit its total credit risk through diversification of the loan portfolio across sectors and by limiting large exposures to groups of connected clients.

Exposure to credit risk

The following table shows the maximum exposure to credit risk for the components of the Statement of Financial Position before the effect of mitigation due to collateral agreements or other credit enhancements. The table also shows related collateral and credit enhancements. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty and the exposure type. The main types of collateral obtained are as follows:

- Real estate: Residential property, commercial real estate and land
- Cash and securities: Cash, treasury notes and bills, asset backed bonds, listed equity, and funds that consist of eligible securities
- Vessels: Ships with assigned fishing quota and other vessels
- Other collateral: Fixed and current assets including vehicles, equipment, inventory and trade receivables

The value of collateral is based on estimated market value. The valuation of real estate is based on market price, official valuation by Registers Iceland, or the opinion of internal or external specialists. The valuation of fishing vessels takes into account related fishing quotas. The quality of collateral is evaluated in the lending process with regards to specialization, location, age and condition and possibilities for reuse.

Collateral value is monitored and additional collateral requested in accordance with the underlying agreement. Collateral value is reviewed in line with the adequacy of the allowance for impairment losses. Collateral values are capped by the related exposure amount.

41. Credit risk, continued

Maximum exposure to credit risk and collateral held against different types of financial instruments subject to the impairment requirements of IFRS 9

		Collateral				
31.3.2022	Maximum exposure	Cash and securities	Real estate	Vessels	Other collateral	Total collateral
Cash and balances with Central Bank	64,395	-	-	-	-	-
Loans to credit institutions at amortized cost	33,838	-	-	-	-	-
Loans to customers at amortized cost	976,383	28,983	728,092	44,995	101,614	903,684
Individuals	*534,395*	*642*	*487,307*	*6*	*15,706*	*503,661*
Corporates	*441,988*	*28,341*	*240,785*	*44,989*	*85,908*	*400,023*
Real estate activities	*94,167*	*211*	*89,677*	*-*	*1,529*	*91,417*
Construction	*42,841*	*297*	*39,348*	*43*	*1,926*	*41,614*
Fishing industry	*77,601*	*1,948*	*13,185*	*43,294*	*16,759*	*75,186*
Information and communication technology	*23,609*	*865*	*1,198*	*-*	*10,179*	*12,242*
Wholesale and retail trade	*70,777*	*135*	*50,895*	*37*	*12,767*	*63,834*
Financial and insurance activities	*46,856*	*24,729*	*2,009*	*-*	*19,086*	*45,824*
Industry, energy and manufacturing	*35,055*	*16*	*21,385*	*-*	*12,484*	*33,885*
Transportation	*13,444*	*7*	*1,553*	*1,147*	*3,775*	*6,482*
Services	*19,189*	*120*	*9,681*	*461*	*6,603*	*16,865*
Public sector	*7,206*	*13*	*2,061*	*7*	*168*	*2,249*
Agriculture and forestry	*11,243*	*-*	*9,793*	*-*	*632*	*10,425*
Other assets with credit risk	39,408	-	-	-	-	-
Financial guarantees	21,304	2,024	6,223	30	4,634	12,911
Undrawn loan commitments and unused overdrafts	170,390	-	-	-	-	-
Fair value through OCI	83,428	-	-	-	-	-
Government bonds	*63,241*	-	-	-	-	-
Bonds issued by financial institutions and corporates	*20,187*	-	-	-	-	-
Balance at the end of the period	1,389,146	31,007	734,315	45,025	106,248	916,595
31.12.2021						
Cash and balances with Central Bank	69,057	-	-	-	-	-
Loans to credit institutions at amortized cost	28,156	-	-	-	-	-
Loans to customers at amortized cost	936,237	29,159	704,442	42,797	85,030	861,428
Individuals	*526,498*	*712*	*481,088*	*15*	*15,139*	*496,954*
Corporates	*409,739*	*28,447*	*223,354*	*42,782*	*69,891*	*364,474*
Real estate activities	*90,321*	*329*	*87,256*	*-*	*1,752*	*89,337*
Construction	*37,010*	*486*	*33,597*	*48*	*1,876*	*36,007*
Fishing industry	*78,094*	*1,967*	*12,850*	*40,999*	*21,056*	*76,872*
Information and communication technology	*16,736*	*939*	*1,219*	*-*	*1,684*	*3,842*
Wholesale and retail trade	*65,298*	*154*	*49,874*	*29*	*9,107*	*59,164*
Financial and insurance activities	*45,798*	*24,433*	*1,814*	*-*	*12,877*	*39,124*
Industry, energy and manufacturing	*27,919*	*7*	*15,206*	*-*	*11,040*	*26,253*
Transportation	*14,162*	*-*	*1,556*	*1,556*	*3,395*	*6,507*
Services	*17,269*	*119*	*8,559*	*143*	*6,235*	*15,056*
Public sector	*6,918*	*13*	*2,120*	*7*	*193*	*2,333*
Agriculture and forestry	*10,214*	*-*	*9,303*	*-*	*676*	*9,979*
Other assets with credit risk	12,721	-	-	-	-	-
Financial guarantees	15,858	1,184	5,618	41	3,888	10,731
Undrawn loan commitments and unused overdrafts	171,799	-	-	-	-	-
Fair value through OCI	133,825	-	-	-	-	-
Government bonds	*112,824*	-	-	-	-	-
Bonds issued by financial institutions and corporates	*21,001*	-	-	-	-	-
Balance at the end of the period	1,367,653	30,343	710,060	42,838	88,918	872,159

Amounts are in ISK millions

41. Credit risk, continued

LTV ratio for residential mortgage lending

The following table describes the loan to value (LTV) and impairment status of the Group's mortgage loan book to individuals. LTV is calculated as the ratio of the gross carrying amount of the loan to the value of the collateral without adjusting for possible costs of obtaining and selling the collateral.

	31.03.2022		31.12.2021	
	Gross carrying amount	Thereof credit impaired	Gross carrying amount	Thereof credit impaired
Less than 50%	137,725	1,170	137,392	1,194
50-70%	236,281	1,841	233,904	1,975
70-90%	91,138	1,064	88,276	1,112
90-100%	2,248	151	1,821	209
100-110%	785	33	753	50
More than 110%	1,700	45	1,716	-
Not classified	-	-	33	-
Balance at the end of the period	469,877	4,304	463,895	4,540

Collateral for financial assets in stage 3

At the end of the period, the gross carrying amount of assets in stage 3 was ISK 15,858 million (31.12.2021: ISK 17,703 million) with ISK 12,517 million in collateral (31.12.2021: ISK 14,421 million), thereof ISK 11,013 million in real estate (31.12.2021: 12,875 million).

Collateral repossessed

The Group did not take position of other assets during the period (31.12.2021: ISK 456 million). For assets are held for sale, see Note 27.

Large exposures

A large exposure is defined as an exposure to a group of financially related borrowers which is equal to or exceeds 10% of the Group's Tier 1 capital according to the Financial Undertakings Act No. 161/2002 and Regulation No. 233/2017 on Prudential Requirements. The definition changed on 28 June 2021 with the adoption of CRR II in Iceland, which specifies Tier 1 capital as benchmark instead of eligible capital. The legal maximum for individual large exposures is 25% of Tier 1 capital, net of eligible credit risk mitigation.

The Group had two large exposures at the end of the period. At year end 2021 the Group had one large exposure.

	31.03.2022		31.12.2021	
No.	Gross	Net	Gross	Net
1	11.7%	11.7%	<10%	<10%
2	11.2%	11.1%	11.5%	11.4%
Sum of large exposure gross and net > 10%	22.9%	22.8%	11.5%	11.4%

Credit quality

The Group uses internal credit ratings and external credit ratings, if available, to monitor credit risk. The Group's internal credit rating system rates customers through application of statistical models based on a variety of information that has been determined to be predictive of default. This includes demographic, behavioral, financial and economic data, coupled with qualitative expert judgment for large corporate exposures. Six exposure type models rate individuals' exposures – mortgages, consumer loans, auto loans, guarantees, loans to individuals for work purposes and other loans. The models are validated annually and recalibrated and updated with current data with the aim of maintaining their predictive power. Year-on-year changes in risk classification of loans may in part be due to model refinement. External ratings are primarily used for marketable securities and loans to credit institutions. For further information on the rating scales used, see Note 56.

The following tables show financial instruments subject to the impairment requirements of IFRS 9 broken down by rating scale, where risk class 5, DD, denotes the highest risk. Assets carried at fair value through profit and loss are not subject to the impairment requirements of IFRS 9. The tables below sum up the gross carrying amount of assets by rating class and impairment stage. The gross carrying amount net of loss allowance is the book value of the underlying assets. For off-balance sheet exposures, the nominal amount is shown. FVOCI stands for fair value through other comprehensive income.

Exposures that are 'Unrated' are typically due to newly formed entities, entities for which the Bank's rating models are not applicable or no external rating is available.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

41. Credit risk, continued

Credit quality profile for financial instruments subject to IFRS 9 impairment requirements

31.03.2022	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	64,395	33,838	83,439
Non-investment grade	-	-	-
Gross carrying amount	64,395	33,838	83,439
Loss allowance	-	-	(11)
Book value	64,395	33,838	83,428

Loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 - (Grades AAA to A-)	168,572	1,677	-	42	170,291
Risk class 1 - (Grades BBB+ to BBB-)	370,956	3	-	32	370,991
Risk class 2 - (Grades BB+ to BB-)	228,176	19,629	-	64	247,869
Risk class 3 to 4 - (Grades B+ to CCC-)	134,108	40,475	-	81	174,664
Risk class 5 - (DD)	-	-	15,671	187	15,858
Unrated	4,679	3	-	-	4,682
Gross carrying amount	906,491	61,787	15,671	406	984,355
Loss allowance	(1,676)	(1,708)	(4,588)	-	(7,972)
Book value	904,815	60,079	11,083	406	976,383
Loans to customers - Individuals					
Risk class 0 - (Grades AAA to A-)	113,734	-	-	42	113,776
Risk class 1 - (Grades BBB+ to BBB-)	284,955	3	-	32	284,990
Risk class 2 - (Grades BB+ to BB-)	93,624	7,326	-	64	101,014
Risk class 3 to 4 - (Grades B+ to CCC-)	21,878	8,319	-	81	30,278
Risk class 5 - (DD)	-	-	5,747	187	5,934
Unrated	271	2	-	-	273
Gross carrying amount	514,462	15,650	5,747	406	536,265
Loss allowance	(497)	(266)	(1,107)	-	(1,870)
Book value	513,965	15,384	4,640	406	534,395
Loans to customers - Companies and sovereign					
Risk class 0 - (Grades AAA to A-)	54,838	1,677	-	-	56,515
Risk class 1 - (Grades BBB+ to BBB-)	86,001	-	-	-	86,001
Risk class 2 - (Grades BB+ to BB-)	134,552	12,303	-	-	146,855
Risk class 3 to 4 - (Grades B+ to CCC-)	112,230	32,156	-	-	144,386
Risk class 5 - (DD)	-	-	9,924	-	9,924
Unrated	4,408	1	-	-	4,409
Gross carrying amount	392,029	46,137	9,924	-	448,090
Loss allowance	(1,179)	(1,442)	(3,481)	-	(6,102)
Book value	390,850	44,695	6,443	-	441,988
Loan commitments, guarantees and unused credit facilities					
Risk class 0 to 1 (Grades AAA to BBB-)	99,548	1,909	-	-	101,457
Risk class 2 to 4 (Grades BB+ to CCC-)	71,518	6,357	1,416	-	79,291
Unrated	10,945	1	-	-	10,946
Nominal	182,011	8,267	1,416	-	191,694
Loss allowance	(370)	(114)	(293)	-	(777)
Nominal less loss allowance	181,641	8,153	1,123	-	190,917

Amounts are in ISK millions

41. Credit risk, continued

31.12.2021	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	69,057	28,125	137,667
Non-investment grade	-	31	-
Gross carrying amount	69,057	28,156	137,667
Loss allowance	-	-	(13)
Book value	69,057	28,156	137,654

Loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 - (Grades AAA to A-)	163,670	3	-	41	163,714
Risk class 1 - (Grades BBB+ to BBB-)	348,912	-	-	12	348,924
Risk class 2 - (Grades BB+ to BB-)	218,228	21,582	-	105	239,915
Risk class 3 to 4 - (Grades B+ to CCC-)	128,930	43,034	-	35	171,999
Risk class 5 - (DD)	-	-	17,469	236	17,705
Unrated	1,188	392	-	-	1,580
Gross carrying amount	860,928	65,011	17,469	429	943,837
Loss allowance	(1,313)	(1,806)	(4,480)	(1)	(7,600)
Book value	859,615	63,205	12,989	428	936,237
Loans to customers - Individuals					
Risk class 0 - (Grades AAA to A-)	120,152	-	-	41	120,193
Risk class 1 - (Grades BBB+ to BBB-)	276,228	-	-	12	276,240
Risk class 2 - (Grades BB+ to BB-)	88,083	6,963	-	105	95,151
Risk class 3 to 4 - (Grades B+ to CCC-)	23,961	6,394	-	35	30,390
Risk class 5 - (DD)	-	-	5,947	236	6,183
Unrated	4	225	-	-	229
Gross carrying amount	508,428	13,582	5,947	429	528,386
Loss allowance	(490)	(246)	(1,151)	(1)	(1,888)
Book value	507,938	13,336	4,796	428	526,498
Loans to customers - Companies and sovereign					
Risk class 0 - (Grades AAA to A-)	43,518	3	-	-	43,521
Risk class 1 - (Grades BBB+ to BBB-)	72,684	-	-	-	72,684
Risk class 2 - (Grades BB+ to BB-)	130,145	14,619	-	-	144,764
Risk class 3 to 4 - (Grades B+ to CCC-)	104,969	36,640	-	-	141,609
Risk class 5 - (DD)	-	-	11,522	-	11,522
Unrated	1,184	167	-	-	1,351
Gross carrying amount	352,500	51,429	11,522	-	415,451
Loss allowance	(823)	(1,560)	(3,329)	-	(5,712)
Book value	351,677	49,869	8,193	-	409,739
Loan commitments, guarantees and unused credit facilities					
Risk class 0 to 1 - (Grades AAA to BBB-)	106,445	-	-	-	106,445
Risk class 2 to 4 - (Grades BB+ to CCC-)	65,119	5,479	1,614	-	72,212
Unrated	8,703	297	-	-	9,000
Nominal	180,267	5,776	1,614	-	187,657
Loss allowance	(293)	(91)	(344)	-	(728)
Nominal less loss allowance	179,974	5,685	1,270	-	186,929

Amounts are in ISK millions

41. Credit risk, continued

Sector split, gross carrying value and loss allowance for financial instruments subject to IFRS 9 impairment requirements

	Stage 1		Stage 2		Stage 3		
31.03.2022	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Book value
Loans to credit instit., securities & cash	181,672	(11)	-	-	-	-	181,661
Loans to individuals	514,462	(497)	15,869	(266)	5,934	(1,107)	534,395
Mortgage	*454,239*	*(129)*	*11,334*	*(107)*	*4,304*	*(224)*	*469,417*
Other	*60,223*	*(368)*	*4,535*	*(159)*	*1,630*	*(883)*	*64,978*
Loans to corporates and sovereign	392,029	(1,179)	46,137	(1,442)	9,924	(3,481)	441,988
Real estate activities	*84,852*	*(148)*	*7,819*	*(104)*	*2,108*	*(360)*	*94,167*
Construction	*40,319*	*(130)*	*2,391*	*(13)*	*290*	*(16)*	*42,841*
Fishing industry	*71,577*	*(92)*	*5,658*	*(74)*	*676*	*(144)*	*77,601*
Information and communication technology	*22,845*	*(42)*	*819*	*(53)*	*82*	*(42)*	*23,609*
Wholesale and retail trade	*55,334*	*(248)*	*14,341*	*(939)*	*3,445*	*(1,156)*	*70,777*
Financial and insurance activities	*38,899*	*(217)*	*7,943*	*(42)*	*719*	*(446)*	*46,856*
Industry, energy and manufacturing	*33,693*	*(62)*	*1,347*	*(9)*	*106*	*(20)*	*35,055*
Transportation	*12,003*	*(33)*	*1,327*	*(24)*	*913*	*(742)*	*13,444*
Services	*15,531*	*(85)*	*3,146*	*(168)*	*1,264*	*(499)*	*19,189*
Public Sector	*6,820*	*(30)*	*313*	*(7)*	*111*	*(1)*	*7,206*
Agriculture and forestry	*10,156*	*(92)*	*1,033*	*(9)*	*210*	*(55)*	*11,243*
Balance at the end of the year	1,088,163	(1,687)	62,006	(1,708)	15,858	(4,588)	1,158,044
31.12.2021							
Loans to credit instit., securities & cash	231,051	(13)	-	-	-	-	231,038
Loans to individuals	508,428	(490)	13,777	(246)	6,181	(1,152)	526,498
Mortgage	*450,305*	*(127)*	*9,055*	*(84)*	*4,536*	*(228)*	*463,457*
Other	*58,123*	*(363)*	*4,722*	*(162)*	*1,645*	*(924)*	*63,041*
Loans to corporates and sovereign	352,500	(823)	51,429	(1,560)	11,522	(3,329)	409,739
Real estate activities	*80,318*	*(160)*	*7,092*	*(45)*	*3,472*	*(356)*	*90,321*
Construction	*34,382*	*(49)*	*2,411*	*(24)*	*317*	*(27)*	*37,010*
Fishing industry	*69,632*	*(58)*	*8,193*	*(199)*	*653*	*(127)*	*78,094*
Information and communication technology	*15,949*	*(58)*	*792*	*(39)*	*128*	*(36)*	*16,736*
Wholesale and retail trade	*46,824*	*(162)*	*17,362*	*(1,032)*	*3,420*	*(1,114)*	*65,298*
Financial and insurance activities	*37,275*	*(135)*	*8,411*	*(45)*	*733*	*(441)*	*45,798*
Industry, energy and manufacturing	*25,937*	*(49)*	*1,900*	*(10)*	*170*	*(29)*	*27,919*
Transportation	*12,474*	*(32)*	*1,065*	*(2)*	*1,649*	*(992)*	*14,162*
Services	*14,125*	*(70)*	*2,796*	*(153)*	*721*	*(150)*	*17,269*
Public Sector	*6,499*	*(29)*	*343*	*(4)*	*110*	*(1)*	*6,918*
Agriculture and forestry	*9,085*	*(21)*	*1,064*	*(7)*	*149*	*(56)*	*10,214*
Balance at the end of the year	1,091,979	(1,326)	65,206	(1,806)	17,703	(4,481)	1,167,275

Amounts are in ISK millions

41. Credit risk, continued

The table below reconciles the opening and closing allowance balance for loans to customers and debt securities at amortized cost and FVOCI and loan commitments, guarantees and unused credit facilities by impairment stages. The reconciliation includes:

Transfers of financial assets between impairment stages

All transfers are presumed to occur before any corresponding remeasurement of the loss allowance.

Net remeasurement of loss allowance

Comprise the impact of changes in model inputs or assumptions, including changes in forward-looking macroeconomic conditions, partial repayments and additional draws on existing facilities, inflation, changes in the measurement following a transfer between stages, effects of foreign exchange rate changes, impairment of interest income due to impaired debt instruments and unwinding of the time value discount due to the passage of time.

New financial assets, originated or purchased

Include purchases and originations and reflect the allowance related to assets newly recognized during the year.

Derecognitions and maturities

Reflect the allowance related to assets derecognized during the year without a credit loss being incurred, including those assets that were derecognized following a modification of terms.

Write-offs

The amount after net remeasurements of loss allowance written off during the year.

31.03.2022

*Impairment loss allowance **	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(1,606)	(1,897)	(4,824)	(1)	(8,328)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(222)	123	99	-	-
Transfers to Stage 2 (lifetime ECL)	48	(81)	33	-	-
Transfers to Stage 3 (credit impaired financial assets)	8	29	(37)	-	-
Net remeasurement of loss allowance **	141	(111)	(372)	1	(341)
New financial assets, originated or purchased	(598)	(68)	(163)	-	(829)
Derecognitions and maturities	182	182	277	-	641
Write-offs ***	1	1	106	-	108
Impairment loss allowance ******	(2,046)	(1,822)	(4,881)	-	(8,749)
Impairment loss allowances for assets only carrying 12-month ECL	(11)	-	-	-	(11)
Total impairment loss allowance	(2,057)	(1,822)	(4,881)	-	(8,760)

* These amounts are a combination of all impairments, including an allowance for loan commitments and guarantees presented as a liability in these Consolidated Financial Statements.

** During the period the loss allowance balance for stage 3 loans was raised by ISK 114 million due to unwinding of interest income.

*** During the period an amount of ISK 97 million was written off but is still subject to enforcement activities subject to Icelandic law.

**** Loss allowance for all assets other than cash, bonds and loans to credit institutions.

Amounts are in ISK millions

41. Credit risk, continued

Impairment loss allowance for loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(1,313)	(1,806)	(4,480)	(1)	(7,600)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(214)	115	99	-	-
Transfers to Stage 2 (lifetime ECL)	45	(78)	33	-	-
Transfers to Stage 3 (credit impaired financial assets)	8	29	(37)	-	-
Net remeasurement of loss allowance	160	(102)	(376)	1	(317)
New financial assets, originated or purchased	(440)	(45)	(163)	-	(648)
Derecognitions and maturities	77	178	230	-	485
Write-offs	1	1	106	-	108
Total loss allowance for loans to customers	(1,676)	(1,708)	(4,588)	-	(7,972)
Impairment loss allowance for loans to customers - Individuals					
Balance at the beginning of the year	(492)	(246)	(1,151)	(1)	(1,890)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(143)	72	71	-	-
Transfers to Stage 2 (lifetime ECL)	22	(32)	10	-	-
Transfers to Stage 3 (credit impaired financial assets)	6	25	(31)	-	-
Net remeasurement of loss allowance	153	(94)	(92)	1	(32)
New financial assets, originated or purchased	(73)	(16)	(11)	-	(100)
Derecognitions and maturities	29	24	25	-	78
Write-offs	1	1	72	-	74
Total loss allowance for loans to individuals	(497)	(266)	(1,107)	-	(1,870)
Impairment loss allowance for loans to customers - Companies and sovereign					
Balance at the beginning of the year	(821)	(1,560)	(3,329)	-	(5,710)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(71)	43	28	-	-
Transfers to Stage 2 (lifetime ECL)	23	(46)	23	-	-
Transfers to Stage 3 (credit impaired financial assets)	2	4	(6)	-	-
Net remeasurement of loss allowance	7	(8)	(284)	-	(285)
New financial assets, originated or purchased	(367)	(29)	(152)	-	(548)
Derecognitions and maturities	48	154	205	-	407
Write-offs	-	-	34	-	34
Total loss allowance for loans to companies and sovereign	(1,179)	(1,442)	(3,481)	-	(6,102)
Impairment loss allowance for loan commitments, guarantees and unused credit facilities					
Balance at the beginning of the year	(293)	(91)	(344)	-	(728)
Transfers					
Transfers to 12-month ECL	(8)	8	-	-	-
Transfers to lifetime ECL	3	(3)	-	-	-
Transfers to credit impaired	-	-	-	-	-
Net remeasurement of loss allowance	(19)	(9)	4	-	(24)
New financial commitments originated	(158)	(23)	-	-	(181)
Derecognitions and maturities	105	4	47	-	156
Total loss allowance for loan commit., guarantees, unused facilities	(370)	(114)	(293)	-	(777)

Amounts are in ISK millions

41. Credit risk, continued

31.12.2021

*Impairment loss allowance **	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(2,083)	(3,882)	(6,995)	(84)	(13,044)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(1,741)	1,465	276	-	-
Transfers to Stage 2 (lifetime ECL)	202	(293)	92	(1)	-
Transfers to Stage 3 (credit impaired financial assets)	60	382	(442)	-	-
Net remeasurement of loss allowance **	3,137	243	(1,332)	-	2,048
New financial assets, originated or purchased	(1,969)	(374)	(327)	-	(2,670)
Derecognitions and maturities	782	552	1,525	(289)	2,570
Write-offs ***	6	10	2,379	373	2,768
Impairment loss allowance **	(1,606)	(1,897)	(4,824)	(1)	(8,328)
Impairment loss allowances for assets only carrying 12-month ECL	(13)	-	-	-	(13)
Total impairment loss allowance	(1,619)	(1,897)	(4,824)	(1)	(8,341)

* These amounts are a combination of all impairments, including an allowance for loan commitments and guarantees presented as a liability in these Condensed Consolidated Interim Financial Statements.

** During the period the loss allowance balance for stage 3 loans was raised by ISK 468 million due to unwinding of interest income.

*** During the period an amount of ISK 2,59 million was written off but is still subject to enforcement activities subject to Icelandic law.

**** Loss allowance for all assets other than cash, bonds and loans to credit institutions.

Impairment loss allowance for loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(1,844)	(3,305)	(6,824)	(84)	(12,057)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(1,585)	1,309	276	-	-
Transfers to Stage 2 (lifetime ECL)	190	(281)	92	(1)	-
Transfers to Stage 3 (credit impaired financial assets)	58	377	(435)	-	-
Net remeasurement of loss allowance	2,774	21	(1,164)	-	1,631
New financial assets, originated or purchased	(1,481)	(267)	(327)	-	(2,075)
Derecognitions and maturities	569	330	1,523	(289)	2,133
Write-offs	6	10	2,379	373	2,768
Total loss allowance for loans to customers	(1,313)	(1,806)	(4,480)	(1)	(7,600)
Impairment loss allowance for loans to customers - Individuals					
Balance at the beginning of the year	(807)	(395)	(1,189)	(84)	(2,475)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(614)	454	160	-	-
Transfers to Stage 2 (lifetime ECL)	112	(162)	51	(1)	-
Transfers to Stage 3 (credit impaired financial assets)	43	157	(200)	-	-
Net remeasurement of loss allowance	921	(333)	(472)	-	116
New financial assets, originated or purchased	(341)	(67)	(107)	-	(515)
Derecognitions and maturities	190	90	284	(289)	275
Write-offs	6	10	322	373	711
Total loss allowance for loans to individuals	(490)	(246)	(1,151)	(1)	(1,888)

Amounts are in ISK millions

41. Credit risk, continued

	Stage 1	Stage 2	Stage 3	POCI	Total
Impairment loss allowance for loans to customers - Companies and sovereign					
Balance at the beginning of the year	(1,037)	(2,910)	(5,635)	-	(9,582)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(971)	855	116	-	-
Transfers to Stage 2 (lifetime ECL)	78	(119)	41	-	-
Transfers to Stage 3 (credit impaired financial assets)	15	220	(235)	-	-
Net remeasurement of loss allowance	1,853	354	(692)	-	1,515
New financial assets, originated or purchased	(1,140)	(200)	(220)	-	(1,560)
Derecognitions and maturities	379	240	1,239	-	1,858
Write-offs	-	-	2,057	-	2,057
Total loss allowance for loans to companies and sovereign	(823)	(1,560)	(3,329)	-	(5,712)

	Stage 1	Stage 2	Stage 3	POCI	Total
Impairment loss allowance for loan commitments, guarantees and unused credit facilities					
Balance at the beginning of the year	(239)	(577)	(171)	-	(987)
Transfers					
Transfers to 12-month ECL	(156)	156	-	-	-
Transfers to lifetime ECL	12	(12)	-	-	-
Transfers to credit impaired	2	5	(7)	-	-
Net remeasurement of loss allowance	363	222	(168)	-	417
New financial commitments originated	(488)	(107)	-	-	(595)
Derecognitions and maturities	213	222	2	-	437
Total loss allowance for loan commit., guarantees, unused facilities	(293)	(91)	(344)	-	(728)

Macroeconomic forecast

The calculation of expected credit losses under IFRS 9 uses forward-looking information in the form of scenarios where the development of macro-economic variables is predicted. The expected credit loss is a probability-weighted average of the estimated forecasts over three scenarios: base case 65%, pessimistic 25% and optimistic 10% (31.12.2021: base case 60%, pessimistic 20% and optimistic 20%). The macroeconomic forecast and scenario probability weights is done by the Bank's Chief Economist and approved by the Bank's IFRS 9 committee. The following table shows values used for IFRS 9 impairment calculations.

	Base case		
	2022	2023	2024
Unemployment rate	4.8%	4.5%	4.1%
Housing prices	14.7%	5.5%	4.6%
Private consumption	3.5%	3.4%	3.1%
GDP	5.0%	2.9%	2.4%

	Optimistic			Pessimistic		
	2022	2023	2024	2022	2023	2024
Unemployment rate	3.8%	3.5%	3.2%	7.2%	6.2%	5.2%
Housing prices	17.0%	7.4%	5.1%	9.3%	2.2%	1.8%
Private consumption	4.8%	4.4%	3.6%	0.6%	1.5%	2.9%
GDP	6.6%	3.1%	3.6%	2.1%	0.7%	2.2%

Sensitivity analysis

Regarding macroeconomic outlook, see Note 3, Significant accounting estimates and judgements. The Group calculates loss for three different scenarios, optimistic, neutral and pessimistic and the loss allowance is the weighted average of the results. As a sensitivity analysis, it can be noted that the loss allowance in stage 1 and 2 for each of these scenarios separately is ISK 1.6 billion, ISK 3.1 billion and ISK 6.8 billion for the optimistic, base case and pessimistic scenarios, respectively. At year end 2021 the corresponding calcualated loss allowance was ISK 1.8 billion, ISK 3.3 billion and ISK 5.9 billion, respectively.

Amounts are in ISK millions

41. Credit risk, continued

Forbearance

The Group grants forbearance measures to facilities where the customer is facing temporary difficulties and needs measures which would not generally be available to customers. These forbearance measures include refinancing and renegotiations of loan terms, including loan extensions and adjustment of the payment schedule. After forbearance measures have been granted, the facility is classified as forborne for a period of at least 24 months. The forborne classification is not removed until the customer has demonstrated repayment capacity.

At the beginning of the Covid-19 public health crisis, the Group partook in widely available schemes to grant moratoria to its customers. These were not classified as forbearance in accordance with guidelines from EBA. These schemes have expired, and concessions granted to customers facing temporary difficulties due to the public health crisis are now classified as forbearance when appropriate according to the definition.

	Stage 1		Stage 2		Stage 3		Total	
31.03.2022	Gross carrying amount	Loss allowance	Gross carrying carrying	Loss allowance	Gross carrying carrying	Loss allowance	Gross carrying carrying	Loss allowance
Individuals	9,827	(18)	1,928	(32)	2,585	(435)	14,340	(485)
Companies	10,409	(59)	14,829	(1,188)	6,585	(2,584)	31,823	(3,831)
Tourism	5,299	(33)	13,014	(1,076)	5,008	(2,153)	23,321	(3,262)
Other than tourism	5,110	(26)	1,815	(112)	1,577	(431)	8,502	(569)
Total	20,236	(77)	16,757	(1,220)	9,170	(3,019)	46,163	(4,316)
31.12.2021								
Individuals	10,972	(20)	1,962	(28)	2,695	(445)	15,629	(493)
Companies	10,912	(54)	17,440	(1,353)	7,104	(2,526)	35,456	(3,933)
Tourism	5,495	(40)	15,710	(1,148)	5,155	(2,055)	26,360	(3,243)
Other than tourism	5,417	(14)	1,730	(205)	1,949	(471)	9,096	(690)
Total	21,884	(74)	19,402	(1,381)	9,799	(2,971)	51,085	(4,426)

Groups with special focus due to the Covid-19 pandemic

Three groups of customers have been identified as a focus for the assessment of the impact of the Covid-19 pandemic on the Group; i) Tourism; where there is a high probability of impact due to public health restrictions; ii) Customers which have had active Covid-19 related payment moratoria in the first quarter leading up to the reporting date; and iii) Recipients of loans through government sponsored loan schemes initiated as a consequence of the pandemic. The exposure to these groups is shown in the following table, broken down by industry sector. Also shown is the amount secured by real estate as this is the largest type of collateral for loans to customers. The same customer can be in more than one group.

31.03.2022	Tourism dependent	Covid-19 related payment moratoria	Recipient of govern-ment sponsored loans	All focus groups	Thereof secured by real estate
Individuals	4,126	78	160	4,362	3,958
Real estate and construction	10,538	-	1,271	11,188	10,964
Services	5,328	-	3,043	5,865	2,253
Transportation	7,713	-	84	7,720	397
Industry, energy and manufacturing	155	-	527	559	243
Wholesale and retail trades	40,371	415	18,078	41,156	36,748
Other sectors	1,361	-	1,025	2,385	1,267
Gross carrying amount	69,592	493	24,188	73,235	55,830
Loss allowance	(3,679)	(2)	(1,771)	(3,741)	
Book value	65,913	491	22,417	69,494	
31.12.2021					
Individuals	4,212	612	161	4,917	4,535
Real estate and construction	10,545	2,627	1,176	11,058	10,870
Services	5,838	33	2,315	6,353	2,251
Transportation	8,679	-	867	8,685	358
Industry, energy and manufacturing	152	550	536	1,119	826
Wholesale and retail trades	43,766	12,588	18,336	44,527	39,681
Other sectors	1,347	-	1,065	2,409	1,282
Gross carrying amount	74,539	16,410	24,456	79,068	59,803
Loss allowance	(3,614)	(955)	(1,675)	(3,683)	
Book value	70,925	15,455	22,781	75,385	

Book value of Covid-19 impacted loans was ISK 69,494 million or 7.1% of loans to customers (31.12.2021: ISK 75,385 million and 8.1%).

Amounts are in ISK millions

42. Market risk

Market risk is the current or prospective risk that changes in financial market prices and rates adversely affect the Group's earnings and equity position due to changes to the value and cash flows of its assets and liabilities.

Market risk arises from imbalances in the Group's balance sheet as well as in market making activities and position taking in bonds, equities, currencies, derivatives and other commitments which are marked to market.

The Group keeps close track of market risk and separates its exposures for the trading book and the banking book. Market risk in the trading book arises from market making activities and non-strategic derivatives positions arising from the Group's operations of meeting customers' investment and risk management needs. Market risk in the banking book arises from various mismatches in assets and liabilities in e.g. currencies, maturities and interest rates. Market risk in the trading book and in the banking book is managed separately.

Market risk allowance is set by the Board in the Bank's risk appetite and limit frameworks are in place for each trading desk. The Asset and Liability Committee (ALCO) is responsible for managing the Bank's overall market risk. Risk Management is responsible for measuring and monitoring market risk exposure, and reporting the exposure, usage and limit breaches.

The Group manages and limits market risk exposure in accordance with its risk appetite and strategic goals for net profit.

Interest rate risk

Interest rate risk arises from the possibility that changes in market rates adversely affect net interest income and fair value of interest-bearing instruments on the Group's balance sheet. The Group's operations are subject to interest rate risk due to mismatches in the fixing of interest rates between assets and liabilities, resulting in a repricing risk for the Group. The Group also faces interest basis risk between interest-bearing assets and interest-bearing liabilities due to different types of floating-rate indices in different currencies.

The Group's interest rate risk for foreign currencies is limited as foreign denominated assets predominantly have short fixing periods and the Group generally applies cash flow hedging for its foreign denominated fixed rate borrowings. For domestic rates, longer fixing periods are more common.

At the beginning of the Covid-19 pandemic, the Icelandic Central Bank lowered interest rates to historic lows which resulted in sharp increase in demand for non-indexed mortgages with floating rates in 2020 and first half of 2021. Inflation in Iceland, currently at 5.1%, has exceeded the Central Bank’s target of 2.5% since June 2020 and is expected to remain over the target until the first half of 2023. The Central Bank has responded by increasing interest rates by 125bps in 2021 with further increases expected. This has resulted in a sharp increase in demand for non-indexed fixed rate mortgages in recent months with corresponding increase in interest rate risk for nominal rates.

Interest rate risk in the banking book

The following table shows the Group's interest-bearing assets and liabilities by interest fixing periods. The figures for loans to customers and borrowings are shown on a fair value basis, see Note 23, and are therefore different from the amounts shown in these Consolidated Financial Statements. The fair value reflects the likelihood of prepayment. Defaulted loans are presented at book value, which is based on the value of the underlying collateral, and are therefore assumed to be independent of interest adjustment periods and placed in the 'Up to 3 months' category. The assets and liabilities of Valitor hf. are not included in the figures as they are classified as held for sale.

31.03.2022 *Assets*	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	61,053	-	-	-	-	61,053
Loans to credit institutions	35,868	-	-	-	-	35,868
Loans to customers	589,099	97,781	268,423	10,817	11,802	977,922
Financial instruments	17,040	41,162	41,942	5,590	288	106,022
Assets	703,060	138,943	310,365	16,407	12,090	1,180,865
Liabilities						
Due to credit institutions and Central Bank	4,270	-	-	-	-	4,270
Deposits	652,489	9,124	15,353	1,691	1,268	679,925
Borrowings	2,034	66,012	259,981	36,841	11,597	376,465
Subordinated liabilities	-	-	36,419	-	-	36,419
Liabilities	658,793	75,136	311,753	38,532	12,865	1,097,079
Derivatives and other off-balance sheet items (net position)	(188,668)	41,390	138,729	3,668	-	(4,881)
Net interest gap	(144,401)	105,197	137,341	(18,457)	(775)	78,905

Amounts are in ISK millions

42. Market risk, continued

31.12.2021 *Assets*	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	65,501	-	-	-	-	65,501
Loans to credit institutions	30,272	-	-	-	-	30,272
Loans to customers	578,253	107,607	235,275	4,920	11,124	937,179
Financial instruments	42,731	64,162	39,278	5,431	249	151,851
Assets	716,757	171,769	274,553	10,351	11,373	1,184,803
Liabilities						
Due to credit institutions and Central Bank	5,000	-	-	-	-	5,000
Deposits	655,476	-	-	-	-	655,476
Borrowings	11,308	34,217	275,315	34,665	11,965	367,470
Subordinated liabilities	-	-	35,860	-	-	35,860
Liabilities	671,784	34,217	311,175	34,665	11,965	1,063,806
Derivatives and other off-balance sheet items (net position)	(196,457)	(5)	193,205	3,766	-	509
Net interest gap	(151,484)	137,547	156,583	(20,548)	(592)	121,506

Sensitivity analysis of interest rate risk in the banking book

The following table shows the sensitivity of the Group's net present value (NPV) of interest-bearing assets and liabilities and variation of annual net interest income (NII), due to changes in interest rates by currencies. The variation is calculated on the basis of simultaneous parallel shifts upwards or downwards of yield curves. The choice of shifts is not an estimate of risk likelihood. Behavioral maturities are taken into account in the NPV calculations, including prepayment likelihood and expected behavior of non-maturing deposits. The change to NII is however primarily based on contractual interest rate adjustments where it is simplistically assumed that all rates are equally sensitive to the presumed change in market rates. Behavioral maturity assumptions are however applied for non-maturing deposits and a zero percentage floor is applied to krona deposit interest rates.

	31.03.2022		31.12.2021	
NPV change	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	(2,394)	2,296	(2,250)	2,418
ISK, Non index-linked	2,079	(2,319)	2,308	(2,322)
Foreign currencies	528	(772)	338	(461)
NII change				
ISK, CPI index-linked	(928)	72	(881)	85
ISK, Non index-linked	(2,187)	1,264	(3,808)	774
Foreign currencies	409	(409)	(12)	15

Sensitivity analysis of interest rate risk in the trading book

The following table shows the interest sensitivity of the Group's net positions in the trading book by currencies. Sensitivity is quantified as the net change in value when assuming a simultaneous parallel shift upwards and downwards of all yield curves by 100 basis points. The sensitivity does not relate to variation of annual net interest income and is not an estimate of risk. The calculations are based on duration and convexity in this table.

	31.03.2022		31.12.2021	
Currency	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	108	(99)	93	(85)
ISK, Non index-linked	29	(16)	(41)	43
Foreign currencies	140	(139)	74	(74)

Amounts are in ISK millions

42. Market risk, continued

Indexation risk

A significant part of the Group's balance sheet is linked to the Icelandic Consumer Price Index (CPI). For index-linked instruments, principal and interest payments are adjusted proportionally to the CPI. The Group is exposed to indexation risk as indexed assets exceed indexed liabilities. Financial instruments held for liquidity or market making purposes are assumed to be on demand.

Book value and maturity profile of indexed assets and liabilities

31.03.2022	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	6,987	44,851	174,953	226,791
Financial instruments	6,164	2,248	9,629	18,041
Off-balance sheet position	-	-	-	-
Assets, CPI index-linked	13,151	47,099	184,582	244,832
Liabilities, CPI index-linked				
Deposits	84,036	15,582	3,081	102,699
Borrowings	306	63,886	43,075	107,267
Subordinated liabilities	-	-	5,398	5,398
Other	1,231	216	1,324	2,771
Off-balance sheet position	1,249	3,297	-	4,546
Liabilities, CPI index-linked	86,822	82,981	52,878	222,681
Net on-balance sheet position	(72,422)	(32,585)	131,704	26,697
Net off-balance sheet position	(1,249)	(3,297)	-	(4,546)
CPI Balance	(73,671)	(35,882)	131,704	22,151
CPI Balance for prudential consolidation, excluding insurance operations *	(72,620)	(37,914)	122,475	11,939

31.12.2021	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	7,500	41,730	172,662	221,892
Financial instruments	5,753	2,541	7,549	15,843
Off-balance sheet position	-	-	-	-
Assets, CPI index-linked	13,253	44,271	180,211	237,735
Liabilities, CPI index-linked				
Deposits	84,902	9,296	3,036	97,234
Borrowings	297	62,355	39,355	102,007
Subordinated liabilities	-	-	5,337	5,337
Other	1,134	222	1,316	2,672
Off-balance sheet position	1,221	3,246	-	4,467
Liabilities, CPI indexed linked	87,554	75,119	49,044	211,717
Net on-balance sheet position	(73,080)	(27,602)	131,167	30,485
Net off-balance sheet position	(1,221)	(3,246)	-	(4,467)
CPI Balance	(74,301)	(30,848)	131,167	26,018
CPI Balance for prudential consolidation, excluding insurance operations *	(73,444)	(33,167)	124,030	17,419

* Consolidated situation as per EU Regulation No 575/2013 (CRR)

Amounts are in ISK millions

42. Market risk, continued

Currency risk

Currency risk is the risk of loss due to adverse movements in foreign exchange rates. The Group is exposed to currency risk through a currency mismatch between assets and liabilities. Net exposures per currency are monitored centrally in the Bank.

Breakdown of assets and liabilities by currency

31.03.2022

Financial assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	63,373	371	274	97	59	33	188	64,395
Loans to credit institutions	1,421	13,771	10,576	3,118	1,744	924	4,314	35,868
Loans to customers	803,878	101,967	49,340	493	17,850	850	2,005	976,383
Financial instruments	144,410	26,636	5,978	94	19	8,449	94	185,680
Other financial assets	12,088	27,133	70	89	26	-	2	39,408
Financial assets	1,025,170	169,878	66,238	3,891	19,698	10,256	6,603	1,301,734
Financial liabilities								
Due to credit inst. and Central Bank	4,100	100	3	9	47	-	11	4,270
Deposits	590,583	34,358	42,000	3,235	2,490	3,734	3,525	679,925
Financial liabilities at fair value	6,911	4,396	716	-	100	192	8	12,323
Other financial liabilities	8,129	1,065	3,342	292	975	81	248	14,132
Borrowings	171,438	189,001	-	-	-	7,527	2,060	370,026
Subordinated liabilities	6,291	706	12,316	-	-	4,432	9,929	33,674
Financial liabilities	787,452	229,626	58,377	3,536	3,612	15,966	15,781	1,114,350
Net on-balance sheet position	237,718	(59,748)	7,861	355	16,086	(5,710)	(9,178)	
Net off-balance sheet position	(43,723)	62,842	(15,271)	(1,991)	(16,538)	5,749	8,932	
Net position	193,995	3,094	(7,410)	(1,636)	(452)	39	(246)	
Non-financial assets								
Investment property	6,586	-	-	-	-	-	-	6,586
Investments in associates	700	-	-	-	-	-	-	700
Intangible assets	9,239	-	-	-	-	-	-	9,239
Tax assets	754	-	-	-	-	-	-	754
Assets and disposal groups held for sale	12,571	120	24	1,954	2	-	35	14,706
Other non financial assets	7,083	100	28	61	-	23	1	7,296
Non-financial assets	36,933	220	52	2,015	2	23	36	39,281
Non-financial liabilities and equity								
Tax liabilities	8,080	-	-	-	-	-	-	8,080
Liabilities associated with disposal groups held for sale	14,555	132	58	163	180	18	16	15,122
Other non-financial liabilities	30,339	71	21	-	3	-	16	30,450
Shareholders' equity	172,333	-	-	-	-	-	-	172,333
Non-controlling interest	680	-	-	-	-	-	-	680
Non-financial liabilities and equity	225,987	203	79	163	183	18	32	226,665
Management reporting of currency risk *	4,941	3,111	(7,437)	216	(633)	44	(242)	

* The net position of the currency risk is presented in accordance with IFRS. The management monitors currency risk with more assets and liabilities underlying as it is considered to be a more accurate measurement of the Group's currency exposure. The net position, as seen by the management, is the position used for managing the currency imbalance.

Amounts are in ISK millions

42. Market risk, continued

31.12.2021 *Financial assets*	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	67,690	608	280	154	75	34	216	69,057
Loans to credit institutions	523	8,145	7,499	6,820	3,647	1,313	2,325	30,272
Loans to customers	780,384	99,748	39,007	768	10,820	1,629	3,881	936,237
Financial instruments	133,340	53,847	18,657	216	9	19,553	35	225,657
Other financial assets	11,936	280	93	1	8	2	400	12,720
Financial assets	993,873	162,628	65,536	7,959	14,559	22,531	6,857	1,273,943
Financial liabilities								
Due to credit inst. and Central Bank	3,982	81	845	9	49	-	34	5,000
Deposits	573,316	26,542	37,278	2,559	10,529	3,030	2,222	655,476
Financial liabilities at fair value	4,463	991	86	135	97	89	16	5,877
Other financial liabilities	4,559	359	2,755	157	604	36	215	8,685
Borrowings	163,044	172,815	-	-	-	18,619	2,159	356,637
Subordinated liabilities	6,245	752	13,224	-	-	4,461	10,406	35,088
Financial liabilities	755,609	201,540	54,188	2,860	11,279	26,235	15,052	1,066,763
Net on-balance sheet position	238,264	(38,912)	11,348	5,099	3,280	(3,704)	(8,195)	
Net off-balance sheet position	(27,584)	40,030	(15,587)	(6,577)	(1,889)	3,703	7,904	
Net position	210,680	1,118	(4,239)	(1,478)	1,391	(1)	(291)	
Non-financial assets								
Investment property	6,560	-	-	-	-	-	-	6,560
Investments in associates	668	-	-	-	-	-	-	668
Intangible assets	9,463	-	-	-	-	-	-	9,463
Tax assets	2	-	-	-	-	-	-	2
Assets and disposal groups held for sale	13,975	78	25	1,903	3	1	62	16,047
Other non financial assets	6,915	124	35	78	-	26	3	7,181
Non-financial assets	37,583	202	60	1,981	3	27	65	39,921
Non-financial liabilities and equity								
Tax liabilities	7,102	-	-	-	-	-	-	7,102
Liabilities associated with disposal groups held for sale	16,136	129	50	174	304	77	65	16,935
Other non-financial liabilities	28,366	81	30	-	3	-	(14)	28,466
Shareholders' equity	193,925	-	-	-	-	-	-	193,925
Non-controlling interest	673	-	-	-	-	-	-	673
Non-financial liabilities and equity	246,202	210	80	174	307	77	51	247,101
Management reporting of currency risk *	2,061	1,110	(4,259)	329	1,087	(51)	(277)	

* The net position of the currency risk is presented in accordance with IFRS. The management monitors currency risk with more assets and liabilities underlying as it is considered to be a more accurate measurement of the Group's currency exposure. The net position, as seen by the management, is the position used for managing the currency imbalance.

Amounts are in ISK millions

42. Market risk, continued

Sensitivity analysis for currency risk

The table below indicates the currencies to which the Group had significant exposure at the end of the year. The analysis calculates the effect of a reasonably possible movement of the currency rate against the ISK, with all other variables held constant, on the Consolidated Income Statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). A negative amount in the table reflects a potential net reduction in the Consolidated Interim Income Statement or equity, while a positive amount reflects a net potential increase. An equivalent decrease in each of the below currencies against the ISK would have resulted in an equivalent but opposite impact (+10% denotes a depreciation of the ISK).

	31.03.2022		31.12.2021	
Currency	-10%	+10%	-10%	+10%
EUR	(311)	311	(111)	111
USD	744	(744)	426	(426)
GBP	(22)	22	(33)	33
DKK	63	(63)	(109)	109
NOK	(4)	4	5	(5)
Other	24	(24)	28	(28)

Equity risk

Equity risk is the risk that the fair value of equities decreases. For information on assets seized and held for sale and equity exposures, see Notes 28 and 22 respectively.

Sensitivity analysis for equity risk

The analysis below calculates the effect of a reasonable possible movement in equity prices that affect the Consolidated Financial Statements. A negative amount in the table reflects a potential net reduction in the Consolidated Income Statement or equity, while a positive amount reflects a potential net increase. Investments in associates are excluded. The result of value-at-risk calculations for the trading book are shown in the Group's Pillar 3 Risk Disclosures.

	31.03.2022		31.12.2021	
Equity	-10%	+10%	-10%	+10%
Trading book - listed	(608)	608	(266)	266
Banking book - listed	(543)	543	(414)	414
Banking book - unlisted	(626)	626	(662)	662

Derivatives

Derivatives are a part of the Group's customer product offering. The types of derivatives currently offered are forward contracts, swaps and options. Eligible underlying market factors are interest rates, foreign exchange rates, equities and commodities. Exposure limits, hedging requirements and collateral requirements are determined in accordance with the Group's risk appetite and monitored by Risk Management on a daily basis. The Group also uses derivatives to hedge market risk on its balance sheet. Note 23 provides a breakdown of the Group's derivative positions by type.

Amounts are in ISK millions

43. Liquidity and Funding risk

Liquidity risk is defined as the risk that the Group, though solvent, either does not have sufficient financial resources available to meet its liabilities when they fall due, or can secure them only at excessive cost. Liquidity risk arises from the inability to manage unplanned decreases or changes in funding sources.

A primary source of funding for the Group is deposits from individuals, businesses and financial undertakings. The Group's liquidity risk stems from the fact that the maturity of loans exceeds the maturity of deposits, of which 76% is on-demand.

Liquidity risk is one of the Group's most significant risk factors and a great deal of emphasis is placed on managing it. The Asset and Liability Committee (ALCO) is responsible for managing liquidity and funding risk within the risk appetite set by the Board of Directors. The Bank's Treasury manages liquidity positions on a day-to-day basis. Risk Management measures, monitors and reports the Bank's liquidity and funding risk on a daily basis.

The Group's strategy in relation to liquidity risk is to actively manage its liquidity positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions. The Group seeks to maintain a stable funding profile which supports its business strategy and liquidity profile, ensuring that the Group can withstand periods of market turbulence, without reliance on volatile funding or external support.

Maturity analysis of assets and liabilities

The maturity analysis is based on contractual cash flows. The amounts are not discounted and include future interest payments, but CPI-linked amounts do not include accrued indexation due to future inflation. The total amount for each item is higher than the corresponding amount on the Bank's balance sheet, since the amounts on the balance sheet are either at amortized cost and do not contain future interest payments, or at fair value where future cash flows have been discounted.

Contractual cash flows differ in many ways from expected cash flows. The difference is most significant for deposits on the liability side and bonds on the asset side. Deposits are always assumed to be withdrawn at the earliest possible date, despite the fact that a large part of the deposit base is considered to be stable funding where behavioral maturity considerably exceeds contractual maturity. Furthermore, although contractual cash flows are presented for bonds held by the Bank, a large portion of the bonds are a part of the Bank's liquidity buffer and are considered to be highly liquid and can be sold or pledged to the Central Bank of Iceland and thus converted into cash at very short notice.

Contractual cash flow of assets and liabilities

31.03.2022 *Financial assets*	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity	Total	Book value
Cash and balances with CB	25,191	32,609	6,694	-	-	-	64,494	64,395
Loans to credit institutions	25,896	7,958	2,084	-	-	-	35,938	35,868
Loans to customers	2,582	102,994	144,831	368,359	844,856	-	1,463,622	976,383
Financial instruments	19,006	15,780	36,187	41,911	16,416	63,957	193,257	185,680
Derivatives - assets leg	-	*69,023*	*8,030*	*7,466*	*636*	-	*85,155*	*80,074*
Derivatives - liabilities leg	-	*(67,118)*	*(7,195)*	*(6,195)*	*(520)*	-	*(81,028)*	*(77,381)*
Other financial instruments	*19,006*	*13,875*	*35,352*	*40,640*	*16,300*	*63,957*	*189,130*	*182,987*
Other financial assets	1,596	32,338	4,279	1,195	-	-	39,408	39,408
Financial assets	74,271	191,679	194,075	411,465	861,272	63,957	1,796,719	1,301,734
Financial liabilities								
Due to credit inst. and Central Bank	2,515	1,803	-	-	-	-	4,318	4,270
Deposits	519,430	132,801	9,585	15,859	3,199	-	680,874	679,925
Financial liabilities at fair value	-	5,799	713	6,825	118	-	13,455	12,323
Derivatives - assets leg	-	*(68,385)*	*(16,592)*	*(29,694)*	*(6,512)*	-	*(121,183)*	*(120,873)*
Derivatives - liabilities leg	-	*73,772*	*17,305*	*36,519*	*6,630*	-	*134,226*	*132,784*
Short position in bonds	-	*412*	-	-	-	-	*412*	*412*
Other financial liabilities	93	11,827	295	1,065	852	-	14,132	14,132
Borrowings	-	7,087	71,396	268,015	52,671	-	399,169	370,026
Subordinated liabilities	-	203	1,657	17,657	23,387	-	42,904	33,674
Financial liabilities	522,038	159,520	83,646	309,421	80,227	-	1,154,852	1,114,350
Net position for assets and liab.	(447,767)	32,159	110,429	102,044	781,045	63,957	641,867	187,384
Off-balance sheet items								
Financial guarantees	-	3,291	6,784	3,524	7,705	-	21,304	21,304
Unused overdraft	-	57,371	-	-	-	-	57,371	57,371
Undrawn loan commitments	-	67,050	10,106	35,863	-	-	113,019	113,019
Off-balance sheet items	-	127,712	16,890	39,387	7,705	-	191,694	191,694
Net contractual cash flow	(447,767)	(95,553)	93,539	62,657	773,340	63,957	450,173	(4,310)

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

43. Liquidity and Funding risk, continued

31.12.2021 *Financial assets*	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity	Total	Book value
Cash and balances with CB	25,975	36,547	6,633	-	-	-	69,155	69,057
Loans to credit institutions	25,663	2,509	51	2,123	-	-	30,346	30,272
Loans to customers	3,033	100,588	137,323	345,777	790,442	-	1,377,163	936,237
Financial instruments	16,091	39,164	60,412	46,502	14,898	56,857	233,924	225,657
Derivatives - assets leg	-	*33,562*	*10,841*	*35,105*	*1,100*	-	*80,608*	*74,952*
Derivatives - liabilities leg	-	*(32,614)*	*(10,779)*	*(31,674)*	*(985)*	-	*(76,052)*	*(72,047)*
Other financial instruments	*16,091*	*38,216*	*60,350*	*43,071*	*14,783*	*56,857*	*229,368*	*222,752*
Other financial assets	679	6,720	3,734	1,588	-	-	12,721	12,721
Financial assets	71,441	185,528	208,153	395,990	805,340	56,857	1,723,309	1,273,944
Financial liabilities								
Due to credit inst. and Central Bank	3,230	1,811	-	-	-	-	5,041	5,000
Deposits	499,362	63,407	80,999	9,557	3,152	-	656,477	655,476
Financial liabilities at fair value	-	3,943	537	2,644	4	-	7,128	5,877
Derivatives - assets leg	-	*(53,896)*	*(3,855)*	*(5,590)*	*(519)*	-	*(63,860)*	*(63,483)*
Derivatives - liabilities leg	-	*57,839*	*4,392*	*8,234*	*523*	-	*70,988*	*69,360*
Other financial liabilities	74	6,010	725	1,033	843	-	8,685	8,685
Borrowings	-	13,996	40,498	258,049	73,001	-	385,544	356,637
Subordinated liabilities	-	1,192	946	42,763	1	-	44,902	35,088
Financial liabilities	502,666	90,359	123,705	314,046	77,001	-	1,107,777	1,066,763
Net position for assets and liab.	(431,225)	95,169	84,448	81,944	728,339	56,857	615,532	207,181
Off-balance sheet items								
Financial guarantees	-	974	5,501	1,942	7,441	-	15,858	15,858
Unused overdraft	-	63,108	-	-	-	-	63,108	63,108
Undrawn loan commitments	-	62,529	23,636	22,410	116	-	108,691	108,691
Off-balance sheet items	-	126,611	29,137	24,352	7,557	-	187,657	187,657
Net contractual cash flow	(431,225)	(31,442)	55,311	57,592	720,782	56,857	427,875	19,524

Net Stable Funding Ratio

The Net Stable Funding Ratio (NSFR) measures the amount of available stable funding (ASF) with the Group against the required stable funding (RSF) as per the definition of the Central Bank of Iceland rules No. 750/2021. In general, RSF is determined by applying different weights to different asset classes depending on the level of liquidity. ASF however is calculated by applying weights to the Group's liabilities depending on maturity and stickiness. The NSFR in total shall exceed 100%.

The NSFR calculations are based solely on figures for the parent company. The Bank's subsidiaries have negligible impact on the funding ratio.

	31.3.2022	31.12.2021
Available stable funding	1,011,948	1,001,543
Required stable funding	904,105	827,953
Net stable funding ratio	112%	117%

Amounts are in ISK millions

43. Liquidity and Funding risk, continued

Liquidity coverage ratio

The Liquidity Coverage Ratio (LCR) is one of the standards introduced in the Basel III Accord. The LCR is the result of a stress test that is designed to ensure that banks have the necessary assets on hand to withstand short-term liquidity disruptions. More precisely, LCR represents the balance between highly liquid assets and the expected net cash outflow of the Group in the next 30 days under stressed conditions.

To qualify as highly liquid assets under the LCR rules, assets must be non-pledged, liquid and easily priced on the market, traded on an active market and not issued by the Group or related entities.

The Bank complies with the Central Bank of Iceland's liquidity rules No. 266/2017, which effectively adopt the liquidity rules of the EU Capital Requirements Regulation (CRR). The Bank is required to maintain a 100% minimum LCR ratio for both the aggregate position in all foreign currencies and all currencies. For LCR in ISK, the requirement is 40% in 2022 and 50% as of 2023.

The following table shows the breakdown for the Group's LCR calculations. The ratio is based on consolidated figures for the Bank and Valitor hf.

31.03.2021	ISK	Foreign currency	Total
Liquid assets level 1 *	92,728	33,810	126,538
Liquid assets level 2	16,506	-	16,506
Liquid assets	109,234	33,810	143,044
Deposits	115,946	34,872	150,818
Borrowings	1,688	2,347	4,035
Other cash outflows	10,134	4,465	14,599
Cash outflows	127,768	41,684	169,452
Short-term deposits with other banks **	1,948	25,331	27,279
Other cash inflows	30,680	38,292	68,972
Cash inflows	32,628	63,623	96,251
Liquidity coverage ratio (LCR) ***	115%	324%	195%

31.12.2021	ISK	Foreign currency	Total
Liquid assets level 1 *	96,563	83,777	180,340
Liquid assets level 2	16,406	-	16,406
Liquid assets	112,969	83,777	196,746
Deposits	107,698	34,682	142,380
Borrowings	433	55	488
Other cash outflows	10,157	6,882	17,039
Cash outflows	118,288	41,619	159,907
Short-term deposits with other banks **	2,287	25,246	27,533
Other cash inflows	32,799	2,575	35,374
Cash inflows	35,086	27,821	62,907
Liquidity coverage ratio (LCR) ***	136%	607%	203%

* Level 1 assets include the Group's cash and balances with the Central Bank, domestic bonds eligible as collateral at the Central Bank and foreign government bonds which receive 100% weight. Under Rules No. 266/2017 the Group's foreign covered bonds are also classified as Level 1 assets and receive 93% weight.

** Short-term deposits with other banks are defined as cash inflows in LCR calculations.

*** LCR is defined as: LCR = Weighted liquid assets / (weighted cash outflows - weighted cash inflows) where weighted cash inflows are capped at 75% of weighted cash outflows.

Amounts are in ISK millions

43. Liquidity and Funding risk, continued

Composition of liquid assets

The following table shows the composition of the Group's liquidity buffer.

31.03.2022	ISK	USD	EUR	Other	Total
Cash and balances with Central Bank	63,373	274	371	377	64,395
Short-term deposits with financial institutions	1,948	7,167	10,350	7,814	27,279
Domestic bonds eligible as collateral with Central Bank	48,856	-	-	-	48,856
Foreign government bonds	-	2,562	22,921	7,300	32,783
Liquidity reserve	114,177	10,003	33,642	15,491	173,313
31.12.2021					
Cash and balances with Central Bank	67,690	280	608	479	69,057
Short-term deposits with financial institutions	2,287	7,170	6,176	11,900	27,533
Domestic bonds eligible as collateral with Central Bank	48,178	-	-	-	48,178
Foreign government bonds	-	14,272	49,016	19,117	82,405
Liquidity reserve	118,155	21,722	55,800	31,496	227,173

LCR deposit categorization

As per the LCR methodology, the Group's deposit base is split into different categories depending on customer type. A second categorization is used where term deposits refer to deposits with residual maturity greater than 30 days. Deposits that can be withdrawn within 30 days are marked stable if the customer has a business relationship with the Group and the amount is covered by the Deposit Insurance Scheme. Other deposit funds are considered less stable. A weight is attributed to each category, representing the expected outflow under stressed conditions, i.e. the level of stickiness.

The table below shows the breakdown of the Group's deposit base according to the LCR categorization, with the associated weighted average of the stressed outflow weights.

LCR categorization - amounts and LCR outflow weights	Deposits maturing within 30 days					
31.03.2022	Less stable	Weight %	Stable	Weight %	Term deposits*	Total deposits
Individuals	90,442	11%	121,307	5%	96,585	308,334
Small and medium enterprises	93,335	11%	18,319	5%	11,440	123,094
Corporations	71,423	40%	3,105	20%	16,002	90,530
Sovereigns, central banks and PSE	36,211	40%	-	-	915	37,126
Pension funds	54,962	100%	-	-	13,944	68,906
Domestic financial entities	41,961	100%	-	-	12,925	54,886
Foreign financial entities	1,319	100%	-	-	-	1,319
Total	389,653		142,731		151,811	684,195
31.12.2021						
Individuals	89,425	11%	125,515	5%	91,170	306,110
Small and medium enterprises	84,557	11%	18,210	5%	9,122	111,889
Corporations	73,261	40%	2,797	20%	16,213	92,271
Sovereigns, central banks and PSE	31,041	40%	-	-	786	31,827
Pension funds	42,334	100%	-	-	13,448	55,782
Domestic financial entities	45,662	100%	-	-	15,641	61,303
Foreign financial entities	1,294	100%	-	-	-	1,294
Total	367,574		146,522		146,380	660,476

* Here term deposits refer to deposits with maturities greater than 30 days.

Amounts are in ISK millions

44. Capital management

Capital adequacy

The focus of capital management at the Group is to normalize the capital structure in the medium term and consequently maintain the Group's capitalization comfortably above regulatory requirements, including the Pillar 2 and combined capital buffer requirements.

The Group's capital ratios are calculated in accordance with the Icelandic Financial Undertakings Act No. 161/2002 and Regulation No. 233/2017 on prudential requirements with later changes. Iceland has adopted the EU Capital Requirements Directive and Regulation and the CRD V / CRR II amendments were adopted on 28 June 2021. The primary impact on capital adequacy was the expansion of the SME supporting factor, which resulted in an ISK 14 billion decrease in total risk-weighted exposure amount. Other changes are smaller. The Group applies the standardized approach to calculate capital requirements for credit risk, including counterparty credit risk, credit valuation adjustment, market risk and operational risk.

The Group's consolidated situation as stipulated in CRR is the Group's accounting consolidation excluding insurance subsidiaries, in particular Vördur.

Valitor hf. is classified as held for sale in these Consolidated Interim Financial Statements. For disclosure, assuming an authorized adjustment of Valitor's contribution to operational risk REA in accordance with Article 317 (4) of CRR, a sale at USD 110 million in accordance with the publicly disclosed definitive agreement with Rapyd would result in an increase in capital ratio (including interim profits) from 22.9% to 24.4%.

Own funds	31.03.2022	31.12.2021
Total equity	173,013	194,598
Unaudited interim net earnings	(5,812)	-
Non-controlling interest not eligible for inclusion in CET1 capital	(680)	(673)
Common Equity Tier 1 capital before regulatory adjustments	166,521	193,925
Intangible assets	(8,490)	(8,435)
Cash flow hedges	4,624	(197)
Additional value adjustments	(207)	(240)
Foreseeable dividend and buyback *	-	(26,773)
Adjustment under IFRS 9 transitional arrangements as amended	1,199	920
Common equity Tier 1 capital	163,647	159,200
Non-controlling interest eligible for inclusion in T1 capital	89	133
Additional Tier 1 capital	12,315	13,225
Tier 1 capital	176,051	172,558
Tier 2 instruments	21,359	21,863
Tier 2 instruments of financial sector entities (significant investments)	(1,089)	(1,056)
Tier 2 capital	20,270	20,807
Total own funds	196,321	193,365
Risk-weighted exposure amount (REA)		
Credit risk, loans	664,568	623,395
Credit risk, securities and other	72,948	69,553
Counterparty credit risk	7,505	7,761
Market risk due to currency imbalance	8,476	4,691
Market risk, other	18,925	8,958
Credit valuation adjustment	2,171	2,379
Operational risk	96,085	96,085
Total risk-weighted exposure amount	870,678	812,822
Capital ratios		
CET1 ratio	18.8%	19.6%
Tier 1 ratio	20.2%	21.2%
Capital adequacy ratio	22.5%	23.8%
Total own funds, including interim profit not eligible for inclusion	199,271	193,365
CET1 ratio, including interim profit not eligible for inclusion	19.1%	19.6%
Tier 1 ratio, including interim profit not eligible for inclusion	20.6%	21.2%
Capital adequacy ratio, including interim profit not eligible for inclusion	22.9%	23.8%

* On 31 March 2022, the interim profits are unaudited and are fully subtracted when calculating CET1 capital. Therefore, there is no further adjustment to CET1 needed to account for the Bank's dividend policy of paying out 50% of profits as dividend. On 31 December 2021, the foreseeable dividend and buyback was the aggregation of an expected dividend of ISK 22.5 billion and the remainder of the buyback program amounting to ISK 4.3 billion based on permission from the FSA from 7 October 2021.

Amounts are in ISK millions

44. Capital management, continued

The Bank has opted to make use of the transitional arrangements for IFRS 9 and Covid-19 in its capital adequacy calculations and this is reflected in the Group's capital ratios. The transitional arrangements increase the capital adequacy ratio by 0.1 percentage points.

Capital ratios of the parent company	31.03.2022	31.12.2021
CET1 ratio	19.4%	20.2%
Tier 1 ratio	20.8%	21.9%
Capital adequacy ratio	23.2%	24.4%

The following table outlines the implementation of the capital buffer requirements in accordance with the Icelandic Financial Undertakings Act No. 161/2002, as prescribed by the Financial Stability Council (FSC) and approved by the FSA. The FSC has announced that the countercyclical capital buffer will increase to 2% on 29 September 2022.

Capital buffer requirement, % of REA

Capital conservation buffer	2.5%
Capital buffer for systematically important institutions	2.0%
Systemic risk buffer *	3.0%
Countercyclical capital buffer *	-
Combined capital buffer requirement	7.5%

The Bank carries out an ongoing process, the Internal Capital Adequacy Assessment Process (ICAAP), with the aim to ensure that the Group has in place sufficient risk management processes and systems to identify, manage and measure the Group's total risk exposure. The ICAAP is aimed at identifying and measuring the Group's risk across all risk types and ensure that the Group has sufficient capital in accordance with its risk profile. The FSA supervises the Group, receives the Group's internal estimation on the capital adequacy and sets the Pillar 2R capital requirements for the Group as a whole following the Supervisory Review and Evaluation Process (SREP). The Group's own funds exceed the FSA's SREP requirements.

The Pillar 1 and Pillar 2R capital requirements may comprise 56.25% CET1 capital, 18.75% AT1 capital and 25% Tier 2 capital.

Capital requirement, % of REA

	CET1	Tier 1	Total
Pillar 1 capital requirement	4.5%	6.0%	8.0%
Pillar 2R capital requirement **	1.8%	2.4%	3.2%
Combined buffer requirement *	7.3%	7.3%	7.3%
Regulatory capital requirement	13.6%	15.7%	18.5%
Available capital	18.8%	20.2%	22.5%

* The Icelandic buffer value shown. In the combined buffer requirement, the effective countercyclical capital buffer is determined by calculating the weighted average of the corresponding buffer levels of each country, the weights being the total risk-weighted exposures for credit risk against counterparties residing in those countries. The systemic risk buffer only applies to domestic exposures and is calculated using the same weighting method.

** The SREP result based on the Group's Financial Statement at 31 December 2020. The Pillar 2 requirement is 3.2% of risk-weighted exposure amount based on the Group's prudential consolidation under CRR, which excludes Vördur.

Leverage ratio

The leverage ratio is seen as a complementary measure to the risk-based capital ratios. The ratio is calculated on the basis of the Group's consolidated situation as per the CRR, which excludes the Group's insurance subsidiaries. The minimum leverage ratio requirement is 3% as stated in the Icelandic Financial Undertakings Act No. 161/2002.

	31.03.2022	31.12.2021
On-balance sheet exposures	1,313,520	1,256,916
Derivative exposures	13,737	4,796
Securities financing transaction exposures	354	720
Off-balance sheet exposures	76,115	102,016
Total exposure	1,403,726	1,364,448
Tier 1 capital	176,051	172,558
Leverage ratio	12.5%	12.6%

Amounts are in ISK millions

44. Capital management, continued

Solvency II	31.03.2022	31.12.2021
Excess of assets over liabilities in accordance with Solvency II	9,726	9,090
Subordinated liabilities	1,069	1,069
Foreseeable dividends	-	-
Own funds	10,795	10,159
Solvency capital requirements (SCR)	7,293	6,902
SCR ratio	148.0%	147.2%

The solvency capital requirement for the subsidiary Vördur is calculated in accordance with the Icelandic Insurance Companies Act.

45. Operational risk

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

Each business unit within the Group is primarily responsible for taking and managing their own operational risk. Risk management is responsible for developing and maintaining tools for identifying, measuring, monitoring and reporting the Group's operational risk.

The Group uses the standardized approach for the calculation of capital requirements for operational risk.

47. Sustainability risk

Sustainability risk is defined as the risk that certain activities or practices compromise the Bank's assets or reputation or the ability of future generations or segments of society to meet their own needs. This can be due to negative effects on the environment, natural or cultural resources or social conditions. The Bank‘s Sustainability Committee is responsible for reviewing the Bank‘s performance in relation to its commitments and policies in relation to environmental, social and governance (ESG) factors and aligning the Bank‘s strategy and risk appetite with them.

The Green Financing Framework

The Bank's Green Financing Framework was published in 2021. Undir this framework the Bank can issue Green Financing Instruments, including covered bonds, bonds, loans, commercial paper, repurchase agreements and deposits. The use of proceeds from these instruments is restricted to the financing of eligible assets as defined in the Framework. Eligible assets are divided into several eligible categories with inclusion and exclusion criteria. The Framework furthermore details the processes for identifying eligible assets, for reporting on use of the framework and for external review. Before the introduction of this framework the Bank had a framework for green deposits but these frameworks have been merged.

Green Financing Instruments	31.03.2022	31.12.2021
Deposits	13,731	8,209
Borrowings	51,659	47,148
Book value	65,390	55,357

Identified eligible green assets by category		
Sustainable fishery and aquaculture	44,337	42,245
Clean transportation	2,927	2,255
Green buildings	57,632	55,881
Energy efficiency	5,143	-
Pollution prevention and control and wastewater management	5,136	5,591
Book value	115,175	105,972

Amounts are in ISK millions

Arion Bank Ltd.
Borgartun 19
105 Reykjavik
Iceland
Id.: 581008-0150