



Condensed Consolidated Interim Financial Statements

1 January - 31 March 2023

Unaudited



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Arion Bank in brief



31.03.2023



13.7%

Return on equity

- 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 Retail Banking



47.0%

Cost-to-core income

- Arion Bank plays an important role in the community through the financing of progressive and sustainable initiatives. Sustainability is a 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 supported by the Bank's app, which has been awarded the best banking app in Iceland six years in a row. 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

- The Bank places a strong emphasis on customer experience, both in digital and face-to-face services, and meeting the financial needs of its customers via a customized product offering and quality financial services which contribute to the success of customers and society as a whole



18.6%

CET1 ratio



Rating from S&P

Long term: BBB

Short term: A-2

Outlook: Stable

Rating from Moody's

Long term: Baa1

Deposit rating: A3

Outlook: Positive



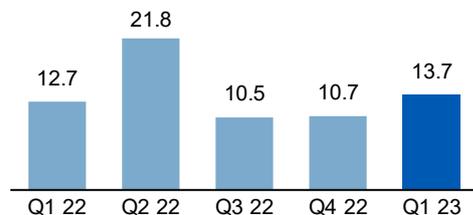
PRINCIPLES FOR RESPONSIBLE BANKING

Key figures (ISK m)

	Q1 2023	Q1 2022
Net earnings	6,291	5,818
ROE	13.7%	12.7%
Net interest margin	3.1%	3.1%
Cost to Core income ratio	47.0%	47.4%
Core operating income / REA	7.3%	6.9%

	31.03.2023	31.12.2022
Total assets	1,500,644	1,469,556
Loans to customers	1,114,128	1,084,757
Deposits	775,023	755,361
Borrowings	390,734	392,563
Total equity	179,932	188,331
Stage 3 gross	1.4%	1.2%
Leverage ratio	11.3%	11.8%
Number of employees	789	781
EUR/ISK	148.90	151.50

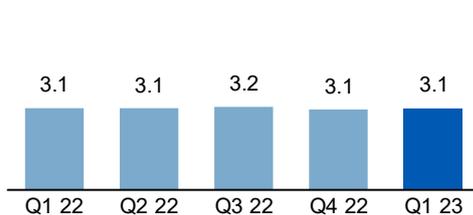
Return on equity (%)



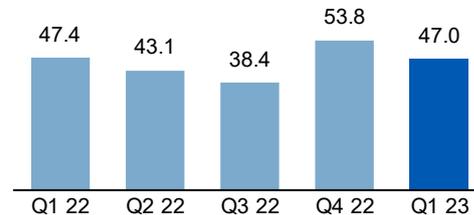
Net earnings (ISK billion)



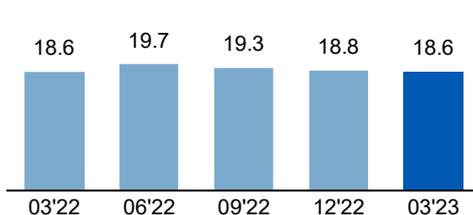
Net interest margin (%)



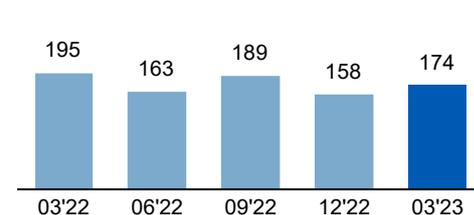
Cost-to-core income (%)



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 2023 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 6.3 billion for the first quarter of 2023 and return on equity was 13.7%. Earnings per share were ISK 4.32. Core income, defined as net interest income, net commission income and net insurance income, increased by 18.3%, compared with the previous year. There was strong growth in net interest income, compared with the previous year, mainly due to the increased base rate and 2.7% growth in the loan book from year-end 2022. Diversified fee generating operations support continued momentum in net fee and commission income. Net insurance income has been affected by challenging conditions and an unusually high volume of claims. Operating expenses increased between years, partly due to new wage agreements and inflation. The number of full-time employees has increased by 36 from the end of March 2022. The cost-to-core income ratio was 47.0%, compared with 47.4% in the first quarter of 2022.

Balance Sheet

The Bank's balance sheet grew by 2.1% from year-end 2022. Loans to customers increased by 2.7% from year-end. The increase was 4.5% in corporate lending and 1.1% in loans to individuals, mainly mortgages. Deposits increased by 2.6%. Total equity amounted to ISK 179,932 million at the end of March. The Group's capital ratio was 23.7% and the CET1 ratio 18.6%. The ratios are determined on the basis of the unaudited net earnings in the quarter, and take into account the deduction of 50% of net earnings as foreseeable dividend in line with the Bank's dividend policy, and ISK 0.9 billion of the outstanding buyback program that had been authorized by the Financial Supervisory Authority of the Central Bank of Iceland (FSA). The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 23.3% and the CET1 ratio was 18.3%. These ratios comfortably exceed the requirements made by the FSA and Icelandic law. The liquidity position was also strong at year-end and well above the regulatory minimum.

Arion Bank's medium-term financial targets compared with the operational results for the period

	Actuals Q1 2023	Arion Bank's medium-term financial targets
Return on equity	13.7%	Exceed 13%
Core operating income / REA	6.9%	Exceed 6.7%
Insurance premium growth (YoY)	11.6%	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 7.5% for 2022)
Cost-to-core income ratio	47.0%	Below 48%
CET1 ratio	270 bps	150-250 bps management buffer (~17.3 - 18.3% based on current capital requirements)
Dividend pay-out ratio	50%	Pay-out ratio of approximately 50% of net earnings attributable to shareholders through either dividends or buyback of the Bank's shares or a combination of both

Economic outlook

Despite the complicated global environment and somewhat familiar domestic economic challenges, the Icelandic economy remains in a relatively robust position. According to preliminary figures from Statistics Iceland, GDP increased by 6.4% between years in 2022, outperforming our main trading partners by a significant margin. Growth was mainly driven by a robust recovery in exports, led by the tourism industry, and record-breaking private consumption. The return of tourism, especially in the latter half of the year, left its mark on the country's foreign trade and played a significant part in curbing the current account deficit, which amounted to 2% of GDP in 2022.

The Icelandic economy started 2023 strongly, with indicators implying that domestic demand had exceeded expectations. The payment card turnover of Icelandic consumers increased by 8% between years in Q1, adjusted for inflation and exchange rate fluctuations, partly due to substantial wage increases in the private market. On average, the wage index is expected to increase by 10% in 2023, fuelling concerns over wage-price spiral. The labour market is currently very tight, with 3.6% registered unemployment and 40% of firms reporting staffing shortages. These conditions are conducive to supporting continued private consumption growth. In addition, the saving ratio is still well above its pre-pandemic average, which means that households can maintain a higher level of spending than most analysts had previously expected. Overall, household consumption is, and will most likely continue to be, one of the main driving forces of economic growth, although high inflation and rising interest rates might put a spanner in the works.

The other pillar of growth is the tourism industry, which is well on its way to reaching previous heights. Tourist arrivals are expected to reach 2.2 million in 2023, a 30% increase between years. With tourism forging ahead and private consumption remaining strong, the Icelandic economy is set for strong growth in 2023, with the latest forecasts expecting growth to be in the range of 3-4%. Nevertheless, the economic outlook remains uncertain, with financial institutions facing difficulties in the international markets and a rocky road to recovery. Quelling inflation has also proven to be difficult, especially in Iceland where inflation passed 10% in February despite 150 bps rate hikes in Q1. The housing market is rapidly cooling, but domestic inflationary pressures remain persistent and import prices continue to rise. Thus, further actions by the Central Bank are likely.

Endorsement and statement by the Board of Directors and the CEO



Outlook for the Bank

Arion Bank's operating performance in the first quarter of 2023 is robust, building on the positive momentum of previous years. The diversified pillars of the business continue to complement each other and support the Group's performance through the evolving external environment. With the rapid changes in the external environment over the past years it is clear that some areas of the Bank's business are impacted more than others, and again the relative stability of the operating performance demonstrates the importance of the diversification of our business model.

The recent events involving Silicon Valley Bank and Credit Suisse are reminders of the importance of long-term strategy and risk management combined with a diversified and agile business model. These aspects have all been core to Arion Bank's strategy and will continue to underpin its long-term performance through the cycle.

While the Icelandic economy has demonstrated its resilience through recent rapid changes to the inflationary and rate environment, it should be expected that over time some of our clients will be impacted by these changes. Arion Bank is in a strong position to support our clients through this period with varied and proven products and services and a long-term strategic perspective. Loan provisioning has also continued to reflect the evolving external environment where IFRS 9 model assumptions scenarios again deteriorated in the quarter, again reflecting a conservative forward perspective.

Funding and liquidity

In terms of funding and liquidity management the Group's liquidity position remains strong. The Bank's liquidity position was above the required minimum, and the liquidity ratio at the end of March 2023 was 174%, with the minimum requirement being 100%.

The Bank issued two private placements, NOK 200m and SEK 300m, despite turbulent market conditions in the first quarter.

Arion Bank continued to issue covered bonds in the domestic market. Total issuance was ISK 32.9 billion (of which ISK 21.6 billion was for the Bank's own account) in the first three months of 2023.

Capital adequacy and dividends

Arion Bank's dividend policy states that the Bank aims to pay 50% of net earnings in dividends and that additional dividend 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 in the medium term to maintain capital adequacy ratios 150-250bps above total regulatory requirements. In the near term however considering more volatile external industry landscape following recent events in the banking sector in Europe and the US as well as the rapid change in global and domestic interest rate environment the Bank will manage capital prudently and maintain a capital buffer above the medium term target.

In March 2023, the Bank paid a dividend of ISK 8.5 per share, approximately ISK 12.5 billion, as authorized by the Annual General Meeting. The Board of Directors has the authority to propose that the Bank pay dividends or other disbursements of equity and may convene a special shareholders' meeting later in the year to propose a payment. The Board is authorized to purchase up to 10% of the Bank's issued share capital.

Arion Bank's capital position is 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 faces challenging economic conditions owing to a number of factors including geopolitical tensions, continually rising interest rates, and high inflation.

The Group's capital adequacy ratio on 31 March 2023 was 23.7% and the CET1 ratio was 18.6%, when the unaudited interim net earnings for the first quarter of 2023 are included. The ratios account for a deduction due to foreseeable dividend payments that represent 50% of net earnings, in line with the Bank's dividend policy. This compares to a regulatory capital requirement of 20.8%, including the combined buffer requirement.

Having temporarily vacated the 2% countercyclical capital buffer in March 2020, the Central Bank of Iceland reinstated the buffer at the same level, effective from 29 September 2022. In March 2023 the Central Bank announced that it would increase the countercyclical buffer to 2.5%, effective from 15 March 2024. Other things being equal, this will increase Arion Bank's total capital requirement by the corresponding percentage.

The Bank's REA increased by ISK 23 billion in the first quarter of 2023. This was driven primarily by an increase of ISK 23.2 billion in the loan portfolio REA, offset by an ISK 3.1 billion decrease in the REA arising from other credit risk. REA changes for other risk factors were less material.

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 decided 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. On 29 September, the Resolution Authority issued Arion Bank's MREL requirement based on the financial position at year-end 2021. The requirement as a percentage of REA is 23.0%. The Bank is in full compliance with this requirement.

Endorsement and statement by the Board of Directors and the CEO



Group ownership

At the end of March 2023 Gildi lífeyrissjóður was the largest shareholder in Arion Bank with a shareholding of 9.60%. Arion Bank held 3.84% of its own shares at the end of March, see Note 36. The number of shareholders was 11,970 at the end of March, compared with 12,059 at the beginning of the year. Further information on Arion Bank's shareholders can be found in Note 36. At the AGM in March 2023 a motion was passed to reduce the company's share capital by ISK 50 million at nominal value, by cancelling the company's own shares. The reduction took place on 25 April 2023.

Governance

At the Bank's AGM on 15 March 2023, six members were elected to serve on the Board of Directors until the next AGM, three women and three men. Additionally, two Alternate Directors (one woman and one man) were elected. All Directors and Alternates are independent of Arion Bank, its management and major shareholders. The Board's composition as regards gender representation complies with statutory requirements, which stipulate that companies employing more than 50 people must ensure that the gender ratio of the board of directors and alternate board is no less than 40%.

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 2023 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 2023 and its financial position as at 31 March 2023. 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 2023 and confirm them by means of their signatures.

Reykjavík, 4 May 2023

Board of Directors

Brynjólfur Bjarnason, Chairman
Paul Richard Horner, Vice Chairman
Gunnar Sturluson
Kristín Pétursdóttir
Liv Fiksdahl
Steinunn Kristín Thórdardóttir

Chief Executive Officer

Benedikt Gíslason



Consolidated Interim Income Statement

	Notes	2023 1.1.-31.3.	2022 1.1.-31.3.
Interest income		29,233	17,329
Interest expense		(18,218)	(7,801)
Net interest income	6	11,015	9,528
Fee and commission income		5,286	4,068
Fee and commission expense		(933)	(516)
Net fee and commission income	7	4,353	3,552
Net insurance income	8	118	5
Net financial income	9	839	991
Share of profit of associates	25	(17)	203
Other operating income	10	36	235
Other net operating income		976	1,434
Operating income		16,344	14,514
Salaries and related expenses	11	(4,099)	(3,540)
Other operating expenses	12	(3,176)	(2,661)
Operating expenses		(7,275)	(6,201)
Bank levy	13	(449)	(393)
Net impairment	14	(52)	(495)
Earnings before income tax		8,568	7,425
Income tax expense	15	(2,287)	(1,703)
Net earnings from continuing operations		6,281	5,722
Discontinued operations held for sale, net of income tax	16	10	96
Net earnings		6,291	5,818
Attributable to			
Shareholders of Arion Bank hf.		6,284	5,812
Non-controlling interest		7	6
Net earnings		6,291	5,818
Earnings per share			
Basic earnings per share attributable to the shareholders of Arion Bank (ISK)	17	4.32	3.67
Diluted earnings per share attributable to the shareholders of Arion Bank (ISK)		4.10	3.50

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



Consolidated Interim Statement of Comprehensive Income

	Notes	2023 1.1.-31.3.	2022 1.1.-31.3.
Net earnings		6,291	5,818
Net change in fair value of financial assets carried at fair value through OCI, net of tax		113	(1,136)
Net realized gain on financial assets carried at FV through OCI, net of tax, and reclassification from OCI equity reserve, transferred to the Income Statement	9	(118)	21
Changes to reserve for financial instruments at fair value through OCI		(5)	(1,115)
Exchange difference on translating foreign subsidiaries		-	(81)
Other comprehensive loss that is or may be reclassified subsequently to the Income Statement		(5)	(1,196)
Total comprehensive income		6,286	4,622
Attributable to			
Shareholders of Arion Bank		6,279	4,616
Non-controlling interest		7	6
Total comprehensive income		6,286	4,622

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



Consolidated Interim Statement of Financial Position

	Notes	31.3.2023	31.12.2022
Assets			
Cash and balances with Central Bank	18	80,272	114,118
Loans to credit institutions	19	62,899	45,501
Loans to customers	20	1,114,128	1,084,757
Financial instruments	21-23	204,996	193,329
Investment property	23	7,875	7,862
Investments in associates	25	770	787
Intangible assets	26	8,575	8,783
Tax assets	27	332	135
Assets and disposal groups held for sale	28	61	61
Other assets	29	20,736	14,223
Total Assets		1,500,644	1,469,556
Liabilities			
Due to credit institutions and Central Bank	22	24,188	11,697
Deposits	22	775,023	755,361
Financial liabilities at fair value	22	20,692	20,997
Tax liabilities	27	10,840	10,303
Other liabilities	30	52,554	42,973
Borrowings	22,31	390,734	392,563
Subordinated liabilities	22,32	46,681	47,331
Total Liabilities		1,320,712	1,281,225
Equity			
Share capital and share premium	35	11,406	13,372
Other reserves		10,826	10,672
Retained earnings		157,044	163,638
Total Shareholders' Equity		179,276	187,682
Non-controlling interest		656	649
Total Equity		179,932	188,331
Total Liabilities and Equity		1,500,644	1,469,556

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



Consolidated Interim Statement of Changes in Equity

	Restricted reserves											Total share- holders' equity	Non- cont- rolling interest	Total equity
	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			
Equity 1 January 2023	1,466	11,906	339	828	6,308	1,941	1,002	(1,383)	1,637	-	163,638	187,682	649	188,331
Impact of adopting IFRS 17 1 Jan. ...											(375)	(375)		(375)
Restated opening balance	<u>1,466</u>	<u>11,906</u>	<u>339</u>	<u>828</u>	<u>6,308</u>	<u>1,941</u>	<u>1,002</u>	<u>(1,383)</u>	<u>1,637</u>	<u>-</u>	<u>163,263</u>	187,307	649	187,956
Net earnings											6,284	6,284	7	6,291
Net change in fair value								113				113		113
Net realized profit transf. to P/L and recl. from OCI equity reserve ..								(118)				(118)		(118)
Total comprehensive income	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(5)</u>	<u>-</u>	<u>-</u>	<u>6,284</u>	6,279	7	6,286
<i>Transactions with owners</i>														
Dividend paid											(12,357)	(12,357)		(12,357)
Purchase of treasury shares	(16)	(2,442)										(2,458)		(2,458)
Share option charge			59									59		59
Share option vested	1	295	(45)									251		251
Share option forfeited			(83)								83	-		-
Incentive scheme	1	194										195		195
Changes in reserves					437	(179)	(31)				(227)	-		-
Equity 31 March 2023	<u>1,452</u>	<u>9,955</u>	<u>270</u>	<u>828</u>	<u>6,745</u>	<u>1,762</u>	<u>971</u>	<u>(1,387)</u>	<u>1,637</u>	<u>-</u>	<u>157,044</u>	179,276	656	179,932

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



Consolidated Interim Statement of Changes in Equity

	Restricted reserves											Total share- holders' equity	Non- cont- rolling interest	Total equity
	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			
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)
Net realized 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
<i>Transactions with owners</i>														
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	<u>1,499</u>	<u>17,455</u>	<u>110</u>	<u>828</u>	<u>7,564</u>	<u>2,856</u>	<u>1,093</u>	<u>(3,052)</u>	<u>1,637</u>	<u>595</u>	<u>141,748</u>	<u>172,333</u>	<u>680</u>	<u>173,013</u>

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



Consolidated Interim Statement of Cash flows

	2023	2022
	1.1.-31.3.	1.1.-31.3.
Operating activities		
Net earnings	6,291	5,818
Non-cash items included in net earnings	(6,241)	(6,917)
<i>Changes in operating assets and liabilities</i>		
Loans to credit institutions, excluding bank accounts	(3,780)	(264)
Loans to customers	(26,076)	(41,142)
Financial instruments and financial liabilities at fair value	(12,423)	42,585
Deposits	15,428	23,406
Borrowings	(4,305)	(8,496)
Other changes in operating assets and liabilities	12,464	3,459
Interest received	20,768	14,234
Interest paid	(4,695)	(3,657)
Dividend received	63	57
Income tax paid	(1,834)	(1,477)
Net cash (to) from operating activities	(4,340)	27,606
Investing activities		
Proceeds from sale of subsidiary and associates	-	241
Acquisition of associates	-	(70)
Acquisition of intangible assets	(62)	(53)
Proceeds from sale of property and equipment	-	238
Acquisition of property and equipment	(79)	(51)
Net cash (to) from investing activities	(141)	305
Financing activities		
Proceeds from vested share option	251	352
Purchase of treasury stock	(2,458)	(4,269)
Dividend paid to shareholders of Arion Bank	(12,357)	(22,489)
Net cash used in financing activities	(14,564)	(26,406)
Net increase in cash and cash equivalents	(19,045)	1,505
Cash and cash equivalents at beginning of the year	150,131	90,678
Effect of exchange rate changes on cash and cash equivalents	(1,237)	(833)
Cash and cash equivalents	129,849	91,350
Cash and cash equivalents		
Cash and balances with Central Bank	80,272	64,395
Bank accounts	57,080	33,550
Mandatory reserve deposit with Central Bank	(7,503)	(6,595)
Cash and cash equivalents	129,849	91,350

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

Notes to the Consolidated Financial Statements

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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 2023 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 2023.

In preparing the Condensed Consolidated Interim Financial Statements, the Group has applied the concept of materiality to the presentation and level of disclosure. Only essential and mandatory information is disclosed which is relevant to an understanding by the reader of the Condensed Consolidated Interim Financial Statements.

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 2022.

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 58 in the Annual Financial Statements 2022;
- 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 137.1 and 148.90 for EUR (31.12.2022: USD 141.80 and EUR 151.50).

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 judgements 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 for stages 1 and 2 are recalculated for each asset, the calculations are based on PD, LGD and EAD models. Stage 3 calculations are based on LGD and EAD parameters. 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 five 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 58 in the Annual Financial Statements 2022.

Macroeconomic outlook

The economic outlook in Iceland is generally positive. Tourism was strong in 2022 and even stronger in Q1 2023 although the peak from 2018 is not expected to be matched until 2024. In line with this, the unemployment rate has quickly recovered from the spike caused by Covid-19, and it is expected to remain stable at around 4% in the coming years. Private consumption grew very strongly in 2022, by 8.1%, and even though the Central bank has been increasing its policy rates, the strong growth seems to be persistent. However, a slower growth is expected in the coming years. The growth in housing prices started to slow down in the second half of 2022 and that trend is expected to continue due to increased supply and increased cost of borrowing although demand is also expected to remain strong from demographic considerations.

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

	Operating activity	Currency	Equity interest	
			31.3.2023	31.12.2022
Eignabjarg ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Landey ehf., Borgartún 19, Reykjavík, Iceland	Real estate	ISK	100.0%	100.0%
Leiguskjól ehf., Bjargargata 1, Reykjavík, Iceland	Rental guarantee	ISK	51.0%	51.0%
Stefnir hf., Borgartún 19, Reykjavík, Iceland	Asset management	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%

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



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 & Stefmir

Markets & Stefmir 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, Premia Service, Private Banking and Pension Fund Administration. The operation of Stefmir hf. is presented under the segment. Stefmir 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. Markets 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 comprehensive financial services to companies and investors with focus on meeting 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's and provides full range lending and insurance products, including guarantees, deposit accounts, payment solutions, and a variety of value-added digital solutions. The Corporate portfolio composition is diversified between sectors, customers and currencies which include international exposures, partly through syndicates with other Icelandic or international banks.

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

Retail Banking

Retail Banking provides a diverse range of financial services in 13 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.

Treasury

Treasury is responsible for the Bank's funding, liquidity and asset-and-liability management. Treasury oversees the internal funds's transfer pricing and manages the relationship with investors, credit rating agencies and financial institutions. Market making activities in domestic securities and FX as well as FX brokerage sits within Treasury.

Other subsidiaries

Subsidiaries include the subsidiaries Landey ehf., 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 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.-31.3.2023	Markets and Stefmir	CIB including insurance	Retail Banking including insurance	Treasury	Subsidi- aries excl. Stefmir and Vördur	Supporting units and elimi- nations	Total
<i>Income Statement</i>							
Net interest income	227	4,974	4,992	887	(65)	-	11,015
Net fee and commission income	1,562	1,497	927	161	98	108	4,353
Net insurance income	-	106	63	-	-	(51)	118
Net financial income	19	170	552	223	(124)	(1)	839
Share of loss of associates	-	-	-	-	-	(17)	(17)
Other operating income	2	(9)	14	2	8	19	36
Operating income	1,810	6,738	6,548	1,273	(83)	58	16,344
Operating expenses	(595)	(572)	(1,479)	(221)	(116)	(4,292)	(7,275)
Allocated expenses	(589)	(1,041)	(2,245)	(346)	(20)	4,241	-
Bank levy	(11)	(146)	(209)	(83)	-	-	(449)
Net impairment	(2)	111	(188)	3	21	3	(52)
Earnings (loss) before income tax	613	5,090	2,427	626	(198)	10	8,568
Net seg. rev. from ext. customers	249	9,137	13,927	(6,960)	(3)	(6)	16,344
Net seg. rev. from other segments	1,561	(2,399)	(7,379)	8,233	(80)	64	-
Operating income	1,810	6,738	6,548	1,273	(83)	58	16,344
<i>Balance Sheet</i>							
Loans to customers	3,669	462,599	648,334	153	74	(701)	1,114,128
Financial instruments	33,778	8,199	20,197	144,554	1,228	(2,960)	204,996
Other external assets	6,916	1,437	6,435	149,125	9,974	7,633	181,520
Internal assets	57,901	-	-	307,930	5,763	(371,594)	-
Total assets	102,264	472,235	674,966	601,762	17,039	(367,622)	1,500,644
Deposits	90,777	268,916	337,605	80,912	-	(3,187)	775,023
Other external liabilities	2,257	10,714	17,089	500,270	8,200	7,159	545,689
Internal liabilities	-	112,069	259,525	-	-	(371,594)	-
Total liabilities	93,034	391,699	614,219	581,182	8,200	(367,622)	1,320,712
Allocated equity	9,230	80,536	60,747	20,580	8,839	-	179,932



Notes to the Condensed Consolidated Interim Financial Statements

5. Operating segments, continued

1.1.-31.3.2022	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other subsidiaries	Supporting units and eliminations	Total
<i>Income Statement</i>							
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
<i>Balance Sheet</i>							
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	-	-	286,728	-	(316,454)	-
Total assets	88,234	410,271	608,236	498,298	37,015	(301,039)	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	-	86,134	223,739	-	6,581	(316,454)	-
Total liabilities	80,791	342,611	551,047	476,122	18,470	(301,039)	1,168,002
Allocated equity	7,443	67,660	57,189	22,176	18,545	-	173,013

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



Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Consolidated Income Statement

6. Net interest income

1.1.-31.3.2023	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
<i>Interest income</i>				
Cash and balances with Central Bank	1,394	-	-	1,394
Loans to credit institutions	190	80	-	270
Loans to customers	26,387	-	-	26,387
Securities	-	297	819	1,116
Other	66	-	-	66
Interest income	28,037	377	819	29,233
<i>Interest expense</i>				
Deposits	(9,902)	-	-	(9,902)
Borrowings	(5,935)	(1,018)	-	(6,953)
Subordinated liabilities	(1,153)	(118)	-	(1,271)
Other	(92)	-	-	(92)
Interest expense	(17,082)	(1,136)	-	(18,218)
Net interest income	10,955	(759)	819	11,015
1.1.-31.3.2022				
<i>Interest income</i>				
Cash and balances with Central Bank	392	-	-	392
Loans to credit institutions	8	15	-	23
Loans to customers	15,997	-	-	15,997
Securities	-	43	814	857
Other	60	-	-	60
Interest income	16,457	58	814	17,329
<i>Interest expense</i>				
Deposits	(3,478)	-	-	(3,478)
Borrowings	(3,957)	159	-	(3,798)
Subordinated liabilities	(520)	38	-	(482)
Other	(43)	-	-	(43)
Interest expense	(7,998)	197	-	(7,801)
Net interest income	8,459	255	814	9,528

Net interest income calculated using the effective interest rate method were ISK 28,031 million during the period (3M 2022: ISK 17,466 million).

	2023 1.1.-31.3.	2022 1.1.-31.3.
<i>Interest spread</i>		
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	3.1%	3.1%



Notes to the Condensed Consolidated Interim Financial Statements

7. Net fee and commission income

	1.1.-31.3.2023			1.1.-31.3.2022		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	1,491	(139)	1,352	1,396	(159)	1,237
Capital markets and corporate finance	666	(12)	654	695	(9)	686
Lending and financial guarantees	1,343	-	1,343	1,046	-	1,046
Collection and payment services	336	(6)	330	340	(26)	314
Cards and payment solution	1,224	(594)	630	430	(144)	286
Other	226	(182)	44	161	(178)	(17)
Net fee and commission income	5,286	(933)	4,353	4,068	(516)	3,552

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

	2023 1.1.-31.3.	2022 1.1.-31.3.
<i>Earned premiums, net of reinsurers' share</i>		
Premiums written	5,400	4,675
Premiums written, reinsurers' shares	(186)	(148)
Change in provision for unearned premiums	(1,474)	(1,176)
Earned premiums, net of reinsurers' share	3,740	3,351
<i>Claims incurred, net of reinsurers' share</i>		
Claims paid	(2,889)	(2,577)
Claims paid, reinsurers' share	69	92
Change in provision for claims	(780)	(864)
Changes in provision for claims, reinsurers' share	(22)	3
Claims incurred, net of reinsurers' share	(3,622)	(3,346)
Net insurance income	118	5
<i>Combined ratio</i>		
Combined ratio	116.3%	115.5%



Notes to the Condensed Consolidated Interim Financial Statements

9. Net financial income

	2023 1.1.-31.3.	2022 1.1.-31.3.
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	682	1,112
Loss on prepayments of borrowings	-	(35)
Net loss on fair value hedge of interest rate swap	(6)	(125)
Net realized gain (loss) on financial assets carried at fair value through OCI and reclassification from OCI equity reserve	159	(28)
Net foreign exchange gain	4	67
Net financial income	839	991
<i>Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss</i>		
Equity instruments	336	624
Debt instruments	266	268
Derivatives	80	220
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	682	1,112
<i>Net loss on fair value hedge of interest rate swap</i>		
Fair value change of interest rate swaps designated as hedging instruments	1,663	(4,483)
Fair value change on bonds issued by the Group attributable to interest rate risk	(1,669)	4,358
Net loss on fair value hedge of interest rate swap	(6)	(125)

10. Other operating income

Net (loss) gain on disposal of assets	(3)	174
Net (loss) gain on assets held for sale	(9)	10
Fair value changes on investment property	5	-
Other income	43	51
Other operating income	36	235
<i>Net (loss) gain on assets held for sale</i>		
Net (loss) income from real estates and other assets	(10)	13
Expense related to real estates and other assets	1	(3)
Net (loss) gain on assets held for sale	(9)	10

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

	2023 1.1.-31.3.	2022 1.1.-31.3.
<i>Number of employees</i>		
Average number of full-time equivalent positions during the period	785	749
Full-time equivalent positions at the end of the period	789	753
<i>Salaries and related expenses</i>		
Salaries	3,136	2,666
Incentive scheme	(25)	14
Share-based payment expenses	59	50
Defined contribution pension plans	462	398
Salary-related expenses	467	412
Salaries and related expenses	4,099	3,540



Notes to the Condensed Consolidated Interim Financial Statements

11. Personnel and salaries, continued

Incentive schemes

During the period the Group revised the provision for the incentive scheme which resulted in a ISK 33 million reversal of expenses, including salary-related expenses (Q1 2022: ISK 19 million provision). At the end of the period the Group's accrual for the incentive scheme payments amounted to ISK 710 million (31.12.2022: ISK 1,997 million).

Current 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. Stefmir 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, Vördur and Stefmir, approved at the Banks annual general meeting. A total expense of ISK 59 million was recognised in the Income Statement during the period (Q1 2022: ISK 50 million). Estimated remaining expenses due the share option contracts are ISK 535 million and will be expensed over the next three years. For further information on the share option program, see Note 35.

12. Other operating expenses

	2023 1.1.-31.3.	2022 1.1.-31.3.
IT expenses	1,188	1,100
Professional services	363	225
Marketing	301	183
Housing expenses	145	150
Other administration expenses	735	429
Depositors' and Investors' Guarantee Fund	-	135
Depreciation of property and equipment	142	128
Depreciation of right of use asset	32	34
Amortization of intangible assets	270	277
Other operating expenses	3,176	2,661

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

	2023 1.1.-31.3.	2022 1.1.-31.3.
<i>Net impairment on financial instruments and value changes on loans</i>		
Net impairment on loans to customers and financial institutions	(70)	(522)
Net impairment on other financial instruments at FVOCI	(1)	1
Other value changes of loans - corporates	5	5
Other value changes of loans - individuals	14	21
Net impairment	(52)	(495)

Net impairment by customer type

Individuals	(114)	34
Corporates	62	(529)
Net impairment	(52)	(495)

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 during the year.



Notes to the Condensed Consolidated Interim Financial Statements

15. Income tax expense

	2023 1.1.-31.3.	2022 1.1.-31.3.
Current tax expense	2,706	2,995
Deferred tax expense	(419)	(1,292)
Income tax expense	2,287	1,703

	2023 1.1.-31.3.		2022 1.1.-31.3.	
<i>Reconciliation of effective tax rate</i>		8,568		7,425
Earnings before income tax		8,568		7,425
Income tax using the Icelandic corporate tax rate	20.0%	1,714	20.0%	1,485
Additional 6% tax on Financial Undertakings	6.5%	556	9.1%	678
Non-deductible expenses	0.2%	17	0.1%	11
Tax exempt revenues / loss	(0.9%)	(81)	(3.9%)	(293)
Non-deductible taxes (Bank levy)	1.1%	90	1.1%	79
Tax incentives not recognized in the Income Statement	0.0%	1	(3.7%)	(273)
Other changes	(0.1%)	(10)	0.2%	16
Effective tax rate	26.7%	2,287	22.9%	1,703

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.

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

	2023 1.1.-31.3.	2022 1.1.-31.3.
Net gain from discontinued operations held for sale	10	109
Income tax expense	-	(13)
Discontinued operations held for sale, net of income tax	10	96

17. Earnings per share

Basic earnings per share is based on net earnings attributable 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	
	2023 1.1.-31.3.	2022 1.1.-31.3.	2023 1.1.-31.3.	2022 1.1.-31.3.	2023 1.1.-31.3.	2022 1.1.-31.3.
Net earnings attributable to the shareholders of Arion Bank	6,274	5,716	10	96	6,284	5,812
Weighted average number of outstanding shares (millions)	1,453	1,583	1,453	1,583	1,453	1,583
Weighted average number of outstanding shares including warrants and options (millions)	1,532	1,661	1,532	1,661	1,532	1,661
Basic earnings per share (ISK)	4.32	3.61	0.01	0.06	4.32	3.67
Diluted earnings per share (ISK)	4.10	3.44	0.01	0.06	4.10	3.50



Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Consolidated Statement of Financial Position

18. Cash and balances with Central Bank

31.3.2023 31.12.2022

Cash on hand	3,560	3,877
Cash with Central Bank	69,209	102,821
Mandatory reserve deposit with Central Bank	7,503	7,420
Cash and balances with Central Bank	80,272	114,118

The mandatory reserve deposit with the Central Bank is not available for the Group to use in its daily operations. The minimum fixed reserve requirement of the Central Bank is 1%.

19. Loans to credit institutions

31.3.2023 31.12.2022

Bank accounts	57,080	43,433
Other loans	5,819	2,068
Loans to credit institutions	62,899	45,501

20. Loans to customers

	Individuals		Corporates		Total	
	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
31.3.2023						
Overdrafts	14,582	14,050	36,921	36,082	51,503	50,132
Credit cards	14,716	14,543	1,976	1,932	16,692	16,475
Mortgage loans	520,421	519,914	57,081	56,947	577,502	576,861
Construction loans	-	-	37,308	37,120	37,308	37,120
Capital lease	3,572	3,551	4,668	4,633	8,240	8,184
Other loans	37,622	36,931	392,372	388,425	429,994	425,356
Loans to customers	590,913	588,989	530,326	525,139	1,121,239	1,114,128
31.12.2022						
Overdrafts	14,893	14,369	33,369	32,571	48,262	46,940
Credit cards	14,304	14,155	1,838	1,792	16,142	15,947
Mortgage loans	514,007	513,605	60,528	60,424	574,535	574,029
Construction loans	-	-	29,227	28,893	29,227	28,893
Capital lease	4,107	4,089	4,163	4,131	8,270	8,220
Other loans	36,835	36,153	378,402	374,575	415,237	410,728
Loans to customers	584,146	582,371	507,527	502,386	1,091,673	1,084,757

The total book value of pledged loans that were pledged against amounts borrowed was ISK 365 billion at the end of the period (31.12.2022: ISK 305 billion). Pledged loans comprised mortgage loans to individuals.

Further analysis of loans is provided in Risk management disclosures.

21. Financial instruments

31.3.2023 31.12.2022

Bonds and debt instruments	148,247	138,174
Shares and equity instruments with variable income	17,226	17,733
Derivatives	9,567	9,516
Securities used for economic hedging	29,956	27,906
Financial instruments	204,996	193,329



Notes to the Condensed Consolidated Interim Financial Statements

22. Financial assets and financial liabilities

31.3.2023

<i>Financial assets</i>	Amortized cost	Fair value through OCI	Manda- torily at fair value thr. P/L	Total
<i>Loans</i>				
Cash and balances with Central Bank	80,272	-	-	80,272
Loans to credit institutions	62,899	-	-	62,899
Loans to customers	1,114,128	-	-	1,114,128
Loans	1,257,299	-	-	1,257,299
<i>Bonds and debt instruments</i>				
Listed	-	123,357	24,208	147,565
Unlisted	-	-	682	682
Bonds and debt instruments	-	123,357	24,890	148,247
<i>Shares and equity instruments with variable income</i>				
Listed	-	-	6,980	6,980
Unlisted	-	-	9,516	9,516
Bond funds with variable income, unlisted	-	-	730	730
Shares and equity instruments with variable income	-	-	17,226	17,226
<i>Derivatives</i>				
OTC derivatives	-	-	9,567	9,567
Derivatives	-	-	9,567	9,567
<i>Securities used for economic hedging</i>				
Bonds and debt instruments, listed	-	-	4,240	4,240
Shares and equity instruments with variable income, listed	-	-	25,716	25,716
Securities used for economic hedging	-	-	29,956	29,956
<i>Other financial assets</i>				
Accounts receivable	2,217	-	-	2,217
Other financial assets	13,040	-	-	13,040
Other financial assets	15,257	-	-	15,257
Financial assets	1,272,556	123,357	81,639	1,477,552
<i>Financial liabilities</i>				
Due to credit institutions and Central Bank	24,188	-	-	24,188
Deposits	775,023	-	-	775,023
Borrowings *	390,734	-	-	390,734
Subordinated liabilities *	46,681	-	-	46,681
Short position in equity	-	-	4	4
Derivatives	-	-	6,458	6,458
Derivatives used for hedge accounting	-	-	14,230	14,230
Other financial liabilities	24,767	-	-	24,767
Financial liabilities	1,261,393	-	20,692	1,282,085

* Including effect from hedge accounting derivatives.



Notes to the Condensed Consolidated Interim Financial Statements

22. Financial assets and financial liabilities, continued

31.12.2022

<i>Financial assets</i>	Amortized cost	Fair value through OCI	Manda- torily at fair value thr. P/L	Total
<i>Loans</i>				
Cash and balances with Central Bank	114,118	-	-	114,118
Loans to credit institutions	43,433	-	2,068	45,501
Loans to customers	1,084,757	-	-	1,084,757
Loans	1,242,308	-	2,068	1,244,376
<i>Bonds and debt instruments</i>				
Listed	-	115,806	21,390	137,196
Unlisted	-	-	978	978
Bonds and debt instruments	-	115,806	22,368	138,174
<i>Shares and equity instruments with variable income</i>				
Listed	-	-	6,429	6,429
Unlisted	-	-	9,709	9,709
Bond funds with variable income, unlisted	-	-	1,595	1,595
Shares and equity instruments with variable income	-	-	17,733	17,733
<i>Derivatives</i>				
OTC derivatives	-	-	9,448	9,448
Derivatives used for hedge accounting	-	-	68	68
Derivatives	-	-	9,516	9,516
<i>Securities used for economic hedging</i>				
Bonds and debt instruments, listed	-	-	3,890	3,890
Shares and equity instruments with variable income, listed	-	-	24,016	24,016
Securities used for economic hedging	-	-	27,906	27,906
<i>Other financial assets</i>				
Accounts receivable	5,255	-	-	5,255
Other financial assets	3,412	-	-	3,412
Other financial assets	8,667	-	-	8,667
Financial assets	1,250,975	115,806	79,591	1,446,372
<i>Financial liabilities</i>				
Due to credit institutions and Central Bank	11,697	-	-	11,697
Deposits	755,361	-	-	755,361
Borrowings *	392,563	-	-	392,563
Subordinated liabilities *	47,331	-	-	47,331
Short position in equity used for economic hedging	-	-	11	11
Derivatives	-	-	4,730	4,730
Derivatives used for hedge accounting	-	-	16,256	16,256
Other financial liabilities	10,099	-	-	10,099
Financial liabilities	1,217,051	-	20,997	1,238,048

* Including effect from hedge accounting derivatives.



Notes to the Condensed Consolidated Interim Financial Statements

22. Financial assets and financial liabilities, continued

<i>Bonds and debt instruments measured at fair value, specified by issuer</i>	Fair value through OCI	Manda- torily at fair value thr. P/L	Total
31.3.2023			
Financial and insurance activities	19,055	9,634	28,689
Public sector	104,302	12,423	116,725
Corporates	-	2,833	2,833
Bonds and debt instruments at fair value	123,357	24,890	148,247
31.12.2022			
Financial and insurance activities	18,898	9,967	28,865
Public sector	96,908	9,319	106,227
Corporates	-	3,082	3,082
Bonds and debt instruments at fair value	115,806	22,368	138,174

The total amount of pledged bonds was ISK 3.0 billion at the end of the period (31.12.2022: ISK 3.6 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

31.3.2023	Level 1	Level 2	Level 3	Total
<i>Assets at fair value</i>				
Bonds and debt instruments	145,173	2,970	104	148,247
Shares and equity instruments with variable income	5,893	9,406	1,927	17,226
Derivatives	-	9,567	-	9,567
Securities used for economic hedging	29,956	-	-	29,956
Investment property	-	-	7,875	7,875
Assets at fair value	181,022	21,943	9,906	212,871
<i>Liabilities at fair value</i>				
Short position in equity	4	-	-	4
Derivatives	-	6,458	-	6,458
Derivatives used for hedge accounting	-	14,230	-	14,230
Liabilities at fair value	4	20,688	-	20,692



Notes to the Condensed Consolidated Interim Financial Statements

23. Fair value hierarchy, continued

31.12.2022

<i>Assets at fair value</i>	Level 1	Level 2	Level 3	Total
Loans to credit institutions	-	2,068	-	2,068
Bonds and debt instruments	135,126	2,946	102	138,174
Shares and equity instruments with variable income	5,214	10,587	1,932	17,733
Derivatives	-	9,448	-	9,448
Derivatives used for hedge accounting	-	68	-	68
Securities used for economic hedging	27,906	-	-	27,906
Investment property	-	-	7,862	7,862
Assets at fair value	168,246	25,117	9,896	203,259
<i>Liabilities at fair value</i>				
Short position in equity used for economic hedging	11	-	-	11
Derivatives	-	4,730	-	4,730
Derivatives used for hedge accounting	-	16,256	-	16,256
Liabilities at fair value	11	20,986	-	20,997

There was no transfer between Level 1 and Level 2 during the period (2022: Transfers from Level 1 to Level 2 ISK 1,098 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.



Notes to the Condensed Consolidated Interim Financial Statements

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 property	Financial assets		Total
		Bonds	Shares	
31.3.2023				
Balance at the beginning of the year	7,862	102	1,932	9,896
Net fair value changes	5	2	(1)	6
Additions	8	-	-	8
Disposals	-	-	(4)	(4)
Balance at the end of the period	7,875	104	1,927	9,906
31.12.2022				
Balance at the beginning of the year	6,560	97	3,808	10,465
Net fair value changes	26	6	135	167
Additions	49	-	29	78
Disposals	(7)	(1)	(1,907)	(1,915)
Transfers from held for sale assets	1,234	-	-	1,234
Transfers out of Level 3	-	-	(133)	(133)
Balance at the end of the year	7,862	102	1,932	9,896

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

1.1.-31.3.2023				
Net financial income	-	2	(1)	1
Other operating income	5	-	-	5
Effects recognized in the Income Statement	5	2	(1)	6
1.1.-31.3.2022				
Net financial income	-	-	252	252
Effects recognized in the Income Statement	-	-	252	252



Notes to the Condensed Consolidated Interim Financial Statements

23. Fair value hierarchy, continued

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

31.3.2023	Carrying value	Fair value	Unrealized gain (loss)
<i>Financial assets not carried at fair value</i>			
Cash and balances with Central Bank	80,272	80,272	-
Loans to credit institutions	62,899	62,899	-
Loans to customers	1,114,128	1,089,276	(24,852)
Other financial assets	15,257	15,257	-
Financial assets not carried at fair value	1,272,556	1,247,704	(24,852)
<i>Financial liabilities not carried at fair value</i>			
Due to credit institutions and Central Bank	24,188	24,188	-
Deposits	775,023	775,023	-
Borrowings	390,734	381,455	9,279
Subordinated liabilities	46,681	46,088	593
Other financial liabilities	24,767	24,767	-
Financial liabilities not carried at fair value	1,261,393	1,251,521	9,872
31.12.2022			
<i>Financial assets not carried at fair value</i>			
Cash and balances with Central Bank	114,118	114,118	-
Loans to credit institutions	45,501	45,501	-
Loans to customers	1,084,757	1,017,671	(67,086)
Other financial assets	8,667	8,667	-
Financial assets not carried at fair value	1,253,043	1,185,957	(67,086)
<i>Financial liabilities not carried at fair value</i>			
Due to credit institutions and Central Bank	11,697	11,697	-
Deposits	755,361	755,361	-
Borrowings	392,563	381,426	11,137
Subordinated liabilities	47,331	48,310	(979)
Other financial liabilities	10,099	10,099	-
Financial liabilities not carried at fair value	1,217,051	1,206,893	10,158

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 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

31.3.2023	Notional value	Fair value	
		Assets	Liabilities
Forward exchange rate agreements	62,672	1,137	286
Fair value hedge of interest rate swap	222,165	-	14,230
Interest rate and exchange rate agreements	77,882	4,391	4,988
Bond swap agreements	5,172	209	20
Share swap agreements	29,590	3,485	1,164
Options - purchased agreements, unlisted	1	345	-
Derivatives	397,482	9,567	20,688
31.12.2022			
Forward exchange rate agreements	73,127	2,383	168
Fair value hedge of interest rate swap	246,965	68	16,256
Interest rate and exchange rate agreements	93,206	2,737	3,540
Bond swap agreements	5,668	277	19
Share swap agreements	36,057	3,694	975
Options - purchased agreements, unlisted	5	357	28
Derivatives	455,028	9,516	20,986



Notes to the Condensed Consolidated Interim Financial Statements

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 EUR 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 59 in the Annual Financial Statements 2022.

	Notional	Maturity date	Fair value		Gain (loss) on FV changes
			Assets	Liabilities	
1.1.2023 - 31.3.2023					
Interest rates swaps - EUR	-	-	-	-	76
Interest rates swaps - EUR	44,670	1-5 years	-	1,942	314
Interest rates swaps - USD	13,705	1-5 years	-	935	158
Interest rates swaps - EUR	74,450	1-5 years	-	7,326	687
Interest rates swaps - EUR	44,670	1-5 years	-	3,753	367
Interest rates swaps - EUR	44,670	1-5 years	-	274	61
			-	14,230	1,663
1.1.2022 - 31.12.2022					
Interest rates swaps - EUR	20,680	0-3 mth	68	-	(747)
Interest rates swaps - EUR	45,451	1-5 years	-	2,332	(1,933)
Interest rates swaps - USD	14,180	1-5 years	-	908	(1,103)
Interest rates swaps - EUR	75,752	1-5 years	-	7,986	(6,911)
Interest rates swaps - EUR	45,451	1-5 years	-	4,151	(3,321)
Interest rates swaps - EUR	45,451	1-5 years	-	879	(840)
			68	16,256	(14,855)

Hedged borrowings and subordinated liabilities

	Book value	Accumulated fair value		Gain (loss) on FV changes
		Assets	Liabilities	
1.1.2023 - 31.3.2023				
EUR 300 million - issued 2018 - 5 years	-	-	-	(156)
EUR 300 million - issued 2020 - 4 years	42,836	2,007	-	(316)
USD 100 million - issued 2020 - Perpetual	12,869	841	-	(111)
EUR 500 million - issued 2021 - 5 years	65,902	6,947	-	(686)
EUR 300 million - issued 2021 - 4 years	41,060	3,598	-	(307)
EUR 300 million - issued 2022 - 2 years	44,446	682	-	(93)
Hedged borrowings and subordinated liabilities	207,113	14,075	-	(1,669)
1.1.2022 - 31.12.2022				
EUR 500 million - issued 2017/18 - 5 years	20,672	156	-	13
EUR 300 million - issued 2018 - 5 years	43,181	2,363	-	1,930
EUR 300 million - issued 2020 - 4 years	13,396	1,001	-	1,024
USD 100 million - issued 2020 - Perpetual	66,231	7,765	-	6,927
EUR 300 million - issued 2021 - 5 years	41,404	3,973	-	3,288
EUR 300 million - issued 2021 - 4 years	44,557	792	-	766
Hedged borrowings and subordinated liabilities	229,441	16,050	-	13,947

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 94-108%.



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			Assets not subject to enforceable netting arrangements	Total assets recognized on Balance Sheet, net
	Gross assets before nettings	Nettings with gross liabilities	Assets recognized on Balance Sheet, net	Financial liabilities	Collateral received	Assets after consideration of netting potential		
31.3.2023								
Reverse repurchase agreements	48,766	(41,114)	7,652	41,114	-	48,766	-	7,652
Derivatives	724	-	724	(43)	-	681	8,843	9,567
Total assets	49,490	(41,114)	8,376	41,071	-	49,447	8,843	17,219
31.12.2022								
Reverse repurchase agreements	17,781	(10,212)	7,569	10,212	-	17,781	-	7,569
Derivatives	842	-	842	(42)	-	800	8,674	9,516
Total assets	18,623	(10,212)	8,411	10,170	-	18,581	8,674	17,085

Financial liabilities subject to enforceable master netting arrangements and similar arrangements

	Liabilities subject to netting arrangements			Netting potential not recognized in the Balance Sheet			Liabilities after consideration of netting potential	Liabilities not subject to enforceable netting arrangements	Total liabilities recognized on balance sheet
	Gross liabilities before nettings	Nettings with gross assets	Liabilities recognized on Balance Sheet, net	Financial assets	Collateral pledged				
31.3.2023									
Repurchase agreements	-	(41,114)	(41,114)	41,114	-	-	-	-	(41,114)
Derivatives	15,980	-	15,980	(43)	-	15,937	4,708	20,688	
Total liabilities	15,980	(41,114)	(25,134)	41,071	-	15,937	4,708	(20,426)	
31.12.2022									
Repurchase agreements	-	(10,212)	(10,212)	10,212	-	-	-	(10,212)	
Derivatives	18,298	-	18,298	(42)	-	18,256	2,689	20,986	
Total liabilities	18,298	(10,212)	8,086	10,170	-	18,256	2,689	10,774	

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

	31.3.2023	31.12.2022
Carrying amount at the beginning of the year	787	668
Acquisitions / increased share capital	-	90
Disposals	-	(241)
Share of (loss) profit of associates and profit from sale	(17)	270
Investment in associates	770	787

The Group's interest in its principal associates

	31.3.2023	31.12.2022
Bílafrágangur ehf., Lágmúli 5, Reykjavík, Iceland	33.4%	33.4%
Háblær ehf., Sudurlandsbraut 18, Reykjavík, Iceland	49.0%	49.0%
Reiknistofa bankanna hf., Katrínartún 2, Reykjavík, Iceland	23.0%	23.0%
SER eignarhaldsfélag ehf., Borgartún 19, Reykjavík	35.3%	35.3%



Notes to the Condensed Consolidated Interim Financial Statements

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

	Goodwill	Infra-structure	Customer relationship and related agreements	Software	Total
31.3.2023					
Balance at the beginning of the year	730	2,383	547	5,123	8,783
Additions	-	-	-	62	62
Amortization	-	-	(15)	(255)	(270)
Intangible assets	730	2,383	532	4,930	8,575
31.12.2022					
Balance at the beginning of the year	669	2,383	607	5,804	9,463
Additions	61	-	-	355	416
Amortization	-	-	(60)	(1,036)	(1,096)
Intangible assets	730	2,383	547	5,123	8,783

Goodwill related to the insurance operation is recognized among assets in the operating segments Corporate & Investment Banking and Retail Banking and in 2022 Leiguskjól acquired a subsidiary including ISK 61 million in goodwill which is recognized in the operating segment Other subsidiaries, see Note 5.

27. Tax assets and tax liabilities

	31.3.2023		31.12.2022	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	9,230	-	8,471
Deferred tax	332	1,610	135	1,832
Tax assets and tax liabilities	332	10,840	135	10,303



Notes to the Condensed Consolidated Interim Financial Statements

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

<i>Assets and disposal groups held for sale</i>	31.3.2023	31.12.2022
Real estate	61	61
Assets and disposal groups held for sale	61	61

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

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. All operations were sold during the years 2020-2022. Following the sale of the operation of Heimsferdir ehf. Sólbjarg became a minority shareholder in Ferdaskrifstofa Íslands ehf. through its ownership in Heimbjarg ehf. (former Heimsferdir ehf.). The holding is held for sale with zero book value.

29. Other assets

	31.3.2023	31.12.2022
Property and equipment	3,724	3,787
Right of use asset	723	745
Accounts receivable	2,217	5,255
Unsettled securities trading	10,590	860
Sundry assets	3,482	3,576
Other assets	20,736	14,223

30. Other liabilities

Accounts payable	1,536	1,013
Unsettled securities trading	10,593	1,844
Technical provision	18,946	21,023
Withholding tax	642	2,637
Bank levy	1,826	1,761
Accrued expenses	3,899	4,776
Prepaid income	1,529	1,590
Impairment of off-balance items	363	449
Lease liability	944	970
Sundry liabilities	12,276	6,910
Other liabilities	52,554	42,973

<i>Technical provision</i>	Technical provision	Reinsurers' share	Total 31.3.2023	Technical provision	Reinsurers' share	Total 31.12.2022
Claims reported and loss adjustment expenses	12,509	(187)	12,322	10,455	(371)	10,084
Claims incurred but not reported	2,306	(62)	2,244	3,168	(90)	3,078
Claims outstanding	14,815	(249)	14,566	13,623	(461)	13,162
Provision for unearned premiums	4,131	(10)	4,121	7,400	(15)	7,385
Own technical provision	18,946	(259)	18,687	21,023	(476)	20,547

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.



Notes to the Condensed Consolidated Interim Financial Statements

31. Borrowings

Currency, original nominal value	First issued	Maturity	Maturity type	Terms of interest	31.3.2023	31.12.2022
ARION CB 24 ISK 28,900 million	2019	2024	At maturity	Fixed, 6.00%	26,021	25,736
ARION CBI 25, ISK 37,940 million	2017	2025	At maturity	Fixed, CPI linked, 3.00%	48,896	47,184
ARION CBI 26 ISK 17,080 million	2019	2026	At maturity	Fixed, CPI linked, 2.00%	19,800	19,219
ARION CBI 29, ISK 27,200 million	2014	2029	At maturity	Fixed, CPI linked, 3.50%	36,841	35,602
ARION CBI 48, ISK 11,680 million	2018	2048	Amortizing	Fixed, CPI linked, 2.50%	11,929	11,828
ARION CB EUR 500 million *	2021	2026	At maturity	Fixed, EUR 0.05%	65,902	66,231
ARION CB 27, ISK 41,000 million	2022	2027	At maturity	Fixed, 5.50%	17,756	7,058
Statutory covered bonds					227,145	212,858
NOK 250 million	2017	2023	At maturity	Fixed, 3.02%	3,370	3,671
EUR 300 million *	2018	2023	At maturity	Fixed, 1.00%	-	20,672
EUR 300 million *	2020	2024	At maturity	Fixed, 0.625 %	42,836	43,181
NOK 250 million	2017	2027	At maturity	Fixed, 3.40%	3,382	3,680
EUR 300 million Green *	2021	2025	At maturity	Fixed, 0.375%	41,060	41,404
ARION 26 1222 Green (ISK 5,760m) ..	2021	2026	At maturity	Fixed, 4.70%	5,466	5,382
ARION 24 1020 Green (ISK 6,020m) ..	2022	2024	At maturity	Floating, REIBOR 3M +0.70%	6,065	6,062
EUR 300 million Green *	2022	2024	At maturity	Fixed, 4.875%	44,446	44,557
NOK 550 million	2022	2025	At maturity	Floating, OIBOR 3M +2.35%	7,243	7,952
SEK 230 million	2022	2025	At maturity	Floating, STIBOR 3M +2.35%	3,060	3,144
NOK 200 million	2023	2025	At maturity	Floating, Oibor 3M + 2,55%	2,626	-
SEK 300 million	2023	2026	At maturity	Floating, Stibor 3M + 3,0%	4,035	-
Senior unsecured bonds					163,589	179,705
Borrowings					390,734	392,563

* 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 391 billion at the end of the period (31.12.2022: ISK 393 billion). The market value of those bonds was ISK 381 billion (31.12.2022: ISK 381 billion). The Group repurchased no own debts during the period (3M 2022: ISK 4 billion).

32. Subordinated liabilities

Currency, original nominal value	Issued	Maturity	First call date	Terms of interest	31.3.2023	31.12.2022
SEK 500 million	2018	2028	22 Nov '23	Floating, 3 month STIBOR +3.10% ..	6,640	6,822
NOK 300 million	2019	2029	9 Jul '24	Floating, NIBOR +3.65%	3,996	4,383
SEK 225 million	2019	2029	20 Dec '24	Floating, 3 month STIBOR +3.70% ..	2,983	3,066
ARION T2I 30 ISK 4,800 million	2019	2030	4 Jan '25	Fixed, CPI linked, 3.875%	5,953	5,841
ARION T2 30 ISK 880 million	2019	2030	4 Jan '25	Fixed, 6.75%	893	908
EUR 5 million	2019	2031	6 Mar '26	Fixed, 3.24%	741	772
ARION T2I 33 9,860 million	2022	2033	15 Dec '28	Fixed, CPI linked, 4.95%	10,306	9,894
ARION T2 33 2,240 million	2022	2033	15 Dec '28	Fixed, 9.25%	2,300	2,249
Tier 2 subordinated liabilities					33,812	33,935
ARION AT1 USD 100 million *	2020	Perpetual	26 Mar '25	Fixed, 6.25%	12,869	13,396
Additional Tier 1 subordinated liabilities					12,869	13,396
Subordinated liabilities					46,681	47,331

* 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.



Notes to the Condensed Consolidated Interim Financial Statements

33. Liabilities arising from financial activities

	1 Jan	Cash flows	Non-cash changes			At period end
			Interest expenses	Foreign exchange	Effect from hedge	
31.3.2023						
Covered bonds in ISK - CPI linked.....	113,833	(453)	4,086	-	-	117,466
Covered bonds in ISK.....	32,794	10,501	483	-	-	43,778
Covered bonds in FX.....	66,231	(373)	488	(1,142)	698	65,902
Senior unsecured bonds in FX.....	168,261	(14,932)	1,714	(3,892)	907	152,058
Senior unsecured bonds in ISK.....	11,444	(95)	181	-	-	11,530
Subordinated bond CPI T2 linked.....	15,735	(111)	635	-	-	16,259
Subordinated bond T2 ISK.....	3,156	(30)	67	-	-	3,193
Subordinated bond T2 FX.....	15,044	(241)	223	(666)	-	14,360
Subordinated bond AT1 FX.....	13,396	(579)	346	(414)	120	12,869
Liabilities arising from financial activities.....	439,894	(6,313)	8,223	(6,114)	1,725	437,415
31.12.2022						
Covered bonds in ISK - CPI linked.....	102,007	(814)	12,640	-	-	113,833
Covered bonds in ISK.....	57,512	(27,114)	2,396	-	-	32,794
Covered bonds in FX.....	43,624	26,690	386	2,515	(6,984)	66,231
Senior unsecured bonds in FX.....	149,970	17,949	2,044	4,278	(5,980)	168,261
Senior unsecured bonds in ISK.....	3,524	7,359	561	-	-	11,444
Subordinated bond CPI T2 linked.....	5,337	9,651	747	-	-	15,735
Subordinated bond T2 ISK.....	907	2,182	68	-	-	3,157
Subordinated bond T2 FX.....	15,619	(596)	643	(623)	-	15,043
Subordinated bond AT1 FX.....	13,225	(867)	880	1,149	(991)	13,396
Liabilities arising from financial activities.....	391,725	34,440	20,365	7,319	(13,955)	439,894

34. Pledged assets

	31.3.2023	31.12.2022
<i>Pledged assets against liabilities</i>		
Assets, pledged as collateral against borrowings	389,031	328,811
Assets, pledged as collateral against loans from the Central Bank, credit institutions and short positions	3,020	3,591
Pledged assets against liabilities	392,051	332,402
Thereof pledged assets against issued covered bonds held by the Bank	(97,316)	(70,850)
Assets against repoed issued bonds	54,140	17,029
Pledged assets against liabilities on balance	348,875	278,581

The Group has pledged assets against due to credit institutions and borrowings, both issued covered bonds and other issued bonds and loan agreements. Pledged loans comprised mortgage loans to individuals. The book value of those liabilities were ISK 242 billion at period end (31.12.2022: ISK 213 billion).

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 36 billion that can be used for repo borrowings at the Central Bank of Iceland, the European Central Bank or sold if market conditions are favorable (31.12.2022: ISK 45 billion). Pledged assets against those covered bonds are ISK 43 billion (31.12.2022: ISK 54 billion).



Notes to the Condensed Consolidated Interim Financial Statements

35. Equity

Share capital and share premium

According to the Bank's Articles of Association, total share capital amounts to ISK 1,510 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 31.3.2023	Share capital	Own shares	Share premium	Total 31.12.2022
Balance at the beginning of the year ..	1,510	(45)	11,907	13,372	1,660	(142)	21,166	22,684
Share capital reduction	-	-	-	-	(150)	150	-	-
Purchase of treasury shares	-	(16)	(2,442)	(2,458)	-	(58)	(9,793)	(9,851)
Share option vested	-	3	295	297	-	4	349	354
Incentive scheme	-	1	194	195	-	1	184	185
Balance at the end of the period	1,510	(57)	9,953	11,406	1,510	(45)	11,907	13,372
Own shares / issued share capital		3.84%				3.01%		

In accordance with the Bank's dividend policy Arion Bank has in place a regular buyback program. On 5 September 2022 the FSA authorized a buyback program which amounts up to a total of 57.3 million shares or up to ISK 10 billion. During the first quarter of 2023 Arion Bank bought back own shares for ISK 2,458 million. At the end of March 6.2 million shares are remaining of the authorized buyback program, or approximately ISK 0.9 billion. The Program will end no later than 1 June 2023.

At the AGM in March 2022 a motion was passed to reduce the Bank's share capital by ISK 150 million. The reduction was effective 4 April 2022.

Share options

Arion Bank has in place a share option plan for all employees of the Bank, Vördur and Stefnir, approved at the Bank's annual general meeting, under which employees may be granted options to purchase ordinary shares. The annual maximum purchase price for each employee is ISK 1.5 million, in line with Article 10 of the Income Tax Act no. 90/2003, 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.

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) - employees of Arion Bank	8,086	2024-2026	95.50
Issued in 2023 (ISK 900,000) - employees of Arion Bank	8,254	2024-2026	153.75
Issued in 2023 (ISK 1,500,000) - employees of Arion Bank	5,912	2024-2026	153.75
Issued in 2022 (ISK 1,500,000) - employees of subsidiaries	2,317	2023-2026	170.90
	<u>24,569</u>		

Movements in share options during the period.

	31.3.2023		31.12.2022	
	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	30,882	143.2	19,728	95.5
Share options granted	14,166	153.8	17,362	180.3
Share options forfeited	(17,835)	168.2	(2,916)	95.5
Share options exercised, WAVG share price ISK 151.79 at exercise date (2022: 187.56)	(2,644)	95.5	(3,292)	95.5
Outstanding share options at the end of the period	24,569	136.2	30,882	143.2

No share options are exercisable at period end. Next exercise periods are in May 2023 and February and May 2024.

All outstanding share options, if exercised, represent approximately 1.6% of the total issued shares.

To meet the Bank's obligations on the basis of the share option plan, the Bank will issue new share capital or deliver treasury shares. Arion Bank has no legal or constructive obligation to repurchase or settle the options in cash.

The fair value of the employee stock options granted is measured by using the Black-Scholes model.

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.



Notes to the Condensed Consolidated Interim Financial Statements

Other information

36. Shareholders of Arion Bank	31.3.2023	31.12.2022
Gildi lífeyrissjóður	9.60%	9.77%
Lífeyrissjóður starfsmanna ríkisins	9.36%	9.53%
Lífeyrissjóður verzlunarmanna	9.14%	9.14%
Stoðir hf.	5.20%	5.20%
Stefnir funds	4.22%	4.05%
Arion banki hf.	3.84%	3.01%
Brú Lífeyrissjóður	3.71%	3.69%
Vanguard	3.47%	2.27%
Birta lífeyrissjóður	3.47%	3.47%
Frjálsi lífeyrissjóðurinn	3.11%	3.17%
Stapi Lífeyrissjóður	3.10%	3.02%
Hvalur hf.	2.44%	2.44%
Íslandsbanki hf.	2.07%	2.38%
Festa lífeyrissjóður	1.93%	1.92%
Almennir lífeyrissjóðir	1.47%	1.47%
Landsbankinn hf.	1.34%	1.21%
Kvika banki hf.	1.25%	1.82%
Landsbréf hf.	1.16%	1.43%
Lífsvirk Pension fund	1.11%	1.08%
Sjóvá tryggingar	0.86%	1.00%
Other shareholders with less than 1% shareholding	28.16%	28.96%
	<u>100.0%</u>	<u>100.0%</u>

At the end of the period the Group's employees held a shareholding of 0.85% in Arion Bank (31.12.2022: 0.65%). The Board of Directors and the members of the Bank's Executive Committee shareholding is as follows:

On 15 March 2023 the AGM approved to reduce the Bank's share capital by ISK 50 million nominal value, amounting 50 million own shares, by cancelling the Bank's own shares. The reduction was carried out on 25 April 2023. The Bank's share capital therefore reduces from ISK 1,510 million to ISK 1,460 million which is divided into an equal number of shares and each share is accompanied by one vote.

	31.03.2023		31.12.2022	
	Warrants / options	Number of shares	Warrants / options	Number of shares
Steinunn Kristín Thórdardóttir, Director	-	12,000	-	12,000
Alternate directors of the Board	-	13,000	-	13,000
Benedikt Gíslason, CEO	997,947	2,561,783	1,006,482	2,506,283
Eight members of the Executive Committee (2022: eight)	4,038,815	971,648	4,945,258	787,751

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



Notes to the Condensed Consolidated Interim Financial Statements

37. 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 period, the Group had several unresolved legal claims.

Contingent liabilities

Legal proceedings regarding damages

In a lawsuit brought in June 2013, Kortabjónustan 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 Kortabjónustan 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, Kortabjónustan 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. In September 2022 the District Court dismissed the claims. EC-Clear appealed the dismissal but with a ruling in January 2023 the Court of Appeal rejected the District Court's ruling and ruled that the case should be heard on its merits by the District Court. 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 1,200 individuals. One case has been filed against the Bank and with a judgement of the District Court of Reykjavik on the 7th of February 2023 the Bank was acquitted. The plaintiffs have requested a right of appeal to the Court of Appeal. Considering the District Court's judgement as well as an outside opinion commissioned by the Bank on its legal position the Bank has 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 was 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. With a judgment in April 2022 FSA was acquitted. The Bank has appealed the ruling and the case will be heard in the Court of Appela in May 2023.

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.

38. 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

39. Commitments

<i>Financial guarantees, unused credit facilities and undrawn loan commitments</i>	31.3.2023	31.12.2022
Financial guarantees	23,757	20,312
Unused overdrafts	59,962	57,259
Undrawn loan commitments	92,913	105,888
Financial guarantees, unused credit facilities and undrawn loan commitments	176,632	183,459

40. Assets under management and under custody

Assets under management	1,317,636	1,298,289
Assets under custody	1,114,648	1,067,052

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

41. Related party

Arion Bank defines related party as shareholders with significant influence over the Group, the key management personnel and the Group's associated companies.

Shareholders with significant influence are shareholders that have the power to participate in the financial and operating decisions of Arion Bank but do not control those policies. At the end of the period no shareholder was defined as related party with an influence over the Group (31.12.2022: none).

The key management personnel includes the Board of Directors and the Executive Committee of Arion Bank, as well as their close family members and legal entities controlled by them. The Executive Committee consists of the CEO, Managing Directors of Retail banking, CIB, Markets, Finance, Risk, IT, Customer experience and head of General council. For compensation, pension and other transactions with the Board of Directors and the Executive Committee, see Notes 11 and 36.

For information on the associated companies, see Note 25.

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.

	Key management personnel		Associated companies	
	31.3.2023	31.12.2022	31.3.2023	31.12.2022
Loans	61	64	55	71
Other assets	2	2	-	-
Total assets	63	66	55	71
Deposits	(15,536)	(1,111)	(133)	(155)
Other liabilities	-	-	(29)	(27)
Total liabilities	(15,536)	(1,111)	(162)	(182)



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 exposures, 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 ensures that the exposure to risk remains within acceptable levels.

The Board of Directors is ultimately responsible for the Bank's risk management framework and for ensuring that satisfactory risk policies and governance for controlling the Group's risk exposure are in place. Each subsidiary is responsible for its own risk management framework but adheres to the Bank's ownership policies which outline the Group's internal control policy, risk appetite and reporting mechanisms. The Board sets the risk appetite for the Bank, and in some cases the Group, which is translated into exposure limits and targets monitored by the Bank's Risk Management division.

The Chief Executive Officer (CEO) is responsible for sustaining an effective risk management framework, processes and controls as well as maintaining a high level of risk awareness among employees, making risk everyone's business.

The Bank operates several committees to manage risk. The Board Risk Committee (BRIC) is responsible for supervising the Bank's risk management framework, risk appetite and the internal capital and liquidity adequacy assessment processes (ICAAP/ILAAP). The Board Credit Committee (BCC) approves certain proposals for credit origination, debt cancellation, underwriting and investments, while the Board of Directors is the supreme authority for cases which entail deviations from risk appetite or strategy. On the management level the CEO has established six primary risk committees. The Asset and Liability Committee (ALCO) is responsible for managing asset-liability mismatches, liquidity and funding risk, market risk, capital adequacy, and decides on underwriting and investment exposures. The Operational Risk Committee (ORCO) is responsible for managing operational risk, which includes information security, financial crimes, regulatory compliance and data management. The Arion Credit Committee (ACC) administers the Bank's credit rules and decides on the origination of credit while the Arion Composition and Debt Cancellation Committee (ADC) is the principal authority for debt cancellation, debt restructuring and composition agreements. ACC and ADC operate within limits set by the BCC. The Sustainability Committee ensures that the Bank's strategy and decision-making are aligned with the Bank's commitments in relation to the environmental, social and governance (ESG) agenda. The committee oversees the Bank's Green Financing Framework. Finally, the Executive Risk Committee (ERCO), chaired by the CRO, oversees the implementation of risk policies, ensures that the Bank's limit framework adheres to the risk appetite, reviews the Bank's ICAAP, ILAAP and stress testing, and approves economic scenarios, credit models and specific provisions under IFRS9. The Executive Committee is concerned with business and strategic risk.

The Bank's Internal Audit conducts independent reviews of the Bank's and several subsidiaries' operations, risk management framework, processes and measurements. Internal Audit discusses its results with management and reports its findings and recommendations to the Board Audit Committee (BAC) and to the Board of Directors.

The Bank's Compliance function is headed by the Compliance Officer. It is independent and centralized and reports directly to the CEO. The Compliance function manages the Bank's conduct and compliance risk, including risk relating to data protection and financial crime.

The Bank's Risk Management division is headed by the Chief Risk Officer. It is independent and centralized and reports directly to the CEO. The division is divided into three units: Risk Analysis, which is responsible for the quantification of risk on a portfolio level, including risk modeling and reporting; Risk Monitoring and Framework, which facilitates and monitors the management of risk and controls in the first line; and Credit Analysis, which supports the Bank's credit transaction process and participates in credit decisions. The Bank's Chief Security Officer and the Bank's Risk Officer for Pension Funds are part of the Risk Management division.

Arion Bank is a small bank in international context but classified as systemically important in Iceland. The Group operates in a small economy which is subject to sectoral concentration, fluctuations in capital flows, and exchange rate volatility. The Group's most significant risks are credit risk, concentration risk, liquidity risk, interest rate risk, cyber risk, third party risk, business risk and sustainability risk. These risk factors are to the largest extent encountered within the parent company. Through the Bank's subsidiaries, the Group bears risk arising from insurance activities and fund management.

Further information on risk management and capital adequacy is provided in the Annual Financial Statements for 2022, in the Pillar 3 Risk Disclosures for 2022 and in the quarterly Additional Pillar 3 Risk Disclosures. These documents are available on the Bank's website, www.arionbank.com.



Notes to the Condensed Consolidated Interim Financial Statements

42. 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, valuation model, 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 action is taken to remedy insufficient collateral coverage where the underlying agreement provides for such remedies. Collateral value is reviewed to ensure the adequacy of the allowance for impairment losses. Collateral values shown are capped by the related book value amount.



Notes to the Condensed Consolidated Interim Financial Statements

42. 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

	Maximum exposure	Collateral				Total collateral
		Cash and securities	Real estate	Vessels	Other collateral	
31.3.2023						
Cash and balances with Central Bank	80,272	-	-	-	-	-
Loans to credit institutions at amortized cost	62,899	-	-	-	-	-
Loans to customers at amortized cost	1,114,128	32,147	818,165	53,254	122,120	1,025,686
<i>Individuals</i>	588,989	453	537,495	17	18,928	556,893
Mortgages	519,914	4	519,606	-	36	519,646
Other	69,075	449	17,889	17	18,892	37,247
<i>Corporates</i>	525,139	31,694	280,670	53,237	103,192	468,793
Real estate activities	104,394	2,611	96,036	8	1,067	99,722
Construction	61,780	356	54,931	48	2,700	58,035
Fishing industry	89,016	916	14,098	50,970	17,161	83,145
Information and communication technology	27,680	65	4,991	-	13,820	18,876
Wholesale and retail trade	93,757	832	50,820	4	33,925	85,581
Financial and insurance activities	42,773	25,695	6,219	-	9,906	41,820
Industry, energy and manufacturing	49,259	902	28,685	-	16,459	46,046
Transportation	14,097	61	1,074	975	3,110	5,220
Services	19,100	255	11,104	1,225	4,032	16,616
Public sector	11,554	1	2,123	7	213	2,344
Agriculture and forestry	11,729	-	10,589	-	799	11,388
Other assets with credit risk	15,257	-	-	-	-	-
Financial guarantees	23,757	1,564	4,281	40	6,009	11,894
Undrawn loan commitments and unused overdrafts	152,875	-	-	-	-	-
Fair value through OCI	123,357	-	-	-	-	-
Government bonds	104,302	-	-	-	-	-
Bonds issued by financial institutions and corporates	19,055	-	-	-	-	-
Balance at the end of the period	1,572,545	33,711	822,446	53,294	128,129	1,037,580
31.12.2022						
Cash and balances with Central Bank	114,118	-	-	-	-	-
Loans to credit institutions at amortized cost	43,433	-	-	-	-	-
Loans to customers at amortized cost	1,084,757	26,285	796,745	51,717	104,911	979,658
<i>Individuals</i>	582,371	517	531,300	16	18,919	550,752
Mortgages	513,605	9	513,252	-	32	513,293
Other	68,766	508	18,048	16	18,887	37,459
<i>Corporates</i>	502,386	25,768	265,445	51,701	85,992	428,906
Real estate activities	105,304	838	101,514	-	368	102,720
Construction	55,208	211	41,157	47	2,478	43,893
Fishing industry	91,427	1,123	14,278	49,501	13,023	77,925
Information and communication technology	24,622	110	1,441	-	14,775	16,326
Wholesale and retail trade	85,005	24	50,831	-	26,584	77,439
Financial and insurance activities	41,378	22,938	6,377	-	7,390	36,705
Industry, energy and manufacturing	44,154	295	25,635	-	13,219	39,149
Transportation	14,058	87	1,127	1,043	3,195	5,452
Services	19,155	131	11,007	1,104	3,904	16,146
Public sector	10,576	11	2,101	6	172	2,290
Agriculture and forestry	11,499	-	9,977	-	884	10,861
Other assets with credit risk	8,667	-	-	-	-	-
Financial guarantees	20,312	2,378	3,872	37	3,288	9,575
Undrawn loan commitments and unused overdrafts	163,147	-	-	-	-	-
Fair value through OCI	115,806	-	-	-	-	-
Government bonds	96,908	-	-	-	-	-
Bonds issued by financial institutions and corporates	18,898	-	-	-	-	-
Balance at the end of the year	1,550,240	28,663	800,617	51,754	108,199	989,233



Notes to the Condensed Consolidated Interim Financial Statements

42. 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 residential mortgage portfolio. LTV is calculated as the ratio of the total exposure of individual borrowers to the value of the pledged real estate without adjusting for possible costs of obtaining and selling the collateral. An exposure to a particular borrower appears in a single row in the table (whole-loan approach). The residential real estate valuation model used gives an estimate of current value on a monthly basis. This model is used when the observed market value becomes older than 2 years.

	31.3.2023		31.12.2022	
	31.3.2023	31.12.2022	31.3.2023	31.12.2022
Less than 50%	175,556	172,790	2,015	1,817
50-60%	91,567	91,201	718	511
60-70%	96,315	90,224	643	826
70-80%	82,351	86,856	434	408
80-90%	69,815	69,629	434	429
90-100%	3,396	2,111	192	153
More than 100%	1,421	1,171	355	118
Not classified	-	25	-	-
Gross carrying amount at the end of the period	520,421	514,007	4,791	4,262

The following table gives an alternative representation of the loan to value profile of the mortgage portfolio. Here, each exposure is split into pieces and each piece is placed into the appropriate LTV bucket. A single exposure can therefore be spread between several rows in the table (loan-splitting approach).

	31.3.2023		31.12.2022	
	31.3.2023	31.12.2022	31.3.2023	31.12.2022
Less than 55%	451,994	445,185	4,051	3,643
55-70%	47,807	48,024	418	380
70-80%	15,543	16,045	146	132
80-90%	4,190	3,895	95	65
90-100%	566	516	35	20
More than 100%	321	317	46	22
Not classified	-	25	-	-
Gross carrying amount at the end of the period	520,421	514,007	4,791	4,262

Collateral for financial assets in stage 3

At the end of the period, the gross carrying amount of assets in stage 3 was ISK 15,310 million (31.12.2022: ISK 12,903 million) with ISK 12,930 million in collateral (31.12.2022: ISK 10,627 million), thereof ISK 11,958 million in real estate (31.12.2022: 9,434 million).

Collateral repossessed

During the period, the Group took possession of no assets due to foreclosures (31.12.2022: nil) and nil in other assets (31.12.2022: nil). Assets acquired due to foreclosure are held for sale, see Note 28.



Notes to the Condensed Consolidated Interim Financial Statements

42. Credit risk, continued

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. 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 (31.12.2022: two large exposures).

No.	31.03.2023		31.12.2022	
	Gross	Net	Gross	Net
1	11.0%	11.0%	<10%	<10%
2	11.0%	11.0%	11.5%	11.5%
3	<10%	<10%	10.3%	10.3%
Sum of large exposure gross and net > 10%	22.0%	22.0%	21.8%	21.8%

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 58 in the Annual Financial Statements 2022.

The following tables show financial instruments subject to the impairment requirements of IFRS 9 broken down by rating scale, where risk class 5, DD, represents exposures in default. 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.



Notes to the Condensed Consolidated Interim Financial Statements

42. Credit risk, continued

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

31.03.2023	Cash and balances with CB	Loans to credit institutions	Financial instru- ments at FVOCI
<i>Loans to credit institutions, securities and cash</i>			
Investment grade	80,272	62,899	123,363
Non-investment grade	-	-	-
Gross carrying amount	80,272	62,899	123,363
Loss allowance	-	-	(6)
Book value	80,272	62,899	123,357

<i>Loans to customers</i>	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 - (Grades AAA to A-)	409,280	108	-	1	409,389
Risk class 1 - (Grades BBB+ to BBB-)	321,040	849	-	71	321,960
Risk class 2 - (Grades BB+ to BB-)	203,397	30,196	-	112	233,705
Risk class 3 to 4 - (Grades B+ to CCC-)	103,298	37,455	-	3	140,756
Risk class 5 - (DD)	-	-	14,961	347	15,308
Unrated	120	1	-	-	121
Gross carrying amount	1,037,135	68,609	14,961	534	1,121,239
Loss allowance	(2,365)	(1,379)	(3,229)	(138)	(7,111)
Book value	1,034,770	67,230	11,732	396	1,114,128

Loans to customers - Individuals

Risk class 0 - (Grades AAA to A-)	303,396	108	-	1	303,505
Risk class 1 - (Grades BBB+ to BBB-)	213,814	604	-	71	214,489
Risk class 2 - (Grades BB+ to BB-)	38,029	7,929	-	112	46,070
Risk class 3 to 4 - (Grades B+ to CCC-)	11,522	8,752	-	3	20,277
Risk class 5 - (DD)	-	-	6,396	165	6,561
Unrated	10	1	-	-	11
Gross carrying amount	566,771	17,394	6,396	352	590,913
Loss allowance	(504)	(324)	(1,096)	-	(1,924)
Book value	566,267	17,070	5,300	352	588,989

Loans to customers - Corporates

Risk class 0 - (Grades AAA to A-)	105,884	-	-	-	105,884
Risk class 1 - (Grades BBB+ to BBB-)	107,226	245	-	-	107,471
Risk class 2 - (Grades BB+ to BB-)	165,368	22,267	-	-	187,635
Risk class 3 to 4 - (Grades B+ to CCC-)	91,776	28,703	-	-	120,479
Risk class 5 - (DD)	-	-	8,565	182	8,747
Unrated	110	-	-	-	110
Gross carrying amount	470,364	51,215	8,565	182	530,326
Loss allowance	(1,861)	(1,055)	(2,133)	(138)	(5,187)
Book value	468,503	50,160	6,432	44	525,139

Loan commitments, guarantees and unused credit facilities

Risk class 0 to 1 (Grades AAA to BBB-)	105,370	-	-	-	105,370
Risk class 2 to 4 (Grades BB+ to CCC-)	59,586	6,472	234	-	66,292
Unrated	4,965	5	-	-	4,970
Nominal	169,921	6,477	234	-	176,632
Loss allowance	(272)	(87)	(5)	-	(364)
Nominal less loss allowance	169,649	6,390	229	-	176,268



Notes to the Condensed Consolidated Interim Financial Statements

42. Credit risk, continued

31.12.2022	Cash and balances with CB	Loans to credit institutions	Financial instru- ments at FVOCI
<i>Loans to credit institutions, securities and cash</i>			
Investment grade	114,118	43,433	133,838
Non-investment grade	-	-	-
Gross carrying amount	114,118	43,433	133,838
Loss allowance	-	-	(13)
Book value	114,118	43,433	133,825

<i>Loans to customers</i>	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 - (Grades AAA to A-)	394,307	1,681	-	-	395,988
Risk class 1 - (Grades BBB+ to BBB-)	316,636	3,157	-	115	319,908
Risk class 2 - (Grades BB+ to BB-)	196,778	35,275	-	53	232,106
Risk class 3 to 4 - (Grades B+ to CCC-)	85,101	44,415	-	14	129,530
Risk class 5 - (DD)	-	-	12,561	341	12,902
Unrated	1,239	-	-	-	1,239
Gross carrying amount	994,061	84,528	12,561	523	1,091,673
Loss allowance	(2,334)	(1,519)	(2,932)	(131)	(6,916)
Book value	991,727	83,009	9,629	392	1,084,757

Loans to customers - Individuals

Risk class 0 - (Grades AAA to A-)	293,411	1,552	-	-	294,963
Risk class 1 - (Grades BBB+ to BBB-)	203,585	2,749	-	115	206,449
Risk class 2 - (Grades BB+ to BB-)	41,795	13,064	-	53	54,912
Risk class 3 to 4 - (Grades B+ to CCC-)	11,301	10,325	-	14	21,640
Risk class 5 - (DD)	-	-	5,861	161	6,022
Unrated	160	-	-	-	160
Gross carrying amount	550,252	27,690	5,861	343	584,146
Loss allowance	(445)	(287)	(1,043)	-	(1,775)
Book value	549,807	27,403	4,818	343	582,371

Loans to customers - Corporates

Risk class 0 - (Grades AAA to A-)	100,896	129	-	-	101,025
Risk class 1 - (Grades BBB+ to BBB-)	113,051	408	-	-	113,459
Risk class 2 - (Grades BB+ to BB-)	154,983	22,211	-	-	177,194
Risk class 3 to 4 - (Grades B+ to CCC-)	73,800	34,090	-	-	107,890
Risk class 5 - (DD)	-	-	6,700	180	6,880
Unrated	1,079	-	-	-	1,079
Gross carrying amount	443,809	56,838	6,700	180	507,527
Loss allowance	(1,889)	(1,232)	(1,889)	(131)	(5,141)
Book value	441,920	55,606	4,811	49	502,386

Loan commitments, guarantees and unused credit facilities

Risk class 0 to 1 - (Grades AAA to BBB-)	109,205	23	-	-	109,228
Risk class 2 to 4 - (Grades BB+ to CCC-)	60,752	9,110	271	-	70,133
Unrated	4,094	4	-	-	4,098
Nominal	174,051	9,137	271	-	183,459
Loss allowance	(351)	(93)	(5)	-	(449)
Nominal less loss allowance	173,700	9,044	266	-	183,010



Notes to the Condensed Consolidated Interim Financial Statements

42. 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		Book value
	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	
31.03.2023							
Loans to credit instit., securities & cash	266,534	(6)	-	-	-	-	266,528
Loans to individuals	566,771	(504)	17,579	(324)	6,563	(1,096)	588,989
Mortgages	502,252	(175)	13,378	(126)	4,791	(206)	519,914
Other	64,519	(329)	4,201	(198)	1,772	(890)	69,075
Loans to corporates	470,364	(1,861)	51,215	(1,055)	8,747	(2,271)	525,139
Real estate activities	95,546	(286)	6,845	(81)	2,759	(389)	104,394
Construction	54,055	(281)	7,650	(41)	414	(17)	61,780
Fishing industry	80,614	(146)	8,499	(74)	219	(96)	89,016
Information and communication technology	25,319	(148)	2,508	(53)	108	(54)	27,680
Wholesale and retail trade	78,715	(405)	13,993	(571)	3,037	(1,012)	93,757
Financial and insurance activities	35,864	(201)	7,149	(113)	78	(4)	42,773
Industry, energy and manufacturing	48,130	(108)	988	(13)	268	(6)	49,259
Transportation	13,818	(83)	313	(5)	76	(22)	14,097
Services	16,262	(132)	2,065	(87)	1,621	(629)	19,100
Public Sector	11,360	(45)	236	(3)	7	(1)	11,554
Agriculture and forestry	10,681	(26)	969	(14)	160	(41)	11,729
Balance at the end of the period	1,303,669	(2,371)	68,794	(1,379)	15,310	(3,367)	1,380,656
31.12.2022							
Loans to credit instit., securities & cash	273,362	(6)	-	-	-	-	273,356
Loans to individuals	550,252	(445)	27,872	(287)	6,022	(1,043)	582,371
Mortgages	486,371	(116)	23,373	(125)	4,262	(160)	513,605
Other	63,881	(329)	4,499	(162)	1,760	(883)	68,766
Loans to corporates	443,809	(1,889)	56,838	(1,232)	6,880	(2,020)	502,386
Real estate activities	94,680	(213)	8,668	(87)	2,609	(353)	105,304
Construction	51,280	(401)	4,161	(74)	252	(10)	55,208
Fishing industry	81,810	(193)	9,633	(137)	368	(54)	91,427
Information and communication technology	21,372	(81)	3,410	(99)	49	(29)	24,622
Wholesale and retail trade	68,357	(321)	16,508	(499)	1,904	(944)	85,005
Financial and insurance activities	33,478	(247)	8,244	(171)	79	(5)	41,378
Industry, energy and manufacturing	41,992	(128)	2,286	(32)	42	(6)	44,154
Transportation	13,877	(73)	205	(6)	61	(6)	14,058
Services	16,183	(136)	2,421	(110)	1,385	(588)	19,155
Public Sector	10,323	(42)	299	(4)	-	-	10,576
Agriculture and forestry	10,457	(54)	1,003	(13)	131	(25)	11,499
Balance at the end of the year	1,267,423	(2,340)	84,710	(1,519)	12,902	(3,063)	1,358,113



Notes to the Condensed Consolidated Interim Financial Statements

42. 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 period.

Derecognitions and maturities

Reflect the allowance related to assets derecognized during the period 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 period.

31.03.2023

<i>Impairment loss allowance</i> *	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(2,678)	(1,612)	(2,937)	(131)	(7,358)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(588)	442	146	-	-
Transfers to Stage 2 (lifetime ECL)	60	(70)	10	-	-
Transfers to Stage 3 (credit impaired financial assets)	20	84	(104)	-	-
Net remeasurement of loss allowance **	823	(326)	(455)	(7)	35
New financial assets, originated or purchased	(499)	(52)	(42)	-	(593)
Derecognitions and maturities	225	65	89	-	379
Write-offs ***	-	3	59	-	62
Impairment loss allowance ****	(2,637)	(1,466)	(3,234)	(138)	(7,475)
Impairment loss allowances for assets only carrying 12-month ECL	(6)	-	-	-	(6)
Total impairment loss allowance	(2,643)	(1,466)	(3,234)	(138)	(7,481)

* 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 122 million due to unwinding of interest income.

*** During the period an amount of ISK 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.



Notes to the Condensed Consolidated Interim Financial Statements

42. Credit risk, continued

<i>Impairment loss allowance for loans to customers</i>	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(2,327)	(1,519)	(2,932)	(131)	(6,909)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(558)	412	146	-	-
Transfers to Stage 2 (lifetime ECL)	57	(67)	10	-	-
Transfers to Stage 3 (credit impaired financial assets)	20	83	(103)	-	-
Net remeasurement of loss allowance	708	(303)	(456)	(7)	(58)
New financial assets, originated or purchased	(427)	(36)	(42)	-	(505)
Derecognitions and maturities	162	48	89	-	299
Write-offs	-	3	59	-	62
Total loss allowance for loans to customers	(2,365)	(1,379)	(3,229)	(138)	(7,111)
<i>Impairment loss allowance for loans to customers - Individuals</i>					
Balance at the beginning of the year	(446)	(287)	(1,043)	-	(1,776)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(158)	107	51	-	-
Transfers to Stage 2 (lifetime ECL)	23	(33)	10	-	-
Transfers to Stage 3 (credit impaired financial assets)	6	35	(41)	-	-
Net remeasurement of loss allowance	89	(152)	(156)	-	(219)
New financial assets, originated or purchased	(49)	(13)	(12)	-	(74)
Derecognitions and maturities	31	17	45	-	93
Write-offs	-	2	50	-	52
Total loss allowance for loans to individuals	(504)	(324)	(1,096)	-	(1,924)
<i>Impairment loss allowance for loans to customers - Corporates</i>					
Balance at the beginning of the year	(1,881)	(1,232)	(1,889)	(131)	(5,133)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(400)	305	95	-	-
Transfers to Stage 2 (lifetime ECL)	34	(34)	-	-	-
Transfers to Stage 3 (credit impaired financial assets)	14	48	(62)	-	-
Net remeasurement of loss allowance	619	(151)	(300)	(7)	161
New financial assets, originated or purchased	(378)	(23)	(30)	-	(431)
Derecognitions and maturities	131	31	44	-	206
Write-offs	-	1	9	-	10
Total loss allowance for loans to corporates	(1,861)	(1,055)	(2,133)	(138)	(5,187)
<i>Impairment loss allowance for loan commitments, guarantees and unused credit facilities</i>					
Balance at the beginning of the year	(351)	(93)	(5)	-	(449)
Transfers:					
Transfers to 12-month ECL	(30)	30	-	-	-
Transfers to lifetime ECL	3	(3)	-	-	-
Transfers to credit impaired	-	1	(1)	-	-
Net remeasurement of loss allowance	115	(23)	1	-	93
New financial commitments originated	(72)	(16)	-	-	(88)
Derecognitions and maturities	63	17	-	-	80
Total loss allowance for loan commit., guarantees, unused facilities	(272)	(87)	(5)	-	(364)



Notes to the Condensed Consolidated Interim Financial Statements

42. Credit risk, continued

31.12.2022

<i>Impairment loss allowance</i> *	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(1,606)	(1,897)	(4,824)	(1)	(13,044)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(1,213)	929	284	-	-
Transfers to Stage 2 (lifetime ECL)	310	(891)	581	-	-
Transfers to Stage 3 (credit impaired financial assets)	42	169	(211)	-	-
Net remeasurement of loss allowance **	1,178	(121)	(1,065)	1	2,048
New financial assets, originated or purchased	(2,192)	(265)	(1,048)	(131)	(2,670)
Derecognitions and maturities	795	457	2,120	(166)	2,570
Write-offs ***	1	7	1,226	166	2,768
Impairment loss allowance ****	(2,685)	(1,612)	(2,937)	(131)	(8,328)
Impairment loss allowances for assets only carrying 12-month ECL	(6)	-	-	-	(13)
Total impairment loss allowance	(2,691)	(1,612)	(2,937)	(131)	(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 2,059 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.

<i>Impairment loss allowance for loans to customers</i>	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)	(1,044)	760	284	-	-
Transfers to Stage 2 (lifetime ECL)	289	(870)	581	-	-
Transfers to Stage 3 (credit impaired financial assets)	41	168	(209)	-	-
Net remeasurement of loss allowance	921	41	(777)	1	186
New financial assets, originated or purchased	(1,683)	(196)	(1,048)	(131)	(3,058)
Derecognitions and maturities	454	377	1,491	(166)	2,156
Write-offs	1	7	1,226	166	1,400
Total loss allowance for loans to customers	(2,334)	(1,519)	(2,932)	(131)	(6,916)

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)	(525)	326	199	-	-
Transfers to Stage 2 (lifetime ECL)	92	(148)	56	-	-
Transfers to Stage 3 (credit impaired financial assets)	18	138	(156)	-	-
Net remeasurement of loss allowance	581	(378)	(474)	1	(270)
New financial assets, originated or purchased	(241)	(74)	(75)	-	(390)
Derecognitions and maturities	121	86	272	-	479
Write-offs	1	7	286	-	294
Total loss allowance for loans to individuals	(445)	(289)	(1,043)	-	(1,777)



Notes to the Condensed Consolidated Interim Financial Statements

42. Credit risk, continued

	Stage 1	Stage 2	Stage 3	POCI	Total
<i>Impairment loss allowance for loans to customers - Corporates</i>					
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)	(520)	434	85	-	(1)
Transfers to Stage 2 (lifetime ECL)	197	(722)	525	-	-
Transfers to Stage 3 (credit impaired financial assets)	23	29	(53)	-	(1)
Net remeasurement of loss allowance	340	419	(303)	-	456
New financial assets, originated or purchased	(1,441)	(123)	(973)	(131)	(2,668)
Derecognitions and maturities	333	291	1,219	(166)	1,677
Write-offs	-	-	940	166	1,106
Total loss allowance for loans to corporates	(1,889)	(1,232)	(1,889)	(131)	(5,141)

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	(169)	169	-	-	-
Transfers to lifetime ECL	21	(21)	-	-	-
Transfers to credit impaired	1	1	(2)	-	-
Net remeasurement of loss allowance	257	(162)	(288)	-	(193)
New financial commitments originated	(509)	(69)	-	-	(578)
Derecognitions and maturities	341	80	629	-	1,050
Total loss allowance for loan commit., guarantees, unused facilities	(351)	(93)	(5)	-	(449)

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 60%, pessimistic 30% and optimistic 10% (31.12.2022: base case 65%, pessimistic 25% and optimistic 10%). The macroeconomic forecast and scenario probability weights is done by the Bank's Chief Economist and approved by the Bank's Executive Risk Committee. The following table shows values used for IFRS 9 impairment calculations.

	Base case			Pessimistic			Optimistic		
	2023	2024	2025	2023	2024	2025	2023	2024	2025
Unemployment rate	3.9%	4.0%	4.1%	6.7%	5.6%	4.5%	2.9%	3.2%	3.4%
Housing prices	2.6%	1.3%	2.9%	-0.9%	-2.7%	4.3%	7.0%	4.4%	3.1%
Private consumption	2.5%	2.5%	2.7%	-0.8%	2.9%	3.0%	4.6%	3.7%	3.0%
GDP	2.6%	2.7%	2.4%	-0.4%	2.9%	2.6%	3.8%	3.1%	2.6%

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 1.3 billion, ISK 2.7 billion and ISK 7.9 billion for the optimistic, base case and pessimistic scenarios, respectively. At year end 2022 the corresponding calculated loss allowance was ISK 1.8 billion, ISK 3.1 billion and ISK 8.4 billion, respectively.



Notes to the Condensed Consolidated Interim Financial Statements

42. 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.

	Stage 1		Stage 2		Stage 3		Total	
	Gross carrying amount	Loss allowance						
31.03.2023								
Individuals	4,636	(8)	2,534	(31)	2,621	(313)	9,791	(352)
Companies	3,983	(38)	11,448	(568)	3,926	(1,303)	19,357	(1,909)
<i>Tourism</i>	2,011	(26)	9,836	(552)	2,544	(1,056)	14,391	(1,634)
<i>Other than tourism</i>	1,972	(12)	1,612	(16)	1,382	(247)	4,966	(275)
Total	8,619	(46)	13,982	(599)	6,547	(1,616)	29,148	(2,261)
31.12.2022								
Individuals	-	-	7,948	(42)	2,254	(257)	10,202	(299)
Companies	-	-	16,815	(606)	3,529	(1,259)	20,344	(1,865)
<i>Tourism</i>	-	-	13,100	(563)	2,511	(1,065)	15,611	(1,628)
<i>Other than tourism</i>	-	-	3,715	(43)	1,018	(194)	4,733	(237)
Total	-	-	24,763	(648)	5,783	(1,516)	30,546	(2,164)



Notes to the Condensed Consolidated Interim Financial Statements

43. 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 fair value 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 9.6%, has exceeded the Central Bank's target of 2.5% since June 2020 and is expected to remain over the target throughout 2023. The Central Bank has responded by increasing interest rates by 675bps from its lowest value of 75bps at the start of 2021. From the second half of 2021 to the start of 2022, this resulted in a sharp increase in demand for non-indexed fixed rate mortgages with corresponding increase in interest rate risk. The risk exposure has been receding over the course of 2022 and beginning of 2023 as the duration of these loans shortens.

Interest rate risk

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 Condensed Consolidated Interim Financial Statements. 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.

31.03.2023	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Assets						
Balances with Central Bank	80,272	-	-	-	-	80,272
Loans to credit institutions	62,899	-	-	-	-	62,899
Loans to customers	739,123	105,833	241,918	2,402	-	1,089,276
Bonds and debt instruments	58,573	58,298	17,922	9,862	3,592	148,247
Bonds and debt instruments used for hedging	-	-	950	1,756	1,534	4,240
Derivatives	149,194	11,140	226,558	-	-	386,892
Assets	1,090,061	175,271	487,348	14,020	5,126	1,771,826
Liabilities						
Due to credit institutions and Central Bank	24,188	-	-	-	-	24,188
Deposits	772,329	2,609	85	-	-	775,023
Derivatives	246,590	125,816	13,133	-	-	385,539
Borrowings	25,698	-	308,303	35,861	11,593	381,455
Subordinated liabilities	-	6,555	27,087	12,446	-	46,088
Liabilities	1,068,805	134,980	348,608	48,307	11,593	1,612,293
Net interest gap	21,256	40,291	138,740	(34,287)	(6,467)	159,533



Notes to the Condensed Consolidated Interim Financial Statements

43. Market risk, continued

31.12.2022	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Assets						
Balances with Central Bank	114,118	-	-	-	-	114,118
Loans to credit institutions	45,501	-	-	-	-	45,501
Loans to customers	679,615	100,734	234,246	3,076	-	1,017,671
Bonds and debt instruments	79,754	43,433	7,181	5,682	2,124	138,174
Bonds and debt instruments used for hedging	-	23	1,890	664	1,313	3,890
Derivatives	127,576	71,983	231,337	-	-	430,896
Assets	1,046,564	216,173	474,654	9,422	3,437	1,750,250
Liabilities						
Due to credit institutions and Central Bank	11,697	-	-	-	-	11,697
Deposits	753,439	1,922	-	-	-	755,361
Derivatives	123,579	292,009	13,445	-	-	429,033
Borrowings	35,373	3,411	298,896	32,446	11,300	381,426
Subordinated liabilities	-	6,819	29,387	12,104	-	48,310
Liabilities	924,088	304,161	341,728	44,550	11,300	1,625,827
Net interest gap	122,476	(87,988)	132,926	(35,128)	(7,863)	124,423

Sensitivity analysis of interest rate risk

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 deposit interest rates. Changes were made to the NII calculations in 2022, for the reference date. The interest rate shifts in both directions take account of the floor on interest rates so that when the floor has an effect then the shifts are restricted.

	31.03.2023		31.12.2022	
	-100 bps	+100 bps	-100 bps	+100 bps
<i>NPV change in the banking book</i>				
ISK, CPI index-linked	(2,530)	2,863	(1,994)	2,782
ISK, Non index-linked	(1,378)	1,301	(1,106)	886
Foreign currencies	(130)	143	(36)	32
<i>NPV change in the trading book</i>				
ISK, CPI index-linked	426	(386)	173	(156)
ISK, Non index-linked	387	(353)	211	(199)
Foreign currencies	(19)	19	(38)	38
<i>NII change</i>				
ISK, CPI index-linked	(1,383)	1,383	(947)	947
ISK, Non index-linked	(1,157)	577	(2,022)	981
Foreign currencies	70	(73)	(83)	71



Notes to the Condensed Consolidated Interim Financial Statements

43. 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
<i>Assets, CPI index-linked</i>				
Loans to customers	8,782	39,647	221,085	269,514
Financial instruments	7,564	3,264	9,954	20,782
Assets, CPI index-linked	16,346	42,911	231,039	290,296
<i>Liabilities, CPI index-linked</i>				
Deposits	94,582	22,088	3,612	120,282
Borrowings	349	70,180	46,937	117,466
Subordinated liabilities	-	-	16,259	16,259
Other	79	243	1,402	1,724
Off-balance sheet position	1,964	1,556	-	3,520
Liabilities, CPI index-linked	96,974	94,067	68,210	259,251
Net on-balance sheet position	(78,664)	(49,600)	162,829	34,565
Net off-balance sheet position	(1,964)	(1,556)	-	(3,520)
CPI balance	(80,628)	(51,156)	162,829	31,045
CPI balance for prudential consolidation, excluding insurance operations *	(79,526)	(54,342)	153,503	19,638
31.12.2022				
<i>Assets, CPI index-linked</i>				
Loans to customers	8,525	37,589	210,878	221,892
Financial instruments	5,208	3,435	9,684	15,843
Assets, CPI index-linked	13,733	41,024	220,562	237,735
<i>Liabilities, CPI index-linked</i>				
Deposits	89,217	20,240	3,493	97,234
Borrowings	336	67,836	45,661	102,007
Subordinated liabilities	-	-	15,735	5,337
Other	1,121	251	1,393	2,672
Off-balance sheet position	1,889	1,520	-	4,467
Liabilities, CPI indexed linked	92,563	89,847	66,282	211,717
Net on-balance sheet position	(76,941)	(47,303)	154,280	30,485
Net off-balance sheet position	(1,889)	(1,520)	-	(4,467)
CPI balance	(78,830)	(48,823)	154,280	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)



Notes to the Condensed Consolidated Interim Financial Statements

43. 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

31.03.2023

	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Financial assets								
Cash and balances with CB	79,117	416	277	115	75	32	240	80,272
Loans to credit institutions	1,642	17,628	30,366	2,001	2,282	6,143	2,837	62,899
Loans to customers	908,708	117,125	56,898	1,697	27,504	795	1,401	1,114,128
Financial instruments	113,228	61,574	9,381	170	317	18,273	2,053	204,996
Other financial assets	15,034	165	37	10	3	5	3	15,257
Financial assets	1,117,729	196,908	96,959	3,993	30,181	25,248	6,534	1,477,552
Financial liabilities								
Due to credit inst. and Central Bank	4,941	16,435	2,748	-	-	-	64	24,188
Deposits	661,244	37,598	62,718	3,901	3,786	3,746	2,030	775,023
Financial liabilities at fair value	2,150	16,713	1,659	19	-	148	3	20,692
Other financial liabilities	13,485	2,837	6,260	346	987	418	434	24,766
Borrowings	172,773	194,244	-	-	-	16,621	7,096	390,734
Subordinated liabilities	19,452	741	12,869	-	-	3,996	9,623	46,681
Financial liabilities	874,045	268,568	86,254	4,266	4,773	24,929	19,250	1,282,084
Net on-balance sheet position	243,684	(71,660)	10,705	(273)	25,408	319	(12,716)	
Net off-balance sheet position	(45,346)	70,129	(11,383)	154	(25,252)	(412)	12,110	
Net position *	198,339	(1,531)	(678)	(119)	156	(93)	(606)	
Non-financial assets								
Investment property	7,875	-	-	-	-	-	-	7,875
Investments in associates	770	-	-	-	-	-	-	770
Intangible assets	8,575	-	-	-	-	-	-	8,575
Tax assets	332	-	-	-	-	-	-	332
Assets and disposal groups								
held for sale	61	-	-	-	-	-	-	61
Other non financial assets	5,221	123	45	67	(3)	22	4	5,479
Non-financial assets	22,834	123	45	67	(3)	22	4	23,092
Non-financial liabilities and equity								
Tax liabilities	10,840	-	-	-	-	-	-	10,840
Other non-financial liabilities	27,751	30	5	-	2	-	-	27,788
Shareholders' equity	179,276	-	-	-	-	-	-	179,276
Non-controlling interest	656	-	-	-	-	-	-	656
Non-financial liabilities and equity ...	218,523	30	5	-	2	-	-	218,560
Management reporting								
of currency risk **	2,650	(1,438)	(638)	(52)	151	(71)	(602)	

* 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.



Notes to the Condensed Consolidated Interim Financial Statements

43. Market risk, continued

31.12.2022

<i>Financial assets</i>	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	112,744	593	257	127	85	43	269	114,118
Loans to credit institutions	1,414	11,884	23,809	3,444	553	1,270	3,127	45,501
Loans to customers	888,036	114,378	51,053	1,551	27,965	146	1,628	1,084,757
Financial instruments	107,687	62,878	3,443	88	372	18,817	44	193,329
Other financial assets	8,239	274	123	11	4	-	1	8,652
Financial assets	1,118,120	190,007	78,685	5,221	28,979	20,276	5,069	1,446,357
<i>Financial liabilities</i>								
Due to credit inst. and Central Bank	9,777	252	231	9	2	-	1,426	11,697
Deposits	662,541	35,413	46,102	3,058	3,023	3,099	2,125	755,361
Financial liabilities at fair value	1,784	16,970	2,008	1	1	195	38	20,997
Other financial liabilities	5,799	1,234	1,775	257	223	589	222	10,099
Borrowings	158,071	216,045	-	-	-	15,303	3,144	392,563
Subordinated liabilities	18,891	772	13,396	-	-	4,383	9,889	47,331
Financial liabilities	856,863	270,686	63,512	3,325	3,249	23,569	16,844	1,238,048
Net on-balance sheet position	261,257	(80,679)	15,173	1,896	25,730	(3,293)	(11,775)	
Net off-balance sheet position	(51,950)	81,095	(15,967)	(1,950)	(25,649)	3,161	11,260	
Net position *	209,307	416	(794)	(54)	81	(132)	(515)	
<i>Non-financial assets</i>								
Investment property	7,862	-	-	-	-	-	-	7,862
Investments in associates	787	-	-	-	-	-	-	787
Intangible assets	8,783	-	-	-	-	-	-	8,783
Tax assets	135	-	-	-	-	-	-	135
Assets and disposal groups								
held for sale	61	-	-	-	-	-	-	61
Other non financial assets	5,275	128	66	86	-	11	6	5,572
Non-financial assets	22,903	128	66	86	-	11	6	23,200
<i>Non-financial liabilities and equity</i>								
Tax liabilities	10,303	-	-	-	-	-	-	10,303
Other non-financial liabilities	32,816	51	6	-	1	-	-	32,874
Shareholders' equity	187,682	-	-	-	-	-	-	187,682
Non-controlling interest	649	-	-	-	-	-	-	649
Non-financial liabilities and equity ...	231,450	51	6	-	1	-	-	231,508
Management reporting								
of currency risk **	760	493	(734)	32	80	(121)	(509)	

* 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.



Notes to the Condensed Consolidated Interim Financial Statements

43. 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 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).

<i>Currency</i>	31.03.2023		31.12.2022	
	-10%	+10%	-10%	+10%
EUR	144	(144)	(49)	49
USD	64	(64)	73	(73)
GBP	5	(5)	(3)	3
DKK	(15)	15	(8)	8
NOK	7	(7)	12	(12)
Other	60	(60)	51	(51)

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 29 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.

<i>Equity</i>	31.03.2023		31.12.2022	
	-10%	+10%	-10%	+10%
Trading book - listed	(224)	224	(165)	165
Banking book - listed	(474)	474	(477)	477
Banking book - unlisted	(404)	404	(430)	430

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.



Notes to the Condensed Consolidated Interim Financial Statements

44. Liquidity and Funding risk

Liquidity risk is 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 70% 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 Group'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

31.03.2023	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity	Total	Book value
Financial assets								
Cash and balances with CB	23,115	49,654	7,707	-	-	-	80,476	80,272
Loans to credit institutions	41,415	21,478	10	-	-	-	62,903	62,899
Loans to customers	4,848	165,740	140,638	487,788	1,211,669	-	2,010,683	1,114,128
Financial instruments	17,069	60,388	58,658	21,130	15,888	42,942	216,075	204,996
Derivatives - assets leg	-	70,543	13,711	27,560	-	-	111,814	110,001
Derivatives - liabilities leg	-	(64,756)	(10,666)	(26,594)	-	-	(102,016)	(100,434)
Other financial instruments	17,069	54,601	55,613	20,164	15,888	42,942	206,277	195,429
Other financial assets	412	12,661	530	1,654	-	-	15,257	15,257
Financial assets	86,859	309,921	207,543	510,572	1,227,557	42,942	2,385,394	1,477,552
Financial liabilities								
Due to credit inst. and Central Bank	4,101	20,213	-	-	-	-	24,314	24,188
Deposits	545,764	192,315	12,919	22,323	3,961	-	777,282	775,023
Financial liabilities at fair value	-	4,342	6,454	21,559	-	-	32,355	20,692
Derivatives - assets leg	-	(24,519)	(28,134)	(14,677)	-	-	(67,330)	(58,499)
Derivatives - liabilities leg	-	28,857	34,588	36,236	-	-	99,681	79,187
Short position in equity	-	4	-	-	-	-	4	4
Other financial liabilities	113	23,170	339	1,145	-	-	24,767	24,767
Borrowings	-	10,058	8,194	357,219	51,843	-	427,314	390,734
Subordinated liabilities	-	898	2,384	21,918	39,471	-	64,671	46,681
Financial liabilities	549,978	250,996	30,290	424,164	95,275	-	1,350,703	1,282,085
Net position for assets and liab.	(463,119)	58,925	177,253	86,408	1,132,282	42,942	1,034,691	195,467
Off-balance sheet items								
Financial guarantees	-	3,402	8,494	4,761	7,100	-	23,757	23,757
Unused overdraft	-	59,962	-	-	-	-	59,962	59,962
Undrawn loan commitments	-	46,447	26,540	17,335	2,591	-	92,913	92,913
Off-balance sheet items	-	109,811	35,034	22,096	9,691	-	176,632	176,632
Net contractual cash flow	(463,119)	(50,886)	142,219	64,312	1,122,591	42,942	858,059	18,835



Notes to the Condensed Consolidated Interim Financial Statements

44. Liquidity and Funding risk, continued

31.12.2022	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity	Total	Book value
Financial assets								
Cash and balances with CB	18,183	88,515	7,531	-	-	-	114,229	114,118
Loans to credit institutions	23,904	21,597	31	-	-	-	45,532	45,501
Loans to customers	2,282	139,996	147,972	470,458	1,138,049	-	1,898,757	1,084,757
Financial instruments	8,527	77,677	43,773	12,384	15,775	41,749	199,885	193,329
<i>Derivatives - assets leg</i>	-	76,104	22,301	32,447	-	-	130,852	123,547
<i>Derivatives - liabilities leg</i>	-	(69,826)	(19,032)	(29,503)	-	-	(118,361)	(114,031)
<i>Other financial instruments</i>	8,527	71,399	40,504	9,440	15,775	41,749	187,394	183,813
Other financial assets	488	1,880	4,935	1,364	-	-	8,667	8,667
Financial assets	53,384	329,665	204,242	484,206	1,153,824	41,749	2,267,070	1,446,372
Financial liabilities								
Due to credit inst. and Central Bank	7,233	4,484	-	-	-	-	11,717	11,697
Deposits	545,764	102,796	84,239	20,568	3,795	-	757,162	755,361
Financial liabilities at fair value	-	1,647	2,973	18,487	-	-	23,107	20,997
<i>Derivatives - assets leg</i>	-	(25,891)	(25,670)	(12,131)	-	-	(63,692)	(62,420)
<i>Derivatives - liabilities leg</i>	-	27,527	28,643	30,618	-	-	86,788	83,406
<i>Short position in bonds used for hedging</i>	-	11	-	-	-	-	11	11
Other financial liabilities	109	8,141	593	1,256	-	-	10,099	10,099
Borrowings	-	21,755	14,169	338,265	50,794	-	424,983	392,563
Subordinated liabilities	-	1,402	1,634	19,685	36,111	-	58,832	47,331
Financial liabilities	553,106	140,225	103,608	398,261	90,700	-	1,285,900	1,238,048
Net position for assets and liab.	(499,722)	189,440	100,634	85,945	1,063,124	41,749	981,170	208,324
Off-balance sheet items								
Financial guarantees	-	2,194	10,024	2,058	6,036	-	20,312	20,312
Unused overdraft	-	57,259	-	-	-	-	57,259	57,259
Undrawn loan commitments	-	47,464	27,308	27,686	3,430	-	105,888	105,888
Off-balance sheet items	-	106,917	37,332	29,744	9,466	-	183,459	183,459
Net contractual cash flow	(499,722)	82,523	63,302	56,201	1,053,658	41,749	797,711	24,865

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.

	31.3.2023	31.12.2022
Available stable funding	1,148,267	1,109,623
Required stable funding	979,338	931,991
Net stable funding ratio	117%	119%



Notes to the Condensed Consolidated Interim Financial Statements

44. 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.

As of January 2023 rules no. 266/2017 were replaced with rules no. 1520/2022 which reference the EU LCR regulations directly. The minimum requirement for the total LCR remains at 100% but the requirement for the LCR in ISK changed to 50% and there is no longer any minimum requirement for the aggregate position in all foreign currencies. Instead the bank is required to maintain an 80% minimum for the LCR in EUR.

The following table shows the breakdown for the Group's LCR calculations.

	ISK	EUR	Total
31.03.2023			
Liquid assets level 1 *	112,031	53,624	187,500
Liquid assets level 2	31,118	-	31,118
Liquid assets	143,149	53,624	218,618
Deposits	147,818	12,880	191,102
Borrowings	2,901	-	6,460
Other cash outflows	7,870	7,525	12,046
Cash outflows	158,589	20,405	209,608
Short-term deposits with other banks **	-	13,780	46,695
Other cash inflows	27,891	7,009	36,963
Cash inflows	27,891	20,789	83,658
Liquidity coverage ratio (LCR) ***	110%	1051%	174%
31.12.2022			
Liquid assets level 1 *	139,562	73,729	213,291
Liquid assets level 2	23,956	-	23,956
Liquid assets	163,518	73,729	237,247
Deposits	155,507	34,631	190,138
Borrowings	580	73	653
Other cash outflows	9,868	6,266	13,949
Cash outflows	165,955	40,970	204,740
Short-term deposits with other banks **	-	23,388	23,388
Other cash inflows	23,854	7,794	31,648
Cash inflows	23,854	31,182	55,036
Liquidity coverage ratio (LCR) ***	115%	720%	158%

* 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.

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

*** LCR is defined as: $LCR = \frac{\text{Weighted liquid assets}}{(\text{weighted cash outflows} - \text{weighted cash inflows})}$ where weighted cash inflows are capped at 75% of weighted cash outflows.



Notes to the Condensed Consolidated Interim Financial Statements

44. Liquidity and Funding risk, continued

Composition of liquid assets

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

	ISK	USD	EUR	Other	Total
31.03.2023					
Cash and balances with Central Bank	79,117	277	416	462	80,272
Short-term deposits with financial institutions	-	19,959	13,780	12,956	46,695
Domestic bonds eligible as collateral with Central Bank	64,650	-	-	-	64,650
Foreign government bonds	-	3,426	53,208	17,676	74,310
Liquidity reserve	143,767	23,662	67,404	31,094	265,927
31.12.2022					
Cash and balances with Central Bank	112,744	257	593	524	114,118
Short-term deposits with financial institutions	-	14,125	4,456	4,807	23,388
Domestic bonds eligible as collateral with Central Bank	50,116	-	-	-	50,116
Foreign government bonds	-	-	55,915	16,435	72,350
Liquidity reserve	162,860	14,382	60,964	21,766	259,972

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					Term deposits*	Total deposits
	Less stable	Weight %	Stable	Weight %			
31.03.2023							
Individuals	94,403	11%	120,431	5%	120,493	335,327	
Small and medium enterprises	96,119	10%	17,270	5%	17,220	130,609	
Operational relationship	15,147	25%	-	5%	-	15,147	
Corporations	110,193	40%	15,380	20%	14,669	140,242	
Sovereigns, central banks and PSE	44,099	40%	-	-	816	44,915	
Pension funds	58,113	100%	-	-	15,842	73,955	
Domestic financial entities	35,484	100%	-	-	6,674	42,158	
Foreign financial entities	1,859	100%	-	-	14,999	16,858	
Total	455,417		153,081		190,713	799,211	
31.12.2022							
Individuals	99,019	10%	117,733	5%	108,788	325,540	
Small and medium enterprises	102,870	10%	16,972	5%	10,155	129,997	
Operational relationship	14,801	25%	-	5%	-	14,801	
Corporations	108,565	40%	15,493	20%	10,907	134,965	
Sovereigns, central banks and PSE	43,869	40%	-	-	778	44,647	
Pension funds	56,987	100%	-	-	14,561	71,548	
Domestic financial entities	39,740	100%	-	-	4,913	44,653	
Foreign financial entities	908	100%	-	-	-	908	
Total	455,538		150,199		161,321	767,058	

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



Notes to the Condensed Consolidated Interim Financial Statements

45. 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 with later changes, through which CRD V / CRR II have been adopted. The Group applies the standardized approach to calculate capital requirements for credit risk, including counterparty credit risk, credit valuation adjustment risk, 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.

<i>Own funds</i>	31.03.2023	31.12.2022
Total equity	179,932	188,331
Unaudited interim net earnings	(6,284)	-
Non-controlling interest not eligible for inclusion in CET1 capital	(656)	(649)
Common Equity Tier 1 capital before regulatory adjustments	172,992	187,682
Intangible assets	(6,601)	(6,425)
Additional value adjustments	(234)	(224)
Foreseeable dividend and buyback *	(897)	(15,980)
Adjustment under IFRS 9 transitional arrangements as amended	687	1,142
Common Equity Tier 1 capital	165,947	166,195
Non-controlling interest eligible for inclusion in T1 capital	103	105
Additional Tier 1 capital	12,869	13,396
Tier 1 capital	178,919	179,696
Tier 2 instruments	33,812	33,935
Tier 2 instruments of financial sector entities (significant investments)	(1,200)	(1,155)
Tier 2 capital	32,612	32,780
Total own funds	211,531	212,476

Risk-weighted exposure amount (REA)

Credit risk, loans and off-balance sheet items	730,700	707,479
Credit risk, securities and other	54,540	57,651
Counterparty credit risk	16,257	14,645
Market risk due to currency imbalance	2,851	1,387
Market risk due to trading book positions	8,647	7,493
Credit valuation adjustment	4,931	6,010
Operational risk	89,166	89,166
Total risk-weighted exposure amount	907,092	883,831

Capital ratios

CET1 ratio	18.3%	18.8%
Tier 1 ratio	19.7%	20.3%
Capital adequacy ratio	23.3%	24.0%
Total own funds, including interim profit not eligible for inclusion	214,673	212,476
CET1 ratio, including interim profit not eligible for inclusion	18.6%	18.8%
Tier 1 ratio, including interim profit not eligible for inclusion	20.1%	20.3%
Capital adequacy ratio, including interim profit not eligible for inclusion	23.7%	24.0%

* On 31 March 2023, the deduction consists of an ongoing buyback program from February 2023. On 31 December 2022, the foreseeable dividend and buyback corresponds to 50% of profits as per the Bank's dividend policy and the remaining part of the buyback authorized by the Central Bank in September 2022.

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.



Notes to the Condensed Consolidated Interim Financial Statements

45. Capital management, continued

<i>Capital ratios of the parent company</i>	31.03.2023	31.12.2022
CET1 ratio	18.4%	18.8%
Tier 1 ratio	19.8%	20.3%
Capital adequacy ratio	23.4%	23.9%

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.

<i>Capital buffer requirement, % of REA</i>	31.03.2023	31.12.2022
Capital conservation buffer	2.5%	2.5%
Capital buffer for systemically important institutions	2.0%	2.0%
Systemic risk buffer *	3.0%	3.0%
Countercyclical capital buffer *	2.0%	2.0%
Combined capital buffer requirement	9.5%	9.5%

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.

<i>Capital requirement, % of REA</i>	CET1	Tier 1	Total
Pillar 1 capital requirement	4.5%	6.0%	8.0%
Pillar 2R capital requirement **	2.0%	2.6%	3.5%
Combined buffer requirement *	9.3%	9.3%	9.3%
Regulatory capital requirement	15.8%	17.9%	20.8%
Available capital	18.3%	19.7%	23.3%

* 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 2021. The Pillar 2R requirement is 3.5% 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.

	31.03.2023	31.12.2022
On-balance sheet exposures	1,457,202	1,415,353
Derivative exposures	30,411	32,118
Securities financing transaction exposures	39,705	10,174
Off-balance sheet exposures	57,645	59,723
Total exposure	1,584,963	1,517,368
Tier 1 capital	178,919	179,696
Leverage ratio	11.3%	11.8%



Notes to the Condensed Consolidated Interim Financial Statements

45. Capital management, continued

MREL

The Group must fulfil a minimum requirement for own funds and eligible liabilities (MREL) in accordance with the Act on Resolution of Credit Institutions and Investment Firms, no. 70/2020 and subsequent amendments, which transpose BRRD I and aspects of BRRD II (relating to MREL) into Icelandic law. Own funds which are not used to fulfil the combined buffer requirement can be used towards the MREL requirement. In September 2022, the Icelandic Resolution Authority (IRA) presented the Group with the MREL requirement based on year-end 2021 financials. According to IRA's methodology, the requirement is calculated as a fraction of total REA but then converted into a fraction of own funds and eligible liabilities which represents the actual requirement. Both ratios are shown in the table below. An MREL subordination requirement has not been implemented in Iceland.

<i>Minimum requirement for own funds and eligible liabilities</i>	31.03.2023	31.12.2022
Own funds	211,531	212,476
Eligible liabilities	160,218	155,667
Own funds and eligible liabilities	371,749	368,143
Combined buffer requirement (CBR)	84,360	82,196
Own funds and eligible liabilities not used for CBR	287,390	285,947
Risk-weighted exposure amount (REA)	907,092	883,832
Own funds and eligible liabilities not used for CBR (% REA)	31.7%	32.4%
MREL requirement (% REA)	23.0%	0
Total liabilities and own funds (TLOF)	1,485,562	1,446,370
Own funds and eligible liabilities not used for CBR (% TLOF)	19.3%	19.8%
MREL requirement (% TLOF)	14.7%	14.7%

Solvency II

Excess of assets over liabilities in accordance with Solvency II	9,461	9,175
Subordinated liabilities	1,175	1,169
Foreseeable dividends	-	-
Own funds	10,636	10,344
Solvency capital requirements (SCR)	7,677	7,114
SCR ratio	138.5%	145.4%

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

46. 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.



Notes to the Condensed Consolidated Interim Financial Statements

47. Sustainability risk

Sustainability risk is 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. Under 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.

<i>Green Financing Instruments</i>	31.03.2023	31.12.2022
Deposits	24,039	21,274
Borrowings	97,036	97,405
Book value	121,075	118,679
<i>Identified eligible green assets by category</i>		
Sustainable fishery and aquaculture	34,494	51,936
Renewable energy	104	-
Clean transportation	4,815	4,879
Green buildings	70,993	64,232
Energy efficiency	9,790	8,189
Pollution prevention and control and wastewater management	6,179	6,174
Book value	126,375	135,410



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