Arion Bank

Consolidated Financial Statements 2023

Contents

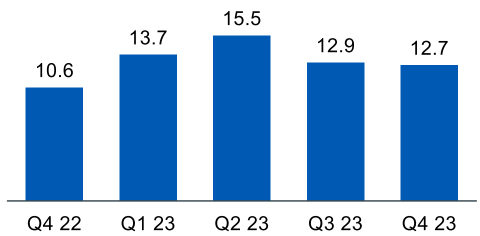
Arion Bank
Highlights 2023

13.6%
Return on equity

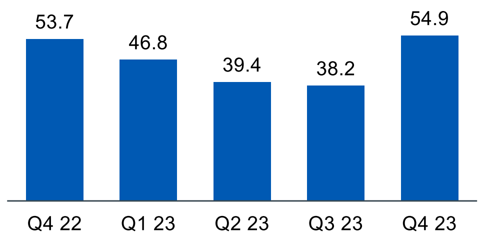
44.7%
Cost-to-core income

19.7%
CET1 ratio

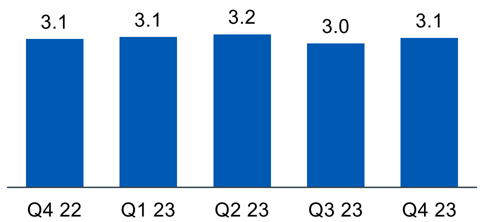
Return on equity (%)



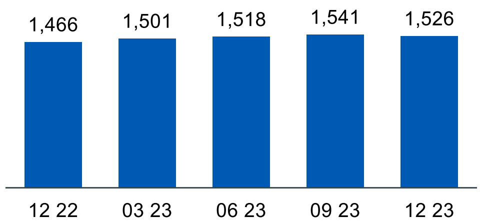
Cost-to-Core income ratio (%)



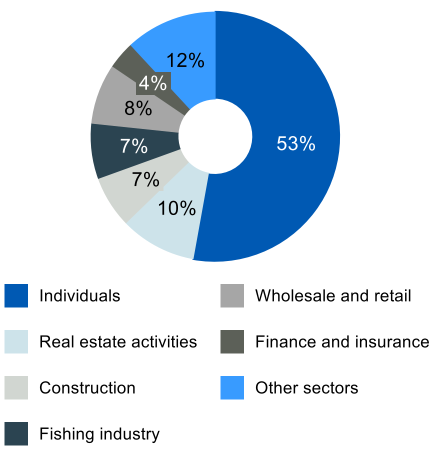
Net interest margin (%)



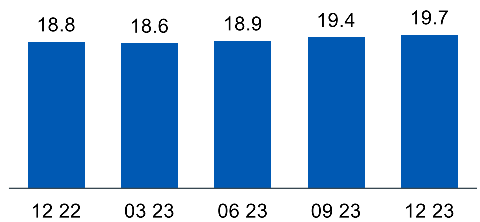
Total assets (ISK bn)



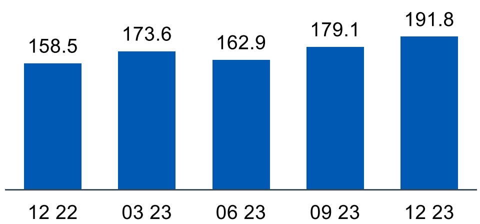
Loans to customers by sector (%)



CET1 ratio (%)



LCR ratio (%)



S&P
Long term: BBB
Short term: A-2
Outlook: Stable

Moody's
Long term: A3
Covered bond: Aa2
Outlook: Stable

THE BANKER
BANK OF THE YEAR 2023
ICELAND

ESG INDUSTRY TOP RATED

UNEP FINANCE INITIATIVE
PRINCIPLES FOR RESPONSIBLE BANKING

Endorsement and statement
by the Board of Directors and the CEO

The Consolidated Financial Statements of Arion Bank for the year ended 31 December 2023 include the Consolidated Financial Statements of Arion Bank ("the Bank") and its subsidiaries, together referred to as "the Group".

About Arion Bank

Arion Bank and its subsidiaries provide comprehensive financial services to the people of Iceland. Arion Bank's role is to help those who want to achieve success in Iceland and the Arctic through smart and reliable financial solutions which enhance financial health and create sustainable value. Arion Bank places great importance on developing long-term relationships with its clients and is a market leader as a provider of cutting-edge and modern banking services.

Arion Bank provides services to individuals, corporates and investors in three business segments: Retail Banking, Corporate & Investment Banking, and Markets. The service offering is further augmented by the subsidiaries Stefnir and Vördur. Stefnir is one of the largest fund management companies in Iceland, and Vördur is the fastest growing insurance company in Iceland, providing non-life and life insurance. The Bank also offers pension services and manages several pensions funds.

The diverse service offering creates a broad revenue base, 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 contribute towards risk management.

The Bank is a market leader in terms of digital solutions and innovation, and the majority of the Bank's services can be obtained using the Arion app. The broad spectrum of digital services makes banking more convenient for customers and also makes the business more cost efficient. The Bank is a leading service provider and advisor to corporate customers and investors and has been a key figure in reinvigorating the Icelandic stock market.

Arion Bank has adopted a clear policy on sustainable operations and environmental and climate issues. A wide range of green financial services, such as green car loans, deposits, corporate loans and mortgages, is available to its customers. Arion Bank has published a green financing framework which addresses the Bank's funding and lending activities. The Bank has pledged to use the capital it obtains on the credit markets through the green financing framework in green loans to corporate and retail customers as defined in the framework.

Arion Bank is a financially robust bank which aspires to operate profitably in harmony with society and the environment. The Bank is committed to paying competitive dividends and is listed on Nasdaq Iceland and Nasdaq Stockholm.

Operations during the year

Income Statement

Net earnings amounted to ISK 25.7 billion, return on equity was 13.6% and earnings per share ISK 17.8. Core income, defined as net interest income, net commission income and insurance service results (excluding opex), increased by 7.3%, compared with the previous year. Net interest income increased by 11.2%, compared with previous year, mainly due to increased base rate and 6% growth in loans to customers from year-end 2022, while Net interest margin remains stable at 3.1%, as funding cost through deposits and borrowings has increased. The year was solid for the fee generating businesses, despite slowing activity in the economy and the capital markets. The operation of the subsidiary Vördur improved between years with insurance revenues increasing by 15.3% while claims increased by 17.7%, mainly due to unfavourable fire insurance claims in 2023. Market conditions were challenging for net financial income in 2023 but markets recovered in the last quarter, resulting in a profit of ISK 1,366 million for the year 2023. Other income was strong due to the ISK 1.6 billion revaluation of the investment property Blikastadir. Operating expenses, including operating expenses of the insurance operation, increased by 6.8% between years which is below the rate of inflation. The cost-to-core income ratio was 44.7%, with expenses of the insurance operation included, compared with 45.0% for 2022. Impairments were calculated at 12bps for the year, which is lower than expected for the Bank through the cycle but represents a negative change from last year when net impairments were positive.

Balance Sheet

Arion Bank's balance sheet grew by 4.1% from year-end 2022. Loans to customers increased by 6.3% from year-end, with an 8.2% increase in corporate lending and 4.6% growth in loans to individuals, mainly mortgages. Deposits increased by 4.9%, primarily individuals and corporates. Total equity amounted to ISK 199,301 million at the end of the year. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 24.1% and the CET1 ratio was 19.7%, assuming around ISK 13 billion dividend payment. 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.

IFRS 17 Insurance contracts

The insurance subsidiary Vördur initially adopted IFRS 17 Insurance contracts on 1 January 2023. The impacts on the Group's Consolidated Financial Statements are listed in Notes 1 and 2.

Volcanic activity in the vicinity of Grindavík

Following the events near Grindavík starting in November 2023, Arion Bank has offered to freeze the mortgages of its customers in Grindavík and to waive interest and indexation on their loans until the end of April 2024. The Bank will continue to closely monitor developments in Grindavík and do its utmost to support the local community. For futher information see disclosure in Note 44.

Endorsement and statement
by the Board of Directors and the CEO

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

	Actuals 2023	Arion Bank's medium-term financial targets
Return on equity	13.6%	Exceed 13%
Core operating income / REA	7.1%	Exceed 6.7%
Insurance premium growth (YoY)	15.0%	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 10.2% for 9M 2023)
Cost-to-core income ratio	44.7%	Below 48%
CET1 ratio above regulatory capital requirements	480 bps	150-250 bps management buffer (*16.4 - 17.4% based on current capital requirements and current AT1 and T2 ratios)
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

GDP growth has slowed down significantly after a period of strong growth in 2022. Domestic product was 3.8% lower in the third quarter of 2023 than the second quarter, and economic growth from the third quarter onwards measured a mere 1.7%. This trend is particularly attributable to slumps in private consumption and investment, which in turn can be linked to the adoption of a tighter monetary stance. Private consumption was down 1.7% year-over-year in the third quarter, and demand appears to be receding, illustrated by the fact that household card turnover was 5.2% lower in the fourth quarter than the same period the previous year. However, exports were up 1.8%, while imports were down 3%, meaning that GDP growth is shifting from being driven by private consumption to being export driven, which is positive for the long-term economic outlook.

The economy is currently the scene of a tug of war between the Monetary Policy Committee and the labour market. While the Covid-19 pandemic was raging, policy rates had been at an all-time low, well below the rate of inflation, and the government ran a budget deficit to lessen the shock to the economy. Households therefore hardly felt the impact of the crisis at the time. Persistent inflation now is partly a consequence of these measures, while sharp wage increases have further buoyed inflation. Despite shrinking demand and steep pay rises, the labour market has remained robust, and seasonally adjusted unemployment measured a mere 3.9% at the end of 2023. Much of this is due to the upturn in tourism. Jobs related to the airlines have increased by 20.9% in a year, and travel companies and related services have seen a 19.3% rise in jobs.

Inflation measured 7.7% at the end of 2023 and little has changed since July. It now seems likely that inflation will recede somewhat over the next few months and Arion Research forecasts 6.1% inflation in March. However, inflation is expected to drop slowly and is projected to average 5.5% over the year. Lower inflation means that real policy interest rates automatically increase, and a tighter monetary stance will be taken. This opens up the possibility of interest rate cuts later in the year.

Uncertainty remains high, however, and there are two factors which could prove critical. Firstly, there is the outcome of the latest round of collective wage negotiations; and secondly how the problem of housing for the displaced population of Grindavík will be resolved. At the beginning of the wage negotiations all parties seemed eager to reach a deal, and it appeared that wage increases would be moderate. However, the tone has changed and it now seems likely that negotiations will result in high pay increases. Although wage increases are positive for households, it could mean that policy rates are kept high for longer than they would have been otherwise. Arion Research thinks it unlikely that policy rates will be cut before deals are reached on both the general and public sector labour markets. Therefore, there is little prospect of an interest rate cut before May. The second major uncertainty concerns measures in response to the situation in Grindavík. How these measures will be implemented is not yet clear, but the government has stated that no one will be forced to remain in Grindavík, suggesting that people will receive some sort of compensation for their homes if they choose to move elsewhere. If the entire population of Grindavík, or a large percentage of them, choose to buy a home elsewhere, it is very likely to have a considerable impact on the housing market, even if mitigation measures are taken.

The foundations of the Icelandic economy remain strong despite its current sluggishness, and domestic demand can be expected to recover next year as policy interest rates are cut and the economy seeks balance.

Outlook for the Bank

The Arion Group follows a strategy to aim to be the best at meeting the needs of its target groups and a leading company which drives the success of its customers and society as a whole. This vision builds on long-term business relationships, diverse services and strong teamwork which forms the basis for a seamless customer experience and sustainable value creation. The Group's performance indicates that we are on the right track. The Group's core operations continued to perform strongly, and all key financial targets were achieved. Operations are underpinned by the Group's diverse business segments which complement each other through economic cycles, create integrated services for customers and bring enhanced operating efficiency.

As in recent years, the operating environment underwent considerable changes in 2023, and the Group was able to call upon its diverse revenue streams and sound infrastructure, yet also had the flexibility to respond to the shifting environment. The economy has been beset by inflation and rising interest rates, and it is positive that goals are reached to bring this under control and to stabilize the economy in the near term, with wage settlements playing a critical role in this respect. Volcanic activity on the Reykjanes Peninsula has also presented a major challenge this year. The Group has worked closely with its customers in the affected area in this difficult period and will continue to do so as events develop.

Arion Bank remains in a strong position to deal with changes in the environment, having strong and diverse revenue streams, high capital ratios by international standards and excellent liquidity.

On 1 March Arion Bank will host a capital markets day at its headquarters where the management will present the key strategic focuses within the Group and refine its operating targets for the next few years.

Employees

The Group had 822 full-time equivalent positions at the end of the year, compared with 781 at the end of 2022.

Arion Bank and Vördur have in place an incentive scheme which came into effect in 2021 for employees of Arion Bank and Vördur. The scheme is in compliance with the FSA's rules on remuneration policies for financial institutions. The scheme is split into two parts. Firstly, employees can receive up to 10% of their fixed salary 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 four to five year lock-up period. The key metric used to determine whether remuneration will be paid for 2023, in part or in full, is whether the Bank's return on equity in the relevant year is higher than the weighted ROE of the Bank's main competitors. Stefnir has a special incentive scheme where other criteria are used as a basis. Since 2021 Arion Bank has had in place share option plan for all employees of the Bank, and the subsidiaries Vördur and Stefnir, which is considered important for aligning the interests of employees with the long-term interests of the Bank. The share option plan was initially for five years and employees are entitled to buy shares for up to ISK 1,500,000 each year. The purchase price is determined by the Bank's average share price 10 days before the share option agreement is signed.

Funding and liquidity

In terms of funding and liquidity management the year was characterized by the Bank's strong liquidity position and continued deposit growth. The Bank's liquidity position was well above the required minimum and the liquidity ratio at the end of 2023 was 192%, with the minimum requirement being 100%. The Bank's solid liquidity position is due to funding on the wholesale markets, while customer deposits increased by 5.0%, from ISK 755 billion to ISK 793 billion.

In May 2023 Arion Bank issued €300 million senior preferred notes with a maturity of 3 years. The notes pay a coupon of 7.25% which corresponds to a spread of 407bp over mid-swaps. The bonds attracted strong demand from a diverse group of investors on the international bond market. Offers totalling approximately €600 million were received from in excess of 70 investors from more than 15 countries in Europe and Asia. At the same time Arion Bank announced an invitation to holders of its outstanding €300 million senior notes due in May 2024 to tender their notes.

In November Arion Bank completed the sale of a new series of senior preferred bonds. The new indexed-linked series, ARION 28 1512, sold for a total of ISK 8,740 million at a yield of 4.40%. It matures on 15 December 2028.

Arion Bank continued to issue covered bonds. In 2023 the Bank issued covered bonds amounting to ISK 44.4 billion (of which ISK 22.6 billion were for own use).

Moody's Investors Service rated Arion Bank's covered bonds for the first time. Arion Bank was assigned an Aa2 long-term rating for its euro-denominated covered bonds. This is the highest rating of any Icelandic issuer. Arion Bank's long term-issuer rating was upgraded from Baa1 to A3. Additionally, the long-term and short-term deposit rating was upgraded from A3/P-2 to A2/P-1. The outlook was changed from positive to stable.

In May S&P Global Ratings affirmed its BBB rating for Arion Bank and revised the outlook from stable to negative. In November, the outlook was revised back to stable.

S&P Global Ratings revised its rating for Arion Bank's covered bond programme from A to A+ with a stable outlook. The covered bond rating is now the same as that of the Icelandic government.

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, capital thresholds as per external rating methodologies will impact the Bank's capital management. This is especially relevant for the Bank's BBB rating from Standard & Poor's. To maintain the current rating, the Bank will need to accumulate Tier 1 capital in excess of regulatory requirements by 4-5% of REA. The Bank's issuer rating from Moody's is A3 with a stable outlook.

The proposed dividend for the year 2023, which will be subject to the approval of the Annual General Meeting on 13 March 2024, corresponds to ISK 9.0 per share or around ISK 13 billion, net of own shares. In March 2023, the Bank paid a dividend of ISK 8.5 per share, approximately ISK 12.5 billion.

On 10 July, the FSA published the result of the Supervisory Review and Evaluation Process (SREP) for Arion Bank, based on financial information at year-end 2022. The additional capital requirement under Pillar 2 is set at 2.1% of total risk-weighted exposure amount (REA), a decrease of 1.4pp from the previous year.

In March 2023 the Central Bank of Iceland announced that it would increase the countercyclical buffer from 2% 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.

Arion Bank's capital position is very strong and will remain so for the foreseeable future. This underpins the Bank's ability to support its customers and the Icelandic economy, as it faces challenging economic conditions owing to a number of factors including geopolitical tensions, persistent high interest rates, high inflation, and the threat of natural disaster.

The Group's capital adequacy ratio on 31 December 2023 was 24.1% and the CET1 ratio was 19.7%. 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 total regulatory capital requirement of 19.3% and a CET1 requirement of 14.9%, including the combined buffer requirement.

The Bank's REA increased by ISK 27.6 billion in 2023. This was driven primarily by an increase of ISK 25.3 billion in loan portfolio REA and 9.5 billion in operational risk REA, partly offset by a ISK 7.2 billion decrease in counterparty credit risk REA. REA changes for other factors were less material.

The Central Bank of Iceland's Resolution Authority approved Arion Bank's resolution plan on 17 October 2023. With the approval of the resolution plan, the Resolution Authority set the Bank's MREL requirement at 20.2% of the total risk exposure amount and 6% of the total exposure measure, based on year-end 2022 data. Arion Bank is in full compliance with the requirement. An MREL subordination requirement is expected to come into effect in Q3 2026.

Group ownership

The main venue at which the Board and the Bank report information to the shareholders and propose decisions is at legally convened shareholders' meetings. The Bank provides an effective and accessible arrangement for communications between shareholders and the Board of Directors between those meetings. Any information sensitive to the market will be released through a MAR press release. Arion Bank also arranges quarterly meetings where the CEO, CFO and Investor Relations present the interim financial results. The Bank has also held its capital markets day on two occasions, in November 2019 and 2021, where the management team discussed the progress in the Bank's operations and key focus areas going forward. The next capital markets day will be held 1 March 2024.

At the end of December 2023 Gildi lífeyrissjódur was the largest shareholder in Arion Bank with a shareholding of 9.85%. Arion Bank held 0.95% of its own shares at the end of December. The number of shareholders was 11,180 at the end of December, compared with 12,059 at the beginning of the year. Further information on Arion Bank's shareholders can be found in Note 38. 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.

Risk management

The Group faces various risks arising from its day-to-day operations as a financial institution. Managing risk is therefore a core activity within the Group. The key to effective risk management is a process of on-going identification of significant risk, quantification of risk exposure, actions to limit risk and constant monitoring of risk. This process of risk management and the ability to manage and price risk factors is critical to the Group's continuing profitability as well as ensuring that the Group's exposure to risk remains within acceptable levels. The Board of Directors is ultimately responsible for the Bank's risk management framework and ensuring that satisfactory risk policies and governance structure for controlling the Bank's risk exposure are in place. The Group's risk management, its structure and main risk factors are described in the notes and in the Bank's unaudited Pillar 3 Risk Disclosures.

Endorsement and statement
by the Board of Directors and the CEO

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%.

The Board of Directors of Arion Bank places great importance on good corporate governance and a corporate culture which fosters open and honest relations between the Bank, its shareholders, and other stakeholders. The Board of Directors is the supreme authority in the affairs of the Bank between shareholders' meetings and tends to those operations of the Bank which are not considered part of the day-to-day business, i.e., taking decisions on issues which are unusual or of a significant nature. The Board of Directors appoints a Chief Executive Officer who is responsible for the day-to-day operations in accordance with a strategy set out by the Board. The CEO hires the Executive Management.

There are five Board sub-committees: The Board Audit Committee, the Board Risk Committee, the Board Credit Committee, the Board Remuneration Committee and the Board Tech Committee. One of the committee members on the Board Audit Committee is not a Board member and is independent of the Bank and its shareholders.

The main roles of the Board, as further specified in the rules of procedure of the Board, include approving the Bank's strategy, supervising financial affairs and accounting, and ensuring that appropriate internal controls are in place. The Board ensures that the Bank has active Internal Audit, Compliance and Risk Management departments. The Internal Auditor is appointed by the Board of Directors and works independently of other departments of the Bank in accordance with a charter from the Board. The Internal Auditor provides independent and objective assurance and advice designed to add value and improve the Bank's operations. The Compliance Officer, who reports directly to the CEO, works independently within the Bank in accordance with a charter from the Board. The main role of Compliance is to ensure that the Bank has in place proactive measures to reduce the risk of rules being breached in the course of its activities. Compliance is also responsible for coordinating the Bank's measures against money laundering and terrorist financing. The duties of Compliance are carried out under a risk-based compliance plan approved by the Board of Directors, including a monitoring and training schedule for employees which addresses the laws and rules under which the Bank operates.

Corporate governance at Arion Bank is described in more detail in the Bank's Corporate Governance Statement which is contained in the unaudited appendix to the Financial Statement and on the website www.arionbanki.is. The Corporate Governance Statement is based on legislation, regulations, and recognised guidelines in force when the Bank's annual financial statements are adopted by the Board of Directors, prepared in accordance with the Guidelines on Corporate Governance, 6th edition, issued by the Icelandic Chamber of Commerce, SA – Business Iceland and Nasdaq Iceland in February 2021. Corporate governance at Arion Bank complies with the guidelines with two exceptions, which are explained in more detail in the Corporate Governance Statement.

In September Birna Hlín Káradóttir, who has been General Counsel at Arion Bank since 2019, took up the role of managing a new division, Operation and Culture, which took over a range of projects which were previously the responsibility of other divisions. The new division also includes a new transformation team. The changes are designed to foster closer collaboration between support units, bring greater efficiency to operations, manage transformation projects more effectively, and bring a clearer focus on service and customer experience. The division will also play a key role in the continued development and shaping of Arion Bank's corporate culture. Operation and Culture will incorporate human resources, back office, operations management, transformation and legal services.

Sustainability and non-financial reporting

Arion Bank places great importance on environmental and social factors and good governance in its operations. The Bank's business model is discussed earlier in this report. Arion Bank's role is to help people who want to achieve success in Iceland and the Arctic through smart and reliable financial solutions which enhance financial health and create sustainable value.

Arion Bank's sustainability policy bears the title Together we make good things happen and signifies that the Bank wants to act as a role model in responsible and profitable business practices, taking into account the environment, the economy and society. At Arion Bank we aim to ensure that social responsibility and sustainability are part of the Bank's day-to-day activities, its decision-making and processes. The Bank's code of ethics serves as a key to responsible decision-making at Arion Bank.

The Bank has a sustainability committee and the management of risk in connection with ESG factors was defined as part of the Bank's risk management system. The CEO is the chairman of the committee, whose role is to monitor the Bank's performance in connection with its policy and commitment on sustainability and to ensure that ESG factors are considered in decisions and plans made by the Bank. A green financing committee and equality committee are sub-committees of this committee.

The Bank has adopted a risk policy on sustainability which is approved by the Board of Directors and reviewed annually. This policy states that the Bank seeks to ensure that its operations and services do not have a negative impact on people or the environment. It also states that the Bank supports Iceland's climate action plan whose goal is to meet the obligations of the Paris Climate Agreement and to achieve the ambitious goal of carbon neutrality in Iceland by 2040. Key performance indicators relating to ESG factors were added to the quarterly risk report to the Board, and the Bank's risk appetite with respect to these factors was defined.

Arion Bank has selected six UN Sustainable Development Goals which the Bank intends to focus on. These goals are number 5 on gender equality; number 7 on affordable and clean energy; number 8 on decent work and economic growth; number 9 on industry, innovation and infrastructure; number 12 on responsible consumption and production; and number 13 on climate action.

Partnerships in sustainability

Arion Bank engages in extensive partnerships in the field of sustainability and social responsibility, both in Iceland and abroad, and is a signatory to numerous treaties and declarations. For example, the Bank is a signatory to the UN Global Compact, the UN Principles for Responsible Investment, the UN Principles for Responsible Banking and UN Women.

In 2023 the CEO of Arion Bank, Benedikt Gíslason, signed a CEO statement with the CEOs of almost 80 Nordic signatories to the Global Compact expressing their support for the UN's Global Compact's Ten Principles and Sustainable Development Goals, while upholding the targets of the Paris Agreement and urging further action to reach these targets. The statement was released to coincide with COP28. At the end of the year, the Bank also became a signatory to the Science Based Targets initiative (SBTi) and the UN-convened Net-Zero Banking Alliance, a global group of banks committed to financing ambitious climate action.

In Iceland the Bank is a member of Festa – Center for Sustainability and one of the founding members of IcelandSIF, the Iceland Sustainable Investment Forum. The Bank is also one the founding members of Green by Iceland, a joint business and government forum on climate issues and green solutions. The Bank has been a signatory to the City of Reykjavík and Festa's Declaration on Climate Change since 2015 and has signed a declaration of intent concerning the Equality Scale, an initiative created by the Association of Icelandic Businesswomen (FKA).

Policy and environment and climate action

Arion Bank has adopted an environment and climate policy and has set targets. The policy, which was updated at the beginning of 2024, spells out the importance of the Bank minimizing the negative environmental impact of its activities and greenhouse gas emissions. The policy states that the Bank will focus its attention on financing projects on sustainable development and green infrastructure, support Iceland's ambitious plans to have net zero emissions by 2040 and aim to be net zero itself the same year.

In 2023 the Bank updated its targets in its environment and climate policy, and the targets were approved by the sustainability committee at the beginning of 2024. Earlier targets were reviewed with respect to the results achieved so far and new targets were added. The Bank's targets are reassessed annually with the aim always being to set higher targets.

Arion Bank's environment and climate targets until 2030:

- Percentage of sustainable lending will be at least 20% of the Bank's total loan book.
- Reduction of greenhouse gas emissions from own activities (Scopes 1 & 2) by 80% calculated from 2015 and remaining emissions will be carbon offset.
- Continuous efforts to get a more accurate picture of emissions from acquired goods and services (Scope 3) in the Bank's activities.
- Aim for reductions in financed emissions in the sectors which have the most impact (Scope 3) in line with the net zero target by 2040. The latest targets are published annually in the Bank's report on financed emissions.
- Targets on financed emissions should be validated by SBTi.

The Bank issued its first comprehensive green financing framework in 2021 and has since then issued four green bonds based on the framework. After two years of solid growth in 2021 and 2022, the proportion of green lending in the total loan portfolio fell slightly in 2023 to 10.7% at year-end. The Bank's original target was to increase the percentage of loans under the Green Financing Framework to at least 20% by 2030. This target was revised at the beginning of 2024, and in the future it will apply both to green loans and loans which have a positive impact on society. Revisions of the green financing framework also commenced during the year. Loans which have a positive impact on society will now also be incorporated into the framework. This work will be completed in 2024.

The Bank's credit policy places an emphasis on sustainability and the credit rules stipulate that ESG factors should be assessed when a credit rating is required, or a company meets the conditions of Article 66d of the Annual Accounts Act.

The Bank's updated targets state that the Bank is trying to reduce greenhouse gas emissions from its own activities by 80% by 2030, i.e. from building premises and vehicles. At the end of 2023 the Bank had reduced these emissions by 75.5% compared with the reference year 2015. The Bank has purchased verified carbon units to offset emissions for which the Bank is directly responsible and emissions from other activities, such as business trips, waste and employee journeys to and from work.

In conjunction with the 2023 Annual and Sustainability Report, Arion Bank is publishing its second report on financed emissions which is based on Partnership for Carbon Accounting Financials (PCAF) methodology. This involves emissions from the Bank's lending and investments. The report reveals that the emissions intensity of the Bank's loan portfolio is similar between years but has improved slightly. Emissions intensity is defined as the volume of greenhouse gas emissions per each ISK 1 million loaned. The emissions intensity of customers decreased from 0.154 ktCO2e/ISKm to 0.151 ktCO2e/ISKm, or by 2%. Corporate loans have the largest impact, with 90% of emissions relating to this type of loan. Emissions intensity decreased by 5.1% between years in this loan category. The report sets out the first climate targets based on the results of financed emissions, and they represent important steps in the Bank's target setting until 2030. The Bank aims to get its climate targets validated by Science Based Targets initiative (SBTi) within two years.

Human Resources

The Bank's human resources policy involves creating a positive and motivational working environment and supporting its employees. We endeavour to attract and retain outstanding employees and help them develop professionally and personally. The Bank has adopted a learning and development policy designed to make employees improve and maintain their knowledge and skills and to ensure they are always well informed and know the laws and rules applicable to their area of work. Employees are also encouraged to show initiative and take responsibility for their own knowledge and skills.

Endorsement and statement
by the Board of Directors and the CEO

The Arion Index is a survey which is regularly sent to all employees of the Bank and measures a range of factors, including how employees experience their own work, working environment and well-being at work. The results of the Arion Index this year indicated that our employees are generally happy at work and satisfied with their working environment. The average Arion Index score during the year was 4.38 on a scale of 1-5. The results of the workplace analysis revealed that 93% of employees are satisfied with their place of work and employee engagement scored 4.27 on a scale from 1-5.

The Bank has adopted a clear equality and human rights policy and a 3-year action plan. The objective of the policy and action plan is to create an environment where people of similar education, work experience and responsibility have equal opportunities and terms, irrespective of gender, gender identity, sexual orientation, origin, nationality, skin colour, age, disability or religion or other factors. The Bank's action plan places emphasis on balancing gender ratios at the Bank, not just at management level but throughout different job families, committees, and business units. If we look at all levels of management at the Bank, 44% are women and 56% are men.

Since 2015 the Bank has had an equal pay system and equal pay certification. The aim is to eliminate the gender pay gap and promote equality. In 2018 we became the first Icelandic bank to get the Ministry of Welfare's equal pay symbol and a pay equity analysis indicated that the unexplained gender pay gap was 2.4%. Since 2022 we have sharpened our focus on this issue and introduced monthly pay analyses in addition to the review performed annually. The review carried out in 2023 revealed an unexplained gender pay gap of 0.2% (women higher) compared with 0.4% in 2022. The target is for this figure to be below 1%. In addition, the Bank has set the target that the median value of total wages paid to men compared with the median value of total wages paid to women will fall to below 1.3. The median value of total wages paid to men compared with the median value of total wages paid to women in 2023 was 1.28, compared with 1.29 in 2022 and 1.43 in 2021. We also measure the ratio in different job families at the Bank.

There is zero tolerance of bullying, gender-based or sexual harassment or other types of violence at Arion Bank. The Bank has an anti-bullying team which is responsible for overseeing the Bank's policy, procedures and training in connection with tackling bullying, gender-based or sexual harassment or violence.

Measures against bribery and corruption

The Bank has introduced a policy on actions against financial crime, such as money laundering, terrorist financing, bribery and corruption or market abuse. During the year the Bank approved a special policy on measures against bribery and corruption with the aim being to establish general indicators on this topic. According to the policy, there is zero tolerance at the Bank of any form of bribery and corruption, and procedures should be in place which ensure that employees report all incidents which may be linked to bribery and corruption. The Bank is aware that risk linked to bribery and corruption is generally present in all areas of financial activities and the main risks have been identified at the Bank, which re-evaluates its measures regularly in response to the risk at any give time. Further information on measures against bribery and corruption is contained in the Bank's 2023 Pillar 3 Risk Disclosures.

Risks associated with sustainability

At the end of 2023 the Bank commenced its annual risk assessment. The assessment was combined with the Bank's risk framework and was carried out parallel to the annual risk assessment process. Inherent risk relating to human resources and social factors is generally rated as low. The main risks concern the ability and development of employees, as well as equality and diversity. The key environmental risks were considered to be greenwashing and the environmental and climate impact of lending and investment. The assessment also revealed that the main governance risks were anti-money laundering measures and violations relating to know-your-customer and data protection. The management of these risk at the Bank was generally rated as adequate or strong.

In 2023 the Central Bank of Iceland's Regulations No. 772/2023 on the Disclosure Obligations of Financial Institutions came into effect, which constitutes the implementation of Commission Implementing Regulation (EU) 2022/2453 on technical standards as regards the disclosure of environmental, social and governance risks. The European Banking Authority (EBA) issued the aforementioned technical standards and the template which the Bank is now publishing for the first time in the 2023 Pillar 3 Risk Disclosures. The Technical Standards are partly based on the recommendations of the Task Force on Climate-related Financial Disclosures (TFCD) which the Bank has used in recent years to gain a better overview of climate-related risk and in its treatment of sustainability risk.

Due diligence process

Arion Bank's activities are governed by the provisions of the Annual Accounts Act on non-financial reporting, Article 66 d. Information in the 2023 Annual and Sustainability Report has been prepared and published in accordance with the Global Reporting Initiative standard, GRI Standards, which helps companies and institutions share information on sustainability in a transparent and comparable way.

When sharing information on sustainability in operations the ESG reporting guide for the Nasdaq Nordic exchange and the 10 Principles of the UN Global Compact are also used a reference. The UN Sustainable Development Goals are also referred to. For the fourth time the progress made in implementing the UN Principles for Responsible Banking is reported on.

In 2023 Arion Bank took its first steps towards implementing the European Sustainability Reporting Standard (ESRS). The standard forms part of the requirements for the expected transposing of the Corporate Sustainability Reporting Directive (CSRD) into Icelandic law. For the first time a double materiality assessment has been published in respect of the standard. The results of the assessment were obtained through discussions with stakeholders, surveys of employees and workshops. Reference is made to the ESRS in the Bank's environmental accounts but the implementation of the standard is far from complete.

Endorsement and statement
by the Board of Directors and the CEO

In 2023 new legislation was introduced in Iceland which obliges the Bank to disclose information in respect of EU Taxonomy. For the first time the Bank is disclosing information in accordance with EU Taxonomy in an annex to the consolidated financial statements for 2023. The annex contains general information on the taxonomy directive, its implementation in Iceland and the activities covered by the taxonomy.

Deloitte provides an opinion with limited assurance on sustainability in the Annual and Sustainability Report in accordance with GRI Standards and Nasdaq Guidelines. Deloitte also provides an opinion with limited assurance on the Bank's progress report to PRB.

In 2023 Arion Bank received the rating "outstanding" in the ESG assessment performed by the Icelandic ratings agency Reitun, for the fourth year in succession. The Bank received 90 points out of a possible 100, placing it in category A3. The rating is based on the Bank's performance in environmental, social and governance (ESG) issues in its operations. The Bank has performed well above average in all categories. Approximately 40 issuers have been rated by Reitun. In 2023 Arion Bank was also rated by the international ratings agency Sustainalytics, which specializes in rating risk related to ESG issues. The rating was positive and Sustainalytics considers the Bank to be one of the best performing banks globally in this area. The Bank scored 10.5 points on a scale from 0-100, with a lower score signifying lower risk. Sustainalytics therefore believes there is minimal risk of significant financial damage due to ESG issues at the Bank. Arion Bank is in the top 5% of more than 1,000 banks worldwide which have been rated by Sustainalytics and in the top 3% of 400 regional banks.

Further information on sustainability and non-financial information can be found in the Annual and Sustainability Report which will be available on the Bank's website on 14 February 2024.

Endorsement of the Board of Directors and the Chief Executive Officer

The Consolidated Financial Statements of Arion Bank for the year ended 31 December 2023 have been prepared in accordance with International Financial Reporting Standards 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 Consolidated Financial Statements give a true and fair view of the financial performance and cash flow of the Group for the year ended 31 December 2023 and its financial position as at 31 December 2023. Furthermore, in our opinion the Consolidated Financial Statements and the Endorsement of the Board of Directors and the CEO give a fair view of the development and performance of the Group's operations and its position and describe the principal risks and uncertainties faced by the Group.

In our opinion, the Consolidated Financial Statements of Arion Bank hf. for the year 2023 with the file name RIL4VBPDB0M7Z3KXSF19-2023-12-31-en.zip is prepared, in all material respects, in compliance with the ESEF Regulation.

The Board of Directors and the CEO have today discussed the Consolidated Financial Statements of Arion Bank for the year ended 31 December 2023 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the Consolidated Financial Statements be approved at the Annual General Meeting of Arion Bank.

Reykjavík, 7 February 2024

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

Independent Auditor's report

To the Shareholders and the Board of Directors of Arion Bank hf.

Opinion

We have audited the consolidated financial statements of Arion Bank hf. for the year ended December 31, 2023 which comprise the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of financial position, consolidated statement of changes in equity, consolidated statement of cash flows for the year then ended and the Notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of Arion Bank hf. as at December 31, 2023, its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional requirements, as applicable, in the Act on Annual Accounts, the Act on Financial Undertakings and rules on accounting for credit institutions.

Our opinion in this report on the consolidated financial statements is consistent with the content of the additional report that has been submitted to the parent company´s audit committee in accordance with the EU Audit Regulation 537/2014 Article 11.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of Arion Bank hf. in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in Iceland, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

Based on the best of our knowledge and belief, no prohibited services referred to in the EU Audit Regulation 537/2014 Article 5.1 has been provided. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

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

Key Audit Matters	***How the matter was addressed in the audit***
Impairment charges for loans and provisions for guarantees	
Loans for the Group amounted to ISK 1,161,340 million at 31 December 2023, and the total allowance account for the Group amounted to ISK 8,917 million (including off-balance positions) at 31 December 2023. The Group valuate it´s impairment on loans based of IFRS 9 resulting in impairment charges are recognised when losses are expected based on forecasting models. Management has provided further information about the accounting policies for expected credit losses in Note 59 and about loan impairment charges and provisions for guarantees in Notes 16 and 44. Measurement of loan impairment charges for loans and provisions for guarantees is deemed a key audit matter as the determination of assumptions for expected credit losses is subjective due to the level of judgement applied by Management. The most significant judgements are: • Assumptions used in the expected credit loss models to assess the credit risk related to the exposure and the expected future cash flows of the customer. • Timely identification of exposures with significant increase in credit risk and credit impaired exposures. • Valuation of collateral and assumptions used for manually assessed credit-impaired exposures.	Based on our risk assessment and industry knowledge, we have examined the impairment charges for loans and provisions for guarantees and evaluated the methodology applied as well as the assumptions made according to the description of the key audit matter. As part of our audit, we have examined the Group's implementation of IFRS 9. As part of our review of the implementation we performed substantive procedures on the Group's impairment models and reviewed the methodology implemented for expected credit loss calculations. We used risk modelling specialists as well as IFRS specialists as part of our audit. Our examination included the following elements: • Testing of key controls over key assumptions used in the expected credit loss models to assess the credit risk related to the exposure and the expected future cash flows of the customer. • Substantively testing evidence to support the assumptions used in the expected credit loss models applied in stage allocation, assumptions applied to derive lifetime possibility of default and methods applied to derive loss given default. • Testing of key controls and substantive testing of timely identification of exposures with significant increase in credit risk and timely identification of credit impaired exposures. • Testing of key controls over models and manual processes for valuation of collateral used in the expected credit loss calculations. • Substantively testing evidence to support appropriate determination of assumptions for loan impairment charges and provisions for guarantees including valuation of collateral and assumptions of future cash flows on manually assessed credit impaired exposures.

Independent Auditor's report

Key Audit Matters	*How the matter was addressed in the audit*
Reliability of information from IT systems relevant to financial reporting	
The Group's financial reporting is highly dependent on IT systems supporting the overall financial reporting process, due to the significant number of transactions processed through various systems needed to support the Group's operations. In the process of preparing the consolidated financial statements the Group uses data from number of complex IT systems. The accuracy and completeness of transactions is important to support the reliability of financial reporting. Due to the importance of data from IT systems to support the financial reporting we consider their reliability a key audit matter.	The procedures performed to respond to the key audit matter included the following, amongst others; • We obtained an understanding of the Group's IT systems and environment that support the overall financial reporting process • We reviewed the design, implementation and effectiveness of control activities, as appropriate, related to access management, change management, accuracy of key automated calculations and operation for the systems considered important for the audit. Deloitte IT audit specialists were involved in the audit • For IT systems that are outsourced and are relevant to the audit we obtained and assessed the ISAE 3402 report issued by the service organisation

Other information

The Board of Directors and CEO are responsible for the other information. The other information comprises the unaudited appendix to the Financial Statements, 5-year overview, key figures, unaudited quarterly statements in Note 6 and Endorsement and statements by the Board of Directors and the CEO.

Our opinion on the consolidated financial Statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon, except the confirmation regarding the Endorsement and the statement by the Board of Directors and the CEO as stated below.

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

In accordance with Paragraph 2 article 104 of the Icelandic Financial Statement Act no. 3/2006, we confirm to the best of our knowledge that the accompanying report of the board of directors includes all information required by the Icelandic Financial Statement Act that is not disclosed elsewhere in the consolidated financial statements.

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

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

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

The board of directors and the audit committee shall supervise the preparation and presentation of the consolidated financial statements.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Arion Bank hf.'s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated and separate financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

In addition to our work as the auditors of Arion Bank hf., Deloitte has provided the Bank with permitted additional services such as review of interim financial statements and other assurance engagement. Deloitte has in place internal procedures in order to ensure its independence before acceptance of additional services. Deloitte has confirmed in writing to the Audit Committee that we are independent of Arion banki hf.

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

Report on other legal and regulatory requirements

Report on European single electronic format (ESEF Regulation)

As part of our audit of the consolidated financial statements of Arion Bank hf. we performed procedures to be able to issue an opinion on whether the consolidated financial statements of Arion Bank hf. for the year 2023 with the file name RIL4VBPDB0M7Z3KXSF19-2023-12-31-en.zip is prepared, in all material respects, in compliance with laws no. 20/2021 disclosure obligation of issuers of securities and the obligation to flag relating to requirements regarding European single electronic format regulation EU 2019/815 which include requirements related to the preparation of the Consolidated Financial Statements in XHTML format and iXBRL markup.

Management is responsible for preparing the consolidated financial statements in compliance with laws no. 20/2021 disclosure obligation of issuers of securities and the obligation to flag. This responsibility includes preparing the consolidated financial statements in a XHTML format in accordance to EU regulation 2019/815 on the European single electronic format (ESEF regulation).

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

In our opinion, the Consolidated Financial Statements of Arion Bank hf. for the year 2023 with the file name RIL4VBPDB0M7Z3KXSF19-2023-12-31-en.zip is prepared, in all material respects, in compliance with the ESEF Regulation.

Appointment of auditor

Deloitte ehf. was appointed auditor of Arion Bank hf. By the general meeting of shareholders on 15 March 2023. Deloitte have been elected as auditor of the Group since the general meeting 2015.

Kópavogur, 7 February 2024

Deloitte ehf.

Gunnar Thorvardarson

State Authorized Public Accountant

Consolidated Income Statement

	Notes	2023	2022*
Interest income		123,116	83,515
Interest expense		(78,431)	(43,314)
Net interest income	7	**44,685**	**40,201**
Fee and commission income		20,120	18,741
Fee and commission expense		(3,731)	(2,292)
Net fee and commission income	8	**16,389**	**16,449**
Insurance revenue		17,416	15,105
Insurance service expenses		(17,264)	(14,490)
Insurance service results	9	**152**	**615**
Net financial income	10	1,366	(3,286)
Other operating income	11	1,589	1,314
Other net operating income		**2,955**	**(1,972)**
Operating income		**64,181**	**55,293**
Operating expenses	12	(25,701)	(24,329)
Bank levy	15	(1,796)	(1,749)
Net impairment	16	(1,348)	144
Earnings before income tax		**35,336**	**29,359**
Income tax expense	17	(9,595)	(9,944)
Net earnings from continuing operations		**25,741**	**19,415**
Discontinued operations held for sale, net of income tax	18	(4)	6,543
Net earnings		**25,737**	**25,958**

Attributable to

	Notes	2023	2022*
Shareholders of Arion Bank hf.		25,755	25,945
Non-controlling interest		(18)	13
Net earnings		**25,737**	**25,958**

Earnings per share

	Notes	2023	2022*
Earnings per share	19		
Basic earnings per share attributable to the shareholders of Arion Bank (ISK)		17.80	17.40
Diluted earnings per share attributable to the shareholders of Arion Bank (ISK)		17.00	16.46

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

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

Amounts are in ISK millions

Consolidated Statement of Comprehensive Income

	Notes	2023	2022*
Net earnings		**25,737**	**25,958**
Net change in FV of financial assets carried at FV through OCI, net of tax		697	(999)
Net realized (gain) loss on financial assets carried at FV through OCI, net of tax and reclassification from OCI equity reserve, transferred to the P/L	10	(15)	1,553
Changes to reserve for financial instruments at FV through OCI		**682**	**554**
Exchange difference on translating foreign subsidiaries		-	(676)
Other comprehensive income (loss) that is or may be reclassified subsequently to the Income Statement		**682**	**(122)**
Total comprehensive income		**26,419**	**25,836**

Attributable to

		2023	2022*
Shareholders of Arion Bank		26,437	25,849
Non-controlling interest		(18)	(13)
Total comprehensive income		**26,419**	**25,836**

Comprehensive income per share

	Notes	2023	2022*
Comprehensive income per share	19		
Basic comprehensive income per share attributable to the shareholders of Arion Bank (ISK)		18.27	17.34
Diluted comprehensive income per share attributable to the shareholders of Arion Bank (ISK)		17.34	16.40

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

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

Amounts are in ISK millions

Consolidated Statement of Financial Position

Assets	Notes	31.12.2023	31.12.2022*
Cash and balances with Central Bank	20	102,095	114,118
Loans to credit institutions	21	28,835	45,501
Loans to customers	22	1,152,789	1,084,757
Financial instruments	23-26	205,706	193,329
Investment property	25	9,493	7,862
Investments in associates	27	789	787
Intangible assets	28	8,051	8,783
Tax assets	29	39	135
Assets and disposal groups held for sale	30	62	61
Other assets	31	17,813	10,276
Total Assets		**1,525,672**	**1,465,609**

Liabilities			
Due to credit institutions and Central Bank	24	2,771	11,697
Deposits	24	792,710	755,361
Financial liabilities at fair value	24	11,646	20,997
Tax liabilities	29	11,169	10,303
Other liabilities	32	46,336	39,401
Borrowings	24,33	420,460	392,563
Subordinated liabilities	24,34	41,279	47,331
Total Liabilities		**1,326,371**	**1,277,653**

Equity	37		
Share capital and share premium		10,634	13,372
Other reserves		12,283	10,672
Retained earnings		175,881	163,263
Total Shareholders' Equity		**198,798**	**187,307**
Non-controlling interest		503	649
Total Equity		**199,301**	**187,956**
Total Liabilities and Equity		**1,525,672**	**1,465,609**

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

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

Amounts are in ISK millions

Consolidated Statement of Changes in Equity

			Restricted reserves											
	Share capital	Share premium	Share option	Warrants reserve	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Debt invest-ments at fair value thr. OCI, unrealized	Statutory reserve	Foreign currency trans-lation reserve	Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
Equity 1 January 2023	1,466	11,906	339	828	6,308	1,941	1,002	(1,383)	1,637	-	163,263	**187,307**	649	**187,956**
Net earnings											25,755	**25,755**	(18)	**25,737**
Net change in fair value								697				**697**		**697**
Net realized gain transferred to P/L ..								(15)				**(15)**		**(15)**
Total comprehensive income	-	-	-	-	-	-	-	682	-	-	25,755	**26,437**	(18)	**26,419**
Transactions with owners														
Dividend paid											(12,357)	**(12,357)**		**(12,357)**
Purchase of treasury shares	(22)	(3,237)										**(3,259)**		**(3,259)**
Share option charge			197									**197**		**197**
Share option vested	1	295	(45)									**251**		**251**
Share option forfeited			(83)								83	**-**		**-**
Incentive scheme	1	194										**195**		**195**
Warrants excercised	-	30		(3)								**27**		**27**
Liquidation of a subsidiary												**-**	(128)	**(128)**
Changes in reserves					1,464	(479)	(122)				(862)	**-**		**-**
Equity 31 December 2023	1,446	9,188	408	825	7,772	1,462	880	(701)	1,637	-	175,881	**198,798**	503	**199,301**

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

Amounts are in ISK millions

Consolidated Statement of Changes in Equity

			Restricted reserves											
	Share capital	Share premium	Share option	Warrants reserve	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Debt invest-ments at fair value thr. OCI, unrealized	Statutory reserve	Foreign currency trans-lation reserve	Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
Equity 1 January 2022	1,518	21,166	99	828	7,245	3,166	1,124	(1,937)	1,637	676	158,403	**193,925**	673	**194,598**
Impact of adopting IFRS 17 1 Jan.* ..											(917)	**(917)**		**(917)**
Restated opening balance	1,518	21,166	99	828	7,245	3,166	1,124	(1,937)	1,637	676	157,486	**193,008**	673	**193,681**
Net earnings											25,982	**25,982**	(24)	**25,958**
Net change in fair value								(999)				**(999)**		**(999)**
Net realized loss transferred to P/L ...								1,553				**1,553**		**1,553**
Translation difference										(676)		**(676)**		**(676)**
Total comprehensive income	-	-	-	-	-	-	-	554	-	(676)	25,982	**25,860**	(24)	**25,836**
Transactions with owners														
Dividend paid											(22,489)	**(22,489)**		**(22,489)**
Purchase of treasury shares	(58)	(9,793)										**(9,851)**		**(9,851)**
Share option charge			279									**279**		**279**
Share option vested	3	349	(38)									**314**		**314**
Incentive scheme	1	184										**185**		**185**
Changes in reserves					(937)	(1,225)	(122)				2,284	**-**		**-**
Equity 31 December 2022	1,466	11,906	339	828	6,308	1,941	1,002	(1,383)	1,637	-	163,263	**187,307**	649	**187,956**

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

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

Amounts are in ISK millions

Consolidated Statement of Cash flows

Operating activities	2023	2022*
Net earnings	25,737	25,958
Non-cash items included in net earnings	(31,229)	(30,399)
Changes in operating assets and liabilities		
Loans to credit institutions, excluding bank accounts	1,857	181
Loans to customers	(46,794)	(123,341)
Financial instruments and financial liabilities at fair value	(10,807)	33,902
Other changes in operating assets and liabilities	13,737	123,959
Interest received	96,849	66,516
Interest paid**	(52,369)	(33,006)
Dividend received	285	363
Income tax paid	(8,633)	(6,741)
Net cash (to) from operating activities	**(11,367)**	**57,392**
Investing activities		
Proceeds from sales of subsidiaries and associates	-	16,841
Acquisition of associates	(72)	(90)
Acquisition of intangible assets	(470)	(416)
Proceeds from sale of property and equipment	22	1,085
Acquisition of property and equipment	(457)	(357)
Net cash (to) from investing activities	**(977)**	**17,063**
Financing activities		
Dividend paid to shareholders of Arion Bank	(12,357)	(22,489)
Purchase of treasury stock	(3,259)	(9,851)
Issued subordinated liabilities	-	12,100
Settlement of subordinated liabilty	(6,586)	-
Warrants excercised	27	-
Proceeds from vested share option	251	315
Liquidation of subsidiaries	(128)	-
Net cash used in financing activities	**(22,052)**	**(19,925)**
Net (decrease) increase in cash and cash equivalents	(34,396)	54,530
Cash and cash equivalents at beginnning of the year	150,131	90,678
Effect of exchange rate changes on cash and cash equivalent	(742)	4,923
Cash and cash equivalents	**114,993**	**150,131**
Cash and cash equivalents		
Cash and balances with Central Bank	102,095	114,118
Bank accounts	28,624	43,433
Mandatory reserve deposit with Central Bank	(15,726)	(7,420)
Cash and cash equivalents	**114,993**	**150,131**

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

** Interest paid includes interest on deposits at the end of the year.

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

Amounts are in ISK millions

Notes to the Consolidated Financial Statements
Contents

Notes to the Consolidated 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 Consolidated Financial Statements for the year ended 31 December 2023 comprise the Parent Company and its subsidiaries (together referred to as "the Group").

1. Basis of preparation

The Consolidated Financial Statements were approved and authorized for publication by the Board of Directors of Arion Bank on 7 February 2024.

In preparing the Consolidated 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 Consolidated Financial Statements.

Statement of compliance

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union and additional requirements in the Icelandic Financial 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 Consolidated Financial Statements as were applied in the Consolidated Financial Statements for the year ended 31 December 2022.

Basis of measurement

The Consolidated 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 59;
- 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 Consolidated 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 year the exchange rate of the ISK against USD was 135.82 and 150.13 for EUR (31.12.2022: USD 141.80 and EUR 151.50).

Comparative figures

The Group adopted IFRS 17 Insurance contracts as of 1 January 2023 for the operation of the Bank's insurance subsidiary Vördur. As a result, the Group has restated relevant comparative figures of the Consolidated Income Statement for the year 2022 and the Consolidated Statement of financial position as of 1 January 2022, see Note 2 for further details.

2. Changes in accounting policies

The Group has not early adopted any standards, interpretations or amendments that have been issued but are not effective.

IFRS 17

The Group applies IFRS 17 Insurance Contracts from 1 January 2023 for its insurance subsidiary Vördur. IFRS 17 replaces IFRS 4 Insurance Contracts and sets out new principles for recognition, measurement, presentation and disclosures of insurance contracts and mainly results in reclassifications within the Consolidated Financial Statements. The transition to IFRS 17 does not affect the Group's capital ratios.

The Group applied the full retrospective approach when adopting IFRS 17. Under the full retrospective approach the Group indentified, recognised and measured each group of insurance and reinsurance contract as if the standard had always been applied and recognises the net difference of ISK 917 million as a deduction of equity as of 1 January 2022 and ISK 542 million increase in net earnings in 2022, which results in a net ISK 375 million change to equity as of 1 January 2023. Amended interim disclosures have been provided for the year 2022, where applicable.

The effects of the adoption of IFRS 17 on the Consolidated Statement of Financial Position at 1 January 2022 is as follows.

	31.12.2021 IFRS 4	Impacts due to IFRS 17	1.1.2022 IFRS 17
Other assets	19,901	(3,154)	16,747
Other liabilities	37,151	(2,237)	34,914
Retained earnings	158,403	(917)	157,486

The Group has restated comparative figures in the Consolidated Income Statement for the year 2022 as follows.

	2022 IFRS 4	Impacts due to IFRS 17	Restated 2022 IFRS 17
Interest income	83,591	(76)	83,515
Interest expense	(43,314)	-	(43,314)
Net interest income	**40,277**	**(76)**	**40,201**
Fee and commission income	18,728	13	18,741
Fee and commission expense	(2,663)	371	(2,292)
Net fee and commission income	**16,065**	**384**	**16,449**
Insurance revenue	2,614	12,491	15,105
Insurance service expenses		(14,490)	(14,490)
Insurance service results (Net insurance income)	**2,614**	**(1,999)**	**615**
Net financial income	(3,095)	(191)	(3,286)
Other operating income	1,337	(23)	1,314
Other net operating income	**(1,758)**	**(214)**	**(1,972)**
Operating income	**57,198**	**(1,905)**	**55,293**
Operating expenses	(26,911)	2,582	(24,329)
Bank levy	(1,749)	-	(1,749)
Net impairment	144	-	144
Earnings before income tax	**28,682**	**677**	**29,359**
Income tax expense	(9,809)	(135)	(9,944)
Net earnings from continuing operations	**18,873**	**542**	**19,415**
Discontinued operations held for sale, net of income tax	6,543	-	6,543
Net earnings	**25,416**	**542**	**25,958**

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

3. Significant accounting estimates and judgements in applying accounting policies

The preparation of the Consolidated 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.

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 59.

Macroeconomic outlook

The Icelandic economy has proven resilient during a period of challenging conditions characterized by persistent high inflation and high interest rates following a sharp rise post-Covid. Having peaked at 10.2% in February 2023, inflation appears to be subsiding but at 7.7% it is still well above the Central Bank’s inflation target of 2.5%. While private consumption has softened and unemployment begun to rise slightly, neither development is likely to accelerate in a materially adverse manner. Despite the increased cost of borrowing, demographic considerations have counteracted downward pressures on house prices resulting in only a modest reduction in real terms which is expected to continue in the near to medium term. Ongoing seismic and volcanic activity in the Reykjanes peninsula is a source of uncertainty and may necessitate material fiscal intervention by authorities.

Impairment of intangible assets

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

Revaluation of investment properties

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

4. The Group

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

			Equity interest	
	Operating activity	Currency	2023	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.

In September 2023 VISA Ísland ehf. sold its entire shareholding in Visa Inc. with minor effects on the Consolidated Income Statement.

Amounts are in ISK millions

Notes to the Consolidated 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

Markets & Stefnir

Markets & Stefnir comprise Asset Management and Capital Markets. Asset Management manages financial assets on behalf of its customers according to a pre-determined investment strategy. Asset Management also administers pension funds. Asset management comprises Institutional Asset Management, Premia Service for extensive banking clients, Private Banking and Pension Fund Administration. The operation of Stefnir hf. is presented under the segment. Stefnir hf. is an independently operating financial company owned by Arion Bank and manages a broad range of mutual funds, investment funds and institutional investor funds. 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.

The corporate segment of the insurance subsidiary Vördur is part of Corporate & Investment Banking.

Retail Banking

Retail Banking provides a diverse range of financial services in 13 branches and service points across Iceland in addition to service centre and 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.

The individuals segment of the insurance subsidiary Vördur is part of Retail Banking.

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 the Group's investment property and the holding company 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, Operations and Culture (new supporting unit in 2023) 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.

5. Operating segments, continued

2023 *Income Statement*	Markets and Stefnir	CIB including insurance	Retail Banking including insurance	Treasury	Subsidi-aries excl. Stefnir and Vördur	Supporting units and elimi-nations	Total
Net interest income	1,011	20,989	19,504	3,394	(251)	38	44,685
Net fee and commission income	5,494	4,906	4,612	771	169	437	16,389
Insurance service results	-	(508)	718	-	-	(58)	152
Net financial income	74	687	783	(91)	(65)	(22)	1,366
Other operating income	6	(7)	41	6	1,627	(84)	1,589
Operating income	6,585	26,067	25,658	4,080	1,480	311	64,181
Operating expenses	(2,714)	(1,479)	(3,759)	(757)	(397)	(16,595)	(25,701)
Allocated expenses	(2,352)	(4,141)	(8,582)	(1,252)	(67)	16,394	-
Bank levy	(44)	(586)	(823)	(353)	-	10	(1,796)
Net impairment	(13)	(950)	(526)	6	128	7	(1,348)
Earnings before income tax	1,462	18,911	11,968	1,724	1,144	127	35,336
Net seg. rev. from ext. customers	2,005	36,578	49,681	(25,844)	1,747	14	64,181
Net seg. rev. from other segments	4,580	(10,511)	(24,023)	29,924	(267)	297	-
Operating income	6,585	26,067	25,658	4,080	1,480	311	64,181
Balance Sheet							
Loans to customers	4,690	474,382	674,364	4	-	(651)	1,152,789
Financial instruments	27,538	11,168	21,342	148,612	107	(3,061)	205,706
Other external assets	6,507	1,358	6,088	119,912	12,437	20,875	167,177
Internal assets	57,584	-	-	286,793	5,189	(349,566)	-
Total assets	96,319	486,908	701,794	555,321	17,733	(332,403)	1,525,672
Deposits	84,424	309,145	362,517	40,257	-	(3,633)	792,710
Other external liabilities	3,078	8,796	17,762	474,624	8,605	20,796	533,661
Internal liabilities	-	87,543	262,023	-	-	(349,566)	-
Total liabilities	87,502	405,484	642,302	514,881	8,605	(332,403)	1,326,371
Allocated equity	8,817	81,424	59,492	40,440	9,128	-	199,301

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

5. Operating segments, continued

2022*	Markets and Stefnir	CIB including insurance	Retail Banking including insurance	Treasury	Subsidi-aries excl. Stefnir and Vördur	Supporting units and elimi-nations	Total
Income Statement							
Net interest income	3,033	20,061	19,626	(2,363)	(65)	(91)	40,201
Net fee and commission income	5,768	5,504	4,960	728	(592)	81	16,449
Insurance service results	-	(639)	1,263	-	(2)	(7)	615
Net financial income	(44)	(168)	(709)	(2,819)	685	(231)	(3,286)
Other operating income	11	107	120	2	52	1,022	1,314
Operating income	8,768	24,865	25,260	(4,452)	78	774	55,293
Operating expenses	(2,282)	(1,782)	(3,675)	(646)	(279)	(15,665)	(24,329)
Allocated expenses	(2,001)	(3,786)	(7,881)	(1,257)	(31)	14,956	-
Bank levy	(67)	(557)	(817)	(319)	-	11	(1,749)
Net impairment	-	546	185	-	373	(960)	144
Earnings (loss) before income tax	4,418	19,286	13,072	(6,674)	141	(884)	29,359
Net seg. rev. from ext. customers	3,030	27,367	44,596	(21,466)	898	868	55,293
Net seg. rev. from other segments	5,738	(2,502)	(19,336)	17,014	(820)	(94)	-
Operating income	8,768	24,865	25,260	(4,452)	78	774	55,293
Balance Sheet							
Loans to customers	622	445,748	638,916	90	74	(693)	1,084,757
Financial instruments	32,204	7,886	19,362	134,729	1,869	(2,721)	193,329
Other external assets	6,333	3,272	5,834	121,362	23,530	27,192	187,523
Internal assets	56,949	-	-	293,393	-	(350,342)	-
Total assets	96,108	456,906	664,112	549,574	25,473	(326,564)	1,465,609
Deposits	84,395	271,929	330,393	72,979	-	(4,335)	755,361
Other external liabilities	2,783	15,464	16,327	451,460	8,145	28,113	522,292
Internal liabilities	-	92,465	257,877	-	-	(350,342)	-
Total liabilities	87,178	379,858	604,597	524,439	8,145	(326,564)	1,277,653
Allocated equity	8,930	77,048	59,516	25,135	17,328	-	187,956

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

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

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

Notes to the Consolidated Income Statement

Quarterly statements

6. Operations by quarters, unaudited

2023	Q1	Q2	Q3	Q4	Total
Net interest income	10,994	11,426	10,918	11,347	44,685
Net fee and commission income	4,451	4,187	3,848	3,903	16,389
Insurance service results	(721)	762	395	(284)	152
Net financial income	796	(617)	(183)	1,370	1,366
Other operating income	19	1,586	8	(24)	1,589
Operating income	15,539	17,344	14,986	16,312	64,181
Operating expenses	(6,470)	(6,009)	(5,392)	(7,830)	(25,701)
Bank levy	(449)	(457)	(468)	(422)	(1,796)
Net impairment	(52)	(568)	(741)	13	(1,348)
Earnings before income tax	8,568	10,310	8,385	8,073	35,336
Income tax expense	(2,287)	(3,226)	(2,274)	(1,808)	(9,595)
Net earnings from continuing operations	6,281	7,084	6,111	6,265	25,741
Discontinued operations, net of tax	10	7	20	(41)	(4)
Net earnings	6,291	7,091	6,131	6,224	25,737

2022*	Q1	Q2	Q3	Q4	Total
Net interest income	9,476	9,745	10,357	10,623	40,201
Net fee and commission income	3,556	4,582	4,057	4,254	16,449
Insurance service results	(564)	924	487	(232)	615
Net financial income	1,120	(2,878)	(1,476)	(52)	(3,286)
Other operating income	432	732	98	52	1,314
Operating income	14,020	13,105	13,523	14,645	55,293
Operating expenses	(5,577)	(6,056)	(5,222)	(7,474)	(24,329)
Bank levy	(393)	(416)	(444)	(496)	(1,749)
Net impairment	(495)	186	42	411	144
Earnings before income tax	7,555	6,819	7,899	7,086	29,359
Income tax expense	(1,716)	(3,588)	(2,885)	(1,755)	(9,944)
Net earnings from continuing operations	5,839	3,231	5,014	5,331	19,415
Discontinued operations, net of tax	96	6,819	(6)	(366)	6,543
Net earnings	5,935	10,050	5,008	4,965	25,958

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

The half-year results were reviewed by the Bank's auditors. Other quarterly statements and the split between quarters were not audited or reviewed by the Bank's auditors.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

7. Net interest income

2023	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	5,747	-	-	5,747
Loans to credit institutions	1,462	13	-	1,475
Loans to customers	109,260	-	-	109,260
Securities	-	1,589	4,983	6,572
Other	62	-	-	62
Interest income	116,531	1,602	4,983	123,116
Interest expense				
Deposits	(46,268)	-	-	(46,268)
Borrowings	(22,189)	(5,176)	-	(27,365)
Subordinated liabilities	(4,107)	(544)	-	(4,651)
Other	(147)	-	-	(147)
Interest expense	(72,711)	(5,720)	-	(78,431)
Net interest income	43,820	(4,118)	4,983	44,685

2022*	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	3,334	-	-	3,334
Loans to credit institutions	218	80	-	298
Loans to customers	76,761	-	-	76,761
Securities	-	446	2,542	2,988
Other	134	-	-	134
Interest income	80,447	526	2,542	83,515
Interest expense				
Deposits	(22,751)	-	-	(22,751)
Borrowings	(18,027)	-	-	(18,027)
Subordinated liabilities	(2,338)	-	-	(2,338)
Other	(198)	-	-	(198)
Interest expense	(43,314)	-	-	(43,314)
Net interest income	37,133	526	2,542	40,201

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

Net interest income calculated using the effective interest rate method were ISK 117,334 million (2022: ISK 83,331 million).

Interest spread	2023	2022
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	3.1%	3.1%

Amounts are in ISK millions

8. Net fee and commission income

	2023			2022*		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	5,473	(591)	4,882	5,433	(596)	4,837
Capital markets and corporate finance	2,596	(36)	2,560	3,156	(43)	3,113
Lending and financial guarantees	4,028	-	4,028	4,298	-	4,298
Collection and payment services	1,586	(80)	1,506	1,520	(105)	1,415
Cards and payment solution	5,523	(2,617)	2,906	3,443	(1,187)	2,256
Other	914	(776)	138	891	(680)	211
Commission expense from insurance operation	-	369	369	-	319	319
Net fee and commission income	20,120	(3,731)	16,389	18,741	(2,292)	16,449

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

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

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.

9. Insurance service results

	2023	2022*
Insurance revenue	17,416	15,105
Incurred claims	(13,316)	(11,310)
Service expenses	(3,411)	(2,978)
Insurance service expenses	(16,727)	(14,288)
Net expense from reinsurance contracts held	(537)	(202)
Insurance service results	152	615

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

Operation results of Vördur

Vördur's operation resulted in a profit of ISK 840 million with a return on equity of 8.7% for the year, compared with loss of ISK 195 million in 2022 and a negative return on equity of 2.1%.

	2023	2022*
Insurance service results	152	615
Insurance revenue elimination	386	425
Insurance service results according to the Financial Statements of Vördur	538	1,040
Investment return	1,080	(1,185)
Net financial loss from insurance contracts	(607)	(32)
Total investment return	473	(1,217)
Other income	11	8
Earnings before income tax	1,023	(169)
Income tax	(183)	(25)
Net earnings	840	(195)

Combined ratio

	2023	2022*
Combined ratio of Vördur, including insurance revenue from the Group	97.0%	93.3%

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

10. Net financial income

	2023	2022*
Net gain (loss) on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	1,167	(510)
(Loss) gain on prepayments of borrowings	(89)	14
Net loss on fair value hedge of interest rate swap	(45)	(908)
Net realized gain (loss) on financial assets carried at fair value through OCI and reclassification from OCI equity reserve	20	(2,099)
Net financial loss from insurance contracts	(607)	(190)
Net foreign exchange gain	920	407
Net financial income	1,366	(3,286)

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

Equity instruments	586	(1,104)
Debt instruments	896	(654)
Derivatives	(315)	1,248
Net profit (loss) on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	1,167	(510)

Net loss on fair value hedge of interest rate swap

Fair value change of interest rate swaps designated as hedging instruments	6,645	(14,855)
Fair value change on bonds issued by the Group attributable to interest rate risk	(6,690)	13,947
Net loss on fair value hedge of interest rate swap	(45)	(908)

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

Net realized gain (loss) on financial assets carried at fair value through OCI and reclassification from OCI equity reserve

During the second quarter of 2022, the Bank identified an immaterial error in accounting for certain treasury bonds, classified at fair value through OCI. From Q3 2019 the accounting for these bonds was not correct due to an implementation of a new system module at that time. The effective interest rate on these bonds was not correctly accounted for during this period which resulted in understated OCI, overstated income statement but with net zero effect on total equity. Management evaluated the impacts of the error for prior periods, both individually and in the aggregate, and determined that the correction of this error was not material to any of its previously issued Financial Statements for the impacted periods on either a quantitative or qualitative basis. This was also evaluated by the Bank's external auditors as well as by independent third-party advisors. The impact was considered immaterial for these applicable accounting periods with the Net Interest Margin impacted by 0bps to 10bps in a single quarter. The accumulative impact from Q3 2019 was ISK 1.9 billion which was reclassified from OCI to retained earnings through net financial income. Split between years, ISK 517 million from 2019-2020, ISK 1,042 million from 2021 and 321 million from Q1 2022. The impact in Q2 2022 on net earnings after tax was ISK 1.4 billion but with zero effect on total equity.

11. Other operating income

	2023	2022*
Fair value changes on investment property	1,569	24
Net (loss) gain on disposal of assets	(1)	722
Net (loss) gain on assets held for sale	(7)	129
Share of (loss) profit of associates and profit from sale	(70)	270
Other income	98	169
Other operating income	1,589	1,314

Net (loss) gain on assets held for sale

Net (loss) income from real estates and other assets	-	141
Expense related to real estates and other assets	(7)	(12)
Net (loss) gain on assets held for sale	(7)	129

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

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

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

12. Operating expenses

	2023	2022*
Salaries and related expenses	16,777	15,856
Other operating expenses	11,968	11,131
Operating expenses from insurance operation	(3,044)	(2,658)
Operating expenses	25,701	24,329

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

13. Personnel and salaries

	2023	2022
Number of employees		
Average number of full-time equivalent positions during the year	794	759
Full-time equivalent positions at the end of the year	822	781

Salaries and related expenses

	2023	2022
Salaries	11,832	10,812
Incentive scheme	1,041	1,236
Share-based payment expenses	197	279
Defined contribution pension plans	1,895	1,789
Salary-related expenses	1,812	1,740
Salaries and related expenses	16,777	15,856

Remuneration to the Board of Directors

	2023				2022			
	Fixed remuner- ation*	Additional remuner- ation**	Pension contribution	Total	Fixed remuner- ation*	Additional remuner- ation**	Pension contribution	Total
Brynjólfur Bjarnason, Chairman	13.1	10.7	2.7	26.5	12.4	9.1	1.8	23.4
Paul Richard Horner, Vice Chairman	13.6	12.0	-	25.6	12.2	10.3	-	22.5
Gunnar Sturluson, Director	6.5	9.3	1.8	17.7	6.2	8.6	1.2	16.0
Kristín Pétursdóttir, Director	5.2	6.1	1.3	12.6	-	-	-	-
Liv Fiksdahl, Director	10.0	10.7	-	20.6	9.4	9.6	-	19.0
Steinunn Kristín Thórdardóttir, Director	9.9	9.3	2.2	21.4	9.1	8.6	1.5	19.2
Alternate directors of the Board	1.1	0.4	0.2	1.6	0.3	0.6	0.1	1.0
Total remuneration	59.4	58.4	8.2	126.0	49.6	46.8	4.6	101.0

* Fixed remuneration represents Board Member compensation for their attendance at meetings of the Board of Directors.

** Additional remuneration represents Board Member compensation for their participation in Board Committees.

Remuneration to key management personnel

	2023				2022			
	Salaries	Performance-based payments	Pension contribution	Total	Salaries	Performance-based payments	Pension contribution	Total
Benedikt Gíslason, CEO	68.0	8.0	10.7	86.7	67.2	9.1	10.9	87.2
Eight members of Executive Committee*	351.9	34.2	54.5	440.6	321.7	24.5	49.2	395.4
Former members of Executive Committee	10.9	6.2	2.5	19.5	28.9	13.9	6.2	49.0
Total remuneration	430.7	48.4	67.7	546.8	417.8	47.4	66.4	531.6

* Members of the Executive Committee are listed in Note 43.

Board Members receive remuneration for their involvement in board committees. In addition to 13 Board meetings (2022: 13) during the year 7 Board Credit Committee meetings (2022: 5), 5 Board Audit Committee meetings (2022: 6), 9 Board Risk Committee meetings (2022: 8), 5 Board Remuneration Committee meetings (2022: 5) and 4 Board Tech committee meetings (2022: 4) were held.

The 2023 Annual General Meeting of the Bank held on 15 March 2023 approved the monthly salaries for 2023 for the Chairman, Vice Chairman and for other Board Members of amounts ISK 1,100,000, ISK 825,000 and ISK 550,000 (2022: ISK 1,050,000; 787,500; 525,000) respectively. Alternate Board Members receive a payment of ISK 550,000 per year and ISK 275,000 for each meeting attended (2022: ISK 262,500 per meeting, up to a maximum of ISK 525,000 per month). Board members residing outside of Iceland receive a further ISK 350,000 for each Board meeting they attend in person. In addition, it was approved to pay Board Members who serve on board committees of the Bank a maximum of ISK 225,000 (2022: ISK 210,000) per month for each committee they serve on and the Chairman of the board committees ISK 337,500 (2022: ISK 315,000).

Amounts are in ISK millions

13. Personnel and salaries, continued

Incentive schemes

In 2023 the Group revised the provision for the incentive scheme which resulted in a ISK 1,354 million in provision, including salary-related expenses (2022: ISK 1,606 million). At the end of the year the Group's accrual for the incentive scheme payments amounted to ISK 2,113 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 four to five 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. Stefnir hf. has a special incentive scheme where other criteria are used as a basis.

Share-based payment expense

Arion Bank has in place a share option plan for all employees of the Bank, Vördur and Stefnir, approved at the Banks annual general meeting. A total expense of ISK 197 million was recognised in the Income Statement during the year (2022: ISK 256 million). Estimated remaining expenses due the share option contracts are ISK 341 million and will be expensed over the next three years. For further information on the share option program, see Note 37.

14. Other operating expenses

	2023	2022
IT expenses	4,631	4,429
Professional services	1,271	1,083
Marketing	1,167	1,144
Housing expenses	599	680
Other administration expenses	2,414	1,938
Depositors' and Investors' Guarantee Fund	-	138
Depreciation and impairment of property and equipment	550	505
Depreciation of right of use asset	134	118
Amortization of intangible assets	1,202	1,096
Other operating expenses	11,968	11,131

Auditor's fee

	2023	2022
Audit and review of the Consolidated Financial Statements for the relevant fiscal year	176	168
Other audit related services for the relevant fiscal year	23	15
Other services from auditors	5	6
Auditor's fee	204	189

15. 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.

16. Net impairment

Net impairment on financial instruments and value changes on loans

	2023	2022
Net impairment on loans to customers and financial institutions	(1,735)	(158)
Net impairment on other financial instruments at FVOCI	2	8
Other value changes of loans - corporates	24	137
Other value changes of loans - individuals	361	157
Net impairment	(1,348)	144

Net impairment by customer type

	2023	2022
Individuals	(417)	321
Corporates	(931)	(177)
Net impairment	(1,348)	144

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.

Amounts are in ISK millions

17. Income tax expense

	2023	2022*
Current tax expense	9,389	8,804
Deferred tax expense	206	1,140
Income tax expense	9,595	9,944

Reconciliation of effective tax rate

	2023	2023	2022*	2022*
Earnings before income tax		35,336		29,359
Income tax using the Icelandic corporate tax rate	20.0%	7,067	20.0%	5,872
Additional 6% tax on Financial Undertakings	5.7%	2,015	5.4%	1,903
Non-deductible expenses	0.2%	57	0.3%	103
Tax exempt revenues / loss	0.2%	69	3.7%	1,300
Non-deductible taxes (Bank levy)	1.0%	359	1.0%	350
Tax incentives not recognized in the Income Statement	(0.5%)	(161)	1.0%	353
Other changes	0.5%	189	0.2%	63
Effective tax rate	27.2%	9,595	33.9%	9,944

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

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.

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

	2023	2022
Net (loss) gain from discontinued operations held for sale	(7)	6,690
Income tax expense	3	(147)
Discontinued operations held for sale, net of income tax	(4)	6,543

In 2022 Arion Bank sold its 100% shareholding in Valitor hf. The financial effects from the sale, less cost to sell, was ISK 5.6 billion and was recognized in the Income Statement. Net earnings of Valitor was ISK 627 million.The operating effects of Sólbjarg ehf. and Stakksberg ehf. in 2022, both subsidiaries of Eignabjarg, were mainly due to fair value changes of underlying assets.

19. Earnings per share

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

	Continued operations		Discontinued operations		Net Earnings	
	2023	2022*	2023	2022*	2023	2022*
Net earnings attributable to the shareholders of Arion Bank	25,759	19,402	(4)	6,543	25,755	25,945
Total compreh.income attributable to the shareholders	26,441	19,306	(4)	6,543	26,437	25,849
Weighted average number of outstanding shares (millions)	1,447	1,491	1,447	1,491	1,447	1,491
Weighted average number of outstanding shares including warrants and options (millions)	1,525	1,576	1,525	1,576	1,525	1,576
Basic earnings per share (ISK)	17.80	13.01	(0.00)	4.39	17.80	17.40
Diluted earnings per share (ISK)	16.89	12.31	(0.00)	4.15	17.00	16.46
Basic comprehensive income per share (ISK)	18.28	12.95	(0.00)	4.39	18.27	17.34
Diluted comprehensive income per share (ISK)	17.34	12.25	(0.00)	4.15	17.34	16.40

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

Notes to the Consolidated Financial Statements

Notes to the Consolidated Statement of Financial Position

20. Cash and balances with Central Bank

	2023	2022
Cash on hand	4,190	3,877
Cash with Central Bank	82,179	102,821
Mandatory reserve deposit with Central Bank	15,726	7,420
Cash and balances with Central Bank	**102,095**	**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 increased from 1% to 2% in May 2023.

21. Loans to credit institutions

	2023	2022
Bank accounts	28,624	43,433
Other loans	211	2,068
Loans to credit institutions	**28,835**	**45,501**

22. Loans to customers

	Individuals		Corporates		Total	
2023	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
Overdrafts	13,840	13,232	43,013	42,129	56,853	55,361
Credit cards	15,972	15,783	2,062	2,010	18,034	17,793
Mortgage loans	550,269	549,371	68,840	68,277	619,109	617,648
Construction loans	-	-	49,267	49,031	49,267	49,031
Capital lease	2,352	2,331	6,893	6,832	9,245	9,163
Other loans	29,184	28,427	379,648	375,366	408,832	403,793
Loans to customers	611,617	609,144	549,723	543,645	1,161,340	1,152,789
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 359 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.

23. Financial instruments

	2023	2022
Bonds and debt instruments	157,197	138,174
Shares and equity instruments with variable income	17,656	17,733
Derivatives	6,602	9,516
Securities used for economic hedging	24,251	27,906
Financial instruments	**205,706**	**193,329**

Amounts are in ISK millions

24. Financial assets and financial liabilities

2023	Amortized cost	Fair value through OCI	Mandatorily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	102,095	-	-	102,095
Loans to credit institutions	28,835	-	-	28,835
Loans to customers	1,152,789	-	-	1,152,789
Loans	1,283,719	-	-	1,283,719
Bonds and debt instruments				
Listed	-	129,564	27,059	156,623
Unlisted	-	-	574	574
Bonds and debt instruments	-	129,564	27,633	157,197
Shares and equity instruments with variable income				
Listed	-	-	7,093	7,093
Unlisted	-	-	9,961	9,961
Bond funds with variable income, unlisted	-	-	602	602
Shares and equity instruments with variable income	-	-	17,656	17,656
Derivatives				
OTC derivatives	-	-	4,539	4,539
Derivatives used for hedge accounting	-	-	2,063	2,063
Derivatives	-	-	6,602	6,602
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	2,195	2,195
Shares and equity instruments with variable income, listed	-	-	22,056	22,056
Securities used for economic hedging	-	-	24,251	24,251
Other financial assets				
Accounts receivable	1,765	-	-	1,765
Other financial assets	10,423	-	-	10,423
Other financial assets	12,188	-	-	12,188
Financial assets	1,295,907	129,564	76,142	1,501,613
Financial liabilities				
Due to credit institutions and Central Bank	2,771	-	-	2,771
Deposits	792,710	-	-	792,710
Borrowings *	420,460	-	-	420,460
Subordinated liabilities *	41,279	-	-	41,279
Short position in bonds	-	-	61	61
Derivatives	-	-	2,332	2,332
Derivatives used for hedge accounting	-	-	9,253	9,253
Other financial liabilities	10,790	-	-	10,790
Financial liabilities	1,268,010	-	11,646	1,279,656

* Including effect from hedge accounting derivatives.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

24. Financial assets and financial liabilities, continued

2022*	Amortized cost	Fair value through OCI	Mandatorily at fair value thr. P/L	Total
Financial assets				
Loans				
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
Bonds and debt instruments				
Listed	-	115,806	21,390	137,196
Unlisted	-	-	978	978
Bonds and debt instruments	-	115,806	22,368	138,174
Shares and equity instruments with variable income				
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
Derivatives				
OTC derivatives	-	-	9,448	9,448
Derivatives used for hedge accounting	-	-	68	68
Derivatives	-	-	9,516	9,516
Securities used for economic hedging				
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
Other financial assets				
Accounts receivable	1,308	-	-	1,308
Other financial assets	3,412	-	-	3,412
Other financial assets	4,720	-	-	4,720
Financial assets	1,247,028	115,806	79,591	1,442,425
Financial liabilities				
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	6,527	-	-	6,527
Financial liabilities	1,213,479	-	20,997	1,234,476

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

** Including effect from hedge accounting derivatives.

Amounts are in ISK millions

24. Financial assets and financial liabilities, continued

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

2023	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial and insurance activities	1,386	10,363	11,749
Public sector	128,178	14,077	142,255
Corporates	-	3,193	3,193
Bonds and debt instruments at fair value	129,564	27,633	157,197
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 year (31.12.2022: ISK 3.6 billion). Pledged bonds comprised Icelandic Government 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.

25. 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

2023

Assets at fair value	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	153,485	3,685	27	157,197
Shares and equity instruments with variable income	7,082	6,979	3,595	17,656
Derivatives	-	4,539	-	4,539
Derivatives used for hedge accounting	-	2,063	-	2,063
Securities used for economic hedging	23,848	403	-	24,251
Investment property	-	-	9,493	9,493
Assets at fair value	184,415	17,669	13,115	215,199
Liabilities at fair value				
Short position in bonds	61	-	-	61
Derivatives	-	2,332	-	2,332
Derivatives used for hedge accounting	-	9,253	-	9,253
Liabilities at fair value	61	11,585	-	11,646

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

25. Fair value hierarchy, continued

2022

Assets at fair value	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

Liabilities at fair value				
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

Transfers from Level 1 to Level 2 amounted to ISK 697 million during the year (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 24 is used as an approximation for the fair value of the asset. This is straight forward for cash and cash equivalents but is also used for short term investments and borrowings to highly rated counterparties, such as credit institutions, on contracts that feature interest close to or equal to market rates and expose the Group to little or no credit risk.

Level 1: Fair value established from quoted market prices

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

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

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

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

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

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

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

25. 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		
2023		Bonds	Shares	Total
Balance at the beginning of the year	7,862	102	1,932	9,896
Net fair value changes	1,569	(72)	652	2,149
Additions	62	-	1,858	1,920
Disposals	-	(3)	(975)	(978)
Transfers into Level 3	-	-	128	128
Balance at the end of the year	9,493	27	3,595	13,115
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

2023				
Net financial income	-	(72)	652	580
Other operating income	1,569	-	-	1,569
Effects recognized in the Income Statement	1,569	(72)	652	2,149
2022				
Net financial income	-	6	135	141
Other operating income	24	-	-	24
Effects recognized in the Income Statement	24	6	135	165

Amounts are in ISK millions

25. Fair value hierarchy, continued

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

2023	Carrying value	Fair value	Unrealized gain (loss)
Financial assets not carried at fair value			
Cash and balances with Central Bank	102,095	102,095	-
Loans to credit institutions	28,835	28,835	-
Loans to customers	1,152,789	1,145,363	(7,426)
Other financial assets	12,188	12,188	-
Financial assets not carried at fair value	1,295,907	1,288,481	(7,426)
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	2,771	2,771	-
Deposits	792,710	792,710	-
Borrowings	420,460	419,008	1,452
Subordinated liabilities	41,279	41,154	125
Other financial liabilities	10,790	10,790	-
Financial liabilities not carried at fair value	1,268,010	1,266,433	1,577
2022*			
Financial assets not carried at fair value			
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	4,720	4,720	-
Financial assets not carried at fair value	1,249,096	1,182,010	(67,086)
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	11,697	11,697	-
Deposits	755,361	755,361	-
Borrowings	392,563	387,882	11,137
Subordinated liabilities	47,331	48,310	(979)
Other financial liabilities	6,527	6,527	-
Financial liabilities not carried at fair value	1,213,479	1,209,777	10,158

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

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	Notional	Fair value	
2023	value	Assets	Liabilities
Forward exchange rate agreements	54,756	414	236
Fair value hedge of interest rate swap	235,726	2,063	9,253
Interest rate and exchange rate agreements	47,377	998	1,017
Bond swap agreements	2,218	67	50
Share swap agreements	24,689	3,060	1,029
Derivatives	364,766	6,602	11,585
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

Amounts are in ISK millions

25. 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 33, arising from changes in interest rates.

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.

During the year 2023 the slope for the regression line was in all cases within the range of 0.92-1.08 and the regression coefficient was at least 0.98. During the year 2022, the slope of the regression line was in all cases within the range of 0.84-1.00 and the regression coefficient was at least 0.92. In all cases the effectiveness is within limits during the year 2023 and 2022.

	Notional	Maturity date	Fair value		Gain (loss) on FV changes
2023			Assets	Liabilities	
Interest rates swaps - EUR	-	-	-	-	76
Interest rates swaps - EUR	11,957	3-6 mth	-	228	650
Interest rates swaps - USD	13,582	1-5 years	-	534	354
Interest rates swaps - EUR	75,067	1-5 years	-	5,183	3,205
Interest rates swaps - EUR	45,040	1-5 years	-	2,725	1,617
Interest rates swaps - EUR	45,040	6-12 mth	-	583	307
Interest rates swaps - EUR	45,040	1-5 years	2,063	-	436
			2,063	9,253	6,645
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
2023		Assets	Liabilities	
EUR 300 million - issued 2018 - 5 years	-	-	-	(156)
EUR 300 million - issued 2020 - 4 years	11,776	206	-	(632)
USD 100 million - issued 2020 - Perpetual	13,216	608	-	(336)
EUR 500 million - issued 2021 - 5 years	69,338	4,455	-	(3,207)
EUR 300 million - issued 2021 - 4 years	42,740	2,303	-	(1,612)
EUR 300 million - issued 2022 - 2 years	44,552	471	-	(305)
EUR 300 million - issued 2023 - 3 years	47,326	(443)	-	(442)
Hedged borrowings and subordinated liabilities	228,948	7,600	-	(6,690)
2022				
EUR 300 million - issued 2018 - 5 years	20,672	156	-	13
EUR 300 million - issued 2020 - 4 years	43,181	2,363	-	1,930
USD 100 million - issued 2020 - Perpetual	13,396	1,001	-	1,024
EUR 500 million - issued 2021 - 5 years	66,231	7,765	-	6,927
EUR 300 million - issued 2021 - 4 years	41,404	3,973	-	3,288
EUR 300 million - issued 2022 - 2 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 92-108%.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

26. Offsetting financial assets and financial liabilities

Financial assets subject to enforceable master netting arrangements and similar arrangements

2023	Assets subject to netting arrangements: Gross assets before nettings	Nettings with gross liabilities	Assets recognized on Balance Sheet, net	Netting potential not recognized in the Balance Sheet: Financial liabilities	Collateral received	Assets after consideration of netting potential	Assets not subject to enforceable netting arr-angements	Total assets recognized on Balance Sheet, net
Reverse repurchase agreements	16,982	(10,164)	6,818	10,164	-	16,982	-	6,818
Derivatives	3,935	-	3,935	(2,452)	-	1,483	2,667	6,602
Bank accounts netted against fin. liab. ...	7,589	-	7,589	(7,589)	-	-	-	7,589
Total assets	28,506	(10,164)	18,342	123	-	18,465	2,667	21,009
2022								
Reverse repurchase agreements	17,781	(10,212)	7,569	10,187	-	17,756	-	7,569
Derivatives	2,642	-	2,642	(1,395)	-	1,247	6,874	9,516
Bank accounts netted against fin. liab. ...	19,517	-	19,517	(19,517)		-		19,517
Total assets	39,940	(10,212)	29,728	(10,725)	-	19,003	6,874	36,602

Financial liabilities subject to enforceable master netting arrangements and similar arrangements

2023	Liabilities subject to netting arrangements: Gross liabilities before nettings	Nettings with gross assets	Liabilities recognized on Balance Sheet, net	Netting potential not recognized in the Balance Sheet: Financial assets	Collateral pledged	Liabilities after consideration of netting potential	Liabilities not subject to enforceable netting arr-angements	Total liabilities recognized on balance sheet
Repurchase agreements	-	(10,164)	(10,164)	10,164	-	-	-	(10,164)
Derivatives	11,430	-	11,430	(9,700)	-	1,730	155	11,585
Deposist netted agains other assets	341	-	341	(341)	-	-	-	341
Total liabilities	11,771	(10,164)	1,607	123	-	1,730	155	1,762
2022								
Repurchase agreements	25	(10,212)	(10,187)	10,212	-	25	-	(10,187)
Derivatives	20,098	-	20,098	(19,559)	-	539	888	20,986
Deposist netted agains other assets	1,353	-	1,353	(1,353)	-	-	-	1,353
Total liabilities	21,476	(10,212)	11,264	(10,700)	-	564	888	12,152

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

27. Investments in associates

	2023	2022
Carrying amount at the beginning of the year	787	668
Acquisitions / increased share capital	72	90
Disposals	-	(241)
Share of (loss) profit of associates and profit from sale	(70)	270
Investment in associates	789	787

The Group's interest in its principal associates

Bílafrágangur ehf., Lágmúli 5, Reykjavík, Iceland	33.4%	33.4%
Háblær ehf., Sudurlandsbraut 18, Reykjavík, Iceland	32.0%	49.0%
Reiknistofa bankanna hf., Katrínartún 2, Reykjavík, Iceland	23.0%	23.0%
SER eignarhaldsfélag ehf., Borgartún 19, Reykjavík	35.3%	35.3%

During second quarter of 2023 share capital of Háblær was increased. Arion Bank invested for ISK 72 million but the Banks shareholding decreased as other shareholders increased their shareholdings even further.

Amounts are in ISK millions

28. 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

2023	Goodwill	Infra-structure	Customer relationship and related agreements	Software	Total
Balance at the beginning of the year	730	2,383	547	5,123	8,783
Additions	-	-	-	470	470
Amortization	-	-	(60)	(1,142)	(1,202)
Intangible assets	730	2,383	487	4,451	8,051

2022	Goodwill	Infra-structure	Customer relationship and related agreements	Software	Total
Balance at the beginning of the year	669	2,383	607	5,804	9,463
Additions	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 wich is recognized in the operating segment Other subsidiaries, see Note 5.

Impairment testing

The methodology for impairment testing on the Infrastructure and Customer relationship, which is part of intangible assets, is based on discounted cash flow model which uses inputs that consider features of the business and the environment.

The model used, to determine the recoverable amount, is most sensitive to changes in the forecast earnings available to shareholders over a five-year period, the cost of equity and to changes in the growth rate. As a result of this analysis no impairment was recognized in 2023 (2022: nil).

	2023		2022	
Discount and growth rates	Discount rates	Growth rates	Discount rates	Growth rates
Asset Management operation	14.3%	3.5%	14.3%	4.0%
Insurance operation	14.3%	4.0%	14.3%	4.0%

Amounts are in ISK millions

29. Tax assets and tax liabilities

	2023		2022	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	9,227	-	8,471
Deferred tax	39	1,942	135	1,832
Tax assets and tax liabilities	39	11,169	135	10,303

Deferred tax assets and tax liabilities are attributable to the following:

	2023 Assets	2023 Liabilities	2022 Assets	2022 Liabilities
Investment property and property and equipment	-	(1,227)	-	(999)
Financial assets	-	(361)	-	(510)
Other assets and liabilities	27	(295)	27	(294)
Deferred tax related to foreign exchange gain	2	(207)	2	(80)
Tax loss carry forward	158	-	157	-
	187	(2,090)	186	(1,883)
Set-off of deferred tax assets together with tax liabilities of the same taxable entities	(148)	148	(51)	51
Deferred tax assets and tax liabilities	39	(1,942)	135	(1,832)

Deferred tax assets are recognized for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgement is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits, together with future tax planning strategies.

Changes in deferred tax assets and tax liabilities

2023	At 1 Jan.	Recognized through equity	Recognized in profit or loss	At 31 Dec.
Investment property and property and equipment	(999)	-	(228)	(1,227)
Financial assets	(510)	-	149	(361)
Other assets and liabilities	(267)	-	(1)	(268)
Deferred foreign exchange differences	(78)	-	(127)	(205)
Tax loss carry forward	157	-	1	158
Change in deferred tax assets and tax liabilities	(1,697)	-	(206)	(1,903)

2022	At 1 Jan.	Recognized through equity	Recognized in profit or loss	At 31 Dec.
Foreign currency denominated assets and liabilities	2	-	(2)	-
Investment property and property and equipment	(728)	-	(271)	(999)
Financial assets	562	-	(1,072)	(510)
Other assets and liabilities	(202)	-	(65)	(267)
Deferred foreign exchange differences	(191)	-	113	(78)
Tax loss carry forward	-	-	157	157
Change in deferred tax assets and tax liabilities	(557)	-	(1,140)	(1,697)

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

Assets and disposal groups held for sale	2023	2022
Real estate	62	61
Assets and disposal groups held for sale	62	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.). Sólbjarg sold its shares in Heimbjarg ehf. in Q2 2023 with minor effects on the Income Statement.

31. Other assets

	2023	2022*
Property and equipment	3,672	3,787
Right-of-use asset	872	745
Accounts receivable	1,765	1,278
Unsettled securities trading	7,781	890
Sundry assets	3,722	3,576
Other assets	17,813	10,276

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

Amounts are in ISK millions

31. Other assets, continued

Property and equipment	Real estate	Equip-ment	Total 2023	Total 2022
Gross carrying amount at the beginning of the year	2,727	3,646	6,373	6,654
Additions	-	457	457	357
Disposals	-	(29)	(29)	(522)
Write-offs	-	(266)	(266)	(116)
Gross carrying amount at the end of the year	2,727	3,808	6,535	6,373
Accumulated depreciation at the beginning of the year	(1,043)	(1,543)	(2,586)	(2,387)
Depreciation	(74)	(439)	(513)	(462)
Disposals	-	7	7	158
Write-offs	-	229	229	105
Accumulated depreciation at the end of the year	(1,117)	(1,746)	(2,863)	(2,586)
Property and equipment	1,610	2,062	3,672	3,787

The official real estate value (Registers Iceland) amounted to ISK 4,223 million at the end of the year (2022: ISK 4,152 million) and the insurance value amounts to ISK 8,093 million (2022: ISK 7,720 million).

Right-of-use asset	2023	2022
Balance at the beginning of the year	745	823
New lease agreements	230	213
Lease agreements terminated	(15)	(215)
Indexation	46	41
Depreciation	(134)	(117)
Right-of-use asset	872	745

Right-of-use asset is due to real estates for own use.

32. Other liabilities

	2023	2022*
Accounts payable	1,274	1,013
Unsettled securities trading	2,474	1,844
Insurance contract liabilities*	20,196	17,451
Withholding tax	6,026	2,637
Bank levy	1,807	1,761
Accrued expenses	4,895	4,776
Prepaid income	1,547	1,590
Impairment of off-balance items	363	449
Lease liability	1,074	970
Sundry liabilities	6,680	6,910
Other liabilities	46,336	39,401

Insurance contract liabilities		
Liabilities for remaining coverage	3,910	3,412
Liabilities for incurred claims	15,597	13,410
Risk adjustment	689	629
Insurance contract liabilities	20,196	17,451

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

Lease liability	2023	2022
Balance at the beginning of the year	970	878
New and amended lease agreements	230	215
Lease agreements terminated	(15)	(34)
Indexation	63	69
Interest expense	45	31
Lease payments	(219)	(189)
Lease liability	1,074	970

Arion Bank Consolidated Financial Statements 2023 Amounts are in ISK millions

Notes to the Consolidated Financial Statements

33. Borrowings

Currency, original nominal value	First issued	Maturity	Maturity type	Terms of interest	2023	2022
ARION CB 24 ISK 28,900 million	2019	2024	At maturity	Fixed, 6.00%	13,664	25,736
ARION CBI 25, ISK 37,940 million	2017	2025	At maturity	Fixed, CPI linked, 3.00%	50,880	47,184
ARION CBI 26 ISK 17,080 million	2019	2026	At maturity	Fixed, CPI linked, 2.00%	20,628	19,219
ARION CBI 29, ISK 27,200 million	2014	2029	At maturity	Fixed, CPI linked, 3.50%	38,239	35,602
ARION CBI 48, ISK 11,680 million	2018	2048	Amortizing	Fixed, CPI linked, 2.50%	12,440	11,828
ARION CB EUR 500 million *	2021	2026	At maturity	Fixed, EUR 0.05%	69,337	66,231
ARION CB 27, ISK 41,000 million	2022	2027	At maturity	Fixed, 5.50%	17,680	7,058
ARION CBI 30, ISK 11,260 million	2023	2030	At maturity	Fixed, CPI linked, 2.75%	10,204	-
Statutory covered bonds					233,072	212,858
NOK 250 million	2017	2023	At maturity	Fixed, 3.02%	-	3,671
EUR 300 million *	2018	2023	At maturity	Fixed, 1.00%	-	20,672
EUR 300 million *	2020	2024	At maturity	Fixed, 0.625 %	11,776	43,181
NOK 250 million	2017	2027	At maturity	Fixed, 3.40%	3,425	3,680
EUR 300 million Green *	2021	2025	At maturity	Fixed, 0.375%	42,740	41,404
ARION 26 1222 Green (ISK 5,760m)	2021	2026	At maturity	Fixed, 4.70%	5,405	5,382
ARION 24 1020 Green (ISK 6,020m)	2022	2024	At maturity	Floating, REIBOR 3M +0.70%	6,105	6,062
EUR 300 million Green *	2022	2024	At maturity	Fixed, 4.875%	44,552	44,557
NOK 550 million	2022	2025	At maturity	Floating, OIBOR 3M +2.35%	7,417	7,952
SEK 230 million	2022	2025	At maturity	Floating, STIBOR 3M +2.35%	3,128	3,144
NOK 200 million	2023	2025	At maturity	Floating, OIBOR 3M + 2.55%	2,683	-
SEK 300 million	2023	2026	At maturity	Floating, STIBOR 3M + 3.00%	4,059	-
EUR 300 million*	2023	2026	At maturity	Fixed, 7.25%	47,326	-
Arion 28 1512, ISK 8,740 million	2023	2028	At maturity	Fixed, CPI linked, 4.35%	8,772	-
Senior unsecured bonds					187,388	179,705
Borrowings					420,460	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 25. The interest rate swaps are hedging the Group's exposure to fair value changes of these fixed-rate bonds in EUR arising from changes in interest rates.

The book value of listed bonds was ISK 420 billion at the end of the year (31.12.2022: ISK 393 billion). The market value of those bonds was ISK 419 billion (31.12.2022: ISK 388 billion). The Group repurchased own debts amounting to ISK 45 billion during the year with a net loss of ISK 89 million recognized in the Income Statement (2022: ISK 14 million gain).

34. Subordinated liabilities

Currency, original nominal value	Issued	Maturity	First call date	Terms of interest	2023	2022
SEK 500 million	2018	2028	22 Nov '23	Floating, 3 month STIBOR +3.10% .	-	6,822
NOK 300 million	2019	2029	9 Jul '24	Floating, NIBOR +3.65%	4,096	4,383
SEK 225 million	2019	2029	20 Dec '24	Floating, 3 month STIBOR +3.70% .	3,046	3,066
ARION T2I 30 ISK 4,800 million	2019	2030	4 Jan '25	Fixed, CPI linked, 3.875%	6,312	5,841
ARION T2 30 ISK 880 million	2019	2030	4 Jan '25	Fixed, 6.75%	908	908
EUR 5 million	2019	2031	6 Mar '26	Fixed, 3.24%	766	772
ARION T2I 33 9,860 million	2022	2033	15 Dec '28	Fixed, CPI linked, 4.95%	10,685	9,894
ARION T2 33 2,240 million	2022	2033	15 Dec '28	Fixed, 9.25%	2,249	2,249
Tier 2 subordinated liabilities					28,062	33,935
ARION AT1 USD 100 million *	2020	Perpetual	26 Mar '25	Fixed, 6.25%	13,217	13,396
Additional Tier 1 subordinated liabilities					13,217	13,396
Subordinated liabilities					41,279	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 25.

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

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

35. Liabilities arising from financial activities

2023	At 1 Jan.	Cash flows	Non-cash changes: Interest expenses	Foreign exchange	Effect from hedge	At 31 Dec.
Covered bonds in ISK - CPI linked	113,833	5,849	12,709	-	-	132,391
Covered bonds in ISK	32,794	(3,689)	2,239	-	-	31,344
Covered bonds in FX	66,231	(5,475)	5,681	(368)	3,268	69,337
Senior unsecured bonds in FX	168,261	(9,597)	5,858	(2,082)	4,666	167,106
Senior unsecured bonds in ISK	11,444	(778)	844	-	-	11,510
Senior unsecured bonds in ISK - CPI linked	-	8,740	32	-	-	8,772
Subordinated bond T2 in ISK - CPI linked	15,735	(750)	2,012	-	-	16,997
Subordinated bond T2 ISK	3,156	(266)	267	-	-	3,157
Subordinated bond T2 FX	15,044	(7,527)	937	(565)	19	7,908
Subordinated bond AT1 FX	13,396	(1,598)	1,437	(395)	377	13,217
Liabilities arising from financial activities	439,894	(15,091)	32,016	(3,410)	8,330	461,739
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 T2 in ISK - CPI 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

36. Pledged assets

Pledged assets against liabilities	2023	2022
Assets, pledged as collateral against borrowings	380,860	328,811
Assets pledged as a collateral against loans from banks and other financial liabilities	10,582	23,108
Pledged assets against liabilities	391,442	351,919
Thereof pledged assets against issued covered bonds held by the Bank	(86,682)	(70,850)
Assets against repoed issued bonds	16,585	17,029
Pledged assets against liabilities on balance	321,345	298,098

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 233 billion at year 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 58 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 70 billion (31.12.2022: ISK 54 billion).

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

37. Equity

Share capital and share premium

According to the Bank's Articles of Association, total share capital amounts to ISK 1,460 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 2023	Share capital	Own shares	Share premium	Total 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	(50)	50	-	-	(150)	150	-	-
Purchase of treasury shares	-	(22)	(3,238)	(3,260)	-	(58)	(9,793)	(9,851)
Share option vested	-	2	295	297	-	4	349	353
Incentive scheme	-	1	194	195	-	1	184	185
Warrants excercised	-	-	30	30				-
Balance at the end of the year	1,460	(14)	9,187	10,634	1,510	(45)	11,907	13,372
Own shares / issued share capital		0.95%				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 amounted up to a total of 57.3 million shares or up to ISK 10 billion. During the first half of 2023 Arion Bank bought back own shares for ISK 3,260 million. The Program ended 1 June 2023.

At the AGM in March 2023 a motion was passed to reduce the Bank’s share capital by ISK 50 million. The reduction was effective 25 April 2023 and Arion Bank's share capital was reduced from ISK 1,510 million to ISK 1,460 million. 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 Banks 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 year 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 2023 (ISK 1,500,000) - employees of subsidiaries	2,183	2024-2026	140.56
	24,435		

Movements in share options during the year.	2023		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	16,349	153.8	17,362	180.3
Share options forfeited	(20,152)	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 year	24,435	136.2	30,882	143.2

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

All outstanding share options, if exercised, represent approximately 1.7% 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.

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 represented approximately 3% of the Bank's total share capital and the Bank is obliged to issue new shares when the warrants are exercised. Approximately 48.5% of the total issue was sold to around 150 employees of the Group and 51.5% to professional investors. The exercise period runs from Q4 2023 to Q3 2024.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

Other information

38. Shareholders of Arion Bank

	2023	2022
Gildi lífeyrissjódur	9.85%	9.77%
Lífeyrissjódur starfsmanna ríkisins	9.62%	9.53%
Lífeyrissjódur verzlunarmanna	9.02%	9.14%
Stodir hf.	5.38%	5.20%
Brú lífeyrissjódur	4.34%	3.69%
Vanguard	3.91%	2.27%
Birta lífeyrissjódur	3.58%	3.47%
Frjálsi lífeyrissjódurinn	3.55%	3.17%
Stapi lífeyrissjódur	2.85%	3.02%
Hvalur hf.	2.52%	2.44%
Festa lífeyrissjódur	2.38%	1.92%
Stefnir funds	2.30%	4.05%
Íslandsbanki hf.	2.24%	2.38%
Kvika banki hf.	1.66%	1.82%
Almenni lífeyrissjódur	1.52%	1.47%
Lífsverk Pension fund	1.23%	1.08%
Sjóvá	1.09%	1.00%
Landsbankinn hf.	1.06%	1.21%
Landsbréf hf.	0.98%	1.43%
Arion banki hf.	0.95%	3.01%
Other shareholders with less than 1% shareholding	29.96%	28.96%
	100.0%	100.0%

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.

At the end of the year the Group's employees held a shareholding of 0.83% 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:

	2023		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
Benedikt Gíslason, CEO	997,947	2,561,783	1,006,482	2,506,283
Eight members of the Executive Committee	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.

39. Legal matters

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

Contingent liabilities

Legal proceedings regarding damages

In a lawsuit brought in June 2013, Kortaþjónustan hf. claimed damages from Arion Bank hf., Íslandsbanki hf., Landsbankinn hf., Borgun hf. and Valitor hf. in the amount of ISK 1.2 billion plus interest. The lawsuit is a result of damage Kortaþjónustan hf. contended the five parties caused the company due to violations of the Competition Act. In June 2017 the Supreme Court dismissed the case on procedural grounds. Since then, Kortaþjónustan hf. and subsequently its largest shareholder EC-Clear have tried to initiate five lawsuits against the same defendants which have all been dismissed, the last one in March 2021. In September 2021 EC-Clear has once again brought the same matter of dispute, claiming damages in the amount of ISK 922 million plus interest, against the same defendants. 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.

Amounts are in ISK millions

39. Legal matters, continued

On-site inspection by the Central Bank

The Financial Supervisory Authority of the Central Bank of Iceland (the “FSA”) did an on-site inspection at the Bank in 2022 into AML/CTF procedures. Following the inspection, the FSA identified and reported deficiencies in the Bank's compliance with the relevant AML Act and regulations. In August 2023, following receipt of FSA´s final report, the Bank requested that the matter be concluded by way of settlement. The matter is now pending with the FSA.

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 Reykjavík on the 7th of February 2023 the Bank was acquitted. The plaintiffs have appealed the judgement 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.

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.

Legal matters concluded

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 of the district court in April 2022 FSA was acquitted. The Bank appealed the ruling and with a judgement of the Court of Appeal in June 2023 the district court’s ruling was confirmed.

40. Events after the reporting period

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

Off balance sheet information

41. Commitments

Financial guarantees, unused credit facilities and undrawn loan commitments	2023	2022
Financial guarantees	21,763	20,312
Unused overdrafts	61,951	57,259
Undrawn loan commitments	69,188	105,888
Financial guarantees, unused credit facilities and undrawn loan commitments	152,902	183,459

42. Assets under management and under custody

Assets under management	1,383,134	1,298,289
Assets under custody	1,233,011	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

43. 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 finanical and operating decisions of Arion Bank but do not control those policies. At the end of the year no shareholder was defined as related party with an influence over the Group

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 Operations and culture. For compensation, pension and other transactions with the Board of Directors and the Executive Committee, see Notes 13 and 38.

For information on the associated companies, see Note 27.

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	
	2023	2022	2023	2022
Loans	61	64	348	71
Other assets	2	2	-	-
Total assets	63	66	348	71
Deposits	(776)	(1,111)	(91)	(155)
Other liabilities	-	-	(37)	(27)
Total liabilities	(776)	(1,111)	(128)	(182)
Interest income	6	10	16	1
Interest expenses	(53)	(7)	(2)	(1)
Commission income	10	14	4	1
Commission expenses	-	-	(105)	(101)
Other income	9	-	-	-
Other expenses	-	(2)	(1,311)	(1,414)
Net (expenses) income	(28)	15	(1,398)	(1,514)

Amounts are in ISK millions

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 risks, quantification of risk exposures, actions to limit risk and regular monitoring. 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 risk exposures remain 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 the Compliance Officer 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 the CRO reports directly to the CEO. The division is divided into four 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; Credit Analysis, which supports the Bank's credit transaction process and participates in credit decisions; and the Security Team, headed by the Bank's Chief Security Officer, which facilitates and monitors information security risk management in the first line. The Bank's Risk Officer for Pension Funds reports to the CRO.

Arion Bank is a small bank in an 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. Among the Group’s most significant risks are credit risk, concentration risk, liquidity risk, interest rate risk, cyber risk, third party risk, business risk and reputational 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 2023, in the Pillar 3 Risk Disclosures for 2023 and in the quarterly Additional Pillar 3 Risk Disclosures. These documents are available on the Bank's website, www.arionbank.com.

44. 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 when 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, group of connected clients, industries, geographies and loan types, 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 Consolidated Financial Statements

44. Credit risk, continued

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

		Collateral				
2023	Maximum exposure	Cash and securities	Real estate	Vessels	Other collateral	Total collateral
Cash and balances with Central Bank	102,095	-	-	-	-	-
Loans to credit institutions at amortized cost	28,835	-	-	-	-	-
Loans to customers at amortized cost	1,152,789	24,586	871,682	55,265	118,627	1,070,160
Individuals	*609,144*	*329*	*558,862*	*16*	*17,026*	*576,233*
Mortgages	*549,371*	*15*	*548,962*	*-*	*33*	*549,010*
Other	*59,773*	*314*	*9,900*	*16*	*16,993*	*27,223*
Corporates	*543,645*	*24,257*	*312,820*	*55,249*	*101,601*	*493,927*
Real estate activities	*114,101*	*2,027*	*108,604*	*28*	*1,621*	*112,280*
Construction	*77,728*	*433*	*72,143*	*30*	*3,177*	*75,783*
Fishing industry	*82,772*	*972*	*14,085*	*53,137*	*11,188*	*79,382*
Information and communication technology	*26,012*	*65*	*1,422*	*-*	*12,912*	*14,399*
Wholesale and retail trade	*90,320*	*40*	*51,332*	*3*	*29,253*	*80,628*
Financial and insurance activities	*41,517*	*19,732*	*6,701*	*-*	*13,914*	*40,347*
Industry, energy and manufacturing	*54,796*	*791*	*34,318*	*22*	*16,531*	*51,662*
Transportation	*8,460*	*-*	*1,254*	*803*	*4,026*	*6,083*
Services	*22,191*	*187*	*10,265*	*1,220*	*8,071*	*19,743*
Public sector	*14,212*	*10*	*2,235*	*6*	*202*	*2,453*
Agriculture and forestry	*11,536*	*-*	*10,461*	*-*	*706*	*11,167*
Other assets with credit risk	12,188	-	-	-	-	-
Financial guarantees	21,763	2,973	4,644	292	6,216	14,125
Undrawn loan commitments and unused overdrafts	131,139	-	-	-	-	-
Fair value through OCI	129,564	-	-	-	-	-
Government bonds	*128,178*	-	-	-	-	-
Bonds issued by financial institutions and corporates	*1,386*	-	-	-	-	-
Balance at the end of the year	1,578,373	27,559	876,326	55,557	124,843	1,084,285
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
Individuals	*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*
Corporates	*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	4,720	-	-	-	-	-
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	1,546,293	28,663	800,617	51,754	108,199	989,233

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

Amounts are in ISK millions

44. 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 market transaction value becomes older than 2 years.

			Thereof in Stage 3	
	2023	2022	2023	2022
Less than 50%	205,543	172,790	2,215	1,817
50-60%	105,773	91,201	888	511
60-70%	100,722	90,224	1,374	826
70-80%	75,783	86,856	1,166	408
80-90%	57,165	69,629	339	429
90-100%	3,332	2,111	130	153
More than 100%	1,951	1,171	305	118
Not classified	-	25	-	-
Gross carrying amount at the end of the period	550,269	514,007	6,417	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).

			Thereof in Stage 3	
	2023	2022	2023	2022
Less than 55%	487,095	445,185	5,457	3,643
55-70%	45,134	48,024	620	380
70-80%	13,198	16,045	183	132
80-90%	3,777	3,895	72	65
90-100%	642	516	41	20
More than 100%	423	317	44	22
Not classified	-	25	-	-
Gross carrying amount at the end of the period	550,269	514,007	6,417	4,262

Collateral for financial assets in stage 3

At the end of the year, the gross carrying amount of assets in stage 3 was ISK 19,857 million (31.12.2022: ISK 12,903 million) with ISK 17,465 million in collateral (31.12.2022: ISK 10,627 million), thereof ISK 16,036 million in real estate (31.12.2022: 9,434 million).

Collateral repossessed

During the year, the Group took possession of assets due to foreclosures. The total value of real estate the Group took possession of during the year and still holds at the end of the year was ISK 25 million (31.12.2022: nil) but nil in other assets (31.12.2022: nil). Assets aquired due to foreclosure are held for sale, see Note 30.

Amounts are in ISK millions

44. 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 no large exposure at the end of the year (31.12.2022: two large exposures).

	2023		2022	
No.	Gross	Net	Gross	Net
1	<10%	<10%	11.5%	11.5%
2	<10%	<10%	10.3%	10.3%
Sum of large exposure gross and net > 10%	0.0%	0.0%	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 59.

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.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

44. Credit risk, continued

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

2023	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	102,095	28,835	129,567
Non-investment grade	-	-	-
Gross carrying amount	102,095	28,835	129,567
Loss allowance	-	-	(3)
Book value	102,095	28,835	129,564

Loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 - (Grades AAA to A-)	407,636	4,102	-	6	411,744
Risk class 1 - (Grades BBB+ to BBB-)	321,459	997	-	162	322,618
Risk class 2 - (Grades BB+ to BB-)	229,165	27,870	-	23	257,058
Risk class 3 to 4 - (Grades B+ to CCC-)	90,096	59,724	-	5	149,825
Risk class 5 - (DD)	-	-	19,610	247	19,857
Unrated	238	-	-	-	238
Gross carrying amount	1,048,594	92,693	19,610	443	1,161,340
Loss allowance	(2,348)	(2,091)	(4,020)	(92)	(8,551)
Book value	1,046,246	90,602	15,590	351	1,152,789
Loans to customers - Individuals					
Risk class 0 - (Grades AAA to A-)	310,023	373	-	6	310,402
Risk class 1 - (Grades BBB+ to BBB-)	208,557	689	-	162	209,408
Risk class 2 - (Grades BB+ to BB-)	42,480	19,203	-	23	61,706
Risk class 3 to 4 - (Grades B+ to CCC-)	10,777	10,835	-	5	21,617
Risk class 5 - (DD)	-	-	8,320	156	8,476
Unrated	8	-	-	-	8
Gross carrying amount	571,845	31,100	8,320	352	611,617
Loss allowance	(559)	(532)	(1,381)	(1)	(2,473)
Book value	571,286	30,568	6,939	351	609,144
Loans to customers - Corporates					
Risk class 0 - (Grades AAA to A-)	97,613	3,729	-	-	101,342
Risk class 1 - (Grades BBB+ to BBB-)	112,902	308	-	-	113,210
Risk class 2 - (Grades BB+ to BB-)	186,685	8,667	-	-	195,352
Risk class 3 to 4 - (Grades B+ to CCC-)	79,319	48,889	-	-	128,208
Risk class 5 - (DD)	-	-	11,290	91	11,381
Unrated	230	-	-	-	230
Gross carrying amount	476,749	61,593	11,290	91	549,723
Loss allowance	(1,789)	(1,559)	(2,639)	(91)	(6,078)
Book value	474,960	60,034	8,651	-	543,645
Loan commitments, guarantees and unused credit facilities					
Risk class 0 to 1 (Grades AAA to BBB-)	91,232	30	-	-	91,262
Risk class 2 to 4 (Grades BB+ to CCC-)	51,795	4,660	292	-	56,747
Unrated	4,893	-	-	-	4,893
Nominal	147,920	4,690	292	-	152,902
Loss allowance	(236)	(125)	(2)	-	(363)
Nominal less loss allowance	147,684	4,565	290	-	152,539

Amounts are in ISK millions

44. Credit risk, continued

2022	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	114,118	43,433	115,811
Non-investment grade	-	-	-
Gross carrying amount	114,118	43,433	115,811
Loss allowance	-	-	(6)
Book value	114,118	43,433	115,805

Loans to customers	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

Amounts are in ISK millions

44. 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		
2023	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Book value
Loans to credit instit., securities & cash	260,497	(3)	-	-	-	-	260,494
Loans to individuals	571,845	(559)	31,296	(532)	8,476	(1,382)	609,144
Mortgages	*516,885*	*(233)*	*26,967*	*(351)*	*6,417*	*(314)*	*549,371*
Other	*54,960*	*(326)*	*4,329*	*(181)*	*2,059*	*(1,068)*	*59,773*
Loans to corporates	476,749	(1,789)	61,593	(1,559)	11,381	(2,730)	543,645
Real estate activities	*100,610*	*(327)*	*10,633*	*(233)*	*4,369*	*(951)*	*114,101*
Construction	*72,394*	*(386)*	*5,255*	*(52)*	*572*	*(55)*	*77,728*
Fishing industry	*73,245*	*(121)*	*8,922*	*(48)*	*1,519*	*(745)*	*82,772*
Information and communication technology	*24,621*	*(202)*	*1,636*	*(145)*	*179*	*(77)*	*26,012*
Wholesale and retail trade	*75,987*	*(252)*	*13,052*	*(466)*	*2,629*	*(630)*	*90,320*
Financial and insurance activities	*30,072*	*(214)*	*11,797*	*(261)*	*128*	*(5)*	*41,517*
Industry, energy and manufacturing	*52,771*	*(98)*	*1,811*	*(88)*	*458*	*(58)*	*54,796*
Transportation	*4,389*	*(19)*	*4,058*	*(89)*	*141*	*(20)*	*8,460*
Services	*18,521*	*(91)*	*3,017*	*(151)*	*1,052*	*(157)*	*22,191*
Public Sector	*14,075*	*(59)*	*200*	*(4)*	*1*	*(1)*	*14,212*
Agriculture and forestry	*10,064*	*(20)*	*1,212*	*(22)*	*333*	*(31)*	*11,536*
Balance at the end of the year	1,309,091	(2,351)	92,889	(2,091)	19,857	(4,112)	1,413,283

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

Amounts are in ISK millions

44. 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.

2023

*Impairment loss allowance **	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(2,685)	(1,612)	(2,937)	(131)	(7,365)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(1,530)	1,250	280	-	-
Transfers to Stage 2 (lifetime ECL)	436	(989)	553	-	-
Transfers to Stage 3 (credit impaired financial assets)	82	304	(386)	-	-
Net remeasurement of loss allowance **	2,111	(1,362)	(2,376)	39	(1,588)
New financial assets, originated or purchased	(1,749)	(339)	(313)	-	(2,401)
Derecognitions and maturities	679	511	513	-	1,703
Write-offs ***	72	21	644	-	737
Impairment loss allowance ****	(2,584)	(2,216)	(4,022)	(92)	(8,914)
Impairment loss allowances for assets only carrying 12-month ECL	(3)	-	-	-	(3)
Total impairment loss allowance	(2,587)	(2,216)	(4,022)	(92)	(8,917)

* 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 year the loss allowance balance for stage 3 loans was raised by ISK 576 million due to unwinding of interest income.

*** During the year an amount of ISK 598 million was written off but is still subject to enforcement activities subject to Icelandic law.

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

Amounts are in ISK millions

44. Credit risk, continued

Impairment loss allowance for loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(2,334)	(1,519)	(2,932)	(131)	(6,916)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(1,437)	1,157	280	-	-
Transfers to Stage 2 (lifetime ECL)	420	(973)	553	-	-
Transfers to Stage 3 (credit impaired financial assets)	81	301	(382)	-	-
Net remeasurement of loss allowance	1,859	(1,294)	(2,380)	39	(1,776)
New financial assets, originated or purchased	(1,528)	(235)	(313)	-	(2,076)
Derecognitions and maturities	519	451	510	-	1,480
Write-offs	72	21	644	-	737
Total loss allowance for loans to customers	(2,348)	(2,091)	(4,020)	(92)	(8,551)

Impairment loss allowance for loans to customers - Individuals	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(445)	(287)	(1,043)	-	(1,775)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(564)	426	138	-	-
Transfers to Stage 2 (lifetime ECL)	112	(155)	43	-	-
Transfers to Stage 3 (credit impaired financial assets)	19	190	(209)	-	-
Net remeasurement of loss allowance	438	(800)	(697)	(1)	(1,060)
New financial assets, originated or purchased	(233)	(114)	(152)	-	(499)
Derecognitions and maturities	113	188	264	-	565
Write-offs	1	20	275	-	296
Total loss allowance for loans to individuals	(559)	(532)	(1,381)	(1)	(2,473)

Impairment loss allowance for loans to customers - Corporates	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(1,889)	(1,232)	(1,889)	(131)	(5,141)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(873)	731	142	-	-
Transfers to Stage 2 (lifetime ECL)	308	(818)	510	-	-
Transfers to Stage 3 (credit impaired financial assets)	62	111	(173)	-	-
Net remeasurement of loss allowance	1,421	(494)	(1,683)	40	(716)
New financial assets, originated or purchased	(1,295)	(121)	(161)	-	(1,577)
Derecognitions and maturities	406	263	246	-	915
Write-offs	71	1	369	-	441
Total loss allowance for loans to corporates	(1,789)	(1,559)	(2,639)	(91)	(6,078)

Impairment loss allowance for loan commitments, guarantees and unused credit facilities	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(351)	(93)	(5)	-	(449)
Transfers					
Transfers to 12-month ECL	(93)	93	-	-	-
Transfers to lifetime ECL	16	(16)	-	-	-
Transfers to credit impaired	1	3	(4)	-	-
Net remeasurement of loss allowance	252	(68)	4	-	188
New financial commitments originated	(221)	(104)	-	-	(325)
Derecognitions and maturities	160	60	3	-	223
Total loss allowance for loan commit., guarantees, unused facilities	(236)	(125)	(2)	-	(363)

Amounts are in ISK millions

44. Credit risk, continued

2022

*Impairment loss allowance **	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(1,606)	(1,897)	(4,824)	(1)	(8,328)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(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	(7)
New financial assets, originated or purchased	(2,192)	(265)	(1,048)	(131)	(3,636)
Derecognitions and maturities	795	457	2,120	(166)	3,206
Write-offs ***	1	7	1,226	166	1,400
Impairment loss allowance ****	(2,685)	(1,612)	(2,937)	(131)	(7,365)
Impairment loss allowances for assets only carrying 12-month ECL	(6)	-	-	-	(6)
Total impairment loss allowance	(2,691)	(1,612)	(2,937)	(131)	(7,371)

* 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 year the loss allowance balance for stage 3 loans was raised by ISK 528 million due to unwinding of interest income.

*** During the year an amount of ISK 910 million was written off but is still subject to enforcement activities subject to Icelandic law.

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

Impairment loss allowance for loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(1,313)	(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	Stage 1	Stage 2	Stage 3	POCI	Total
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)

Amounts are in ISK millions

44. Credit risk, continued

	Stage 1	Stage 2	Stage 3	POCI	Total
Impairment loss allowance for loans to customers - Corporates					
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		
	2024	2025	2026
Unemployment rate	4.4%	4.4%	4.2%
Housing prices, year-on-year change	2.5%	4.7%	6.9%
Private consumption, growth	1.9%	2.7%	2.9%
GDP growth	2.3%	2.7%	2.5%

	Optimistic			Pessimistic		
	2024	2025	2026	2024	2025	2026
Unemployment rate	3.3%	3.7%	4.0%	6.2%	5.6%	4.4%
Housing prices, year-on-year change	7.0%	7.7%	7.4%	-4.0%	1.2%	7.9%
Private consumption, growth	4.7%	3.5%	3.1%	-1.8%	1.9%	2.5%
GDP growth	4.2%	3.2%	2.9%	-1.2%	2.5%	2.3%

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 1.5 billion, ISK 3.0 billion and ISK 8.8 billion for the optimistic, base case and pessimistic scenarios, respectively (31.12.2022: ISK 1.8 billion, ISK 3.1 billion and ISK 8.4 billion, respectively).

Amounts are in ISK millions

44. 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	
2023	Gross carrying amount	Loss allowance	Gross carrying carrying	Loss allowance	Gross carrying carrying	Loss allowance	Gross carrying carrying	Loss allowance
Individuals	2,614	(17)	2,001	(39)	3,873	(467)	8,488	(523)
Companies	3,432	(21)	13,242	(415)	2,659	(519)	19,333	(955)
Tourism	2,049	(15)	8,980	(376)	1,358	(254)	12,387	(645)
Other than tourism	1,383	(6)	4,262	(39)	1,301	(265)	6,946	(310)
Total	6,046	(38)	15,243	(454)	6,532	(986)	27,821	(1,478)
2022								
Individuals	-	-	7,948	(42)	2,254	(257)	10,202	(299)
Companies	-	-	16,815	(606)	3,529	(1,259)	20,344	(1,865)
Tourism	-	-	13,100	(563)	2,511	(1,065)	15,611	(1,628)
Other than tourism	-	-	3,715	(43)	1,018	(194)	4,733	(237)
Total	-	-	24,763	(648)	5,783	(1,516)	30,546	(2,164)

Volcanic activity in the vicinity of Grindavík

The volcanic events in the vicinity of Grindavík have an impact on the credit quality of a section of the Group's loan portfolio. The carrying amount of loans to individuals and corporates domiciled in the area is ISK 10.3 billion, thereof ISK 8.3 billion to corporates and ISK 2.0 billion to individuals. These loans are well collateralized with strong average LTVs of 53% for the mortgage portfolio and 42% for the corporate portfolio. Of the loans to corporates, ISK 6.0 billion is secured by fishing vessels with appurtenant quota which are not impacted by the events. The other main collateral is residential and commercial real estate. These are required by law to be insured against the risk of fire based on an official fire insurance value, which is generally higher than the tax value in the area. The Natural Catastrophe Insurance of Iceland covers real estate up to the fire insurance value in case of destruction by a natural disaster. Compensation has been paid out for some of the properties that have been deemed destroyed.

It should be noted that these events are still ongoing, with an eruption occurring after the year-end reporting date on 14-15 January, with lava flow partly within the town's perimeter. Thus, the Bank will continue to monitor the situation and work with its customers through these times of uncertainty. The Bank has transferred most of the exposure in Grindavík (96%) to stage 2 as this event amounts to a significant increase in credit risk. Impairments remain modest but the assessment of expected credit losses will be subject to careful and continuous review in the coming quarters. Potential government intervention may impact the Group's assessment.

Amounts are in ISK millions

45. 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 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 tracks market risk closely 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.

Following the outbreak of Covid-19, the Central Bank of Iceland lowered interest rates to historic lows, resulting in a sharp increase in demand for non-indexed mortgages with floating rates in 2020 and 2021. Inflation in Iceland, measured at 7.7% at year-end 2023, has exceeded the Central Bank’s target of 2.5% since June 2020 and is expected to remain over the target throughout 2024 at least. The Central Bank has responded by increasing interest rates by 8.5% from its lowest value of 0.75% 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 for the Bank. This risk exposure is receding as the bulk of those loans is subject to interest rate reset in 2024. Interest rate risk for indexed rates is however increasing due to new issuance of fixed-rate indexed covered bonds.

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 25, and are therefore different from the amounts shown in these Condensed Consolidated 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.

2023 *Assets*	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	102,095	-	-	-	-	102,095
Loans to credit institutions	28,835	-	-	-	-	28,835
Loans to customers	782,864	170,223	191,527	749	-	1,145,363
Bonds and debt instruments	79,710	46,599	14,657	9,150	7,081	157,197
Bonds and debt instruments used for hedging		403	617	199	977	2,196
Derivatives	108,752	75,100	182,078	-	-	365,930
Assets	1,102,256	292,325	388,879	10,098	8,058	1,801,616
Liabilities						
Due to credit institutions and Central Bank	2,771	-	-	-	-	2,771
Deposits	785,509	7,201	-	-	-	792,710
Derivatives	221,119	134,951	8,389	-	-	364,459
Borrowings	22,775	68,633	268,304	46,906	12,390	419,008
Subordinated liabilities	-	7,005	34,149	-	-	41,154
Liabilities	1,032,174	217,790	310,842	46,906	12,390	1,620,102
Net interest gap	70,082	74,535	78,037	(36,808)	(4,332)	181,514

Amounts are in ISK millions

45. Market risk, continued

2022 *Assets*	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
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, 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.

	2023		2022	
NPV change in the banking book	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	(1,855)	1,721	(1,994)	2,782
ISK, Non index-linked	(1,487)	1,462	(1,106)	886
Foreign currencies	(418)	416	(36)	32
NPV change in the trading book				
ISK, CPI index-linked	133	(122)	173	(156)
ISK, Non index-linked	195	(185)	211	(199)
Foreign currencies	(31)	31	(38)	38

Amounts are in ISK millions

45. 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

2023	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	11,667	81,695	282,842	376,204
Financial instruments	7,813	5,028	8,797	21,638
Assets, CPI index-linked	19,480	86,723	291,639	397,842
Liabilities, CPI index-linked				
Deposits	111,523	16,253	3,939	131,715
Borrowings	373	81,870	58,920	141,163
Subordinated liabilities	-	-	16,997	16,997
Other	-	-	1,028	1,028
Off-balance sheet position	1,466	151	-	1,617
Liabilities, CPI index-linked	113,362	98,274	80,884	292,520
Net on-balance sheet position	(92,416)	(11,400)	210,755	106,939
Net off-balance sheet position	(1,466)	(151)	-	(1,617)
CPI balance	(93,882)	(11,551)	210,755	105,322
CPI balance for prudential consolidation, excluding insurance operations *	(95,084)	(16,579)	201,957	90,296

2022	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	8,525	37,589	210,878	256,992
Financial instruments	5,208	3,435	9,684	18,327
Assets, CPI index-linked	13,733	41,024	220,562	275,319
Liabilities, CPI index-linked				
Deposits	89,217	20,240	3,493	112,950
Borrowings	336	67,836	45,661	113,833
Subordinated liabilities	-	-	15,735	15,735
Other	1,121	251	1,393	2,765
Off-balance sheet position	1,889	1,520	-	3,409
Liabilities, CPI indexed linked	92,563	89,847	66,282	248,692
Net on-balance sheet position	(76,941)	(47,303)	154,280	30,036
Net off-balance sheet position	(1,889)	(1,520)	-	(3,409)
CPI balance	(78,830)	(48,823)	154,280	26,627
CPI balance for prudential consolidation, excluding insurance operations *	(77,727)	(52,007)	144,954	15,220

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

Amounts are in ISK millions

45. 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

2023 *Financial assets*	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	100,837	412	301	112	137	28	268	102,095
Loans to credit institutions	1,321	11,870	10,833	1,214	1,513	299	1,785	28,835
Loans to customers	961,822	105,897	52,705	1,150	28,602	1,327	1,286	1,152,789
Financial instruments	86,667	87,955	13,446	158	205	15,753	1,522	205,706
Other financial assets	5,107	264	6,808	-	5	4	-	12,188
Financial assets	1,155,754	206,398	84,093	2,634	30,462	17,411	4,861	1,501,613
Financial liabilities								
Due to credit inst. and Central Bank	2,096	185	432	-	-	-	58	2,771
Deposits	691,181	33,847	56,528	4,317	3,273	1,599	1,965	792,710
Financial liabilities at fair value	1,573	9,156	739	-	-	169	9	11,646
Other financial liabilities	6,156	1,426	2,024	250	538	138	258	10,790
Borrowings	184,019	215,728	-	-	-	13,526	7,187	420,460
Subordinated liabilities	20,155	766	13,217	-	-	4,096	3,045	41,279
Financial liabilities	905,180	261,108	72,940	4,567	3,811	19,528	12,522	1,279,656
Net on-balance sheet position	250,574	(54,710)	11,153	(1,933)	26,651	(2,117)	(7,661)	
Net off-balance sheet position	(32,394)	58,658	(11,253)	1,851	(26,069)	2,075	7,132	
Net position *	218,180	3,948	(100)	(82)	582	(42)	(529)	
Non-financial assets								
Investment property	9,493	-	-	-	-	-	-	9,493
Investments in associates	789	-	-	-	-	-	-	789
Intangible assets	8,051	-	-	-	-	-	-	8,051
Tax assets	39	-	-	-	-	-	-	39
Assets and disposal groups held for sale	62	-	-	-	-	-	-	62
Other non financial assets	5,201	233	78	85	1	27	-	5,625
Non-financial assets	23,635	233	78	85	1	27	-	24,059
Non-financial liabilities and equity								
Tax liabilities	11,169	-	-	-	-	-	-	11,169
Other non-financial liabilities	35,493	48	2	-	1	-	2	35,546
Shareholders' equity	198,798	-	-	-	-	-	-	198,798
Non-controlling interest	503	-	-	-	-	-	-	503
Non-financial liabilities and equity	245,963	48	2	-	1	-	2	246,016
Management reporting of currency risk **	(4,148)	4,133	(24)	3	582	(15)	(531)	

* The net position of the currency risk is presented in accordance with IFRS.

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

Amounts are in ISK millions

45. Market risk, continued

2022*

Financial assets	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	4,292	274	123	11	4	-	1	4,705
Financial assets	1,114,173	190,007	78,685	5,221	28,979	20,276	5,069	1,442,410
Financial liabilities								
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	2,227	1,234	1,775	257	223	589	222	6,527
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	853,291	270,686	63,512	3,325	3,249	23,569	16,844	1,234,476
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)	
Non-financial assets								
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
Non-financial liabilities and equity								
Tax liabilities	10,303	-	-	-	-	-	-	10,303
Other non-financial liabilities	32,816	51	6	-	1	-	-	32,874
Shareholders' equity	187,307	-	-	-	-	-	-	187,307
Non-controlling interest	649	-	-	-	-	-	-	649
Non-financial liabilities and equity	231,075	51	6	-	1	-	-	231,133
Management reporting of currency risk ***	1,135	493	(734)	32	80	(121)	(509)	

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

** The net position of the currency risk is presented in accordance with IFRS.

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

Amounts are in ISK millions

45. 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).

	2023		2022	
Currency	-10%	+10%	-10%	+10%
EUR	(413)	413	(49)	49
USD	2	(2)	73	(73)
GBP	(0)	0	(3)	3
DKK	(58)	58	(8)	8
NOK	2	(2)	12	(12)
Other	53	(53)	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 31 and 24 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.

	2023		2022	
Equity	-10%	+10%	-10%	+10%
Trading book - listed	(334)	334	(165)	165
Banking book - listed	(397)	397	(477)	477
Banking book - unlisted	(526)	526	(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 25 provides a breakdown of the Group's derivative positions by type.

Amounts are in ISK millions

46. 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 71% 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

2023 *Financial assets*	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity	Total	Book value
Cash and balances with CB	2,556	83,848	16,227	-	-	-	102,631	102,095
Loans to credit institutions	20,977	7,842	16	-	-	-	28,835	28,835
Loans to customers	6,942	161,250	155,075	531,276	1,385,530	-	2,240,073	1,152,789
Financial instruments	9,376	81,687	47,647	17,548	13,463	39,711	209,432	205,706
Derivatives - assets leg	-	*42,180*	*33,090*	*31,428*	-	-	*106,698*	*94,662*
Derivatives - liabilities leg	-	*(39,292)*	*(32,374)*	*(27,621)*	-	-	*(99,287)*	*(88,060)*
Other financial instruments	*9,376*	*78,799*	*46,931*	*13,741*	*13,463*	*39,711*	*202,021*	*199,104*
Other financial assets	519	9,229	774	1,666	-	-	12,188	12,188
Financial assets	40,370	343,856	219,739	550,490	1,398,993	39,711	2,593,159	1,501,613
Financial liabilities								
Due to credit inst. and Central Bank	1,640	1,162	-	-	-	-	2,802	2,771
Deposits	561,728	191,128	21,724	16,906	-	-	791,486	792,710
Financial liabilities at fair value	-	3,791	5,726	16,209	-	-	25,726	11,646
Derivatives - assets leg	-	*(30,271)*	*(10,276)*	*(4,118)*	-	-	*(44,665)*	*(39,726)*
Derivatives - liabilities leg	-	*34,001*	*16,002*	*20,327*	-	-	*70,330*	*51,311*
Short position in bonds	-	*61*	-	-	-	-	*61*	*61*
Other financial liabilities	76	9,640	340	734	-	-	10,790	10,790
Borrowings	-	1,191	92,107	304,564	63,417	-	461,279	420,460
Subordinated liabilities	-	1,291	1,776	20,326	32,471	-	55,864	41,279
Financial liabilities	563,444	208,203	121,673	358,739	95,888	-	1,347,947	1,279,656
Net position for assets and liab.	(523,074)	135,653	98,066	191,751	1,303,105	39,711	1,245,212	221,957
Off-balance sheet items								
Financial guarantees	-	4,005	6,629	3,711	7,418	-	21,763	21,763
Unused overdraft	-	61,951	-	-	-	-	61,951	61,951
Undrawn loan commitments	-	44,220	15,009	9,354	605	-	69,188	69,188
Off-balance sheet items	-	110,176	21,638	13,065	8,023	-	152,902	152,902
Net contractual cash flow	(523,074)	25,477	76,428	178,686	1,295,082	39,711	1,092,310	69,055

Amounts are in ISK millions

46. Liquidity and Funding risk, continued

2022* *Financial assets*	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity	Total	Book value
Cash and balances with CB	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
Derivatives - assets leg	-	*76,104*	*22,301*	*32,447*	-	-	130,852	*123,547*
Derivatives - liabilities leg	-	*(69,826)*	*(19,032)*	*(29,503)*	-	-	(118,361)	*(114,031)*
Other financial instruments	*8,527*	*71,399*	*40,504*	*9,440*	*15,775*	*41,749*	187,394	*183,813*
Other financial assets	488	858	2,611	763	-	-	4,720	4,720
Financial assets	53,384	328,643	201,918	483,605	1,153,824	41,749	2,263,123	1,442,425
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
Derivatives - assets leg	-	*(25,891)*	*(25,670)*	*(12,131)*	-	-	*(63,692)*	*(62,420)*
Derivatives - liabilities leg	-	*27,527*	*28,643*	*30,618*	-	-	*86,788*	*83,406*
Short position in bonds used for hedging	-	*11*	-	-	-	-	*11*	*11*
Other financial liabilities	109	5,121	343	954	-	-	6,527	6,527
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	137,205	103,358	397,959	90,700	-	1,282,328	1,234,476
Net position for assets and liab.	(499,722)	191,438	98,560	85,646	1,063,124	41,749	980,795	207,949
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)	84,521	61,228	55,902	1,053,658	41,749	797,336	24,490

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

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.

	2023	2022
Available stable funding	1,167,158	1,109,623
Required stable funding	982,601	931,991
Net stable funding ratio	119%	119%

Amounts are in ISK millions

46. 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.

2023	ISK	EUR	Total all currencies
Liquid assets level 1 *	124,792	83,916	243,122
Liquid assets level 2	9,302	-	9,302
Liquid assets	134,094	83,916	252,424
Deposits	131,959	9,158	164,787
Borrowings	672	-	759
Other cash outflows	5,402	10,436	12,380
Cash outflows	138,033	19,594	177,926
Short-term deposits with other banks **	-	8,569	19,918
Other cash inflows	23,118	888	26,412
Cash inflows	23,118	9,457	46,330
Liquidity coverage ratio (LCR) ***	117%	828%	192%

2022	ISK	FX	Total
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 = Weighted liquid assets / (weighted cash outflows - weighted cash inflows) where weighted cash inflows are capped at 75% of weighted cash outflows.

Arion Bank Consolidated Financial Statements 2023 74 Amounts are in ISK millions

46. Liquidity and Funding risk, continued

Composition of liquid assets

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

2023	ISK	USD	EUR	Other	Total
Cash and balances with Central Bank	100,837	301	412	545	102,095
Short-term deposits with financial institutions	-	6,961	8,569	4,388	19,918
Domestic bonds eligible as collateral with Central Bank	30,046	-	-	-	30,046
Foreign government bonds	-	18,888	83,504	14,675	117,067
Liquidity reserve	130,883	26,150	92,485	19,608	269,126

2022	ISK	USD	EUR	Other	Total
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					
2023	Less stable	Weight %	Stable	Weight %	Term deposits*	Total deposits
Individuals	107,999	10%	115,140	5%	146,109	369,248
Small and medium enterprises	106,030	10%	17,758	5%	19,827	143,615
Operational relationship	7,540	25%	-	5%	-	7,540
Corporations	116,348	40%	15,759	20%	22,679	154,786
Sovereigns, central banks and PSE	27,678	40%	15	0	753	28,446
Pension funds	47,390	100%	-	-	17,211	64,601
Domestic financial entities	20,521	100%	-	-	4,780	25,301
Foreign financial entities	1,944	100%	-	-	-	1,944
Total	435,450		148,672		211,359	795,481

2022	Less stable	Weight %	Stable	Weight %	Term deposits*	Total deposits
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.

Amounts are in ISK millions

47. 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.

Own funds	2023	2022*
Total equity	199,301	187,956
Non-controlling interest not eligible for inclusion in CET1 capital	(503)	(649)
Common Equity Tier 1 capital before regulatory adjustments	198,798	187,307
Intangible assets	(7,211)	(6,425)
Additional value adjustments	(227)	(224)
Foreseeable dividend and buyback **	(12,877)	(15,980)
Adjustment under IFRS 9 transitional arrangements as amended	952	1,142
Common Equity Tier 1 capital	179,435	165,820
Non-controlling interest eligible for inclusion in T1 capital	117	105
Additional Tier 1 capital	13,217	13,396
Tier 1 capital	192,769	179,321
Tier 2 instruments	28,062	33,935
Tier 2 instruments of financial sector entities (significant investments)	(1,247)	(1,155)
Tier 2 capital	26,815	32,780
Total own funds	219,584	212,101
Risk-weighted exposure amount (REA)		
Credit risk, loans and off-balance sheet items	732,760	707,479
Credit risk, securities and other	52,032	56,714
Credit risk, derivatives and repos	7,442	14,645
Market risk due to currency imbalance	4,751	1,387
Market risk due to trading book positions	11,066	7,493
Credit valuation adjustment	3,680	6,010
Operational risk	98,740	89,166
Total risk-weighted exposure amount	910,471	882,894
Capital ratios		
CET1 ratio	19.7%	18.8%
Tier 1 ratio	21.2%	20.3%
Capital adequacy ratio	24.1%	24.0%

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

** On 31 December 2023, the deduction consists of 50% of profits as per the Bank's dividend policy. On 31 December 2022, the foreseeable dividend and buyback corresponded to 50% of profits 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.

Arion Bank Consolidated Financial Statements 2023 76 Amounts are in ISK millions

Notes to the Consolidated Financial Statements

47. Capital management, continued

Capital ratios of the parent company	2023	2022
CET1 ratio	19.9%	18.8%
Tier 1 ratio	21.4%	20.3%
Capital adequacy ratio	24.3%	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.

Capital buffer requirement, % of REA	2023	2022
Capital conservation buffer	2.5%	2.5%
Capital buffer for systematically 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.

Capital requirement, % of REA	CET1	Tier 1	Total
Pillar 1 capital requirement	4.5%	6.0%	8.0%
Pillar 2R capital requirement **	1.2%	1.6%	2.1%
Combined buffer requirement *	9.2%	9.2%	9.2%
Regulatory capital requirement	14.9%	16.8%	19.3%
Available capital	19.7%	21.2%	24.1%

* 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 2022. The Pillar 2R requirement is 2.1% 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.

	2023	2022
On-balance sheet exposures	1,477,968	1,415,353
Derivative exposures	15,953	32,118
Repos	10,326	10,174
Off-balance sheet exposures	46,087	59,723
Total exposure	1,550,334	1,517,368
Tier 1 capital	192,769	179,321
Leverage ratio	12.4%	11.8%

Amounts are in ISK millions

47. 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, as amended, which transposes BRRD I/II into Icelandic law. Own funds which are not used to fulfil the combined buffer requirement can be used towards the MREL requirements. In October 2023, the Icelandic Resolution Authority (IRA) presented the Group with the MREL requirements based on year-end 2022 financials. The requirements are expressed as a fraction of total REA, and as a fraction of the total exposure measure. Both ratios are shown in the table below. The Bank expects an MREL subordination requirement to come into effect in Iceland on 1 August 2026.

Minimum requirement for own funds and eligible liabilities	2023	2022
Own funds	219,584	212,101
Eligible liabilities	124,955	155,667
Own funds and eligible liabilities	344,539	367,768
Combined buffer requirement (CBR)	83,763	82,196
Own funds and eligible liabilities not used for CBR	260,775	285,572
Risk-weighted exposure amount (REA)	910,471	882,894
Own funds and eligible liabilities not used for CBR (% REA)	28.6%	32.3%
MREL requirement (% REA)	20.2%	23.0%
Total exposure measure (TEM)	1,550,334	1,517,368
Own funds and eligible liabilities (% TEM)	22.2%	24.2%
MREL requirement (% TEM)	6.0%	

Solvency II for insurance subsidiary Vördur	2023	2022
Excess of assets over liabilities in accordance with Solvency II	10,232	9,175
Subordinated liabilities	1,263	1,169
Foreseeable dividends	-	-
Own funds	11,495	10,344
Solvency capital requirements (SCR)	8,294	7,114
SCR ratio	138.6%	145.4%

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

48. 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.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

49. 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. The following table excludes committed green exposures.

Green Financing Instruments	2023	2022
Deposits	25,477	21,274
Borrowings	98,801	97,405
Book value	124,278	118,679

Identified eligible green assets by category		
Sustainable fishery and aquaculture	25,493	51,936
Renewable energy	429	-
Clean transportation	6,317	4,879
Green buildings	67,484	64,232
Energy efficiency	16,644	8,189
Pollution prevention and control and wastewater management	6,523	6,174
Book value	122,890	135,410

Amounts are in ISK millions

Significant accounting policies

The accounting policies adopted in the preparation of these Consolidated Financial Statements are consistent with those followed in the preparation of the Annual Financial Statements for the year ended 31 December 2022, except for when there have been made amendmends to current IFRS valid from 1 January 2023, Icelandic Act on Financial Statements, Act on Financial Undertakings and rules on Accounting for Credit Institutions. A number of new standards and interpretations were effective from 1 January 2023. Only IFRS 17 Insurance contracts had some effects on these Consolidated Financial Statements.

IFRS 17 Insurance Contracts came into effect on 1 January 2023. The standard apply to all issued insurance and reinsurance contracts. The issuers of insurance contracts should present them in the balance sheet as the sum of the cash flow and the margin yielded by the contracts. Cash flow refers to the estimated premiums which the company collects minus the payment of claims and cost, taking into account time and risk. Margin refers to the estimated profit from the insurance contracts. The impact of the standard on the company's results was not significant. The insurance reserve in the balance sheet at the beginning of 2023 was considerably lower than the reserve according to the previous methods. Firstly, the presentation of the premium reserve is such that only pre-paid premiums are considered part of the premium reserve, which resulted in a considerable decrease in the reserve and a corresponding decrease in receivables. Secondly, the calculation of the claims reserve changes somewhat and did not have a significant impact on the reserve amount.

50. 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 Consolidated Financial Statements are prepared on a going concern basis.

51. Principles underlying the consolidation

Subsidiaries

Subsidiaries are entities controlled by the Group. The Financial Statements of subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases. The Financial Statements of the subsidiaries are prepared for the same reporting period as the parent entity, using consistent accounting policies.

Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date, i.e. when control is transferred to the Group. The Group controls an investee if, and only if, the Group has:

- power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect its returns.

Generally, there is a presumption that a majority of voting rights result in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including (i) the contractual arrangement with the other vote holders of the investee, (ii) rights arising from other contractual arrangements and (iii) the Group's voting rights and potential voting rights. The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.

The Group measures goodwill at the acquisition date as:
- the fair value of the consideration transferred; plus
- the recognized amount of any non-controlling interests in the acquiree; less
- if the business combination is achieved in stages, the fair value of the pre-existing equity interest in the acquiree; less
- the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

When the excess is negative, a bargain purchase gain is recognized immediately in profit or loss.

Transaction costs incurred are expensed and included in administration expense.

Non-controlling interests

Non-controlling interests represent the portion of profit or loss and equity not owned, directly or indirectly, by the Group; such interests are presented separately in the Income Statement and are included in equity in the Statement of Financial Position, separately from equity attributable to owners of the Group.

For each business combination, the Group elects to measure any non-controlling interests in the acquiree either:
- at fair value; or
- at their proportionate share of the acquiree's identifiable net assets, which are generally at fair value.

Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

51. Principles underlying the consolidation, continued

Loss of control

On the loss of control, the Group derecognizes the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control is recognized in profit or loss.

Transactions eliminated on consolidation

Intragroup balances, income and expenses arising from intragroup transactions, are eliminated in preparing the Consolidated Financial Statements. This also applies to subsidiaries classified as disposal groups held for sale.

Funds management

The Group manages and administers assets held in unit trusts and investment vehicles on behalf of investors. The Financial Statements of these entities are not included in these Consolidated Financial Statements except when the Group controls the entity.

When assessing whether to consolidate investment funds, the Group reviews all facts and circumstances to determine whether the Group, as fund manager, is acting as agent or principal. The Group is deemed to be a principal, and hence controls and consolidates a fund, when the Group acts as fund manager and cannot be removed without cause, has variable returns through significant holdings, and is able to influence the returns of the funds by exercising its power. The Group is defined as agent in all instances.

52. Associates

Associates are those entities over which the Group has a significant influence, i.e. the power to participate in the financial and operating policy decisions of the associates but not control or joint control over those policies. Significant influence generally exists when the Group holds 20% or more of the voting power, including potential voting rights, unless it can be clearly demonstrated that this is not the case. Investments in associates are initially recognized at cost. The carrying amount of investments in associates includes intangible assets and accumulated impairment loss.

The considerations made in determining significant influence are similar to those necessary to determine control over subsidiaries.

The Group's investments in its associate are accounted for using the equity method.

The Financial Statements include the Group's share of the total recognized income and expenses of associates from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its carrying value of associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the Group resumes recognizing its share of those profits only after its share of the profits equals the share of losses not recognized.

Upon loss of significant influence over the associate, the Group measures and recognizes any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognized in profit or loss.

Impairment on investments in associates

After applying the equity method to account for investments in associates, the Group determines whether it is necessary to recognize any impairment loss with respect to its investments in associates. The Group first determines whether there is any objective evidence that an investment in an associate is impaired. If such evidence exists, the Group then tests the entire carrying amount of the investment for impairment, by comparing its recoverable amount, which is the higher of value in use and fair value less costs to sell, with its carrying amount. The recoverable amount of an investment in an associate is assessed for each associate, unless the associate does not generate cash inflows from continuing use that are largely independent of those from other assets of the Group. The excess of the carrying amount over the recoverable amount is recognized in the Income statement as an impairment loss. Impairment losses are subsequently reversed through the Income Statement if the reasons for the impairment loss no longer apply.

53. Foreign currency

Items included in the Consolidated Financial Statements of each of the Group's subsidiaries are measured using the functional currency of the respective entity.

Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. All differences arising on settlement or translation of monetary items are taken to the Income Statement. Non-monetary assets and liabilities denominated in foreign currencies are reported at historic cost.

54. Interest

Interest income and expense are recognized in the Income Statement using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and financial liability and is not revised subsequently.

The calculation of the effective interest rate includes all transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Interest income and expense presented in the Income Statement include Income and expenses of assets and liabilities carried at:

- amortized cost;
- fair value through profit and loss (FVTPL); and
- fair value through other comprehensive income (FVOCI).

55. Fee and commission

The Group provides various services to its clients and earns income therefrom, such as income from Corporate Banking, Retail Banking, Capital Markets, Corporate Finance, Asset Management and Private Banking. Fees earned from services that are provided over a certain period of time are recognized as the services are provided, i.e. point in time. Fees earned from transaction type services are recognized when the service has been completed, i.e. point in time. Fees that are performance linked are recognized when the performance criteria are fulfilled, i.e. point in time.

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

56. Net financial income

Net financial income comprises Dividend income, Net gain on financial assets and liabilities at fair value and Net foreign exchange gain.

i) Dividend income is recognized when the right to receive dividend is established. Usually this is the ex-dividend date for equity securities.

ii) Net gain on financial assets and liabilities at fair value comprises all realized and unrealized fair value changes, except for interest (which is included in Interest income and Interest expense) and foreign exchange gain and losses (which are included in Net foreign exchange gains as described below).

iii) Net foreign exchange gain comprise all foreign exchange differences arising on the settlement of foreign currency monetary assets and liabilities and on translating foreign currency monetary assets and liabilities at rates different from those at which they were translated on initial recognition during the year or in previous Consolidated Financial Statements.

Net foreign exchange gain also include foreign exchange differences arising on translating non-monetary assets and liabilities which are measured at fair value in foreign currencies and whose other gain and loss are also recognized in profit or loss.

57. Insurance service results

Insurance revenues recognized in the Income Statement are insurance premium and other income from insurance contracts earned during the operating year.

Insurance service expenses are claims incurred during the year and the increase or decrease due to claims from last year, acquisition cost and other costs from activities, such as marketing costs, salary costs, office and administration costs.

58. Income tax expense

Tax expense comprises current and deferred tax. Income tax for the year has been calculated and recognized in the Consolidated Financial Statements.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Taxable profit may differ from earnings before tax as reported in the Income Statement as it may exclude income or expense that is deductible in other years and it excludes income or expense that are never taxable or deductible.

Current and deferred tax relating to items recognized directly in equity is recognized in equity and not in the statement of profit or loss.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities and the realization of foreign exchange gain or loss, for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantively enacted at the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realized. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from the initial recognition (other than in a business combination) of assets and liabilities in transaction that affects neither the taxable profit nor the accounting profit. In addition, tax liabilities are not recognized if the temporary difference arises from the initial recognition of goodwill.

59. Financial assets and financial liabilities

Recognition and initial measurement

The Group initially recognizes financial assets and financial liabilities on the date that they are originated at the fair value of consideration paid. Regular-way purchases and sales of financial assets are recognized on the trade date at which the Group commits to purchase or sell assets. All other financial assets and liabilities are recognized on the trade date, which is the date that the Group becomes a party to the contractual provision of the instrument.

A financial asset or financial liability is measured initially at fair value and for an item not at fair value through profit or loss, transaction cost that are directly attributable to its acquisition or issue.

Derecognition

Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or when the Group has transferred substantially all risks and rewards of ownership.

Financial liabilities are derecognized when the obligation of the Group specified in the contract is discharged or cancelled or expires.

Debt instruments

Debt instruments, including loans and debt securities, are classified into one of the following measurement categories:

- amortized cost;
- fair value through profit and loss (FVTPL); or
- fair value through other comprehensive income (FVOCI).

A debt instrument is measured at amortized cost only if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to collect contractual cash flows; and
- its contractual cash flows are solely payments of principal and interest on the principal amount outstanding (here after SPPI).

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to collect contractual cash flows and selling financial assets; and
- its contractual cash flows are SPPI.

All other debt instruments are carried at FVTPL.

59. Financial assets and financial liabilities, continued

Business model assessment

Business model assessment involves determining whether financial assets are managed in order to generate cash flows from collection of contractual cash flows, selling financial assets or both. The Group assesses the business model at a portfolio level reflective of how groups of assets are managed together to achieve a particular business objective. For the assessment of business models the Group takes into consideration the following factors:

- how the performance of assets in a portfolio is evaluated and reported to group heads and other key decision makers within the Group's business lines;
- the risks that affect the performance of assets held within a business model and how those risks are managed;
- whether the assets are held for trading purposes, i.e. assets that the Group acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is manage together for short-term profit or position taking;
- how compensation is determined for the Group's business lines' management that oversee the assets; and
- the frequency and volume of sales in prior periods and expectations about future sales activity.

Cash flow characteristics assessment

The contractual cash flow characteristics assessment involves assessing the contractual features of an instrument to determine if they give rise to cash flows that are consistent with a basic lending arrangement. Contractual cash flows that are consistent with a basic lending arrangement are considered SPPI.

Interest is defined as consideration for the time value of money, the banks funding costs, the credit risk associated with the principal amount outstanding and other costs (e.g liquidity risk and administrative costs), as well as a profit margin. Indexation of loans to the Consumer Price Index (CPI) are considered part of interest as CPI guarantees the time value of money of the original outstanding balance. Principal may change over the life of the instruments due to repayments. Indexation on principal accumulates over time.

In performing this assessment, the Group takes into consideration contractual features that could change the amount or timing of contractual cash flows, such that the cash flows are no longer consistent with a basic lending arrangement. If the Group identifies any contractual features that could modify the cash flows of the instruments such that they are no longer consistent with a basic lending arrangement, the related financial assets is classified at FVTPL.

Debt instruments measured at amortized cost

Debt instrument are measured at amortized cost if they are held within a business model whose objective is to hold for collection of contractual cash flows where those cash flows represent solely payments of principal and interest. After initial measurement, debt instruments in this category are carried at amortized cost using the effective interest rate method. The effective interest rate is the rate that discounts contractual cash payments or receipt through the contractual lifetime of the financial asset to the gross carrying amount of a financial asset. Amortized cost is calculated taking into account any discount or premium on acquisition, transaction cost and fees that are an integral part of the effective interest rate. Amortization is included in interest income in the Consolidated Income Statement.

Impairment on debt instruments measured at amortized cost is calculated using the expected credit loss (ECL) approach. Loans and debt securities measured at amortized cost are presented net of allowance for credit losses in the Consolidated Statement of Financial Position.

Debt instruments measured at FVOCI

Debt instrument are measured at FVOCI if they are held within a business model whose objective is to hold for collection of contractual cash flows and/or selling financial assets, where the assets' cash flows represent payments that are solely payments of principal and interest. Subsequent to initial recognition, unrealized gains and losses on debt instruments measured at FVOCI are recorded in Other Comprehensive Income (OCI). At realization the accumulated profit or loss recognized in OCI in previous periods is recycled to the Consolidated Income Statement. Foreign exchange gains and losses of the debt instrument are recognized in the Consolidated Income Statement. Interest income are recognized in the Income Statement in accordance with effective interest rate method.

Impairment on debt instruments measured at FVOCI is calculated using the expected credit loss approach. The ECL on debt instruments measured at FVOCI does not reduce the carrying amount of the asset in the Statement of Financial Position, which remains at its fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortized cost is recognized in OCI with a corresponding charge to net impairment in the Consolidated Statement of Comprehensive Income. The accumulated allowance recognized in OCI is recycled to the Consolidated Statement of Comprehensive Income upon derecognition of the debt instrument.

59. Financial assets and financial liabilities, continued

Debt instruments measured at FVTPL

Debt instrument are measured at FVTPL if they are held for short term gain, held as part of a portfolio managed on a fair value basis or the cash flows do not represent payments that are solely payments of principal and interest. These instruments are measured at fair value in the Consolidated Statement of Financial Position. Realized and unrealized gains and losses are recognized as part of Net financial income in the Consolidated Income Statement.

Purchased loans

All purchased loans are initially measured at fair value on the date of acquisition. As a result no allowance for credit losses would be recorded in the Consolidated Statement of Financial Positions on the date of acquisition. Purchased loans may fit into either of the two categories: Performing loans or Purchased or Originated Credit Impaired (POCI) loans.

Purchased performing loans are reflected in Stage 1 and will follow the same accounting as other performing loans. They will be subject to a 12-month allowance for credit losses which is recorded as provision for credit losses in the Consolidated Income Statement. The fair value adjustments set up for these loans on the date of acquisition is amortized into interest income over the life of these loans.

POCI loans do not have allowance at initial recognition but subsequently the allowance will reflect the changes in the lifetime expected losses. At recognition the discount of each POCI loan is split up into two categories, impairment discount and interest discount or premium. Interest is calculated with a credit adjusted effective interest rate and is posted to interest income. Periodically the Group recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original credit adjusted effective interest rate, any changes in the expected cash flows since the date of acquisition are recorded as a charge/recovery in net impairment in the Consolidated Income Statement at the end of all reporting periods subsequent to the date of acquisition.

Equity instruments

Equity instruments are measured at FVTPL.

For equity instruments measured at FVTPL, changes in fair value are recognized as part of Financial income in the Consolidated Income Statement.

The Group can elect to classify non-trading equity instruments at FVOCI. This election will be used for certain equity instruments for strategic or longer term investment purposes. The FVOCI election is made upon initial recognition, on an instrument-by-instrument basis and once made is irrevocable. Gains and losses on these instruments including when derecognized/sold are recorded in OCI and are not subsequently reclassified to the Consolidated Income Statement. Dividends received are recorded in Financial income in the Consolidated Income Statement. Any transaction costs incurred upon purchase of the security are added to the cost basis of the security and are not reclassified to the Consolidated Income Statement of the security.

Offsetting

Financial assets and liabilities are set off and the net amount reported in the Statement of Financial Position when, and only when, the Group has a legal right to offset the recognized amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains or losses arising from a group of similar transactions such as in the Group's trading activity.

Expected credit losses

Expected credit loss (ECL) is established for all financial assets, except for financial assets classified or designated as FVTPL and equity instruments designated as FVOCI, which are not subject to impairment assessment. Assets subject to impairment assessment are primarily debt instruments (including loans to customers) measured at amortized cost or FVOCI. ECL on financial assets is presented in Net impairment. Other financial assets carried at amortized cost are presented net of ECL in the Group's Consolidated Statement of Financial Position. Off-balance sheet items subject to impairment assessment include financial guarantees and undrawn loan commitments. ECL for Off-balance sheet items is separately calculated and included in Other Liabilities.

59. Financial assets and financial liabilities, continued

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

Stage	Criteria	Assessment of expected credit loss, and effective interest rates.
1	Exposures not impaired and with no significant increase in credit risk	12 month expected credit loss is recorded. The expected credit loss is computed using a probability of default occurring over the next 12 months. For those instruments with a remaining maturity of less than 12 months, a probability of default corresponding to remaining term to maturity is used. The effective interest rate is calculated on the gross carrying
2	Exposures not impaired with significant increase in credit risk subsequent to origination.	Lifetime expected credit loss is recorded, based on the probability of default over the remaining estimated life of the financial instrument. Effective interest rate is calculated on the gross carrying amount.
3	Exposures in default / Credit impaired	Lifetime expected credit loss is recorded. Effective interest rate is calculated on the book value.

The ECL is an unbiased discounted probability-weighted estimate of the cash shortfalls expected to result from defaults occurring in the next 12 months or, in cases where credit risk has significantly increased, in the expected lifetime of an exposure. For guarantees and loan commitments, credit loss estimates consider the portion of the commitment that is expected to be paid out or expected to be drawn over the relevant time period, contingent on significant financial difficulty.

Increases or decreases in the required ECL attributable to purchases and new originations, derecognitions or maturities, and remeasurements due to changes in loss expectations or state migrations are recorded in net impairment. Write-offs and recoveries of amounts previously written off are recorded against ECL.

The ECL represents an unbiased estimate of expected credit losses on our financial assets as at the balance sheet date. Judgement is required in making assumptions and estimations when calculating the ECL, including movements between the three stages and the application of forward looking scenarios. The underlying assumptions and estimates may results in changes to the provisions from period to period that significantly affect our results of operations.

Definition of default

The Group defines default in accordance with article 178 of EU Regulation No 575/2013 (CRR). The Group considers a financial asset to be in default when:

- the asset is more than 90 days past due, or
- the borrower is considered to be unlikely to pay.

For corporate counterparties, more than 90 days past due means that the counterparty has been past due on a material exposure each day in the last 90 days. For individuals, more than 90 days past due means that the individual has been past due on a material exposure in the same exposure portfolio each day in the last 90 days.

In assessing whether a borrower is unlikely to pay, the Group considers both qualitative and quantitative indicators, e.g. overdue status, debt and equity ratios, market circumstances and other data developed internally or obtained from external sources.

An asset does not return to non-defaulted status until after a probation period which is at least either three months if no forbearance measures have been granted or one year if forbearance measures have been granted.

For corporate counterparties it is assumed that if one exposure is in default, all other exposures to that counterparty are also in default (cross-default). For individuals however, the Group defines six different exposure portfolios and has different statistical credit risk models for each of them - mortgages, consumer loans, auto loans, guarantees, loans to individuals for work purposes and other loans. Each exposure portfolio is assessed separately, meaning that if an individual is in default on a loan belonging to one portfolio, their other exposures, belonging to other portfolios, are not automatically assumed to be in default. However, defaults in other portfolios are also considered and cross-default applies when they are significant.

Probability of default and credit risk rating

The Group allocates to each exposure a credit risk rating (e.g. A+, A, A-, BBB+, etc.) based on the calculated 12 month probability of default ('the PD'). The PD is assessed through the Group's credit rating models or based on external ratings if available. The Group's credit rating models are statistical models based on a variety of information that has been determined to be predictive of default. These include demographic, behavioral, financial and economic data, coupled with qualitative expert judgement for large corporate exposures. Factors vary depending on the nature of the exposure and the profile of the borrower. The PD estimates used for the purpose of calculating IFRS 9 impairments are point-in-time, i.e. dependent on the economic cycle. The Group's credit rating models are subject to annual performance tests and are recalibrated on a regular basis if needed.

59. Financial assets and financial liabilities, continued

The Group's rating scale is shown below, including mapping of external ratings. The lower bounds are inclusive.

Risk class	Rating	Lower PD	Upper PD	S&P / Fitch	Moody's	Description
0	AAA	0.000%	0.006%	AAA	Aaa	Investment Grade
	AA+	0.006%	0.018%	AA+	Aa1	
	AA	0.018%	0.029%	AA	Aa2	
	AA-	0.029%	0.045%	AA-	Aa3	
	A+	0.045%	0.070%	A+	A1	
	A	0.070%	0.110%	A	A2	
	A-	0.110%	0.170%	A-	A3	
1	BBB+	0.170%	0.260%	BBB+	Baa1	Investment Grade
	BBB	0.260%	0.410%	BBB	Baa2	
	BBB-	0.410%	0.640%	BBB-	Baa3	
2	BB+	0.640%	0.990%	BB+	Ba1	Non-investment Grade
	BB	0.990%	1.540%	BB	Ba2	
	BB-	1.540%	2.400%	BB-	Ba3	
3	B+	2.400%	3.730%	B+	B1	Non-investment Grade
	B	3.730%	5.800%	B	B2	
	B-	5.800%	9.010%	B-	B3	
4	CCC+	9.010%	14.000%			Non-investment Grade
	CCC	14.000%	31.000%			
	CCC-	31.000%	99.990%			
5	DD	99.99%	100.00%	D	C	Default / Impaired

The Group uses external ratings for counterparties that receive such ratings from recognized rating agencies such as Moody's, Standard & Poor's and Fitch. The Group's internal rating scale was originally calibrated to match historical default rates shown in publications of the aforementioned rating agencies and using smoothing techniques. External ratings are primarily used to assess expected losses for counterparties of marketable securities, money market and deposit accounts positions which fall under the Impairment requirements of IFRS 9. The Group's ECL is broken down by investment grade and non-investment grade classes for such exposures, as per the definition of the corresponding rating agency.

Each exposure is allocated a credit risk rating at initial recognition. The calculations are based on available information at the time of origination. Exposures are continuously monitored and revaluated using the models described above and this may result in transitions between risk ratings.

Probability of default

The Group's PDs and PD term structures are based on both quantitative and qualitative factors and in some cases external ratings are used. PD's are re-assessed on a regular basis with different frequencies depending on the type of counterparty and/or exposure.

In addition to calculating PD and allocating a credit risk rating to each exposure, the Group calculates the lifetime probability of default (LPD), which is an assessment of the probability that a default event occurs over the lifetime of the exposure. The LPD incorporates management's view of possible future macroeconomic developments and the likelihood of rating transitions over the lifetime of the exposure. For the determination of LPD, the Bank calculates PD term structures – which effectively provides the probability of default for any given time period, one for each rating grade, PD model and economic scenario. The annualized lifetime probability of default (ALPD) of an exposure is the fixed 12 month PD (without transitions) that corresponds to the exposure's LPD. The credit risk rating that corresponds to the ALPD is defined as the lifetime credit risk rating.

The assessed 12 months PDs are the basis for the determination of the term structure of PDs for exposures. The Group applies transition models, developed on the basis of historical data, to predict the development of risk grades for periods that exceed one year. The Group has separated transition behavior due to specific and general risk and applies its macro-economic forecasts to the latter. The analysis of credit rating transitions due to general risk includes the identification and calibration of relationships between changes in default rates and changes in key macro-economic factors. Unemployment rate is the predominant predictive variable. Among other indicators examined are GDP growth, private consumption expenditure, inflation, development of housing prices and benchmark interest rates.

59. Financial assets and financial liabilities, continued

Assumptions on key macro-economic indicators are on an ongoing basis estimated based on internal and external information available at each time. The Group formulates a 'base case' view of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios. The Group uses these forecasts to adjust its estimates of lifetime probability of default and other factors that affect the lifetime expected credit loss.

The Group has six different exposure specific PD models for individuals: mortgages, consumer loans, auto loans, guarantees, loans to individuals for work purposes and other loans. The Bank has a different model or rating logic for the following corporate portfolios – large corporates, retail SMEs, holding companies, construction projects, financial institutions (external ratings), municipalities, state related entities and cooperatives.

Loss given default

Each credit facility is assigned an LGD. The LGD is an assessment of loss conditional on a default occurrence. The Group splits LGD into three components; the probability of cure, the expected recovery from liquidation of collateral, and the recovery rate for the unsecured part of the exposure. The cure rate is modeled on the Group's historical data of assets returning to performing status after being in default without loss. The expected recovery is the outcome of the Group's collateral allocation algorithm which takes into account the seniority of debt and collateral type. Haircuts are applied to different types of collaterals based on expert judgment, supported by historical data, and take into account costs and the time value of money. Different haircuts are applied for different macro-economic scenarios in the ECL calculations. In some instances, assets are considered to be fully covered by collateral after haircut application and therefore carry no ECL. The recovery rate for the unsecured part of the exposure is based on expert judgment, taking into account historical loss experience.

The cut-off period for cure is taken to be 18 months from default, which means that a return to non-default after that period is not considered a cure. Furthermore, cure is defined on a portfolio level instead of on a loan level i.e. the same level as the PD models. In this version, statistical cure rate models have been created for the largest portfolios – mortgages, consumer loans and large corporates and retail SMEs. As the explanatory variables in the statistical cure rate models can be related to variables in PD models, this change prompts a consideration of PD-cure correlation. The correlation effects are taken into account in the Bank's ECL calculations. Furthermore, long-run average cure rate models using macro-economic variables have been created. The models can be used to assess cure rate under different economic conditions to be able to apply different cure rates for different economic scenarios given different economic conditions.

Exposure at default

The EAD represents the expected exposure at the event of a default. For a given exposure, the Group derives the EAD from the contractual amortization schedule and takes into account the likelihood of pre-payments, drawdowns, rollovers, extensions and use of unused allowance in the period leading up to default. These behavioral estimates, which are based on historical observations and forward-looking forecasts, apply differently to each type of exposure.

Significant increase in credit risk

The assessment of significant increase in credit risk requires significant judgment. In determining whether the risk of default for an exposure has increased significantly since initial recognition, the Group considers relevant, reasonable and supportable information on an ongoing basis. Assumptions are drawn based on the Group's historical experience and expert judgement including forward-looking expectations. If a debt investment security has low credit risk and is considered investment grade at the reporting date, the Group determines that the credit risk on the asset has not increased significantly since initial recognition.

For a given exposure, the Group considers a significant increase in credit risk to have occurred if one of the following holds:

- the exposure's credit risk rating on reporting date is not in risk class 0 or 1 and has deteriorated by more than one risk rating compared to the credit risk rating at origination;
- the exposure's lifetime credit risk rating on reporting date is not in risk class 0 or 1 and has deteriorated by more than one risk grade (two or more) compared to the lifetime credit risk rating at origination. As the Group does not have the benefit of hindsight, this comparison is only used for exposures that originate on or after 1 January 2018;
- the exposure has received forbearance measures in the past six months;
- the number of days in arrears exceeds 30 days; or
- the exposure is on the Group's watch list.

The Group monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that the criteria is capable of identifying significant increases in credit risk before an exposure is in default and there is no unwarranted volatility in loss allowance from transfers between 12-month ECL (stage 1) and lifetime ECL (stage 2).

59. Financial assets and financial liabilities, continued

Exposures in default

Exposures in default at each reporting date, according to the Group's definition, are considered to be credit impaired.

The amount of the loss impaired is the difference between the assets' gross carrying value and the present value of estimated future cash flow. In some instances, the impairment of exposures is zero due to collateral coverage.

Impairment losses are recognized in net impairment, see note 44. Any decreases in impairment loss amounts are reversed through net impairment.

Expected credit loss measurement

The expected credit loss (ECL) calculations are based on three main components:

- probability of default (PD),
- loss given default (LGD); and
- exposure at default (EAD).

Each component is derived from internally generated models, apart from external credit ratings. The models are developed with statistical methods and/or expert judgement supported by historical data and adjusted for expected macro-economic effects.

The Group measures ECL considering the risk of default over the maximum contractual period (including any extension periods) over which it is exposed to credit risk. The maximum contractual period extends to the date at which the Group has the right to require repayment of an advance or terminate a loan commitment or guarantee. However, for overdrafts and credit card facilities that include both a loan and an undrawn commitment component, the Group measures ECL over a period longer than the maximum contractual period if the Group's procedures for extensions do not limit the Group's exposure to credit losses to the contractual period. These facilities do not have a fixed term or repayment structure. The Group can cancel them with immediate effect but this contractual right is not enforced in the normal day-to-day management, but only when the Group becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that the Group expects to take and that serve to mitigate ECL. These include a reduction in limits, cancellation of the facility and/or turning the outstanding balance into a loan with fixed repayment terms. The ECL calculations involve discounting using the exposures' effective interest rates.

Forward looking scenarios

The ECL for an exposure is the weighted average of the expected credit loss for different macro-economic scenarios provided by the Group's management. The Group currently considers three scenarios: 'base case', 'optimistic' and 'pessimistic' and assigns its best estimate of the likelihood of occurrence to each one. The development of macro-economic variables and the corresponding weights are based on expert judgement supported by historical data. The Group incorporates forward-looking macro-economic information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition (via the lifetime credit risk rating comparison) and its measurement of ECL as the PD term structures, LGD and EAD include macro-economic adjustments for each of the scenarios.

The predominant macro-economic variable used across all portfolios is the unemployment rate in Iceland, as measured by the Directorate of Labor. Among other variables considered are GDP growth, private consumption expenditure, inflation, development of housing prices and benchmark interest rates. The average cure is also correlated with unemployment rate, depending on portfolio, and collateral haircuts are adjusted for different scenarios. Exit and pre-payment rates, which affects EAD, are dependent on refinancing spreads and due to the correlation between interest rates and unemployment rate they are adjusted for different scenarios.

Write-off of loans

Loans are written off, either partially or in full, when there is no realistic prospect of recovery i.e. the bankruptcy of the borrower or an ineffective attachment or distraint. Collateralized loans are generally written of when the realization of collateral have been received. After write-off, exposures continue to be subject to collection activities in accordance with Icelandic law.

59. Financial assets and financial liabilities, continued

Modifications

The original terms of a financial asset may be renegotiated or otherwise modified, resulting in changes to the contractual terms of the financial asset that affect the contractual cash flow. The treatment of such modifications is primarily based on the process undertaken to execute the renegotiation and the nature and extent of changes made. Modifications which are performed for credit reasons, primarily related to troubled debt restructurings, are generally treated as modifications of the original financial asset unless modifications are significant. Significant modifications are generally considered to be an expiry of the original cash flows; accordingly, such renegotiations are treated as a derecognition of the original financial asset and recognition of a new financial asset.

If a modification of terms does not result in derecognition of the financial asset, the carrying amount of the financial asset is recalculated as the present value of the renegotiated or modified contractual cash flows, discounted at the original effective interest rate and gain or loss is recognized. The financial asset continues to be subject to the same assessments for significant increase in credit risk relative to initial recognition and credit-impairment, as described above. A modified financial asset will migrate out of Stage 3 if the conditions that led to it being identified as credit-impaired are no longer present and relate objectively to an event occurring after the original credit-impairment was recognized. A modified financial asset will migrate out of Stage 2 when it no longer satisfies the relative thresholds set to identify significant increase in credit risk, which are based on changes in its PD, lifetime PD, days past due and other qualitative considerations.

If a modification of terms results in derecognition of the original financial asset and recognition of the new financial asset, the new financial asset will generally be recorded in Stage 1, unless it is determined to be credit-impaired at the time of renegotiation. For the purposes of assessing for significant increase in credit risk, the date of initial recognition for the new financial asset is the date of modification.

60. Hedge accounting

The Group has chosen to continue to apply the hedge accounting requirements of IAS 39 as an accounting policy choice as permitted under IFRS 9. The Group has chosen to continue to apply the hedge accounting requirements of IAS 39 as an accounting policy choice as permitted under IFRS 9.

The Group applies fair value hedge accounting with respect to designated hedging relationship of certain fixed-rate foreign currency denominated notes issued by the Bank as the hedged items and certain foreign currency denominated interest rate swaps as the hedging instruments. The Group recognizes the changes in fair value of the interest rate swaps together with changes in the fair value of bonds attributable to interest rate risk immediately in profit or loss in the line item of Note 10, Net gain on fair value hedge of interest rate swap. Calculated accrued interest on both swaps and bonds are included in the line item of Note 7, Interest expense.

On initial designation of the hedges, the Group formally documented the relationship between the hedging instruments and hedged items, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationships. The Group makes an assessment, both at inception of the hedge relationships and on an ongoing basis, of whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value of the hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within the range of 80–125%.

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

Other derivatives, not designated in a qualifying hedge relationship, are used to manage its exposure to foreign currency, interest rate, equity market and credit risk. The financial instruments used include, but are not limited to, interest rate swaps, cross-currency swaps, forward contracts, futures, options, credit swaps and equity swaps.

61. Cash and cash equivalents

Cash and cash equivalents in the Statement of Cash Flows consist of cash, demand deposits with the Central Bank and demand deposits with other credit institutions. Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition. Cash and cash equivalents are carried at amortized cost in the Statement of Financial position.

62. Loans

Loans are financial instruments with fixed or determinable payments that are not quoted in an active market and that the Group does not intend to sell immediately or in the near term. Loans include loans provided by the Group to credit institutions and to its customers, participation in loans from other lenders and purchased loans.

Loans are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortized cost using the effective interest method.

When the Group is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of the asset to the lessee, the arrangement is classified as a capital lease and a receivable equal to the net investment in the lease is recognized and presented within loans.

When the Group purchases an asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date reverse repo or stock borrowing, the arrangement is accounted for as a loan, and the underlying asset is not recognized in the Group's Consolidated Financial Statements.

63. Derivatives

A derivative is a financial instrument or other contract, the value of which changes in response to a change in an underlying variable, such as share, commodity or bond prices, an index value or an exchange or interest rate, which requires no initial net investment or initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors and which is settled at a future date.

Derivatives are recognized at fair value. Fair value changes are recognized in the Income Statement. Changes in fair values of derivatives are split into interest income, foreign exchange differences and net financial gain or loss. Interest income is recognized on an accrual basis. Derivatives with positive fair values are recognized as Financial instruments and derivatives with negative fair values are recognized as Financial liabilities at fair value.

64. Intangible assets

Goodwill and infrastructure

Goodwill and infrastructure that arises on the acquisition of subsidiaries is presented with intangible assets. Subsequent to initial recognition goodwill and infrastructure is measured at cost less accumulated impairment losses.

Customer relationship and related agreements

Customer relationship and related agreements are measured at cost less any accumulated impairment losses.

Software

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

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

Amortization of intangible assets

Amortization of intangible assets is recognized in the Income Statement on a straight-line basis over the estimated useful life, from the date that it is available for use. The estimated useful life of intangible assets for the current and comparative periods is three to ten years.

65. Investment property

An investment property is a property which is held either to earn rental income or for capital appreciation or for both.

Investment property is initially measured at cost and subsequently at fair value. Gains or losses arising from changes in the fair values of investment properties are included in the Income Statement.

66. Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets, other than assets held for sale, investment property and deferred tax assets, are reviewed at each reporting date to determine, whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. The recoverable amount of intangible assets is assessed annually.

An impairment loss is recognized if the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognized in profit or loss.

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.

An impairment loss in respect of other assets, where impairment losses have been recognized in prior periods, are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

67. Deposits

Deposits are initially measured at fair value plus transaction costs, and subsequently measured at their amortized cost using the effective interest method.

68. Borrowings

Borrowings are measured at amortized cost with any difference between cost and redemption amount being recognized in the Income Statement over the period of the borrowings on an effective interest basis. Accrued interest is included in the carrying amount of the borrowings.

69. Subordinated liabilities

Subordinated liabilities are financial liabilities in the form of subordinated capital which, in case of the Group's voluntary or compulsory winding-up, will not be repaid until after the claims of ordinary creditors have been met. In the calculation of the capital ratio, they are included within both Tier 1 and Tier 2, based on terms of each instrument. The Group may only retire subordinated liabilities with the permission of the FSA.

Subordinated liabilities are recognized initially at fair value less attributable transaction costs. Subsequent to initial recognition, subordinated liabilities are stated at principal amount due plus accrued interest, which is recognized in the Income Statement based on the contractual terms of the borrowing.

70. Assets and disposal groups held for sale

The Group classifies a Asset or disposal group as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case the asset or disposal group must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such asset or disposal group and the sale must be highly probable.

Immediately before classification as held for sale, the measurement of the qualifying assets and all assets and liabilities in a disposal group is brought up-to-date in accordance with applicable IFRS. Then, on initial classification as held for sale, Assets and disposal groups are recognized at the lower of carrying amount and fair value less costs to sell. Impairment losses on initial classification as held for sale are included in the Income Statement, even when there is a revaluation. The same applies to gains and losses on subsequent remeasurement. Revaluation through the reversal of impairment in subsequent periods is limited so that the carrying amount of the held for sale, Assets or disposal groups does not exceed the carrying amount that would have been determined had no impairment loss been recognized in prior years.

71. Other assets and other liabilities

Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses. When parts of an item of property and equipment have different useful lives, they are accounted for as separate items of property and equipment.

Subsequent expenditure is capitalized only when it is probable that the future economic benefits of the expenditure will flow to the Group. Ongoing repairs and maintenance are expensed as incurred.

The depreciable amount of property and equipment is determined after deducting its residual value. Depreciation is charged to the Income Statement on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. The estimated useful lives are as follows:

Real estates	33 years
Equipment	3-15 years

The depreciation methods, useful lives and residual values are reassessed annually.

Right-of-use asset and lease liability

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

Other assets and other liabilities

Other assets and other liabilities are stated at cost less impairment.

Insurance contract liabilities

Insurance contract liabilities comprise liabilities for remaining coverage and liabilities from incurred claims. Liabilities for remaining coverage is estimated using a simplified method which is based on paid premiums minus premiums from insurance services recognized as income. A loss factor is added in the case of onerous contracts. Liabilities from incurred claims are estimated as the best estimate of discounted cash flows plus a risk adjustment due to non-financial risk and other expected cost of claims. Liabilities for remaining coverage are estimated in the same way as the best estimate for claims reserve pursuant to the Insurance Activities Act No. 100/2016. These calculation methods are in accordance with the rules of IFRS 17 Insurance Contracts.

72. Equity

Share capital and share premium

Par value of issued share capital is 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 has been fully paid.

Treasury shares

The consideration paid for the purchase of own shares is deducted from the shareholders equity as treasury shares. No gain or loss is recognised in the Income Statement on purchase or sale of treasury stock.

Dividends

Dividends on shares are recognized in equity in the period in which they are approved by Arion Bank's shareholders.

Option reserve

The option reserve represents the cumulative charge to the Income Statement for options for employees of the Group to purchase shares in Arion Bank. The stock option plan is set up in accordance with article 10 in the Icelandic Act on income tax No. 90/2003.

Warrants reserve

The warrants reserve represents the consideration received for outstanding warrants.

72. Equity, continued

Reserve for investments in subsidiaries and associates

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

Reserve for investments in securities

According to the Financial Statements Act No. 3/2006 fair value changes of financial assets from the initial reporting, shall be transferred from retained earnings to a fair value equity reserve, net of tax. The fair value equity reserve is not subject to dividend payments. The fair value equity reserve shall be released in accordance with fair value changes recognized when financial asset is sold or redeemed or the assumptions for the fair value change is no longer in force.

Reserve due to capitalized development cost

According to the Financial Statements Act No. 3/2006 entities that capitalize development costs shall transfer a corresponding amount from retained earnings to a separate reserve. The reserve is not subject to dividend payments. The reserve shall be eliminated in an amount corresponding to the annual depreciation of the capitalized development cost. The reserve shall be released if the asset is sold or fully depreciated.

Financial assets at fair value through OCI

A reserve for unrealized fair value changes, net of tax, for assets held at fair value through other comprehensive income. The fair value reserve is released in correlation with realization of gains or losses of financial assets at derecognition.

Statutory reserve

According to the Icelandic Companies Act No. 2/1995 at least 10% of the profit of the Group which is not devoted to meeting losses from previous years and is not contributed to other legal reserves must be contributed to the statutory reserve until it amounts to 10% of the share capital. When that limit has been reached the contribution must be at least 5% of the profit until the statutory reserve amounts to 25% of the share capital of the Bank.

Foreign currency translation reserve

The foreign currency translation reserve comprises all foreign exchange differences arising from the translation of the Consolidated Financial Statements of foreign operations.

73. Earnings per share

The Group presents basic and diluted earnings per share (EPS). Basic earnings per share is calculated by dividing the net earnings attributable to the shareholders of Arion Bank hf. by the weighted average number of ordinary shares outstanding during the year. Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding during the year to assume conversion of all dilutive potential ordinary shares, which comprise share options granted to employees and issued warrants.

74. Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognized in the Consolidated Financial Statements at fair value, being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amount initially recognized less, when appropriate, cumulative amortization recognized in the Income Statement, and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee. Any increase in the liability relating to financial guarantees is recorded in the Income Statement. The premium received is recognized in the Income Statement in Net fees and commission income on a straight line basis over the life of the guarantee.

75. Fiduciary activities

The Group provides asset custody, asset management, investment management and advisory services to its clients. These services require the Group to make decisions on the treatment, acquisition or disposal of financial instruments. Assets in the Group's custody are not reported in its Statement of Financial Position.

76. Employee benefits

All entities with employees within the Group have defined contribution plans. The entities pay fixed contributions to publicly or privately administered pension plans on a mandatory and contractual basis. The Group has no further payment obligations once these contributions have been paid. The contributions are recognized as an expense in the Income Statement when they become due. The Group does not operate any pension fund which confers pension rights.

Share-based payment expense

Equity-settled share-based payments to employees are measured at the fair value of the equity instruments at grant date. The grant date fair value of equity-settled share-based payments granted to employees is recognized as an salary expense, with a corresponding increase in equity, over the contratual period. The amount recognized as an expense is adjusted to reflect the number of shares that are expected to be exercised at the vesting date.

5-year overview

Income Statement

	2023	2022*	2021	2020	2019
Net interest income	44,685	40,201	32,063	31,158	30,317
Net fee and commission income	16,389	16,449	14,673	11,642	9,950
Net insurance income	152	615	3,442	3,071	2,886
Net financial income	1,366	(3,286)	6,220	2,745	3,212
Other operating income	1,589	1,314	1,827	2,148	1,633
Operating income	64,181	55,293	58,225	50,764	47,998
Operating expenses	(25,701)	(24,329)	(25,875)	(24,441)	(26,863)
Bank levy	(1,796)	(1,749)	(1,516)	(1,301)	(2,984)
Net impairment	(1,348)	144	3,169	(5,044)	(382)
Earnings before income tax	35,336	29,359	34,003	19,978	17,769
Income tax expense	(9,595)	(9,944)	(6,782)	(3,231)	(3,714)
Net earnings from continuing operations	25,741	19,415	27,221	16,747	14,055
Discontinued operations, net of tax	(4)	6,543	1,394	(4,278)	(12,955)
Net earnings	25,737	25,958	28,615	12,469	1,100

Statement of Financial Position

Assets

	2023	2022*	2021	2020	2019
Cash and balances with Central Bank	102,095	114,118	69,057	42,136	95,717
Loans to credit institutions	28,835	45,501	30,272	28,235	17,947
Loans to customers	1,152,789	1,084,757	936,237	822,941	773,955
Financial instruments	205,706	193,329	225,657	227,251	117,406
Investment property	9,493	7,862	6,560	6,132	7,119
Investments in associates	789	787	668	891	852
Intangible assets	8,051	8,783	9,463	9,689	8,367
Tax assets	39	135	2	2	2
Assets and disposal groups held for sale	62	61	16,047	16,811	43,626
Other assets	17,813	10,276	19,901	18,618	16,864
Total Assets	1,525,672	1,465,609	1,313,864	1,172,706	1,081,855

Liabilities and Equity

	2023	2022*	2021	2020	2019
Due to credit institutions and Central Bank	2,771	11,697	5,000	13,031	5,984
Deposits	792,710	755,361	655,476	568,424	492,916
Financial liabilities at fair value	11,646	20,997	5,877	5,240	2,570
Tax liabilities	11,169	10,303	7,102	4,262	4,404
Liabilities associated with disposal groups held for sale	-		16,935	16,183	28,631
Other liabilities	46,336	39,401	37,151	32,714	32,697
Borrowings	420,460	392,563	356,637	298,947	304,745
Subordinated liabilities	41,279	47,331	35,088	36,060	20,083
Total liabilities	1,326,371	1,277,653	1,119,266	974,861	892,030
Shareholders' equity	198,798	187,307	193,925	197,672	189,644
Non-controlling interest	503	649	673	173	181
Total equity	199,301	187,956	194,598	197,845	189,825
Total Liabilities and Equity	1,525,672	1,465,609	1,313,864	1,172,706	1,081,855

* Comparative figures have been restated in accordance with IFRS 17, see Notes 1 and 2 for further information.

Amounts are in ISK millions

Appendices

Unaudited

Corporate Governance Statement of Arion Bank for 2023

Arion Bank (Arion Bank or the Bank) is an Icelandic public limited company whose shares are listed on Nasdaq Iceland and Nasdaq Stockholm. Here the Board submits its Corporate Governance Statement for 2023. Corporate governance is focused on how responsibilities are allocated among the various bodies of the Bank and how systems for decision making are constructed, in accordance with prevailing laws and regulations. Arion Bank's shareholders exercise governance principally by electing the Board of Directors, which in turn appoint the CEO and monitor the Bank's conduct of business. The CEO is responsible for the day-to-day operations of the Bank and represents the Bank in all matters concerning normal operations. The CEO must in this respect comply with the relevant legislation, the Bank's Articles of Association and the policies and instructions laid down by the Board. The CEO is responsible for the implementation of the Bank's policies.

Fundamentals to corporate governance at Arion Bank are the Articles of Association which are approved by shareholders, and policies and other documents adopted by the Board of Directors. These include the Board's Rules of Procedure, and the Rules of Procedure of the Board's Sub-Committees, and policies regarding the Bank's operations and enterprise risk management architecture. These policies are revised every year, and whenever deemed necessary. Even more important is the Bank's corporate culture, strategy, and operational procedures. Good corporate governance and corporate culture help to foster open and honest relations between the Board of Directors, shareholders, customers, and other stakeholders, such as the Bank's employees and the public. Corporate governance also provides the foundations for responsible management and decision-making, with the objective of generating sustainable long-term value creation. The Board of Directors places great importance on good corporate governance and re-evaluates its governance practices regularly on the basis of recognized guidelines on corporate governance.

A central part of governance for financial institutions involves managing risks which will invariably arise in operations. Risk management is described in more detail later in this statement, in the Bank's Annual Report and in the Bank's Pillar 3 report. Establishing and maintaining effective risk management and controls constitutes a key challenge in the Bank's activity and to the Bank's overall soundness.

This Corporate Governance Statement is based on the legislation, regulations and recognized guidelines which are in force at the time the Bank's financial statement is adopted by the Board of Directors.

Excellence in corporate governance

Arion Bank has been recognized as a company which has achieved excellence in corporate governance, following a formal assessment based on the Icelandic Guidelines on Corporate Governance issued by the Icelandic Chamber of Commerce, SA – Business Iceland and Nasdaq Iceland, initially in December 2015, April 2019, August 2022 and again in August 2023. This recognition was granted following an in-depth assessment by an independent party of corporate governance at the Bank, including governance by the Board of Directors, sub-committees and management.

Compliance with guidelines on good corporate governance

In respect to corporate governance arrangements, Arion Bank applies the European Banking Authority (EBA) Guidelines on Internal Governance (EBA/GL/2021/05), in line with requirements found in Regulation (EU) 1093/2010 and Act 24/2017, on European Financial Supervision. The Guidelines on Internal Governance are available on the website of the Financial Supervisory Authority of the Central Bank of Iceland.

Furthermore, according to the Financial Undertakings Act No. 161/2002 Arion Bank is obliged to comply with recognized guidelines on corporate governance. The Bank complies with the sixth edition of the Icelandic Guidelines on Corporate Governance issued by Iceland Chamber of Commerce, SA – Business Iceland and Nasdaq Iceland, published in February 2021 and in force as of 1 July 2021. According to the guidelines a company shall state whether it has deviated from the guidelines, if so, which parts and also explain why it has done so.

The Bank complies with the guidelines with two variations:
Article 5.1.2. states that the rules of procedure of sub-committees of the Board shall be posted on the Bank's website. The rules of the Board Credit Committee have not been published on the Bank's website with respect to their nature.

The final sub-paragraph of article 5.4.5 states that the role of a remuneration committee shall include taking an independent stance on the effect of wages on the Company's risk exposure and risk management, in cooperation with the Company's Audit Committee. In line with, inter alia, the EBA Guidelines on Internal Governance and article 78(3) of the Act on Financial Undertakings, this role falls to the Board's Remuneration Committee in cooperation with the Board's Risk Committee.

The role of the Nomination Committee at Arion Bank is to promote good corporate governance and to facilitate informed decision-making by shareholders when selecting Board members to ensure that Board members have wide and versatile qualifications and experience. The Committee has an advisory role regarding the election of Board members and makes a proposal on their remuneration.
The Committee relies on the Bank's Suitability Policy when making nominations. At the Bank's annual general meeting on 15 March 2023, two members of the Nomination Committee were appointed, Júlíus Thorfinnsson and Audur Bjarnadóttir. According to the Rules of Procedure for the Nomination Committee, the third member of the Committee shall be the Chairman of the Board of Directors or another Board Member appointed by the Board.

Legal framework for the Bank's operation

Arion Bank is a financial institution which operates in accordance with the Financial Undertakings Act No. 161/2002.

Acts of law which also apply to the Bank's operations include e.g., the Act on Markets for Financial Instruments No. 115/2021, to Act on Undertakings for Collective Investment in Transferable Securities (UCITS) No. 116/2021 and Act on Alternative Investment Fund Managers No. 45/2020, Act on Payment Services No. 114/2021, Act No. 5/2023 on Payment Accounts, Act on Measures Against Money Laundering and Terrorist Financing No. 140/2018, Act on Consumer Mortgages No. 118/2016, Consumer Loans Act No. 33/2013, Competition Act No. 44/2005 and Public Limited Companies Act No. 2/1995.

Arion Bank is a strongly capitalized bank whose goal is to excel by helping those who want to achieve success in Iceland and elsewhere in the Arctic through smart and reliable financial solutions which enhance financial health and create sustainable value as well as aiming to be the best at meeting the needs of our target groups – a leader which is a driver of success for our customers and society as a whole. As noted, the Bank is listed on Nasdaq Iceland and Nasdaq Stockholm. The Bank has also issued financial instruments which have been admitted for trading on regulated securities markets in Iceland and Luxembourg. The Bank is, therefore, subject to the disclosure requirements of issuers pursuant to the Act on Markets for Financial Instruments and the rules of the relevant stock exchanges.

The Financial Supervisory Authority of the Central Bank of Iceland (FSA) supervises the operations of Arion Bank in accordance with the provisions of Act No. 87/1998 on the Official Supervision of Financial Operations. Further information on the FSA and an overview of the legal and regulatory framework applicable to the Bank, as well as FSA guidelines and guidelines issued by European Financial Supervisory institutions, can be seen on the FSA's website, www.cb.is/financial-supervision/ . Numerous other legislations apply to the operations of financial undertakings.

Internal controls, auditing and accounting

Internal control
The Bank is committed to the highest standards of corporate governance and regards internal control as an integral part of its risk management system. An effective internal control system is built to mitigate risk to acceptable levels by facilitating enlightened decision-

making, thus supporting the Bank in achieving its objectives and enabling the creation and preservation of value.

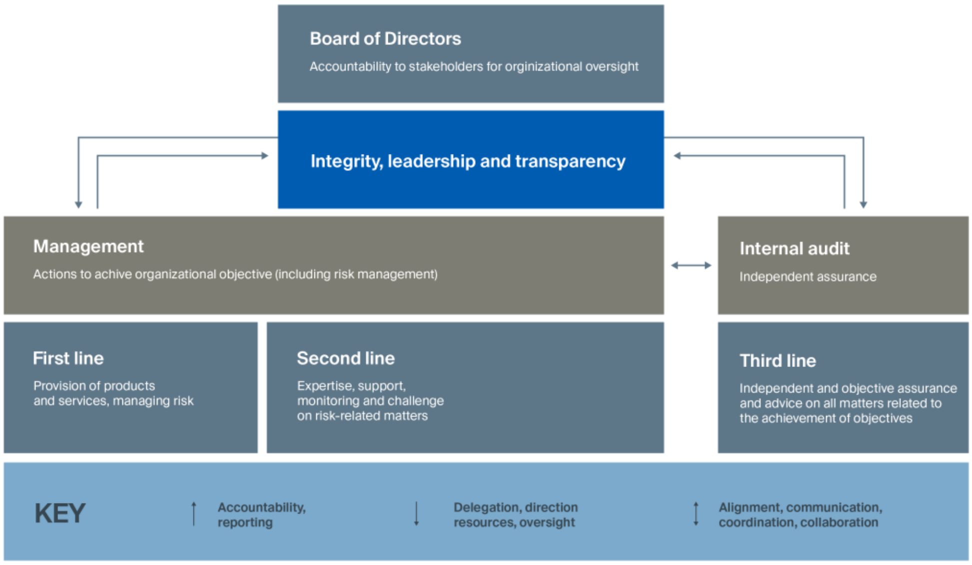
The objective of the Bank's system of internal controls is to ensure:

- The Bank's policies, objectives and business plans are achieved within set risk appetite and threshold.
- The actions of the Board of Directors, management and employees comply with the Bank's policies, standards, processes and all relevant laws and regulations.
- The Bank's assets and resources, including its people, systems, and data are adequately protected.
- Data and information published either internally or externally is accurate, reliable, and timely.
- The risks that are inherent in the Bank's operations are managed.
- Practical controls and processes have been established that require and encourage the Board, management, and employees to carry out their duties and responsibilities in an efficient and effective manner.
- The key components of the internal control framework are Control Environment, Risk Assessments, Control Activities, Information and Communication, and Monitoring Activities. These components are interrelated with all operations of the Bank.
- Control Environment includes the governance and management function of the Bank, as well as the attitude of senior management towards internal control and its importance. The key principles relating to control environment include:
    - Integrity and ethical values.
    - The attitude of senior management and tone from the top.
    - Organizational structure.
    - Assignment of authority and responsibility.
    - Employee skills, human resources policy and its implementation.

Risk Assessment is a process of identifying internal and external factors that can affect the objectives of the Bank and assess their impact and importance. It forms a basis for determining how risk should be managed so that risk-taking is in accordance with risk appetite.

Control Activities are the actions performed at all levels within the Bank and are intended to mitigate risks to acceptable levels while achieving objectives. Information is necessary for the Bank to carry out its internal control responsibilities. Communication occurs both internally and externally and provides the Bank with relevant, quality information needed to carry out day-to-day controls. Monitoring Activities are the ongoing or separate evaluations that are used to ascertain whether each of the five components of internal controls is present and functioning.

Arion Bank looks to the Three Lines Model for organizing internal controls. All lines work together to contribute to the creation and protection of value. Alignment of activities is achieved through communication, cooperation, and collaboration. This ensures the reliability, coherence, and transparency of information needed for risk-based decision making.



The first line is made up of employees who supervise the operations and organization of the Bank on a day-to-day basis. They are responsible for establishing and maintaining effective internal controls and managing risk in day-to-day operations. This involves identifying and evaluating risk and putting in place appropriate countermeasures to reduce risk. The first line is responsible for supervising the implementation of internal rules and processes in compliance with the law, regulations and the Bank's strategy and it must ensure that all actions are in compliance with established procedures and that corrective action is taken if any deficiencies are detected.

The second line is set up to ensure that the first line has established adequate internal controls which work as intended. Risk Management and Compliance are the main participants in the second line, although other units may also be assigned specific monitoring roles.

The third line is Internal Audit, which provides independent and objective assurance and advice on the adequacy and effectiveness of governance, risk management and controls, through systematic and disciplined processes, expertise and insight. It reports its findings to management and the Board of Directors to promote and facilitate continuous improvement.

Internal audit is accountable to the Board of Directors, as independence from management is critical to its objectivity, authority, and credibility.

Compliance

Compliance is an independent control function which reports directly to the CEO and works in accordance with a special charter from the Board.

The main role of Compliance is to ensure that the Bank has in place proactive measures to reduce the risk of rules being breached in the course of its activities. Compliance is also responsible for coordinating the Bank's measures against money laundering and terrorist financing to reduce the risk of the Bank's services being used for illegal purposes. Furthermore, the Compliance Officer has the role of the Bank's Data Protection Officer. The Bank has adopted a data protection statement which can be seen on the Bank's website.

The duties of Compliance are carried out under a risk-based compliance plan approved by the Board of Directors, including a monitoring and training schedule for employees which addresses the laws and rules under which the Bank operates. Compliance provides the Board of Directors with a quarterly report on its activities.

Further information can be found on the Bank's website.

Risk Management
A central feature of the activities of all financial institutions is well informed risk-taking according to a predetermined strategy. Arion Bank thus takes on risks compatible with its defined risk appetite, which is regularly reviewed and approved by the Board of Directors. The Bank's risk appetite is translated into exposure and risk limits which are monitored by Risk Management. The Board is responsible for Arion Bank's internal capital adequacy assessment process, the main objective of which is to ensure awareness of the Bank's risk profile and ensure that it has systems in place to assess, quantify and monitor its total risk exposure.

As defined in the Bank's enterprise risk policy, the Bank is exposed to seven significant risk factors and has set up risk policies for each one. These are credit risk, market risk, liquidity risk, operational risk, conduct and compliance risk, sustainability risk and business risk.

The Bank's Risk Management division is headed by the Chief Risk Officer. It is independent and centralized and reports directly to the CEO and operates in accordance with a special charter from the Board. Risk Management comprises four departments whose role is to analyze, monitor and regularly report to the management body and Board of Directors on the risks faced by the Bank.

Further information on risk management is contained in the Bank's annual report and the Bank's risk report.

Internal Audit
The Internal Auditor is appointed by the Board of Directors and reports directly to the Board. The Board sets the Internal Auditor a charter which sets out the responsibilities associated with the position and the scope of the work. The role of the Internal Auditor is to provide independent and objective assurance and advice designed to add value and improve the Bank's operations. The scope of the audit is the Bank, its subsidiaries and pension funds serviced by Arion Bank.

The internal audit department will govern itself and, with independent and disciplined methods, confirms the adequacy and effectiveness of the first and the second line. The internal audit department advises with independent and objective assurance on the adequacy and effectiveness of Corporate Governance, Risk management, and internal controls. This is done with independent audits. The internal audit department reports its findings to the management, the Board Audit Committee, and the Board of Directors.

Accounting and auditing
The Bank's Finance division is responsible for preparing the accounts and this is done in accordance with the International Financial Reporting Standards (IFRS) and Icelandic laws. The Bank publishes its financial statement on a quarterly basis and management statements are generally submitted to the Board ten times a year. The Board Audit Committee examines the annual financial statement and interim financial statements, while the external auditors review and audit the accounts twice a year. The Board Audit Committee gives its opinion on the accounts to the Board of Directors, which then approves and endorses the accounts.

Arion's values and code of ethics
The Bank's values are designed to provide guidance when making decisions and in everything else employees say and do. They refer to the Bank's role, attitude, and conduct. Arion Bank's values are: Find solutions, work together, and say what we mean.

The management and employees of Arion Bank are conscious of the fact that the Bank's activities affect different stakeholders and society at large. The Bank's code of ethics is designed to serve as a key to responsible decision-making at Arion Bank. The code of ethics is approved by the Board of Directors.

Sustainability
Arion Bank has a sustainability committee and the management of risk in connection with ESG factors has been defined as part of the Bank's risk management system. The CEO is the chairman of the committee, whose role is to monitor the Bank's performance in connection with its policy and commitment on sustainability and to ensure that ESG factors are considered in decisions and plans made by the Bank. A green financing committee and equality committee are sub-committees of this committee.

The Bank has adopted a risk policy on sustainability which is approved by the Board of Directors and reviewed annually. This policy states that the Bank seeks to ensure that its operations and services do not have a negative impact on people or the environment. It also states that the Bank supports Iceland's climate action plan whose goal is to meet the obligations of the Paris Climate Agreement and to achieve the ambitious goal of carbon neutrality in Iceland by 2040. Key performance indicators relating to ESG issues are part of monthly risk report to the Board and the Bank's risk appetite connected to these issues have been defined.

Further information on sustainability at Arion Bank can be found in the Bank's 2023 Annual and Sustainability

Report and Pillar 3 disclosures. Further information can be found on the Bank's website.

Board of Directors and Sub-committees

The main duty of the Board of Directors of Arion Bank is to manage the Bank between shareholders' meetings according to applicable laws, regulations, and articles of association. The Board tends to those operations of the Bank which are not considered part of the day-to-day business, i.e. it makes decisions on issues which are unusual or of a significant nature. One of the Board's main duties is to supervise the Bank's activities. The Board's work, duties and role are defined in detail in the rules of procedure of the Board of Directors, which have been established on the basis of the EBA Guidelines on Internal Governance, Article 54 of the Financial Undertakings Act No. 161/2002, Article 70 of the Public Limited Companies Act No. 2/1995, FSA Guidelines No. 1/2010, and the articles of association of the Bank. The rules of procedure of the Board of Directors can be found on the Bank's website.

The Board of Directors appoints a Chief Executive Officer who is responsible for the day-to-day operations in accordance with a strategy set out by the Board.

The Board of Directors and the Chief Executive Officer shall carry out their duties with integrity and ensure that the Bank is run in a sound and reasonable manner in the interests of the customers, the community, the shareholders and the Bank itself, cf. Article 1 (1) of the Financial Undertakings Act. The Chief Executive Officer shall ensure that the Board receives sufficient support to carry out its duties.

The Board of Directors is generally elected for a term of one year at the Bank's annual general meeting. At Arion Bank's annual general meeting on 15 March 2023, six Directors and two Alternates were elected to the Board of Directors.

The elected Board Directors have diverse backgrounds and extensive skills, experience, and expertise. When electing the Board care is taken to ensure at least 40% representation of each gender among directors and alternates. Currently the Board consists of three men and three women.

Information on the independence of Directors is published on the Bank's website before the annual general meeting or a shareholders' meeting where a Board member is to be elected. The minutes of the annual general meeting and shareholders' meetings are also published on the Bank's website.

The Board of Directors meets at least ten times a year. In 2023 the Board met on 13 occasions. The Chairman of the Board is responsible for ensuring that the Board performs its role in an efficient and organized manner. The Chairman chairs Board meetings and ensures that there is enough time allocated to the discussion of important issues and that strategy issues are discussed thoroughly. The Chairman is not permitted to undertake any other work for the Bank unless part of the normal duties of the Chairman.

According to the Board's Rules of Procedure the Board is permitted to establish committees to discuss particular areas of the Bank's operations. No later than one month following the annual general meeting the Board appoints members to each of its sub-committees and assesses whether it is necessary to appoint external members to certain committees in order to bring in a greater level of expertise. One of the committee members in the Board Audit Committee, Heimir Thorsteinsson, is not a Board member and is independent of the Bank and its shareholders.

The Board sub-committees are as follows:

- Board Audit Committee (BAC): The BAC's main role is to contribute to the high-quality statutory auditing of the Bank and monitor the effectiveness of the Bank's internal quality control, risk management systems and internal audit function, with regard to the Bank's financial reporting. The Committee met five times in 2023.

- Board Risk Committee (BRIC): The Committee's main role is, inter alia, to evaluate the Bank's risk policy and risk appetite, monitor all the Bank's defined risks and to have a thorough knowledge of the risk assessments and methods used to manage risk employed by the Bank. Committee members should have the qualifications and experience necessary to be able to discharge their duties including forming the Bank's risk policy and risk appetite. The Committee met 9 times in 2023.

- Board Credit Committee (BCC): Its main task is to attend to credit issues which exceed the credit limits of its sub-committees. The Committee met seven times in 2023.

- Board Remuneration Committee (BRC): The Committee's main role is to prepare a remuneration policy for the Bank on an annual basis. It also advises the Board on remuneration to the CEO, Managing Directors, the Compliance Officer and the Chief Internal Auditor, and on the Bank's incentive scheme and other work-related payments. The Bank's remuneration policy shall be examined and approved by a shareholders' meeting annually. The Committee met five times in 2023.

- Board Tech Committee (BTC): The purpose of the BTC is to assist the Board of Directors in fulfilling its oversight responsibilities with respect to the role of technology in executing the business strategy of the Bank, including, but not limited to, major technology investments, technology strategy, technological operation efficiency and technology trends that may affect the Bank. The BTC shall furthermore have a surveillance role pertaining to the Bank's compliance with rules and regulation applicable to Information Technology. The Committee met 4 times in 2023.

Sub-committees regularly inform the Board of their activities. Furthermore, the Board has access to all material used by the sub-committees and their minutes.

Below is an overview of the attendance of individual Directors and committee members.

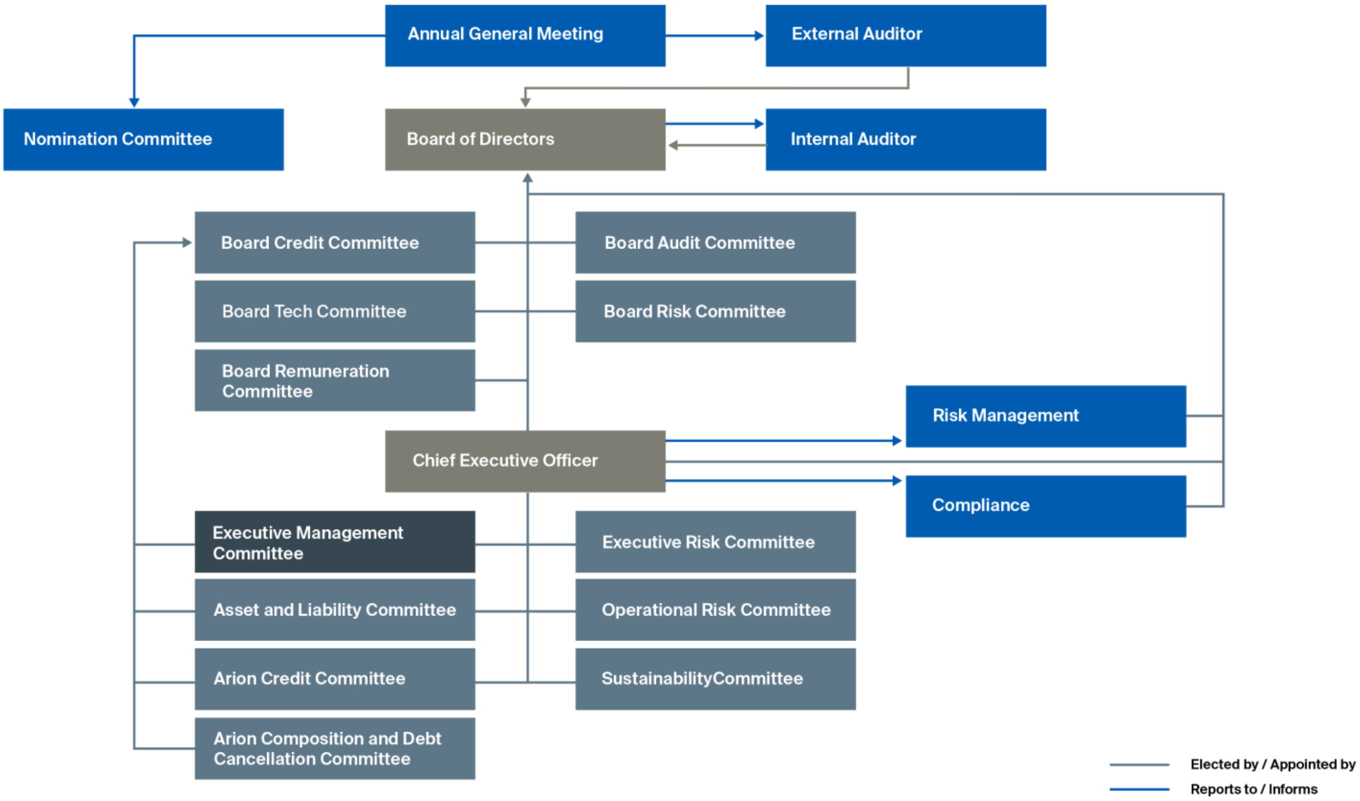
Director	**Period**	**Board** (13)	**BAC** (5)	**BRIC** (9)	**BCC** (7)	**BRC** (5)	**BTC** (4)
Brynjólfur Bjarnason	1 Jan - 31 Dec	13	5	-	7	5	4
Paul Horner	1 Jan - 31 Dec	13	5	9	7	-	4
Gunnar Sturluson	1 Jan - 31 Dec	13	5	9	7	-	-
Kristín Pétursdóttir[1]	1 Jan - 31 Dec	10		6	-	3	3
Liv Fiksdahl	1 Jan - 31 Dec	13	5	-	-	5	4
Steinunn Kr. Thórdardóttir	1 Jan - 31 Dec	12	-	9	-	5	4
Sigurbjörg Á. Jónsdóttir	1 Jan - 31 Dec	-	-	-	-	-	-
Thröstur Ríkhardsson	1 Jan - 31 Dec	-	-	-	-	-	-
Heimir Thorsteinsson[2]	1 Jan - 31 Dec	-	5	-	-	-	-

[1] Kristín Pétursdóttir was elected to the Board of Directors of Arion bank at the Annual General Meeting 15 March 2023.
[2] Heimir Thorsteinsson is certified public accountant and appointed as an external member of the BAC.

The Board carries out an annual performance appraisal, at which it assesses its work, the Board composition with respect to experience and skills, working procedures and methods, the performance of the CEO, their achievements, and the work of the subcommittees with respect to the aforementioned. This appraisal was last performed by the Board during the period October to December 2023.

The Board of Directors of Arion Bank

- Brynjólfur Bjarnason
- Paul Horner
- Gunnar Sturluson
- Kristín Pétursdóttir
- Liv Fiksdahl
- Steinunn Kristín Thórdardóttir.



Brynjólfur Bjarnason, Chairman

Brynjólfur was born in 1946. He was first elected as a Director at a shareholders' meeting on 20 November 2014, and is a non-executive director. He is not a shareholder in Arion Bank and is an independent Director. Brynjólfur is Chairman of the Board, and sits on the Board Remuneration Committee, the Board Credit Committee, the Board Audit Committee and the Board Tech Committee.

Brynjólfur graduated with an MBA from the University of Minnesota in 1973 and a cand. oecon. degree in business studies from the University of Iceland in 1971.

He was managing director of the Enterprise Investment Fund from 2012 to 2014. Between 2002 and 2010 he was the chief executive officer of the telecommunications company Síminn/Skipti. Brynjólfur was chief executive officer of the seafood company Grandi hf. from 1984 to 2002. Between 1976 and 1983 he was managing director of the publisher AB bókaútgáfa Book Publishing. He was also head of the economics department of VSÍ (today SA) from 1973 to 1976. Brynjólfur has broad experience as a director and has served on numerous boards of seafood, telecommunications, finance and industrial companies as well as cultural and other organisations, and been chairman of several of them.

Brynjólfur is currently a board member of Marinvest ehf. And the aluminium company ISAL hf. – Rio Tinto.

Paul Horner

Paul was born in 1962. He was first elected as a Director at a shareholders' meeting on 8 August 2019, and is a non-executive director. He is not a shareholder in Arion Bank and is an independent candidate. Paul is Vice Chairman of the Board, Chairman of the Board Credit Committee and member of the Board Risk Committee, the Board Audit Committee and the Board Tech Committee.

Paul graduated with M.A. Honours in music from the University of Oxford in 1983 and is an associate of the UK Chartered Institute of Bankers. Paul has extensive experience of risk and general management in retail, commercial, investment and private banking, gained across various international markets. Paul held various executive and risk management roles at Barclays PLC between 1988 and 2003. In 2003 Paul joined The Royal Bank of Scotland Group and served as an executive and senior manager of Royal Bank of Scotland PLC and was appointed to various senior risk and general management roles until June 2019. In 2012 to 2017, Paul was the chief risk officer of Coutts & Co Ltd. and CEO of Coutts & Co Ltd., Zurich, in 2016-2017. In 2018 Paul was chief risk officer of Ulster Bank DAC, Dublin, and a non-executive director at Coutts & Co Ltd. in Zurich from 2018-2021.

Today Paul serves on the board of AIB (UK) P.L.C., chairs its risk committee and is member of its audit and operational resilience committees. He also serves on the Board of LHV (UK) Ltd. and chairs its risk committee, as well as sitting as a member of its audit, remuneration and nomination committees. Finally, he serves on the Board of the UK subsidiary of The National Bank of Kuwait, chairs its Risk Committee and serves on its Audit Committee.

Gunnar Sturluson

Gunnar was born in 1967. He was first elected as a Director at a shareholders' meeting on 8 August 2019, and is a non- executive director. He is not a shareholder of Arion Bank and is an independent Director. Gunnar is a member of the Board Credit Committee and the Board Risk Committee. He was also appointed to the Board Audit Committee in May 2020, which he is currently chairing.

Gunnar graduated as Cand. Jur from the University of Iceland in 1992, gained an LL.M. degree in Law from the University in Amsterdam in 1995 and received a license to practice before the District Court in Iceland in 1993 and before the Supreme Court in 1999.

Gunnar has practiced law at LOGOS legal services since 1992 and a became partner in 1995. He was the managing partner of LOGOS from 2001-2013. Gunnar has been the president of the International Federation of Icelandic Horse Associations since 2014 and a board member of the Performing of the Arts Center in Iceland since 2021. Furthermore, Gunnar serves on the Board of Harpan Conference Center.

Gunnar has previously held various directorships, including the board of directors at Gamma hf. in 2017-2019, chairman of the board of directors of the Icelandic National Broadcasting Service (RÚV) 2016-2017, director at the Nordic Arbitration Center, chairman of the board of directors of the Icelandic Dance Company 2013-2016 and was voted by ALTHINGI the Icelandic parliament to serve on the National Electoral Commission in 2013-2017. Gunnar also lectured in competition law in 1995-2007 at the University of Iceland, Faculty of Law.

Kristín Pétursdóttir

Kristín was born in 1965. She was first elected as a Director at Arion bank's Annual General Meeting on 15 March 2023, and is a non-executive director. She is not a shareholder in Arion bank and is an independent Director. Kristín is a member of the Board Risk Committee, the Board Remuneration Committee and the Board Tech Committee.

Kristín graduated as an economist from the University of Iceland in 1991 and with an MBA from Handelshöyskole in Norway in 1993.

Kristín was a co-founder of Audur Capital and served as chief executive officer of the company from 2007 to 2013 and as Chairman of the Board of Directors from 2013 to 2017 (later Virðing hf.). Kristín was also a Chairman of the Board of Directors at Kvika hf. from 2018 to 2020, CEO at Mentor hf. from 2015 to 2017, Managing Director of Treasury at Kaupthing Bank from 1997 to 2005, and Deputy CEO at Singer & Friedlander from 2005-2007. Kristín has also served as a board member at Ölgerdin, Tal, Yggdrasil, Singer & Freidlander, Vidskiptarád, Eyrir Invest, Samtök atvinnulífsins and Samtök fjármálafyrirtækja. Kristín has also served as a member of investment committees of Edda, Freyja, and Audur I initiative funds.

Today Kristín is a self-employed Leadership Consultant and Coach and serves as a member of the Board of Directors of Grid ehf. and Miðeind ehf.

Liv Fiksdahl

Liv was born in 1965. She was first elected as a Director at Arion Bank's Annual General Meeting on 20 March 2019, and is a non-executive director. She is not a shareholder in Arion Bank and is an independent Director. Liv is chairman of the Board Remuneration Committee and the Board Tech Committee and member of the Board Audit Committee.

Liv holds a degree in finance and management from Trondheim Business School (today NTNU) in 1986. In 2018, Liv completed programs at Stanford University in Big Data, strategic decisions and analysis, and the Innovative Technology Leader. She has also completed an advanced management program for executives in management, innovation and technology at Massachusetts Institute of Technology.

Liv has held various senior roles at DNB and was part of the executive management team for 10 years, and her most recent role was as the Group EVP, CIO/COO, for IT & Operations. Liv has a broad experience from DNB and has held different positions across the value-chain within the bank. Before DNB she had key account roles for corporate clients within Danske Bank/Fokus Bank, and Svenska Handelsbanken. Liv has served on numerous boards, including Scandinavian Airlines SAS AB, Intrum AB, BankAxept, Sparebankforeningen, Doorstep, Finans Norge and Trondheim Kommune Bystyret.

Today, Liv is a Vice President within Financial Services at Capgemini Invent, Norway, and serves on the boards of Posten Norge AS and Hexagon Purus ASA.

Steinunn Kristín Thórdardóttir

Steinunn was born in 1972. She was first elected as a Director at a shareholders' meeting on 30th November 2017, and is a non-executive Director. She is a shareholder in Arion Bank (her shareholding is 12000 shares) and is an independent Director. Steinunn is the chairman of the Board Risk Committee and a member of the Board Remuneration Committee and the Board Tech Committee.

Steinunn holds a master's degree international management from Thunderbird, Arizona, and a BA in international business and politics from University of South Carolina. Steinunn has previously held several directorships in Europe and was a board member at the Icelandic State Financial Investment (ISFI). Steinunn was previously a partner and CEO of Beringer Finance Norway in 2015-2017 and interim CEO of Beringer Finance in Iceland and global head of food and seafood in 2017. She founded Akton AS and Acton Capital AS, a management consulting and investment company in Norway, where she works with investments and consulting. Steinunn worked at Íslandsbanki (later Glitnir) as the managing director and head of the bank's UK operation and prior to that she was an executive director heading the international corporate credit and syndications.

Today Steinunn works actively with tech companies in Norway both as an investor and advisor in regard to strategy. The software companies she works with are international scale-up companies. She is also the chairman of the board of Acton Capital AS, and the chairman of the board for the Norwegian-Icelandic Chamber of Commerce. Steinunn is a member of the nomination committee of Síminn and serves as a board member at YES-EU AS and Alda hf. Finally, she is a mentor to young talented women and founded Women Empower Women and is the chairman of a charitable organization in Norway.

Alternate directors:

Sigurbjörg Ásta Jónsdóttir, lawyer, and Thröstur Ríkhardsson, Supreme Court attorney.[3]

More information on the Board of Directors can be found on the Bank's website.

Communication between the share-holders and the Board of Directors

The main venue at which the Board and the Bank report information to the shareholders and propose decisions to be made is at legally convened shareholders' meetings. The Bank provides an effective and accessible arrangement for communications between shareholders and the Board of Directors between those meetings. Any information sensitive to the market will be released through a MAR press release. As part of the investor relations program, Arion Bank has also arranged quarterly meetings where the CEO, CFO, Chief Economist and Investor Relations present the interim financial results.

Benedikt Gíslason, Chief Executive Officer

Benedikt was born in 1974. Benedikt was appointed CEO on 1 July 2019.

Benedikt joined FBA (later Íslandsbanki) in 1998, held a variety of managerial positions at Straumur-Burdarás, was managing director of capital markets at FL Group and was managing director of the investment banking division of MP Bank. Benedikt worked as a senior advisor for Iceland's Ministry of Finance and Economic Affairs and was vice-chairman of a government task force on the liberalization of the capital controls between 2013 and 2016. He served on the board of directors of Kaupthing from 2016 to 2018 and was an advisor to Kaupthing on matters relating to Arion Bank. Benedikt was elected to the Board of Directors of Arion Bank in September 2018 and served on the Board until his appointment as CEO.

Benedikt gained a C.Sc. in mechanical and industrial engineering from the University of Iceland in 1998.

[3] Thröstur Ríkhardsson announced his resignation as an alternate Board director as he agreed to take up a position with Arion Bank in July 2023.

Executive Committee

The Bank's Executive Committee consists of the following people and the CEO:

- Ida Brá Benediktsdóttir, Deputy CEO and Managing Director of Retail Banking
- Birna Hlín. Káradóttir, COO
- Hákon Hrafn Gröndal, Managing Director of Corporate and Investment Banking
- Jóhann Möller, Managing Director of Markets
- Ólafur Hrafn Höskuldsson, Chief Financial Officer
- Steinunn Hlíf Sigurdardóttir, Managing Director of Customer Experience
- Björn Björnsson, Managing Director of Information Technology & CTO
- Úlfar F. Stefánsson, Chief Risk Officer

More information on the Executive Committee can be found on the Bank's website.

Information on violations of laws and regulations and legal cases

Arion Bank has not been denied registration, authorization, membership or permission to conduct certain business, activity or operations. The Bank has not been subject to withdrawal, revocation or dismissal of registration, authorization, membership or permission. Information on the main legal cases relating to Arion Bank can be found in the notes to the annual financial statement.

The Board of Directors annually reviews and approves the Corporate Governance Statement. This Corporate Governance Statement was examined and approved at a meeting of the Board of Directors on 7 February 2024.

EU Taxonomy Regulation

In 2023 new legislation was introduced in Iceland which requires Arion Bank and its subsidiaries Stefnir and Vörður to disclose information in respect of EU Taxonomy. Information in accordance with the EU Taxonomy is being published for the first time in an annex to the Consolidated Financial Statements for 2023.

On June 1 2023 Act No. 25/2023 on sustainable finance disclosure and taxonomy for sustainable investment came into force. The act transposed into Icelandic law two EU regulations. Firstly, Regulation (EU) 2019/2088 of the European Parliament and of the Council on Sustainable Financial Disclosure (SFDR); and secondly Regulation (EU) 2020/852 of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088 (Taxonomy Regulation).

The Taxonomy Regulation, which partly came into effect in the EU on 12 July 2020, and came fully into effect on 1 January 2023, establishes a harmonized European taxonomy with definitions of what is considered to be an *environmentally sustainable economic activity*.

The aims of the Taxonomy Regulation include reorienting capital flows towards sustainable investment, increasing transparency and consistency in companies' disclosure with respect to what activities can be considered environmentally sustainable and to combat greenwashing, which involves companies defining and marketing activities as sustainable without basic criteria having been met.

Eligible and environmentally sustainable activities

An activity is considered to be eligible if it is defined in delegated EU regulations, established in the basis of the Taxonomy Regulation, on the technical screening criteria which the activity needs to fulfil in order to be considered environmentally sustainable according to the EU Taxonomy. If the Taxonomy applies to the activity, it is considered eligible. Eligibility does not, however, determine whether a particular activity is eligible, but just states that there are technical screening criteria for the activity which enable it to be analyzed in accordance with the Taxonomy.

The Taxonomy Regulation covers six environmental objectives:

- Climate change mitigation
- Climate change adaptation
- The sustainable use and protection of water and marine resources
- The transition to a circular economy
- Pollution prevention and control
- Protection and restoration of biodiversity and ecosystems

The first delegated EU regulation no. 2021/2139 (the Delegated Climate Regulation) addresses the environmental objectives *Climate change mitigation* and *climate change adaptation.* The economic activity which the EU Taxonomy covers now is any activity which is important for reducing greenhouse gas emissions and to increase resilience. Therefore, manufacturing, construction, energy and transportation are eligible economic activities under the regulation. Eventually, the EU Taxonomy will apply to more economic activities and the other four environmental objectives. Delegated regulation (EU) 2023/2486 on these four environmental objectives came into force in the EU in December and is waiting to be implemented in Iceland.

In order for an economic activity to be considered environmentally sustainable it must be aligned with one of the six environmental objectives of the regulation but at the same time must do no significant harm to other objectives. This is to prevent an economic activity from being considered environmentally sustainable if it then does such harm to the environment that it outweighs the activity's contribution to the environmental objective. The activity also needed to be carried out in accordance with minimum safeguards which, among other things, address human rights, and to meet technical screening criteria.

Reporting on the EU Taxonomy in 2023

From January 2022 companies operating on the EU market have been required to publish information on eligible assets in their annual financial statements. A year later the disclosure requirement was broadened so that companies, other than credit institutions, were required to publish key performance indicators in accordance with the entire regulation. From January 2024 onwards, credit institutions in Iceland and the EU have been required to publish information on environmentally sustainable assets. Financial institutions need data from their counterparties in order to publish their own key performance indicators on both eligible and environmentally sustainable activities, which explains the one-year delay in publishing KPIs for credit institutions. In Iceland the regulation did not come into force until 2023, meaning that Icelandic companies are publishing information in accordance with the EU Taxonomy for the first time in 2024, unlike other companies in the EU which have been doing it in their annual financial statements since the 2021 financial year.

The EU Taxonomy is still under development and gradually the scope of disclosure will increase and companies will get a better handle on disclosure in accordance with the Taxonomy Regulation. The EU Taxonomy was referred to some extent when the Bank's green financing framework was devised in 2021. It will gradually be incorporated into the Bank's strategy, including in the sustainability financial framework, which is scheduled for publication in 2024, and the Bank's product range. This is a long-term project, and the implementation of the regulation is far from complete.

Assets under the scope of KPIs

The Green Asset Ratio (GAR) is a key performance indicator for credit institutions. The indicator shows the ratio of a financial institution's assets which finance an economic activity aligned to the EU Taxonomy. i.e. assets considered environmentally sustainable, as a ratio of total covered assets under Delegated Regulation (EU) 2021/2178.

Risk exposures relating to governments, central banks and supranational issuers are excluded from the equation on GAR.

Credit institutions shall disclose relevant KPIs on the basis of the scope of their prudential consolidation determined in accordance with Regulation (EU) No. 575/2013 Title II, Chapter 2, Section 2.

On 18 January 2024, the register of annual accounts announced on its website limited exemptions from the requirement to publish information in suitable templates where relevant and/or reliable information does not exist. Since there is virtually zero experience in Iceland in disclosure relating to the EU Taxonomy and the data required to calculate KPIs is very limited, the Bank is publishing a condensed version of template 1 from Annex VI to the Disclosure Delegated Act No. 2021/2178 and other tables from that annex are excluded due to a lack of data. The Bank's Pillar 3 Risk Disclosures contain a more detailed breakdown of the Group's assets in accordance with the EU Taxonomy Regulation.

	2023				
Assets	**Gross carrying amount**	**Share of total covered assets, %**	**EU Taxonomy eligible assets**	**Share of eligible assets of total covered assets, %**	**Eu Taxonomy aligned assets***
Covered assets in both numerator and denominator					
Loans and advances, debt securities and equity instruments not HfT eligible for GAR calculation	**768.919**	**57,5**	**557.344**	**42**	
Financial corporations	**57.379**	**4,3**			
of which credit institutions	1.387				
of which other financial corporations	55.992				
Non-financial corporations (subject to NFRD disclosure obligations)	**91.704**	**6,9**			
Households	**609.144**	**45,6**	**557.344**	**41,7**	
of which loans collateralised by residential immovable property	552.587		552.587	41,3	
of which building renovation loans	0		0	0,0	
of which motor vehicle loans*	4.757		4.757	0,4	
Local governments financing	**10.692**	**0,8**			
Housing financing	0				
Other local governments financing	10.692				
Collateral obtained by taking possession: residential and commercial	25	0,0	25	0,0	
TOTAL GAR ASSETS	**768.944**	**57,5**	**557.369**	**41,7**	
Assets excluded from the numerator for GAR calculation (covered in the denominator)					
EU Non-financial corporations (not subject to NFRD disclosure obligations)	364.088				
Non-EU Non-financial corporations (not subject to NFRD disclosure obligations)	38.088				
Derivatives	2.063				
On demand interbank loans	28.623				
Cash and cash-related assets	102.095				
Other assets (e.g. Goodwill, commodities etc.)	33.125				
TOTAL ASSETS IN THE DENOMINATOR (total covered assets)	**1.337.025**				
Other assets excluded from both the numerator and denominator for GAR					
Sovereigns	128.178				
Central banks exposure	0				
Trading book	40.179				
Total assets	**1.505.383**				
Off-balance sheet exposures - Corporates subject to NFRD disclosure obligations					
Financial guarantees	**8.692**				
Assets under management	**453.655**		**2.994**		**140**
Of which debt securities (NFRD obliged corporates)	251.436		0		0
Of which equity instruments (NFRD obliged corporates)	202.219		2.994		140

* Based on the Turnover KPI of the counterparty

** Motor vehicle loans generated after 1st of June 2023

Companies within scope

There are approximately 300 companies in Iceland within the scope of the Taxonomy Directive and they are required to implement EU Taxonomy and disclose information on the taxonomy in the 2023 annual financial statements. These are companies which are required to publish non-financial information, cf. Article 66 d of the Annual Accounts Act, i.e. major companies, parent companies of major groups and public-interest entities, often called NFRD[1] companies.

A list of Icelandic companies subject to these disclosure requirements was obtained from an analyst which manages such information. At the end of 2023 the Bank's exposure to NFRD companies was 11% of the total covered assets. In Iceland, the vast majority of companies are defined as small or medium, and until now such companies are not required to disclose information with respect to the EU Taxonomy. At the end of 2023 the Bank's exposure to SMEs was 27% of the total covered assets.

Implementation in Iceland and lack of necessary data

The provisions of Article 8 of the Taxonomy Regulation concern information which companies should disclose

[1] NFRD stands for Non-Financial Reporting Directive

Amounts are in ISK millions

with respect to the Eu Taxonomy and these provisions are expanded on in the Disclosure Delegated Act No. 2021/2178. This describes in detail the methodology, subject matter and configuration of disclosure, plus a timeline for entry into force and implementation of the Regulation for credit institutions and other companies.

The implementation of the regulation is arranged so that companies can implement EU Taxonomy disclosure in stages over a period of years. The Taxonomy Regulation entered into force in the EU on 12 July 2020 and implementation of the regulation is based on that date. In Iceland, however, the regulation came into force on 1 June 2023 and those companies required to disclose information with respect to the EU Taxonomy will publish this information for the first time in 2024, i.e. for the 2023 annual financial statements. Companies operating in the EU have therefore published this information in their financial statements since 2021 and how it has been implemented therefore differs from the situation in Iceland.

The regulation stipulates that credit institutions should use counterparties' data and KPIs to calculate their own KPIs. The Bank's counterparties which come under the scope of the legislation are, like the Bank, disclosing information on the EU Taxonomy for the first time in 2024 in the 2023 annual financial statements. This means that the data required to calculate the Green Asset Ratio covered by the EU Taxonomy, and to what extent these assets are considered environmentally sustainable, is not yet available.

Loans to households

In the Taxonomy Regulation loans to households are divided into loans with a mortgage in residential housing, loans to renovate housing and car loans These loan categories cover 41.7% of the total covered assets as defined in the regulation. Loans to individual borrowers therefore represent the majority of assets considered eligible under the Taxonomy Regulation today.

Loans need to meet stringent technical screening criteria to be considered environmentally sustainable. In order to assess whether the criteria have been met, certain data is required but in reality the lack of data, as noted above, prevents this from being possible in Iceland.

Retail mortgages

Loans for property and to renovate property are defined in the Climate Delegated Act and therefore these loan categories are considered eligible in every respect.

In order to meet the requirements for a mortgage to be considered environmentally sustainable, information needs to be available on the energy efficiency of the housing subject to the loan. In Iceland the building regulations do not require information on the energy efficiency of housing to be available, unlike in many areas of Europe.

A harmonized methodology is being prepared for the calculation of the energy efficiency of housing and publication of criteria for energy categories of buildings for Icelandic conditions is also being prepared. The action plan for the Build a Green Future scheme, a joint initiative of the government and construction industry on eco-friendly construction assumes that this will be ready by the end of 2024. According to this action plan, a requirement on the energy efficiency of new buildings should have been incorporated into Icelandic building regulations by 2028.

Since data on the energy efficiency of housing in Iceland is not available, it is not possible to determine whether loans to homes with a mortgage in property are considered environmentally sustainable according to the definitions of the EU Taxonomy.

Consumer car loans

Loans secured by a car can be considered to strongly support climate change adaptation if the criteria set out in the Climate Delegated Act are met. Only those car loans which were granted after 1 June 2023, i.e. after the date the regulation was introduced, can be considered eligible.

In order for a car loan to be considered environmentally sustainable it may not have a significantly adverse impact on other environmental objectives. In order to be able to assess this with respect to a vehicle, information is required on the vehicles CO2 emissions, the reuse, recycling and recovery ratios of the vehicle, the external rolling noise and the rolling resistance coefficient of the tyres.

The Bank does not have any data on the car tyres of its customers, which makes it impossible to determine whether car loans can be considered environmentally sustainable.

Off-balance sheet exposures

Assets under management
Icelandic companies which come under the scope of the Taxonomy Regulation will publish their first figures on the proportion of environmentally sustainable turnover and capital expenditure in 2024 in the annual financial statement for 2023. Therefore, it was impossible for Arion Asset Management and Stefnir to calculate the proportion of environmentally sustainable turnover and capital expenditure for their assets in domestic equities and bonds and domestic alternative investments.

Furthermore, no international equities fund or international alternative investment fund in asset portfolios of Arion clients or Stefnir funds has published the eligibility or ratio of their environmentally sustainable assets. Reporting in accordance with the Taxonomy Regulation from the investment funds is expected in their annual financial statements for 2023.

Since the implementation of the Taxonomy Regulation commenced earlier for companies in the EU, those companies covered by the regulation have already reported their mitigation and adaptation to climate change. Therefore, is possible to estimate the eligibility and the proportion of environmentally sustainable turnover and capital expenditure for certain investments in individual foreign assets.

However, this is a negligible proportion of total assets under management at Arion and Stefnir and only 4% of assets under management are in individual foreign equities. Data on eligible and environmentally sustainable assets was obtained from Bloomberg.

Government bonds are not covered by the regulation so there is no disclosure requirement for them.

For the reasons given above the publication of KPIs for assets under management at Arion Bank and Stefnir is limited for 2023.

KPI’s for assets under management

	Gross carrying amount	Gross carrying amount*	EU Taxonomy eligible assets	Eu Taxonomy aligned assets**	Eu Taxonomy aligned assets***
Assets under management	**1.173.103**	**453.655**	**2.994**	**191**	**140**
of which debt securities	667.711	251.436	0	0	0
of which equity instruments	505.392	202.219	2.994	191	140

* Non-financial corporations (subject to NFRD disclosure obligations)
** Based on the CapEx KPI of the counterparty
*** Based on the Turnover KPI of the counterparty

Amounts are in ISK millions

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