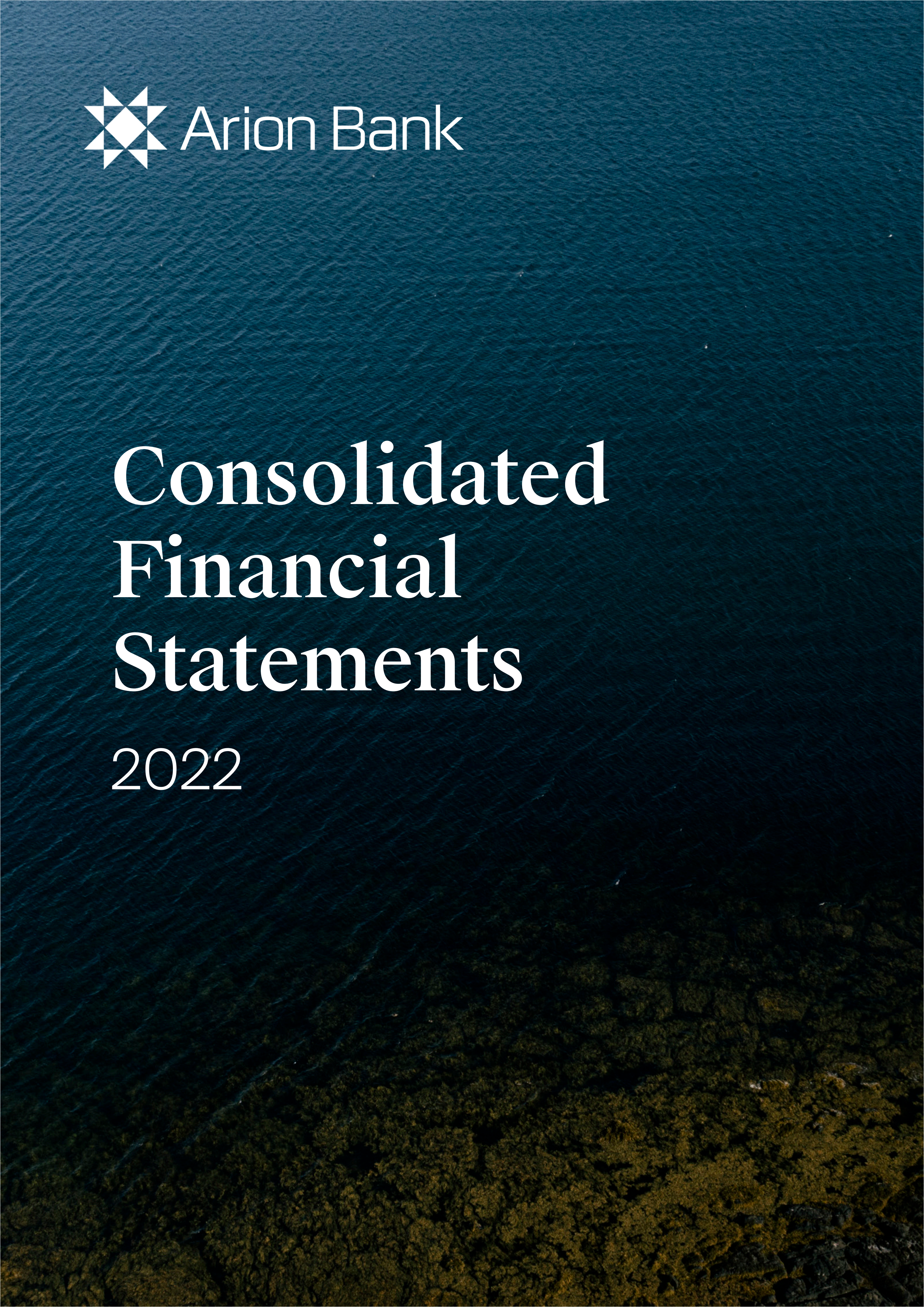
Arion Bank



Consolidated Financial Statements

2022

Contents

Arion Bank in brief

31.12.2022

13.7%
Return on equity

45.6%
Cost-to-core income

18.8%
CET1 ratio

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

Rating from Moody's
Long term: Baa1
Deposit rating: A3
Outlook: Positive

The Banker
Bank of the Year 2022
ICELAND

SUSTAINALYTICS
ESG INDUSTRY TOP RATED
2023

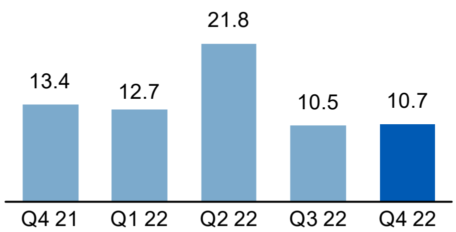
UNEP FINANCE INITIATIVE
PRINCIPLES FOR RESPONSIBLE BANKING

- Arion Bank provides services to households, corporates, institutions and investors. The Bank has three business segments: Retail Banking, Corporate & Investment Banking (CIB), and Markets. The service offering is further augmented by the subsidiaries Stefnir and Vördur. Stefnir is an Icelandic fund management company, and Vördur is an insurance company providing non-life and life insurance with sales channels through CIB and Retail Banking
- Arion Bank plays an important role in the community through the financing of progressive and sustainable initiatives. Sustainability is a part of the Bank's day-to-day activities, its decision-making and processes
- The diverse service offering at Arion Bank means that the revenue base is broad and the loan portfolio is well diversified between retail and corporate customers. The high percentage of mortgages and the healthy distribution of loans across different sectors reduces credit risk
- The Bank is a market leader in digital solutions and innovation supported by the Bank's app, which has been awarded the best banking app in Iceland six years in a row. Numerous new digital solutions have been launched in the past few years, enhancing service to customers and making the Bank's operations more efficient, which in the long term reduces operating expenses
- The Bank places a strong emphasis on customer experience, both in digital and face-to-face services, and meeting the financial needs of its customers via a customized product offering and quality financial services which contribute to the success of customers and society as a whole

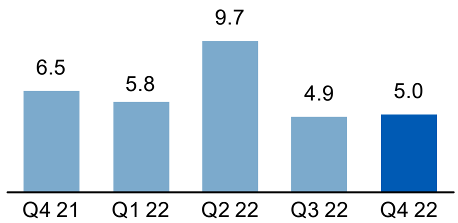
Key figures (ISK m)

	2022	2021
Net earnings	25,416	28,615
ROE	13.7%	14.7%
Net interest margin	3.1%	2.8%
Cost to Core income ratio	45.6%	51.6%
Operating income / REA	6.7%	7.6%
	31.12.2022	**31.12.2021**
Total assets	1,469,556	1,313,864
Loans to customers	1,084,757	936,237
Deposits	755,361	655,476
Borrowings	392,563	356,637
Total equity	188,331	194,598
Stage 3 gross	1.2%	1.9%
Leverage ratio	11.8%	12.7%
Number of employees	781	751
EUR/ISK	151.50	147.60

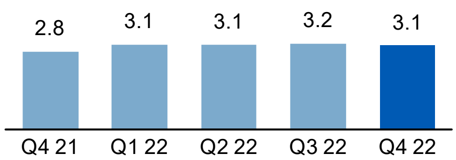
Return on equity (%)



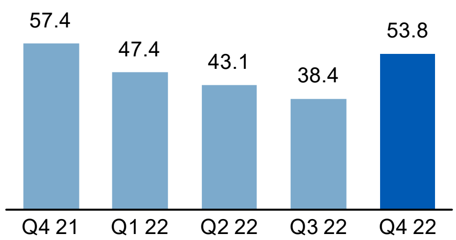
Net earnings (ISK billion)



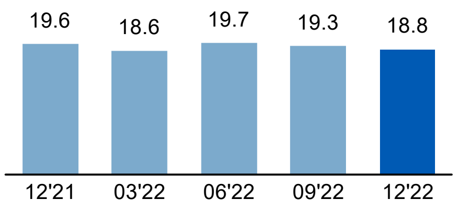
Net interest margin (%)



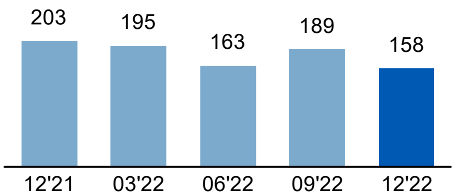
Cost-to-core income (%)



CET 1 ratio (%)



LCR ratio (%)



Endorsement and statement
by the Board of Directors and the CEO

The Consolidated Financial Statements of Arion Bank for the year ended 31 December 2022 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 Icelandic society. The Bank's strategy is to excel by offering smart and reliable financial solutions which create future value for our customers, shareholders and society as a whole. 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. In partnership with our customers the Bank stimulates shared growth and progress in Icelandic society.

Arion Bank provides services to households, corporates, institutes 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 diverse service offering at Arion Bank means that the revenue base is broad and the loan portfolio is well diversified between retail and corporate customers. The high percentage of mortgage loans and the healthy distribution of loans across different sectors reduces credit risk.

The Bank is a market leader in terms of digital solutions and innovation. Numerous new digital solutions have been launched in the past few years, enhancing service to customers and making the Bank's operations more efficient, which in the long term reduces operating expenses. The Bank's structure has been simplified and the branch network and business premises have been streamlined.

Arion Bank is a financially robust bank which places great importance on operating responsibly in harmony with society and the environment. The Bank places importance on paying competitive dividends to shareholders. The Bank is listed on the main lists of Nasdaq Iceland and Nasdaq Stockholm.

Arion Bank is an Icelandic bank which operates in Iceland. It also places a focus on companies in the Arctic and businesses in the seafood sector in Europe and North America.

Operations during the year

Income Statement

Net earnings amounted to ISK 25.4 billion for the year 2022 and return on equity was 13.7%. Earnings per share were ISK 17.06. Core income, defined as net interest income, net commission income and net insurance income, increased by 17.5%, compared with the previous year. There was strong growth in net interest income, compared with the previous year, mainly due to the increased base rate and 15.9% growth in the loan book from year-end 2021. Diversified fee generating operations support continued momentum in net fee and commission income. Net insurance income was affected by challenging conditions in 2022 and an unusually high volume in claims. Negative net financial income is affected by difficult markets conditions in 2022. Operating expenses increase slightly between years despite higher inflation in 2022. The cost-to-core income ratio in 2022 was 45.6%, compared with 51.6% 2021.

At the end of June 2022 Arion Bank sold its 100% shareholding in Valitor to Rapyd. The total consideration was ISK 14.6 billion (USD 112.5 million), resulting in a profit of ISK 5.6 billion, post cost of sale, which is recognized in the Income Statement. Transactions, mainly net fee and commission, between Valitor and Arion Bank are included in the results from the third quarter, while previously these have been lost in consolidation.

Balance Sheet

The Bank's balance sheet grew by 11.8% from year-end 2021. Loans to customers increased by 15.9% from year-end. The increase was 22.6% in corporate lending and 10.6% in loans to individuals, mainly mortgages. Deposits increased by 15.2%. Total equity amounted to ISK 188,331 million at the end of December. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 24.0% at year-end and the CET1 ratio was 18.8%, assuming ISK 16.0 billion dividend payment and buyback of own shares, that had received permission from the Financial Supervisory Authority of the Central Bank of Iceland (FSA). 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.

Assets held for sale and discontinued operations

The operating results of the subsidiaries Valitor hf., Stakksberg ehf. and Sólbjarg ehf. were presented as discontinued operations as they have all been classified as held for sale in these Financial Statements. As stated above Arion Bank sold its entire shareholding in Valitor at the end of June 2022. Stakksberg's main assets, the plot of land and industrial facilities of the silicon plant at Helguvík, were transferred to Landey, Arion Bank's property development company, at the end of the year and thus is no longer classified as an asset held for sale. Stakksberg had a negative impact of ISK 0.5 billion in 2022 due to the impairment of the silicon plant and operating expenses. Sólbjarg has sold the vast majority of its assets and at year-end the main asset is a 27.5% shareholding in Ferdaskrifstofa Íslands. Sólbjarg had a positive impact of ISK 0.4 billion in 2022 and the main reason for this is the sale of the company's underlying assets.

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 2022	Arion Bank's medium-term financial targets
Return on equity	13.7%	Exceed 13%
Operating income / REA	6.7%	Exceed 7.3%
Insurance premium growth (YoY)	10.2%	Premium growth (net of reinsurance) to exceed the growth of the domestic market by more than 3% (Premium growth in the domestic insurance market was 7.5% for 9M 2022)
Loan growth	15.9%	In line with nominal economic growth (Arion Bank forecasts GDP growth of 14.0% in 2022)
Cost-to-income ratio	47.0%	Below 45%
CET1 ratio	300 bps	150-250 bps management buffer (~17.3 - 18.3% based on current capital requirements)
Dividend pay-out ratio	79% net of own shares 113% pay-out ratio	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

In many ways, the Icelandic economy is in an enviable position. According to preliminary figures from Statistics Iceland, GDP increased by 7.3% between years in Q3 2022, outperforming our main trading partners and exceeding expectations by a significant margin. As in previous quarters, growth was driven by exports, especially tourism which continued to gain strength, and record-breaking private consumption. The tourism high season left its mark on the country's foreign trade, with the current account turning into a surplus in Q3, for the first time since 2021. However, robust domestic economic activity, as well as continued development of the export sectors, has led to rapid imports growth, resulting in one of the largest trade deficits since records began.

Despite the slightly brighter global economic outlook, uncertainty remains high with the risks tilted to the downside. Nevertheless, the Icelandic economy is still set for strong growth in 2023, with domestic analysts expecting economic growth to be in the range of 2-3%, driven by tourism and household consumption. The tourism industry has already gained its former strength, with tourist arrivals in 2H reaching 98% of 2H 2019. The tourism industry is expected to forge ahead in 2023, with a growing number of tourists visiting the country and increasing export revenues. Households are also in a favorable position, despite the continued record-breaking private consumption, thanks to a stronger than expected growth of disposable income. As a result, the saving ratio is still well above its pre-pandemic average, which means that households can maintain this high level of spending. In this context, it's important to keep in mind that Icelandic households do not face the same cost-of-living crisis as their European counterparts, as nearly every household relies on domestically produced renewable energy sources for heating and electricity. Conditions on the labor market are also well suited for supporting continued private consumption growth, as unemployment is well below its natural rate, staffing shortages at their highest since 2007 and substantial wage increases have been negotiated for a large part of the private sector.

Although the Icelandic economy came relatively unscathed out of last year, the economic outlook remains uncertain. No country is an economic island, not even Iceland, and the outlook will largely depend on fate of our main trading partners, many of which are facing subpar growth, even recession. Quelling inflation has also proven to be difficult, despite further rate hikes by the Central Bank in Q4. The housing market is rapidly cooling, but domestic inflationary pressures remain persistent and import prices continue to rise. Thus, further actions by the Central Bank are still in the picture.

Outlook for the Bank

The Bank continued to perform strongly in its core operations in 2022, while the business was simplified and the focus refined with the sale of the subsidiary Valitor. As in recent years, the operating environment has been complex and various external factors impacting financial institutions have changed substantially. The shifting inflation environment resulted in rising interest rates and had a widespread impact on the operating environment. Arion Bank is in a strong position due to its diversified operating model and robust infrastructure while it is also sufficiently flexible to navigate the changing operating environment. It is important to regain balance in the economy and the union wage negotiations plays a key role in this respect. It is therefore positive that important milestones have been reached in this respect recently.

One of the main areas of uncertainty in the Bank's operating environment has been the funding markets, particularly the international markets which play a key role in the Bank's funding mix. In the second half of the year spreads on these market increased significantly for Icelandic banks, and even though Arion Bank does not have any imminent maturities, the situation has fuelled uncertainty. It is therefore positive to see in early 2023 spreads beginning to decrease and growing interest from investors in bonds issued by Icelandic banks. The banks are well placed and have some of the highest capital ratios seen internationally and have robust liquidity. The Icelandic economy is also in a good position in terms of energy production which is a critical consideration today. It is important that investors and funding bodies are aware of this situation and the positive trend in interest spreads in recent weeks indicate that this is the case.

The decision was made during the quarter, after extensive talks with the main stakeholders and potential operators, that the sale of Stakksberg silicon plant at Helguvík was not thought likely to result in the recommissioning of the plant. Instead the idea is to develop current infrastructure for other purposes. The company's assets were also revalued and transferred to the Bank's development company Landey, which has extensive experience of such projects. There is considerable potential to redevelop this property and the existing infrastructure, partly due to its location near the international airport and the harbour at Helguvík.

Endorsement and statement
by the Board of Directors and the CEO

Following on from the updated business plan which was approved by the Board of Directors at the end of the year, it was decided to review the Group's financial targets. The main change was that costs and operating income to REA will both be based on core income which does not take into account net financial income or other income besides core income. Such a change would make the target more focused as financial income can be volatile. The target on lending growth has also been removed due to the uncertainties in the external operating environment and the importance of being flexible in this respect.

Employees

The Group had 781 full-time equivalent positions at the end of the year, compared with 751 at the end of 2021.

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 incentive schemes to employees of 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 three-year lock-up period. The criterion used to determine whether something will be paid for 2022, in part or in full, is whether the Bank's return on equity in 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. Arion Bank has also 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 is 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 above the required minimum and the liquidity ratio at the end of 2022 was 158%, with the minimum requirement being 100%. The Bank's solid liquidity position is due to funding on the wholesale markets, while deposits increased by 15.2%, from ISK 655 billion to ISK 755 billion.

The Bank had one ISK denominated covered bond series maturing in 2022 in addition to smaller international issues.

In 2022 Arion Bank issued its second green bond on the international market in the amount of €300 million. The proceeds were used to refinance a maturity of an equal size in March 2023. At the same time the Bank bought back outstanding bonds maturing in 2023 for €144 million.

Arion Bank increased an existing euro denominated covered bond issue by €200 million in March 2022 at terms equivalent to 0.37% over interbank rates.

In May 2022 S&P Global Ratings upgraded its rating of the Bank's covered bonds from A- to A with a stable outlook. The Bank now has the same rating for its covered bonds as the Icelandic government. In July 2022 S&P Global Ratings affirmed its rating of BBB/A-2 with a stable outlook. In July 2022 Moody's Investors Services issued for the first time a rating of Baa1 as an issuer rating and a rating of A3 for deposits for Arion Bank. Both ratings carry a positive outlook.

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 to maintain capital adequacy ratios 150-250bps above total regulatory requirements. The Bank has released equity through dividend payments and the purchase of own shares to meet this objective. In March 2022, the Bank paid dividends of ISK 22.5 billion, or ISK 15 per share, on the basis of the authority given by the Annual General Meeting. Following the completion of the sale of Valitor, the Bank received the approval of the FSA for a buyback program of up to ISK 10 billion. Based on this, the Bank initiated a process to purchase own shares for ISK 5 billion in September 2022 and ISK 2 billion in December. At the reporting date, ISK 0.8 billion remained of the approved program. In February 2023, the Board of Directors approved a further buyback of ISK 2.4 billion. These amounts are deducted from CET1 capital as foreseeable dividend and buyback.

On July 7, the FSA published the result of the Supervisory Review and Evaluation Process (SREP) for Arion Bank, based on financial information at year-end 2021. The additional capital requirement under Pillar 2 is set at 3.5% of total risk-weighted exposure amount (REA), which was an increase of 0.3pp from the previous year. On 29 September 2022, the countercyclical buffer in Iceland rose from 0% to 2% based on a decision made by the Icelandic Financial Stability Committee a year earlier. In light of this, Arion Bank's total capital requirement is 20.8% of REA and the CET1 capital requirement 15.8%.

The proposed dividend for the year 2022, which will be subject to the approval of the annual general meeting on 15 March 2023, corresponds to ISK 8.5 per share or around ISK 12.5 billion, net of own shares. The Board of Directors has the authority to propose that the Bank pay dividends or other disbursement of equity and may convene a special shareholders' meeting later in the year to propose a payment.

The Group's capital adequacy ratio on 31 December 2022 was 24.0% and the CET1 ratio 18.8%, where foreseeable dividends and buybacks are deducted. In December 2022, the Bank issued Tier 2 capital instruments in the amount of ISK 11 billion, thus fully utilizing the Bank's Tier 2 capacity. As the Bank's Additional Tier 1 capacity is not fully utilized, approximately ISK 5.6 billion of CET1 capital is supplemented to meet the Tier 1 capital requirement.

The capital position of Arion Bank is very strong and will remain so for the foreseeable future. This underpins the Bank's ability to support its customers and the Icelandic economy as it faces new risks stemming from geopolitical tensions, volatile commodity prices, rising interest rates and inflation.

The Bank's REA increased by ISK 71 billion in 2022. REA for the loan portfolio increased by ISK 84.1 billion, as loans to customers grew by ISK 148.5 billion. The sale of Valitor reduced the Group's REA by ISK 18.3 billion, primarily due to lower operational risk and credit risk. Reduced equity positions in the trading book and banking book result in lower REA and are expected to contribute to a lower Pillar 2 requirement in 2023. REA due to counterparty credit risk and credit valuation adjustment has however increased markedly in 2022.

The Central Bank of Iceland's Resolution Authority approved the resolution plan of Arion Bank on 26 April 2022. With the approval of the resolution plan, the Resolution Authority decided on the minimum required own funds and eligible liabilities (MREL), in accordance with the Act on Resolution of Credit Institutions and Investment Firms, No. 70/2020. On 29 September, the Resolution Authority issued Arion Bank's MREL requirement based on the financial position at year-end 2021. The requirement as a percentage of REA is 23.0%. The Bank is in full compliance with this requirement.

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 is expected to be held in Q4 2023.

At the end of December 2022 Gildi lífeyrissjódur was the largest shareholder in Arion Bank with a shareholding of 9.77%. Arion Bank owned 3.01% of its own shares at the end of 2022, see Note 36. The number of shareholders has grown from around 11,287 at the beginning of the year to 12,059 at the end of the year. Further information on Arion Bank's shareholders can be found in Note 37. At the AGM in March 2022 a motion was passed to reduce the company's share capital by ISK 150 million at nominal value, by cancelling the company's own shares. The reduction took place on 4 April 2022.

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.

Governance

At the Bank's AGM on 16 March 2022, five members were elected to serve on the Board of Directors until the next AGM, two women and three men. Additionally, two Alternate Directors (one woman and one man) were elected. 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 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.

Sustainability and non-financial reporting

Arion Bank places great importance on environmental and social issues and good corporate governance in its operations. 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.

We refer to Arion Bank's values as cornerstones and they are designed to provide guidance when making decisions and in everything the employees do. The cornerstones address our role, mentality and conduct and they are: we make a difference, we get things done, we say what we mean, and we find solutions. The Bank's code of ethics also serves as a key to responsible decision-making at Arion Bank.

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.

Arion Bank has 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 2021 Arion Bank became a signatory to the Partnership for Carbon Accounting Financials (PCAF). This is a global partnership of financial institutions that work together to develop and implement a harmonized approach to assess and disclose the greenhouse gas (GHG) emissions associated with their loans and investments. At the end of 2022 Arion Bank published its first report on financed emissions which is based on PCAF methodology. Assessing and disclosing GHG emissions which are financed through lending and investments is a prerequisite for the Bank's ability able to set targets on reducing emissions, and this is the next step.

In order to gain a better overview of the risk related to climate change the Bank has made use of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The section on sustainability risk in the Bank's 2022 Pillar 3 Risk Disclosures is based on these recommendations amongst other things. It contains an analysis of the Bank's loan portfolio in respect of climate risk. The Bank formally became a signatory to TCFD in February 2022.

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 signed a declaration of intent on investment for a sustainable recovery devised by the Prime Minister's Office, Festa – Center for Sustainability, the Icelandic Financial Services Association (SFF) and the National Association of Pension Funds (LL) in 2020. The Bank has also signed a declaration of intent concerning the Equality Scale, an initiative created by the Association of Icelandic Businesswomen (FKA).

The Bank's human resources policy involves creating a positive and motivational working environment and supporting its employees. There is a strong emphasis on attracting and retaining outstanding employees and helping 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.

The Bank has adopted a clear equality and human rights policy, which was reviewed in 2021, 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 factor. The Bank's action plan places greater emphasis on balancing gender ratios at the Bank, not just at management level but throughout different job families, committees and business units.

The Bank has had an equal pay system and equal pay certification since 2015. In 2018 it 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%. In 2022 the Bank underwent an equal pay audit which revealed an unexplained gender pay gap of 0.4%, with women receiving higher pay. The Bank's target is for the result of the equal pay audit to be less than 1%. One of the Bank's equality goals set out in the 2021-2024 action plan is to reduce the median value of total salary payments to men compared with total salary payments to women to below 1.3. Good progress has been made in this respect and in mid-year the median value was 1.29 compared with 1.43 in 2021.

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.

Arion Bank has adopted an environment and climate policy and set goals in this area. The policy spells out the importance of the Bank minimizing the negative environmental impact of its activities and greenhouse gas emissions. The policy also states that the Bank will turn its focus on to financing projects which relate to sustainable development and green infrastructure. In 2021 the Bank published a comprehensive green financing framework and has since then held four green bond issues based on the framework, two of which were in 2022. Green deposits continued to grow in 2021, and there was a significant increase in loans to buy vehicles which run on 100% renewables.

The Bank's credit policy places an emphasis on sustainability and increasing the percentage of green loans, and quantifiable targets have been set. The Bank's credit rules also stipulate that environmental, social and governance factors must be considered when assessing loans. In 2023, we will continue to make environment, social and governance (ESG) factors more important when assessing loans. At the end of 2022, 12.5% of the Bank's total loans came under the definition of the green financing framework, and the Bank aims to increase this figure to at least 20% by 2030. This target on the ratio of green loans will be reviewed annually, taking into consideration the opportunities over the next few years for green financing and the implementation of EU taxonomy in Iceland. The Bank hopes that this figure will grow even faster and that the number of green corporate loans will increase.

Endorsement and statement
by the Board of Directors and the CEO

At the beginning of 2022 Arion Bank published its first impact and allocation report for the Bank's green financing framework. The report specifies the allocation of funds raised through green bond issues and green deposits in 2021, and there is also a section on the positive environment and climate impact of green projects at Arion Bank. Deloitte provided confirmation with limited assurance of the allocation of funds to green projects which have been raised through green bond issues and green deposits. The Bank aims to publish the 2022 impact and allocation report in the first half of 2023.

The Bank's targets in environment and climate issues include reducing greenhouse gas emissions from own activities by 55% by 2030, i.e. emissions from the Bank's business premises and vehicles. At the end of 2022 the Bank had reduced these emissions by 55.6% 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.

Arion 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. In addition to the CEO, the sustainability committee includes the managing directors of Retail Banking, Corporate & Investment Banking, Markets, Customer Experience and Finance. The Chief Risk Officer, the Head of Corporate Communications and Sustainability, and the Sustainability Officer attend meetings but do not have voting rights. Meetings are also attended by representatives of Stefnir and Vörður as required.

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 monthly risk report to the Board and the Bank's risk appetite with respect to these factors was defined.

At the beginning of 2022 a special risk assessment of ESG factors at the Bank was made, and the assessment was reviewed at the beginning of 2023. The main social risks relate to employee equality and diversity, disclosure on social factors and relations with stakeholders. The main environmental risks were insufficient action in environmental and climate issues in connection with goods and services at the Bank, employees' compliance with the Bank's environment and climate policy and the risk of greenwashing. The assessment revealed that the main governance risks were anti-money laundering measures and know-your-customer, data protection and ESG reporting. The management of these risk at the Bank was rated as adequate or strong.

The Bank has introduced a policy on actions against financial crime, such as money laundering, terrorist financing, bribery and corruption or market abuse. On the basis of this policy the Bank places great importance on knowing all customers and understanding their business so that the Bank is able to identify any suspicious transactions. Suspicious transactions are immediately reported to the authorities. Employees are given regular training on measures against financial crime and how to respond if they have any suspicions. The Bank also re-evaluates its measures regularly to respond to the main threats at any given time. Further information on actions against financial crime are contained in the Bank's 2022 Pillar 3 Risk Disclosures.

In recent years Arion Bank has been recognized as a company which had achieved excellence in corporate governance following a formal assessment based on guidelines on corporate governance issued by the Icelandic Chamber of Commerce, the Confederation of Icelandic Employers, and Nasdaq Iceland. Further information on corporate governance can be found in the corporate governance statement.

In 2022 Arion Bank received the rating "outstanding" in the ESG assessment performed by the Icelandic ratings agency Reitun, for the third 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 ESG factors in its operations. The Bank performs well above average in all categories. A total of 35 issuers have been rated by Reitun. In 2022 Arion Bank was also rated by the international ratings agency Sustainalytics, which specializes in rating risk related to ESG factors. The rating was positive and Sustainalytics considers the Bank to be one of the best performing banks globally in this area. The Bank scored 12 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 factors at the Bank. Arion Bank is in the top 6% of more than 1,000 banks worldwide which have been rated by Sustainalytics and in the top 4% of 400 regional banks.

Arion Bank's activities are governed by the provisions of the Annual Accounts Act on non-financial reporting, Article 66 d. Information in the 2022 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 non-financial factors of the business, 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 third time the Bank is reporting on the progress made in implementing the UN Principles for Responsible Banking.

Deloitte is providing an opinion with limited assurance on non-financial reporting by Arion Bank in 2022 which is presented in accordance with the Global Reporting Initiative, GRI Standards and the Nasdaq ESG Reporting Guide. Deloitte also provides an opinion with limited assurance on the Bank's progress report to PRB.

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 15 February 2023: arsskyrsla2022.arionbanki.is.

Endorsement and statement
by the Board of Directors and the CEO

Endorsement of the Board of Directors and the Chief Executive Officer

The Consolidated Financial Statements of Arion Bank for the year ended 31 December 2022 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 2022 and its financial position as at 31 December 2022. 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 2022 with the file name RIL4VBPDB0M7Z3KXSF19-2022-12-31-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 2022 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, 8 February 2023

Board of Directors

Brynjólfur Bjarnason, Chairman

Paul Richard Horner, Vice Chairman

Gunnar Sturluson

Liv Fiksdahl

Steinunn Kristín Thórdardóttir

Chief Executive Officer

Benedikt Gíslason

Independent Auditor's report

To the Board of Directors and shareholders of Arion Bank.

Opinion

We have audited the Consolidated Financial Statements of Arion Bank hf. for the year ended December 31 2022 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, 2022, 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 financial statements in Iceland, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. This includes that, 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 to the audited company or, where applicable, its parent company or its controlled companies within the EU. 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 1,091,673 million at 31 December 2022, and the total allowance account for the Group amounted to ISK 7,371 million (including off-balance positions) at 31 December 2022. 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 58 and about loan impairment charges and provisions for guarantees in notes 15 and 43. 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 the Endorsement and statements by the Board of Directors and the CEO 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 management either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so.

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 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 skepticism throughout the audit. We also:

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

From the matters communicated with the Board of Directors and the Board 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.

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. Arion Bank hf. audit committee also has in place internal procedures to approve additional services before they commence. The audit committee also evaluates the independence of the company's auditors on yearly basis in order to ensure their independence and objectivity. Deloitte has provided to the audit committee written confirmation that Deloitte is independent of Arion banki hf.

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 2022 with the file name RIL4VBPDB0M7Z3KXSF19-2022-12-31-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 2022 with the file name RIL4VBPDB0M7Z3KXSF19-2022-12-31-en.zip is prepared, in all material respects, in compliance with the ESEF Regulation.

Deloitte ehf. was appointed auditor of Arion Bank hf. By the general meeting of shareholders on 16 March 2022. Deloitte have been elected as auditor of the Group since the general meeting 2015.

Kópavogur, 8 February 2023

Deloitte ehf.

Gunnar Thorvardarson
State Authorized Public Accountant

Consolidated Income Statement

	Notes	2022	2021
Interest income		83,591	53,958
Interest expense		(43,314)	(21,895)
Net interest income	7	**40,277**	**32,063**
Fee and commission income		18,728	16,706
Fee and commission expense		(2,663)	(2,033)
Net fee and commission income	8	**16,065**	**14,673**
Net insurance income	9	2,614	3,442
Net financial income	10	(3,095)	6,220
Share of profit of associates	26	270	22
Other operating income	11	1,067	1,805
Other net operating income		**856**	**11,489**
Operating income		**57,198**	**58,225**
Salaries and related expenses	12	(15,856)	(14,638)
Other operating expenses	13	(11,055)	(11,237)
Operating expenses		**(26,911)**	**(25,875)**
Bank levy	14	(1,749)	(1,516)
Net impairment	15	144	3,169
Earnings before income tax		**28,682**	**34,003**
Income tax expense	16	(9,809)	(6,782)
Net earnings from continuing operations		**18,873**	**27,221**
Discontinued operations held for sale, net of income tax	17	6,543	1,394
Net earnings		**25,416**	**28,615**

Attributable to

Shareholders of Arion Bank hf.		25,440	28,605
Non-controlling interest		(24)	10
Net earnings		**25,416**	**28,615**

Earnings per share

	Notes	2022	2021
	18		
Basic earnings per share attributable to the shareholders of Arion Bank (ISK)		17.06	17.96
Diluted earnings per share attributable to the shareholders of Arion Bank (ISK)		16.14	16.93

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

Amounts are in ISK millions

Consolidated Statement of Comprehensive Income

	Notes	2022	2021
Net earnings		**25,416**	**28,615**
Net change in fair value of financial assets carried at fair value through OCI, net of tax		(999)	(2,131)
Net realized gain on financial assets carried at FV through OCI, net of tax, and reclassification from OCI equity reserve, transferred to the Income Statement	10	1,553	335
Changes to reserve for financial instruments at fair value through OCI		**554**	**(1,796)**
Exchange difference on translating foreign subsidiaries		(676)	21
Other comprehensive loss that is or may be reclassified subsequently to the Income Statement		**(122)**	**(1,775)**
Total comprehensive income		**25,294**	**26,840**

Attributable to

	2022	2021
Shareholders of Arion Bank	25,318	26,830
Non-controlling interest	(24)	10
Total comprehensive income	**25,294**	**26,840**

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

Amounts are in ISK millions

Consolidated Statement of Financial Position

Assets	Notes	2022	2021
Cash and balances with Central Bank	19	114,118	69,057
Loans to credit institutions	20	45,501	30,272
Loans to customers	21	1,084,757	936,237
Financial instruments	22-24	193,329	225,657
Investment property	24	7,862	6,560
Investments in associates	26	787	668
Intangible assets	27	8,783	9,463
Tax assets	28	135	2
Assets and disposal groups held for sale	29	61	16,047
Other assets	30	14,223	19,901
Total Assets		**1,469,556**	**1,313,864**

Liabilities	Notes	2022	2021
Due to credit institutions and Central Bank	23	11,697	5,000
Deposits	23	755,361	655,476
Financial liabilities at fair value	23	20,997	5,877
Tax liabilities	28	10,303	7,102
Liabilities associated with disposal groups held for sale	29	-	16,935
Other liabilities	31	42,973	37,151
Borrowings	23,32	392,563	356,637
Subordinated liabilities	23,33	47,331	35,088
Total Liabilities		**1,281,225**	**1,119,266**

Equity	36	2022	2021
Share capital and share premium		13,372	22,684
Other reserves		10,672	12,838
Retained earnings		163,638	158,403
Total Shareholders' Equity		**187,682**	**193,925**
Non-controlling interest		649	673
Total Equity		**188,331**	**194,598**
Total Liabilities and Equity		**1,469,556**	**1,313,864**

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

Amounts are in ISK millions

Consolidated Statement of Changes in Equity

	Share capital	Share premium	Share option	Warrants reserve	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Debt invest-ments at fair value thr. OCI, unrealized	Statutory reserve	Foreign currency trans-lation reserve	Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
	Restricted reserves													
Equity 1 January 2022	1,518	21,166	99	828	7,245	3,166	1,124	(1,937)	1,637	676	158,403	**193,925**	673	**194,598**
Net earnings											25,440	**25,440**	(24)	**25,416**
Net change in fair value								(999)				**(999)**		**(999)**
Net realized loss transf. to P/L and recl. from OCI equity reserve								1,553				**1,553**		**1,553**
Translation difference										(676)		**(676)**		**(676)**
Total comprehensive income	-	-	-	-	-	-	-	554	-	(676)	25,440	**25,318**	(24)	**25,294**
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	4	349	(38)									**315**		**315**
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	-	163,638	**187,682**	649	**188,331**

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 2021	1,718	49,613	-	-	7,421	694	1,054	(141)	1,637	655	135,021	**197,672**	173	**197,845**
Net earnings											28,605	**28,605**	10	**28,615**
Net change in fair value								(2,131)				**(2,131)**		**(2,131)**
Net realized loss transferred to P/L ...								335				**335**		**335**
Translation difference										21		**21**		**21**
Total comprehensive income	-	-	-	-	-	-	-	(1,796)	-	21	28,605	**26,830**	10	**26,840**
Transactions with owners														
Dividend paid											(2,857)	**(2,857)**		**(2,857)**
Purchase of treasury shares	(200)	(28,447)										**(28,647)**		**(28,647)**
Share option charge			99									**99**		**99**
Warrants sold				828								**828**		**828**
Increase in non-controlling interest ..												**-**	490	**490**
Changes in reserves					(176)	2,472	70				(2,366)	**-**		**-**
Equity 31 December 2021	1,518	21,166	99	828	7,245	3,166	1,124	(1,937)	1,637	676	158,403	**193,925**	673	**194,598**

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

Amounts are in ISK millions

Consolidated Statement of Cash flows

	2022	2021
Operating activities		
Net earnings	25,416	28,615
Non-cash items included in net earnings	(30,399)	(32,006)
Changes in operating assets and liabilities		
Loans to credit institutions, excluding bank accounts	181	3,163
Loans to customers	(123,341)	(105,988)
Financial instruments and financial liabilities at fair value	33,902	4,783
Deposits	81,536	90,642
Borrowings	32,502	54,566
Other changes in operating assets and liabilities	10,463	(1,440)
Interest received	66,516	41,866
Interest paid *	(33,006)	(15,883)
Dividend received	363	95
Income tax paid	(6,741)	(3,942)
Net cash from operating activities	**57,392**	**64,471**
Investing activities		
Proceeds from sale of subsidiary and associates	16,841	356
Acquisition of associates	(90)	(111)
Acquisition of intangible assets	(416)	(1,005)
Proceeds from sale of property and equipment	1,085	1,045
Acquisition of property and equipment	(357)	(581)
Net cash from (to) investing activities	**17,063**	**(296)**
Financing activities		
Issued subordinated liabilities	12,100	-
Proceeds from issued warrants	-	828
Proceeds from vested share options	315	-
Purchase of treasury stock	(9,851)	(28,647)
Dividend paid to shareholders of Arion Bank	(22,489)	(2,857)
Net cash used in financing activities	**(19,925)**	**(30,676)**
Net increase in cash and cash equivalents	54,530	33,499
Cash and cash equivalents at beginning of the year	90,678	58,284
Effect of exchange rate changes on cash and cash equivalents	4,923	(1,105)
Cash and cash equivalents	**150,131**	**90,678**
Cash and cash equivalents		
Cash and balances with Central Bank	114,118	69,057
Bank accounts	43,433	28,156
Mandatory reserve deposit with Central Bank	(7,420)	(6,535)
Cash and cash equivalents	**150,131**	**90,678**

* Interest paid includes interest credited to deposit accounts at the end of the year.

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

Amounts are in ISK millions

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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 2022 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 8 February 2023.

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 2021.

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 58;
- 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 141.80 and 151.50 for EUR (31.12.2021: USD 129.75 and EUR 147.60).

2. Changes in accounting policies

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

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 Consolidated Financial Statement were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising that are beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

Notes to the Consolidated Financial Statements

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

Impairment of financial assets

The book value of financial assets which fall under the impairment requirements of IFRS 9 are presented net of expected credit losses in the statement of financial position. On a monthly basis expected credit losses for stages 1 and 2 are recalculated for each asset, the calculations are based on PD, LGD and EAD models. Stage 3 calculations are based on LGD and EAD parameters. In addition to the model outcomes, the assessment of expected credit losses is based on three key factors: management's assumptions regarding the development of macroeconomic factors over the next five years, how those factors affect each model and how to estimate a significant increase in credit risk. The assumptions for macroeconomic development are incorporated into each model for three scenarios: a base case, an optimistic case, and a pessimistic case. Management estimates the probability weight for each scenario used for calculations of the probability weighted expected credit losses. The amount of expected credit losses to be recognized is dependent on the Bank's definition of significant increase in credit risk, which controls the impairment stage each asset is allocated to. Management has estimated factors to measure significant increase in credit risk from origination, by comparison of changes in PD values, annualized lifetime PD values, days past due and watch list. For further information see Note 58.

Macroeconomic outlook

The economic outlook in Iceland is generally positive, despite the effects of the war in Ukraine and the challenges that European economies face. In Iceland, electricity and heating are almost exclusively generated from local renewable sources and the country is a net commodities exporter. Tourism has been strong in 2022 although the peak from 2018 is not expected to be matched until 2024. In line with this, it is expected that the unemployment rate will continue to decrease and that GDP growth will be strong over the coming years. Private consumption grew very strongly in 2021, by 7.6%, and a slower growth is expected in the coming years, also due to the persistence of inflation. The growth in housing prices is also expected to slow down in the second half of 2022 and in the coming years due to increased supply and increased cost of borrowing although demand is also expected to remain strong from demographic considerations.

Impairment of intangible assets

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

Revaluation of investment properties

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

4. The Group

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

			Equity interest	
	Operating activity	Currency	2022	2021
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%
SRL slhf., Borgartún 19, Reykjavík, Iceland	Real estate	ISK	100.0%	100.0%
Stefnir hf., Borgartún 19, Reykjavík, Iceland	Asset management	ISK	100.0%	100.0%
Valitor hf., Dalshraun 3, Hafnarfjördur, Iceland	Payment solutions	ISK	-	100.0%
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%

On 30 June 2022 Arion Bank sold its entire shareholding in the subsidiary Valitor hf. Valitor was classified as held for sale in accordance with IFRS, see Notes 17 and 29.

Stakksberg ehf. and Sólbjarg ehf., the subsidiaries of the holding company Eignabjarg ehf., are classified as held for sale in accordance with IFRS 5, see Note 29.

SRL slhf. sold its entire shareholding in Landey ehf. to Arion Bank at year end. Landey ehf. holds a 51% shareholding in its subsidiary Arnarland ehf. and recognizes minority interest accordingly.

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

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

Markets & Stefnir

Markets & Stefnir comprise Asset Management and Capital Markets. Asset Management manages financial assets on behalf of its customers according to a pre-determined investment strategy. Asset Management also administers pension funds. Asset management comprises Institutional Asset Management, Premia Service, 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.

Retail Banking

Retail Banking provides a diverse range of financial services in 13 branches and service points across Iceland and offers digital solutions both in the Arion app and online banking. These services include deposits and loans, savings, payment cards, pensions, insurance, securities and funds. In order to improve efficiency the branch network is split into four regions, and smaller branches can therefore benefit from the strength of larger units within each region.

Treasury

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

Other subsidiaries

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

Supporting units

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

Notes to the Consolidated Financial Statements

5. Operating segments, continued

2022 *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	3,033	20,086	19,677	(2,363)	(65)	(91)	40,277
Net fee and commission income	5,768	5,350	4,730	728	(592)	81	16,065
Net insurance income	-	40	2,642	-	(2)	(66)	2,614
Net financial income	(44)	(103)	(642)	(2,819)	685	(172)	(3,095)
Share of profit of associates	1,234	-	-	-	(1)	(963)	270
Other operating income	11	114	136	2	53	751	1,067
Operating income	10,002	25,487	26,543	(4,452)	78	(460)	57,198
Operating expenses	(2,282)	(2,641)	(5,398)	(646)	(279)	(15,665)	(26,911)
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	5,652	19,049	12,632	(6,674)	141	(2,118)	28,682
Net seg. rev. from ext. customers	4,264	27,989	45,879	(21,466)	898	(366)	57,198
Net seg. rev. from other segments	5,738	(2,502)	(19,336)	17,014	(820)	(94)	-
Operating income	10,002	25,487	26,543	(4,452)	78	(460)	57,198
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	4,456	8,597	121,362	23,530	27,192	191,470
Internal assets	56,949	-	-	293,393	-	(350,342)	-
Total assets	96,108	458,090	666,875	549,574	25,473	(326,564)	1,469,556
Deposits	84,395	271,929	330,393	72,979	-	(4,335)	755,361
Other external liabilities	2,783	16,536	18,827	451,460	8,145	28,113	525,864
Internal liabilities	-	92,465	257,877	-	-	(350,342)	-
Total liabilities	87,178	380,930	607,097	524,439	8,145	(326,564)	1,281,225
Allocated equity	8,930	77,161	59,777	25,135	17,328	-	188,331

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

5. Operating segments, continued

2021 *Income Statement*	Markets and Stefnir	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other sub-sidiaries	Supporting units and elimi-nations	Total
Net interest income	965	12,854	15,658	2,653	84	(120)	(31)	32,063
Net fee and commission income	5,642	5,027	4,061	614	(179)	(791)	299	14,673
Net insurance income	-	-	-	-	3,504	-	(62)	3,442
Net financial income	326	1,246	-	2,948	2,125	(436)	11	6,220
Share of profit of associates	-	(8)	-	-	-	-	30	22
Other operating income	4	14	507	43	33	397	807	1,805
Operating income	6,937	19,133	20,226	6,258	5,567	(950)	1,054	58,225
Operating expenses	(1,966)	(1,792)	(5,147)	(605)	(2,591)	(222)	(13,552)	(25,875)
Allocated expenses	(1,982)	(2,743)	(6,873)	(1,036)	(15)	(5)	12,654	-
Bank levy	(68)	(436)	(709)	(303)	-	-	-	(1,516)
Net impairment	-	2,267	1,874	2	-	(443)	(531)	3,169
Earnings (loss) before income tax	2,921	16,429	9,371	4,316	2,961	(1,620)	(375)	34,003
Net seg. rev. from ext. customers	4,570	23,190	33,227	(9,029)	5,435	118	714	58,225
Net seg. rev. from other segments	2,367	(4,057)	(13,001)	15,287	132	(1,068)	340	-
Operating income	6,937	19,133	20,226	6,258	5,567	(950)	1,054	58,225
Balance Sheet								
Loans to customers	15	364,925	572,117	-	-	4	(824)	936,237
Financial instruments	47,474	171	-	151,445	26,099	2,796	(2,328)	225,657
Other external assets	5,500	7,056	2,732	74,141	8,180	35,992	18,369	151,970
Internal assets	27,845	-	-	273,762	-	-	(301,607)	-
Total assets	80,834	372,152	574,849	499,348	34,279	38,792	(286,390)	1,313,864
Deposits	68,124	235,378	303,719	61,112	-	-	(12,857)	655,476
Other external liabilities	4,997	5,733	1,366	390,526	21,205	11,889	28,074	463,790
Internal liabilities	-	69,756	222,567	-	993	8,291	(301,607)	-
Total liabilities	73,121	310,867	527,652	451,638	22,198	20,180	(286,390)	1,119,266
Allocated equity	7,713	61,285	47,197	47,710	12,081	18,612	-	194,598

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

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

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

Notes to the Consolidated Income Statement

Quarterly statements

6. Operations by quarters, unaudited

2022	Q1	Q2	Q3	Q4	Total
Net interest income	9,528	9,804	10,421	10,524	40,277
Net fee and commission income	3,552	4,539	4,002	3,972	16,065
Net insurance income	5	1,086	690	833	2,614
Net financial income	991	(2,911)	(1,332)	157	(3,095)
Share of profit of associates	203	23	41	3	270
Other operating income	235	719	62	51	1,067
Operating income	14,514	13,260	13,884	15,540	57,198
Salaries and related expense	(3,540)	(3,843)	(3,100)	(5,373)	(15,856)
Other operating expense	(2,661)	(2,806)	(2,710)	(2,878)	(11,055)
Operating expenses	(6,201)	(6,649)	(5,810)	(8,251)	(26,911)
Bank levy	(393)	(416)	(444)	(496)	(1,749)
Net impairment	(495)	186	42	411	144
Earnings before income tax	7,425	6,381	7,672	7,204	28,682
Income tax expense	(1,703)	(3,488)	(2,803)	(1,815)	(9,809)
Net earnings from continuing operations	5,722	2,893	4,869	5,389	18,873
Discontinued operations, net of tax	96	6,819	(6)	(366)	6,543
Net earnings	5,818	9,712	4,863	5,023	25,416

2021	Q1	Q2	Q3	Q4	Total
Net interest income	7,342	8,016	7,937	8,768	32,063
Net fee and commission income	3,277	3,562	3,755	4,079	14,673
Net insurance income	671	914	992	865	3,442
Net financial income	1,500	2,203	1,366	1,151	6,220
Share of profit of associates	1	25	7	(11)	22
Other operating income	306	284	833	382	1,805
Operating income	13,097	15,004	14,890	15,234	58,225
Salaries and related expense	(3,271)	(3,575)	(2,899)	(4,893)	(14,638)
Other operating expense	(2,777)	(2,797)	(2,689)	(2,974)	(11,237)
Operating expenses	(6,048)	(6,372)	(5,588)	(7,867)	(25,875)
Bank levy	(330)	(355)	(486)	(345)	(1,516)
Net impairment	1,080	812	718	559	3,169
Earnings before income tax	7,799	9,089	9,534	7,581	34,003
Income tax expense	(1,866)	(1,408)	(1,920)	(1,588)	(6,782)
Net earnings from continuing operations	5,933	7,681	7,614	5,993	27,221
Discontinued operations, net of tax	106	135	624	529	1,394
Net earnings	6,039	7,816	8,238	6,522	28,615

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

7. Net interest income

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	-	383	2,542	2,925
Effect from hedge accounting	-	13	-	13
Other	260	-	-	260
Interest income	80,573	476	2,542	83,591
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	37,259	476	2,542	40,277

2021	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	573	-	-	573
Loans to credit institutions	73	49	-	122
Loans to customers	49,044	-	-	49,044
Securities	-	610	2,642	3,252
Effect from hedge accounting	-	777	-	777
Other	190	-	-	190
Interest income	49,880	1,436	2,642	53,958
Interest expense				
Deposits	(6,820)	-	-	(6,820)
Borrowings	(13,065)	-	-	(13,065)
Subordinated liabilities	(1,891)	-	-	(1,891)
Other	(119)	-	-	(119)
Interest expense	(21,895)	-	-	(21,895)
Net interest income	27,985	1,436	2,642	32,063

Net interest income calculated using the effective interest rate method were ISK 83,331 million during the year (2021: ISK 49,739 million).

Interest spread	2022	2021
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	3.1%	2.8%

Amounts are in ISK millions

8. Net fee and commission income

	2022			2021		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	5,433	(596)	4,837	5,430	(552)	4,878
Capital markets and corporate finance	3,156	(43)	3,113	2,565	(40)	2,525
Lending and financial guarantees	4,298	-	4,298	4,686	-	4,686
Collection and payment services	1,520	(105)	1,415	1,461	(113)	1,348
Cards and payment solution	3,443	(1,187)	2,256	1,777	(520)	1,257
Other	878	(732)	146	787	(808)	(21)
Net fee and commission income	18,728	(2,663)	16,065	16,706	(2,033)	14,673

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

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

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

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

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

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

9. Net insurance income

	2022	2021
Earned premiums, net of reinsurers' share		
Premiums written	15,579	14,032
Premiums written, reinsurers' shares	(617)	(486)
Change in provision for unearned premiums	(741)	(644)
Earned premiums, net of reinsurers' share	14,221	12,902
Claims incurred, net of reinsurers' share		
Claims paid	(9,882)	(8,186)
Claims paid, reinsurers' share	291	157
Change in provision for claims	(2,129)	(1,374)
Changes in provision for claims, reinsurers' share	113	(57)
Claims incurred, net of reinsurers' share	(11,607)	(9,460)
Net insurance income	2,614	3,442
Combined ratio		
Combined ratio	99.2%	93.2%

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

10. Net financial income

	2022	2021
Net (loss) gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	(510)	6,589
Gain on prepayments of borrowings	14	-
Net loss on fair value hedge of interest rate swap	(908)	(216)
Net realized loss on financial assets carried at fair value through OCI and reclassification from OCI equity reserve	(2,098)	(453)
Net foreign exchange gain	407	300
Net financial income	(3,095)	6,220

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

	2022	2021
Equity instruments	(1,104)	5,126
Debt instruments	(654)	1,246
Derivatives	1,248	217
Net (loss) gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	(510)	6,589

Net loss on fair value hedge of interest rate swap

	2022	2021
Fair value change of interest rate swaps designated as hedging instruments	(14,855)	(2,262)
Fair value change on bonds issued by the Group attributable to interest rate risk	13,947	2,046
Net loss on fair value hedge of interest rate swap	(908)	(216)

Net realized 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 has not been 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 has also been evaluated by the Bank's external auditors as well as by independent third-party advisors. The impact is 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 is ISK 1.9 billion which is now being 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 on net earnings after tax is ISK 1.4 billion but with zero effect

11. Other operating income

	2022	2021
Net gain on disposal of assets	722	542
Net gain on assets held for sale	129	227
Fair value changes on investment property	26	545
Net realised gain on investment property	(2)	28
Other income	192	463
Other operating income	1,067	1,805

Net gain on assets held for sale

	2022	2021
Income from real estates and other assets	141	259
Expense related to real estates and other assets	(12)	(32)
Net gain on assets held for sale	129	227

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. Personnel and salaries

	2022	2021
Number of employees		
Average number of full-time equivalent positions during the year	759	758
Full-time equivalent positions at the end of the year	781	751
Salaries and related expenses		
Salaries	10,812	10,216
Incentive scheme	1,236	1,215
Share-based payment expenses	279	99
Defined contribution pension plans	1,789	1,692
Salary-related expenses	1,740	1,577
Capitalization of salaries due to implementation of core systems	-	(161)
Salaries and related expenses	15,856	14,638

Remuneration to the Board of Directors

	2022				2021			
	Fixed remuner-ation*	Additional remuner-ation**	Pension contribution	Total	Fixed remuner-ation*	Additional remuner-ation**	Pension contribution	Total
Brynjólfur Bjarnason, Chairman	12.4	9.1	1.8	23.4	11.8	6.8	1.7	20.3
Paul Richard Horner, Vice Chairman	12.2	10.3	-	22.5	10.9	7.0	-	17.9
Gunnar Sturluson, Director	6.2	8.6	1.2	16.0	5.9	7.0	1.0	13.9
Liv Fiksdahl, Director	9.4	9.6	-	19.0	8.1	7.7	-	15.8
Steinunn Kristín Thórdardóttir, Director	9.1	8.6	1.5	19.2	8.1	7.0	1.3	16.3
Renier Lemmens, Director until 16.3.2021	-	-	-	-	2.5	1.5	0.3	4.3
Alternate directors of the Board	0.3	0.6	0.1	1.0	0.7	1.4	0.1	2.3
Total remuneration	49.6	46.8	4.6	101.0	48.0	38.5	4.4	90.9

* 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

	2022				2021			
	Salaries	Performance-based payments	Pension contribution	Total	Salaries	Performance-based payments	Pension contribution	Total
Benedikt Gíslason, CEO	67.2	9.1	10.9	87.2	61.0	-	8.8	69.8
Eight members of the								-
Executive Committee (7 until 6.9.2021)	321.7	24.5	49.2	395.4	279.8	3.5	39.9	323.2
Former members of the Executive Comm.	28.9	13.9	6.2	49.0	32.0	2.0	4.6	38.6
Total remuneration	417.8	47.4	66.4	531.6	372.8	5.5	53.3	431.6

Performance based payments in 2021 are deferred payments based on the Group's performance in 2017.

Board Members receive remuneration for their involvement in board committees. In addition to 13 Board meetings (2021: 14) during the year 5 Board Credit Committee meetings (2021: 11), 6 Board Audit Committee meetings (2021: 5), 8 Board Risk Committee meetings (2021: 8), 5 Board Remuneration Committee meetings (2021: 4) and 4 Board Tech committee meetings (2021: 6) were held.

The 2022 Annual General Meeting of the Bank held on 16 March 2022 approved the monthly salaries for 2022 for the Chairman, Vice Chairman and for other Board Members of amounts ISK 1,050,000, ISK 787,500 and ISK 525,000 (2021: ISK 981,400; 736,200; 490,900) respectively. It was also approved that the salary of Alternate Board Members would be ISK 262,500 (2021: ISK 248,600) per meeting, up to a maximum of ISK 525,000 (2021: ISK 490,900) per month. Board members residing outside of Iceland receive ISK 320,000 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 210,000 (2021: ISK 196,300) per month for each committee they serve on and the Chairman of the board committees ISK 315,000 (2021: ISK 255,000).

Amounts are in ISK millions

12. Personnel and salaries, continued

Incentive schemes

In 2022 the Group made a provision of ISK 1,606 million (2021: ISK 1,580 million) for the incentive scheme, including salary-related expenses. At the end of the year the Group's accrual for the incentive scheme payments amounted to ISK 1,997 million (31.12.2021: ISK 1,638 million).

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

Share-based payment expense

Arion Bank has in place a share option plan for all employees of the Bank, Vördur and Stefnir, approved at the Banks annual general meeting. A total expense of ISK 279 million was recognised in the Income Statement during the year (2021: ISK 45 million). Estimated remaining expenses due the share option contracts are ISK 384 million and will be expensed over the next four years. For further information on the share option program, see Note 36.

13. Other operating expenses

	2022	2021
IT expenses	4,429	4,686
Professional services	1,083	937
Housing expenses	680	718
Other administration expenses	3,006	2,414
Depositors' and Investors' Guarantee Fund	138	558
Depreciation of property and equipment	505	565
Depreciation of right of use asset	118	128
Amortization of intangible assets	1,096	1,231
Other operating expenses	11,055	11,237

Auditor's fee

	2022	2021
Audit and review of the Consolidated Financial Statements for the relevant fiscal year	168	151
Other audit related services for the relevant fiscal year	15	9
Other services from auditors	6	15
Auditor's fee	189	175

Amounts are in ISK millions

14. 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.

15. Net impairment

	2022	2021
Net impairment on financial instruments and value changes on loans		
Net impairment on loans to customers and financial institutions	(158)	2,538
Net impairment on other financial instruments at FVOCI	8	-
Other value changes of loans - corporates	137	71
Other value changes of loans - individuals	157	560
Net impairment	144	3,169

	2022	2021
Net impairment by customer type		
Individuals	321	917
Corporates	(177)	2,151
Financial institutions	-	101
Net impairment	144	3,169

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.

16. Income tax expense

	2022	2021
Current tax expense	8,669	6,607
Deferred tax expense	1,140	175
Income tax expense	9,809	6,782

Reconciliation of effective tax rate	2022		2021	
Earnings before income tax		28,682		34,003
Income tax using the Icelandic corporate tax rate	20.0%	5,736	20.0%	6,801
Additional 6% tax on Financial Undertakings	6.6%	1,903	4.1%	1,411
Non-deductible expenses	0.4%	103	0.1%	24
Tax exempt revenues / loss	4.5%	1,300	(4.3%)	(1,455)
Non-deductible taxes (Bank levy)	1.2%	350	0.9%	303
Tax incentives not recognized in the Income Statement	1.2%	353	(1.0%)	(350)
Other changes	0.2%	64	0.1%	48
Effective tax rate	34.2%	9,809	19.9%	6,782

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

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

Amounts are in ISK millions

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

	2022	2021
Net gain from discontinued operations held for sale	6,690	1,415
Income tax expense	(147)	(21)
Discontinued operations held for sale, net of income tax	6,543	1,394
Valitor hf.	6,656	903
Stakksberg ehf.	(504)	(211)
Sólbjarg ehf.	391	702
Discontinued operations held for sale, net of income tax	6,543	1,394

At the end of June 2022 Arion Bank sold its entire 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. The net profit from Valitor's operation was ISK 627 million during the first six months of 2022 whereas Valitor's positive contribution to the Group, after taking into account the Group's eliminations, was ISK 1,088 million. For the first six months of 2022 operating income of Valitor was ISK 3,322 million, or ISK 3,822 million after taking into account the Group's eliminations.

Operating effects of Sólbjarg are mainly due to a sale of assets held by the company. Operating effects of Stakksberg are due to fair value changes of underlying assets.

For further information about Valitor hf., Stakksberg ehf. and Sólbjarg ehf., see Note 29.

18. Earnings per share

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

	Continued operations		Discontinued operations		Net Earnings	
	2022	2021	2022	2021	2022	2021
Net earnings attributable to the shareholders of Arion Bank	18,897	27,211	6,543	1,394	25,440	28,605
Weighted average number of outstanding shares (millions)	1,491	1,593	1,491	1,593	1,491	1,593
Weighted average number of outstanding shares including warrants and options (millions)	1,576	1,690	1,576	1,690	1,576	1,690
Basic earnings per share (ISK)	12.67	17.08	4.39	0.88	17.06	17.96
Diluted earnings per share (ISK)	11.99	16.10	4.15	0.82	16.14	16.93

Notes to the Consolidated Financial Statements

Notes to the Consolidated Statement of Financial Position

19. Cash and balances with Central Bank

	2022	2021
Cash on hand	3,877	3,556
Cash with Central Bank	102,821	58,966
Mandatory reserve deposit with Central Bank	7,420	6,535
Cash and balances with Central Bank	114,118	69,057

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

20. Loans to credit institutions

	2022	2021
Bank accounts	43,433	28,156
Other loans	2,068	2,116
Loans to credit institutions	45,501	30,272

21. Loans to customers

	Individuals		Corporates		Total	
2022	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
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
2021						
Overdrafts	14,255	13,691	18,301	17,785	32,556	31,476
Credit cards	13,192	13,037	1,449	1,409	14,641	14,446
Mortgage loans	463,895	463,457	41,588	41,420	505,483	504,877
Construction loans	-	-	17,798	17,775	17,798	17,775
Capital lease	4,471	4,451	3,882	3,843	8,353	8,294
Other loans	32,573	31,862	332,433	327,507	365,006	359,369
Loans to customers	528,386	526,498	415,451	409,739	943,837	936,237

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

Further analysis of loans is provided in Risk management disclosures.

22. Financial instruments

	2022	2021
Bonds and debt instruments	138,174	151,852
Shares and equity instruments with variable income	17,733	25,063
Derivatives	9,516	2,905
Securities used for economic hedging	27,906	45,837
Financial instruments	193,329	225,657

Amounts are in ISK millions

23. Financial assets and financial liabilities

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	5,255	-	-	5,255
Other financial assets	3,412	-	-	3,412
Other financial assets	8,667	-	-	8,667
Financial assets	1,250,975	115,806	79,591	1,446,372
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	10,099	-	-	10,099
Financial liabilities	1,217,051	-	20,997	1,238,048

* Including effect from hedge accounting derivatives.

Amounts are in ISK millions

23. Financial assets and financial liabilities, continued

2021	Amortized cost	Fair value through OCI	Mandatorily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	69,057	-	-	69,057
Loans to credit institutions	28,156	-	2,116	30,272
Loans to customers	936,237	-	-	936,237
Loans	1,033,450	-	2,116	1,035,566
Bonds and debt instruments				
Listed	-	133,825	17,344	151,169
Unlisted	-	-	683	683
Bonds and debt instruments	-	133,825	18,027	151,852
Shares and equity instruments with variable income				
Listed	-	-	7,707	7,707
Unlisted	-	-	13,079	13,079
Bond funds with variable income, unlisted	-	-	4,277	4,277
Shares and equity instruments with variable income	-	-	25,063	25,063
Derivatives				
OTC derivatives	-	-	1,805	1,805
Derivatives used for hedge accounting	-	-	1,100	1,100
Derivatives	-	-	2,905	2,905
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	14,044	14,044
Shares and equity instruments with variable income, listed	-	-	31,793	31,793
Securities used for economic hedging	-	-	45,837	45,837
Other financial assets				
Accounts receivable	5,104	-	-	5,104
Other financial assets	7,617	-	-	7,617
Other financial assets	12,721	-	-	12,721
Financial assets	1,046,171	133,825	93,948	1,273,944
Financial liabilities				
Due to credit institutions and Central Bank	5,000	-	-	5,000
Deposits	655,476	-	-	655,476
Borrowings *	356,637	-	-	356,637
Subordinated liabilities *	35,088	-	-	35,088
Derivatives	-	-	4,974	4,974
Derivatives used for hedge accounting	-	-	903	903
Other financial liabilities	8,685	-	-	8,685
Financial liabilities	1,060,886	-	5,877	1,066,763

* Including effect from hedge accounting derivatives.

Amounts are in ISK millions

23. Financial assets and financial liabilities, continued

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

2022	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
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

2021			
Financial and insurance activities	21,001	7,561	28,562
Public sector	112,824	8,325	121,149
Corporates	-	2,141	2,141
Bonds and debt instruments at fair value	133,825	18,027	151,852

The total amount of pledged bonds was ISK 3.6 billion at the end of the year (31.12.2021: ISK 8.6 billion). Pledged bonds comprised Icelandic Government Bonds and Financial Institutions Bonds that were pledged against funding received and included in Due to credit institutions and Central Bank as well as short positions included in Financial liabilities at fair value.

24. 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

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

Amounts are in ISK millions

24. Fair value hierarchy, continued

2021

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

Transfers from Level 1 to Level 2 amounted to ISK 1,098 million during the year. There was no transfer from Level 2 to Level 1 (2021: Transfers from Level 1 to Level 2 ISK 172 million and transfers from Level 2 to Level 1 ISK 122 million).

Fair value of assets and liabilities

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

Methods for establishing fair value

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

In some cases, the carrying value of an asset in Note 23 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

24. Fair value hierarchy, continued

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

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

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

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

Movements in Level 3 assets measured at fair value

	Investment	Financial assets		
2022	property	Bonds	Shares	Total
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
2021				
Balance at the beginning of the year	6,132	358	1,685	8,175
Net fair value changes	545	12	664	1,221
Additions	15	301	1,655	1,971
Disposal	(132)	(574)	(196)	(902)
Balance at the end of the year	6,560	97	3,808	10,465

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

2022				
Net financial income	-	6	135	141
Other operating income	24	-	-	24
Effects recognized in the Income Statement	24	6	135	165
2021				
Net financial income	-	12	664	676
Other operating income	573	-	-	573
Effects recognized in the Income Statement	573	12	664	1,249

Amounts are in ISK millions

24. Fair value hierarchy, continued

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

2022	Carrying value	Fair value	Unrealized gain (loss)
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	8,667	8,667	-
Financial assets not carried at fair value	1,253,043	1,185,957	(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	381,426	11,137
Subordinated liabilities	47,331	48,310	(979)
Other financial liabilities	10,099	10,099	-
Financial liabilities not carried at fair value	1,217,051	1,206,893	10,158
2021			
Financial assets not carried at fair value			
Cash and balances with Central Bank	69,057	69,057	-
Loans to credit institutions	30,272	30,272	-
Loans to customers	936,237	937,179	942
Other financial assets	12,721	12,721	-
Financial assets not carried at fair value	1,048,287	1,049,229	942
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	5,000	5,000	-
Deposits	655,476	655,476	-
Borrowings	356,637	367,470	(10,833)
Subordinated liabilities	35,088	35,590	(502)
Other financial liabilities	8,685	8,685	-
Financial liabilities not carried at fair value	1,060,886	1,072,221	(11,335)

Loans to customers largely bear variable interest rates. Those loans, including corporate loans, are presented at book value as they generally have a short duration and very limited interest rate risk. Loans with fixed interest rates, mainly 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 value	Fair value	
2022		Assets	Liabilities
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
2021			
Forward exchange rate agreements	59,089	229	444
Fair value hedge of interest rate swap	190,095	1,100	903
Interest rate and exchange rate agreements	51,426	692	874
Bond swap agreements	10,947	359	20
Share swap agreements	31,029	348	3,530
Options - purchased agreements, unlisted	22	177	106
Options - purchased agreements, listed	16	-	-
Derivatives	342,624	2,905	5,877

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

24. 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 32, arising from changes in interest rates. On 1 January 2018 the Group adopted IFRS 9, but has elected to continue to apply the hedge accounting principles under IAS 39. For further information about the Group's hedge accounting policy, see Note 59.

2022	Notional	Maturity date	Fair value Assets	Fair value Liabilities	Gain (loss) on FV changes
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)
2021					
Interest rates swaps - EUR	-	-	-	-	(122)
Interest rates swaps - EUR	44,280	1-5 years	802	-	(463)
Interest rates swaps - EUR	44,280	1-5 years	-	151	(301)
Interest rates swaps - USD	12,975	1-5 years	298	-	(526)
Interest rates swaps - EUR	44,280	1-5 years	-	350	(388)
Interest rates swaps - EUR	44,280	1-5 years	-	402	(462)
			1,100	903	(2,262)

Hedged borrowings and subordinated liabilities

2022	Book value	Accumulated fair value Assets	Accumulated fair value Liabilities	Gain (loss) on FV changes
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
2021				
EUR 500 million - issued 2017/18 - 5 years	-	-	-	(106)
EUR 300 million - issued 2018 - 5 years	41,491	119	-	461
EUR 300 million - issued 2020 - 4 years	44,021	293	-	306
USD 100 million - issued 2020 - Perpetual	13,224	-	82	526
EUR 300 million - issued 2021 - 5 years	43,624	382	-	391
EUR 300 million - issued 2021 - 4 years	43,681	455	-	468
Hedged borrowings and subordinated liabilities	186,041	1,249	82	2,046

The effectiveness of each hedge is measured regularly with linear regression. The relationship between fair value changes of an interest rate swap on the one hand and a borrowing on the other hand is examined. In all cases the effectiveness is within limits, or between 84-100%.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

25. Offsetting financial assets and financial liabilities

Financial assets subject to enforceable master netting arrangements and similar arrangements

2022	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 arrangements	Total assets recognized on Balance Sheet, net
Reverse repurchase agreements	17,781	(10,212)	7,569	10,212	-	17,781	-	7,569
Derivatives	842	-	842	(42)	-	800	8,674	9,516
Total assets	18,623	(10,212)	8,411	10,170	-	18,581	8,674	17,085
2021								
Reverse repurchase agreements	8,560	(720)	7,840	720	-	8,560	-	7,840
Derivatives	1,689	-	1,689	(830)	-	859	1,216	2,905
Total assets	10,249	(720)	9,529	(110)	-	9,419	1,216	10,745

Financial liabilities subject to enforceable master netting arrangements and similar arrangements

2022	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 arrangements	Total liabilities recognized on balance sheet
Repurchase agreements	-	(10,212)	(10,212)	10,212	-	-	-	(10,212)
Derivatives	18,298	-	18,298	(42)	-	18,256	2,689	20,987
Total liabilities	18,298	(10,212)	8,086	10,170	-	18,256	2,689	10,775
2021								
Repurchase agreements	-	(720)	(720)	720	-	-	-	(720)
Derivatives	2,000	-	2,000	(830)	-	1,170	3,877	5,877
Total liabilities	2,000	(720)	1,280	(110)	-	1,170	3,877	5,157

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

26. Investments in associates

	2022	2021
Carrying amount at the beginning of the year	668	891
Acquisitions / increased share capital	90	111
Disposals	(241)	(356)
Share of profit of associates and profit from sale	270	22
Investment in associates	787	668

The Group's interest in its principal associates

Bílafrágangur ehf., Lágmúli 5, Reykjavík, Iceland	33.4%	-
Háblær ehf., Sudurlandsbraut 18, Reykjavík, Iceland	49.0%	-
Reiknistofa bankanna hf., Katrínartún 2, Reykjavík, Iceland	23.0%	23.0%
SER eignarhaldsfélag ehf., Borgartún 19, Reykjavík	35.3%	35.3%
Audkenni hf., Borgartún 31, Reykjavík, Iceland	-	25.4%

Arion Bank sold its entire shareholding in Audkenni hf. The sale generated a profit of ISK 152 million and is recognized in the Income Statement. In March 2022 Arion Bank invested in Bílafrágangur ehf. and holds a 33.4% shareholding.

In 2022 the subsidiary Eignabjarg ehf. invested in the associated company Háblær ehf.

Amounts are in ISK millions

27. 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

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
2021					
Balance at the beginning of the year	669	2,383	667	5,970	9,689
Additions	-	-	-	844	844
Additions, capitalized salaries	-	-	-	161	161
Amortization	-	-	(60)	(1,171)	(1,231)
Intangible assets	669	2,383	607	5,804	9,463

Goodwill related to the insurance operation is recognized among assets in the operating segments Corporate & Investment Banking and Retail Banking (2021: recognized in the operating segment Vördur) 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 2022 (2021: nil).

	2022		2021	
Discount and growth rates	Discount rates	Growth rates	Discount rates	Growth rates
Asset Management operation	14.3%	4.0%	13.0%	2.5%
Insurance operation	14.3%	4.0%	13.0%	2.5%

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28. Tax assets and tax liabilities

	2022		2021	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	8,471	-	6,543
Deferred tax	135	1,832	2	559
Tax assets and tax liabilities	135	10,303	2	7,102

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

	2022 Assets	2022 Liabilities	2021 Assets	2021 Liabilities
Foreign currency denominated assets and liabilities	-	-	2	-
Investment property and property and equipment	-	(999)	-	(728)
Financial assets	-	(510)	562	-
Other assets and liabilities	27	(294)	57	(259)
Deferred tax related to foreign exchange gain	2	(80)	-	(191)
Tax loss carry forward	157	-	-	-
	186	(1,883)	621	(1,178)
Set-off of deferred tax assets together with tax liabilities of the same taxable entities	(51)	51	(619)	619
Deferred tax assets and tax liabilities	135	(1,832)	2	(559)

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.

The Group has ISK 12 million (31.12.2021: ISK 235 million) of tax losses carried forward which is not reflected in a tax asset by the Group. These losses relate to subsidiaries that have a history of losses and may not be used to offset taxable income elsewhere in the Group. The subsidiaries neither have any taxable temporary difference nor any tax planning opportunities available that could partly support the recognition of these losses as deferred tax assets. On this basis, the Group has determined that it cannot recognize deferred tax assets on the tax losses carried forward. If the Group was able to recognize all unrecognized deferred tax assets, profit and equity would have increased by ISK 2 million (2021: ISK 47 million).

Changes in deferred tax assets and tax liabilities

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)

2021	At 1 Jan.	Recognized through equity	Recognized in profit or loss	At 31 Dec.
Foreign currency denominated assets and liabilities	26	-	(24)	2
Investment property and property and equipment	(542)	-	(186)	(728)
Financial assets	613	-	(51)	562
Other assets and liabilities	(120)	350	(432)	(202)
Deferred foreign exchange differences	(438)	-	247	(191)
Change in deferred tax assets and tax liabilities	(461)	350	(446)	(557)

Amounts are in ISK millions

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

Assets and disposal groups held for sale	2022	2021
Valitor hf.	-	12,294
Stakksberg ehf.	-	1,548
Sólbjarg ehf.	-	1,671
Disposal groups held for sale	-	15,513
Real estate	61	500
Other assets	-	34
Assets and disposal groups held for sale	61	16,047

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

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

Valitor hf.

Arion Bank's shareholding in the subsidiary Valitor hf. was 100%. In accordance with IFRS 5 Non-current assets and disposal groups held for sale, Valitor was classified as asset held for sale in these Consolidated Financial Statements. In 2022 Arion Bank sold its entire shareholding in Valitor with a profit of ISK 5.6 billion, post cost of sale, which is recognised in the Income Statement.

Stakksberg ehf., a subsidiary of Eignabjarg ehf.

Stakksberg ehf. is a company owned by Arion Bank, which in early 2018 took over the operations of the silicon plant at Helguvík following the bankruptcy of the previous owner, United Silicon hf. Since then Stakksberg has devised a remedial action plan for the plant and has sought suitable buyers able to operate the plant in a responsible manner. After consulting the appropriate authorities, a new environmental impact assessment based on the remedial action plan was completed and the plant attracted considerable interest from investors. Arion Bank has always stipulated that prospective buyers had to be dependable companies with extensive experience of operating silicon plants.

At the beginning of 2022 the Bank entered exclusive talks with PCC which has operated a silicon plant at Bakki in northern Iceland and maintained good relations with the local community. The Bank believed that PCC possessed the necessary expertise and experience to successfully run the plant at Helguvík. Representatives of PCC and Arion Bank agreed that a prerequisite for recommencing silicon production at Helguvík was that it would be done with the consent of the authorities and residents of Reykjanesbær. After having presented its ambitious plans to various stakeholders, PCC concluded that there was not a basis to continue negotiations on the acquisition by PCC of the silicon plant.

As a result, Arion Bank considers it unlikely that the plant will be restarted for silicon production and will now seek to sell the existing infrastructure at Helguvík, either to be transported elsewhere and/or to be used for the purpose of developing other activities at the site. Discussions are being held with several prospective parties, both Icelandic and international. As this is now considered a development plot and not a sale of a silicon metal plant, Stakksberg's main assets, the plot of land and industrial facilities at Helguvík, were transferred to Landey, Arion Bank's real estate development company, at the end of the year. These assets were correspondingly revalued as such and are now valued at ISK 1,230 million within Landey. Remaining assets within Stakksberg are mostly raw materials and other minor operating assets which are valued at zero.

Sólbjarg ehf., a subsidiary of Eignabjarg ehf.

Sólbjarg ehf. is a holding company of the former TravelCo hf. tour operator group which included Terra Nova Sól ehf., Heimsferdir ehf. and TravelCo Nordic/Bravo Tours. In the first quarter of 2020 Sólbjarg completed the sale of Terra Nova Sól ehf., in the fourth quarter the sale of its 59.4% share in the Danish operator Bravo Tours 1998 A/S and in the second quarter of 2022 the sale of all operations, brand, and domain of Heimsferdir ehf. Sólbjarg is a minority shareholder in Ferdaskrifstofa Íslands ehf. through its ownership in Heimbjarg ehf. (former Heimsferdir ehf.). The holding is held for sale with zero book value.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

30. Other assets

	2022	2021
Property and equipment	3,787	4,298
Right of use asset	745	823
Accounts receivable	5,255	5,104
Unsettled securities trading	860	5,113
Investment for life assurance policyholders where risk is held by policyholder	117	1,281
Sundry assets	3,459	3,282
Other assets	14,223	19,901

Property and equipment	Real estate	Equip- ment	Total 2022	Total 2021
Gross carrying amount at the beginning of the year	3,967	7,977	11,944	12,072
Additions	-	357	357	583
Disposals	(433)	(89)	(522)	(711)
Gross carrying amount at the end of the year	3,534	8,245	11,779	11,944
Accumulated depreciation at the beginning of the year	(1,883)	(5,764)	(7,647)	(7,281)
Depreciation	(79)	(426)	(505)	(565)
Disposals	112	48	160	200
Accumulated depreciation at the end of the year	(1,850)	(6,142)	(7,992)	(7,646)
Property and equipment	1,684	2,103	3,787	4,298

The official real estate value (Registers Iceland) amounted to ISK 4,152 million at the end of the year (2021: ISK 4,097 million) and the insurance value amounts to ISK 7,680 million (2021: ISK 7,489 million).

Right-of-use asset	2022	2021
Balance at the beginning of the year	823	754
New lease agreements	213	185
Lease agreements terminated	(215)	-
Indexation	41	18
Depreciation	(117)	(134)
Right-of-use asset	745	823

31. Other liabilities

Accounts payable	1,013	818
Unsettled securities trading	1,844	1,259
Depositors' and Investors' Guarantee Fund	-	138
Technical provision	21,023	18,170
Technical provision for life assurance policyholders were investment risk is held by policyholder	117	1,281
Withholding tax	2,637	810
Bank levy	1,761	1,516
Accrued expenses	4,776	4,200
Prepaid income	1,590	1,476
Impairment of off-balance items	449	711
Lease liability	970	878
Sundry liabilities	6,793	5,894
Other liabilities	42,973	37,151

Amounts are in ISK millions

31. Other liabilities, continued

Technical provision	Technical provision	Reinsurers' share	Total 2022	Technical provision	Reinsurers' share	Total 2021
Claims reported and loss adjustment expenses	10,455	(371)	10,084	9,473	(110)	9,363
Claims incurred but not reported	3,168	(90)	3,078	2,021	(64)	1,957
Claims outstanding	13,623	(461)	13,162	11,494	(174)	11,320
Provision for unearned premiums	7,400	(15)	7,385	6,676	(12)	6,664
Own technical provision	21,023	(476)	20,547	18,170	(186)	17,984

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

Lease liability	2022	2021
Balance at the beginning of the year	878	787
New and amended lease agreements	215	183
Lease agreements terminated	(34)	-
Indexation	69	31
Interest expense	31	20
Lease payments	(189)	(143)
Lease liability	970	878

32. Borrowings

Currency, original nominal value	First issued	Maturity	Maturity type	Terms of interest		
ARION CB 22, ISK 31,720 million	2015	2022	At maturity	Fixed, 6.50%	-	31,508
ARION CB 24 ISK 28,900 million	2019	2024	At maturity	Fixed, 6.00%	25,736	26,004
ARION CBI 25, ISK 37,940 million	2017	2025	At maturity	Fixed, CPI linked, 3.00%	47,184	43,341
ARION CBI 26 ISK 17,080 million	2019	2026	At maturity	Fixed, CPI linked, 2.00%	19,219	17,747
ARION CBI 29, ISK 27,200 million	2014	2029	At maturity	Fixed, CPI linked, 3.50%	35,602	29,902
ARION CBI 48, ISK 11,680 million	2018	2048	Amortizing	Fixed, CPI linked, 2.50%	11,828	11,017
ARION CB EUR 500 million *	2021	2026	At maturity	Fixed, EUR 0.05%	66,231	43,624
ARION CB 27, ISK 8,100 million	2022	2027	At maturity	Fixed, 5.50%	7,058	-
Statutory covered bonds					212,858	203,143
NOK 750 million	2019	2022	At maturity	Floating, NIBOR +1.82%	-	11,096
SEK 150 million	2019	2022	At maturity	Floating, 3 month STIBOR +1.33%	-	2,159
NOK 250 million	2017	2023	At maturity	Fixed, 3.02%	3,671	3,757
EUR 300 million *	2018	2023	At maturity	Fixed, 1.00%	20,672	41,491
EUR 300 million *	2020	2024	At maturity	Fixed, 0.625 %	43,181	44,021
NOK 250 million	2017	2027	At maturity	Fixed, 3.40%	3,680	3,766
EUR 300 million Green *	2021	2025	At maturity	Fixed, 0.375%	41,404	43,680
ARION 26 1222 Green (ISK 5,760m)	2021	2026	At maturity	Fixed, 4.70%	5,382	3,524
ARION 24 1020 Green (ISK 6,020m)	2022	2024	At maturity	Floating, REIBOR 3M +0.70%	6,062	-
EUR 300 million Green *	2022	2024	At maturity	Fixed, 4.875%	44,557	-
NOK 550 million	2022	2025	At maturity	Floating, OIBOR 3M +2.35%	7,952	-
SEK 230 million	2022	2025	At maturity	Floating, STIBOR 3M +2.35%	3,144	-
Senior unsecured bonds					179,705	153,494
Borrowings					392,563	356,637

* The Group applies fair value hedge accounting to these bond issuances and uses certain foreign currency denominated interest rate swaps as hedging instruments, see Note 24.

The book value of listed bonds was ISK 393 billion at the end of the year (31.12.2021: ISK 357 billion). The market value of those bonds was ISK 381 billion (31.12.2021: ISK 367 billion). The Group repurchased own debts amounting to ISK 28 billion during the year with a net gain of ISK 14 million recognized in the Income Statement (2021: nil).

Amounts are in ISK millions

33. Subordinated liabilities

Currency, original nominal value	Issued	Maturity	First call date	Terms of interest	2022	2021
SEK 500 million	2018	2028	22 Nov '23	Floating, 3 month STIBOR +3.10%	6,822	7,174
NOK 300 million	2019	2029	9 Jul '24	Floating, NIBOR +3.65%	4,383	4,461
SEK 225 million	2019	2029	20 Dec '24	Floating, 3 month STIBOR +3.70%	3,066	3,232
ARION T2I 30 ISK 4,800 million	2019	2030	4 Jan '25	Fixed, CPI linked, 3.875%	5,841	5,337
ARION T2 30 ISK 880 million	2019	2030	4 Jan '25	Fixed, 6.75%	908	907
EUR 5 million	2019	2031	6 Mar '26	Fixed, 3.24%	772	752
ARION T2I 33 9,860 million	2022	2033	15 Dec '28	Fixed, CPI linked, 4.95%	9,894	-
ARION T2 33 2,240 million	2022	2033	15 Dec '28	Fixed, 9.25%	2,249	-
Tier 2 subordinated liabilities					33,935	21,863
ARION AT1 USD 100 million *	2020	Perpetual	26 Mar '25	Fixed, 6.25%	13,396	13,225
Additional Tier 1 subordinated liabilities					13,396	13,225
Subordinated liabilities					47,331	35,088

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

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

34. Liabilities arising from financial activities

2022	At 1 Jan.	Cash flows	Non-cash changes: Interest expenses	Non-cash changes: Foreign exchange	Non-cash changes: Effect from hedge	At 31 Dec.
Covered bonds in ISK - CPI linked	102,007	(814)	12,640	-	-	113,833
Covered bonds in ISK	57,512	(27,114)	2,396	-	-	32,794
Covered bonds in FX	43,624	26,690	386	2,515	(6,984)	66,231
Senior unsecured bonds in FX	149,970	17,949	2,044	4,278	(5,980)	168,261
Senior unsecured bonds in ISK	3,524	7,359	561	-	-	11,444
Subordinated bond CPI T2 linked	5,337	9,651	747	-	-	15,735
Subordinated bond T2 ISK	907	2,182	68	-	-	3,157
Subordinated bond T2 FX	15,619	(596)	643	(623)	-	15,043
Subordinated bond AT1 FX	13,225	(867)	880	1,149	(991)	13,396
Liabilities arising from financial activities	391,725	34,440	20,365	7,319	(13,955)	439,894

35. Pledged assets

Pledged assets against liabilities	2022	2021
Assets, pledged as collateral against borrowings	328,811	287,449
Assets, pledged as collateral against loans from the Central Bank, credit institutions and short positions	3,591	8,560
Pledged assets against liabilities	332,402	296,009
Thereof pledged assets against issued covered bonds held by the Bank	(70,850)	(43,182)
Assets against repoed issued bonds	17,029	864
Pledged assets against liabilities on balance	278,581	253,691

The Group has pledged assets against borrowings, both issued covered bonds and other issued bonds and loan agreements. Pledged loans comprised mortgage loans to individuals. The book value of the borrowings was ISK 213 billion at period end (31.12.2021: ISK 203 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 45 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 (31.12.2021: ISK 35 billion). Pledged assets against those covered bonds are ISK 54 billion (31.12.2021: ISK 42 billion).

Amounts are in ISK millions

36. Equity

Share capital and share premium

According to the Bank's Articles of Association, total share capital amounts to ISK 1,510 million, with par value of ISK 1 per share. The holders of ordinary shares are entitled to receive dividends as approved by the AGM and are entitled to one vote per share at shareholders' meetings.

	Share capital	Own shares	Share premium	Total 2022	Share capital	Own shares	Share premium	Total 2021
Balance at the beginning of the year ...	1,660	(142)	21,166	22,684	1,730	(11)	49,612	51,331
Share capital reduction	(150)	150	-	-	(70)	70	-	-
Purchase of treasury shares	-	(58)	(9,793)	(9,851)	-	(201)	(28,446)	(28,647)
Share option vested	-	4	349	354	-	-	-	-
Incentive scheme	-	1	184	185	-	-	-	-
Balance at the end of the year	1,510	(45)	11,907	13,372	1,660	(142)	21,166	22,684
Own shares / issued share capital		3.01%				8.54%		

In accordance with the Bank's dividend policy and based on a share buyback programs authorized by the Financial Supervisory Authority of the Central Bank of Iceland (FSA) Arion Bank bought back own shares for ISK 9,851 million in 2022. On 5 September 2022 the FSA authorized a buyback program which amounts up to a total of 57.3 million shares or up to ISK 10 billion. In 2022 Arion Bank management decided to launch 70% of the buyback program and approved by the Board of Directors. The Program will end no later than 15 March 2023. Based on a share buyback program authorized by the FSA and which was launched in October 2021, Arion Bank bought back own shares for ISK 4,269 million during the first quarter of 2022. In March 2022 the programme was concluded. Buybacks in 2021 were based on authorisation from the FSA from 2020 and 2021.

At the AGM in March 2022 a motion was passed to reduce the Bank’s share capital by ISK 150 million at nominal value, totalling 150 million shares, by cancelling the company’s own shares. The reduction was effective 4 April 2022. The company’s share capital was reduced from ISK 1,660 million to ISK 1,510 million at nominal value, divided into an equal number of shares and with one vote attached to each share. At the AGM in March 2021 a motion was passed to reduce the Bank’s share capital by ISK 70 million. The reduction was effective 20 April 2021.

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	13,520	2023-2026	95.5
Issued in 2022 (ISK 900,000) - employees of Arion Bank	10,620	2023-2026	181.7
Issued in 2022 (ISK 1,500,000) - employees of Arion Bank	4,425	2023-2026	181.7
Issued in 2022 (ISK 1,500,000) - employees of subsidiaries	2,317	2023-2026	170.9
	30,882		

Amounts are in ISK millions

36. Equity, continued

Movements in share options during the year.	2022		2021	
	Number of shares (in ths.)	Weighted average contract rate	Number of shares (in ths.)	Weighted average contract rate
Outstanding at the beginning of the year	19,728	95.5	-	-
Share options granted	17,362	180.3	19,728	95.5
Share options forfeited	(2,916)	95.5	-	-
Share options exercised - weighted average share price of ISK 187.6 at date of exercise	(3,292)	95.5	-	-
Outstanding share options at the end of the year	30,882	143.2	19,728	95.5

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

All outstanding share options, if exercised, represent approximately 2.0% of the total issued shares.

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

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

Warrants

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

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

Other information

37. Shareholders of Arion Bank

	2022	2021
Gildi lífeyrissjóður	9.77%	8.83%
Lífeyrissjóður starfsmanna ríkisins	9.53%	9.10%
Lífeyrissjóður verzlunarmanna	9.14%	8.81%
Stodir hf.	5.20%	4.73%
Stefnir funds	4.05%	2.88%
Brú lífeyrissjóður	3.69%	2.35%
Birta lífeyrissjóður	3.47%	3.16%
Frjálsi lífeyrissjóðurinn	3.17%	2.88%
Stapi lífeyrissjóður	3.02%	2.71%
Arion banki hf.	3.01%	8.54%
Hvalur hf.	2.44%	2.22%
Íslandsbanki hf.	2.38%	2.22%
Vanguard	2.27%	0.00%
Festa lífeyrissjóður	1.92%	1.23%
Kvika banki hf.	1.82%	2.20%
Almenni lífeyrissjóður	1.47%	1.33%
Landsbréf hf.	1.43%	0.97%
Landsbankinn hf.	1.21%	0.70%
Lífsverk Pension fund	1.08%	1.07%
Sjóvá tryggingar	1.00%	0.78%
Kvika Asset Management	0.87%	1.31%
Akta sjóðir	0.15%	0.91%
MainFirst Bank AG	0.00%	1.19%
Bóksal ehf.	0.00%	1.26%
Other shareholders with less than 1% shareholding	27.94%	28.62%
	100.0%	100.0%

At the end of the year the Group's employees held a shareholding of 0.65% in Arion Bank (31.12.2021: 0.51%). The Board of Directors and the members of the Bank's Executive Committee shareholding is as follows:

	2022		2021	
	Warrants / options	Number of shares	Warrants / options	Number of shares
Steinunn Kristín Thórdardóttir, Director	-	12,000	-	12,000
Alternate directors of the Board	-	13,000	-	13,000
Benedikt Gíslason, CEO	1,006,482	2,506,283	992,953	2,300,000
Eight members of the Executive Committee (2021: eight)	4,945,258	787,751	4,482,724	1,633,076

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

Amounts are in ISK millions

38. 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.

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 will appeal the judgement. Considering the District Court’s judgement as well as an outside opinion commissioned by the Bank on its legal position the Bank has not made any provision.

Administrative fine from Central Bank of Iceland

On 7 July 2020 the Financial Supervisory Authority of the Central Bank of Iceland (FSA) published its decision to impose an administrative fine on Arion Bank of ISK 87.7 million due to the Bank’s alleged breach of an obligation to disclose insider information in a timely manner. The decision was published on FSA´s website. Arion Bank paid the fine but filed a claim with the district court of Reykjavik in October 2020 demanding that FSA’s decision be annulled. With a judgment in April 2022 FSA was acquitted. The Bank has appealed the ruling.

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.

39. 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.

Notes to the Consolidated Financial Statements

Off balance sheet information

40. Commitments

Financial guarantees, unused credit facilities and undrawn loan commitments	2022	2021
Financial guarantees	20,312	15,858
Unused overdrafts	57,259	63,108
Undrawn loan commitments	105,888	108,691
Financial guarantees, unused credit facilities and undrawn loan commitments	183,459	187,657

41. Assets under management and under custody

Assets under management	1,298,289	1,351,573
Assets under custody	1,067,052	1,148,203

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

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

Related party

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

The key management personnel includes the Board of Directors and the Executive Committee of Arion Bank, as are their close family members and legal entities controlled by them. For compensation, pension and other transactions with the Board of Directors and the Executive Committee, see Notes 12 and 37.

For information on the associated companies, see Note 26.

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	
	2022	2021	2022	2021
Loans	64	138	71	-
Other assets	2	1	-	530
Total assets	66	139	71	530
Deposits	(1,111)	(279)	(155)	(10)
Other liabilities	-	(4)	(27)	(301)
Total liabilities	(1,111)	(284)	(182)	(311)
Interest income	10	25	1	-
Interest expenses	(13)	(1)	(2)	(1)
Commission income	14	328	1	-
Commission expenses	-	-	(101)	(308)
Other income	-	92	-	-
Other expenses	(2)	-	(1,414)	(1,471)
Net income	9	444	(1,515)	(1,780)

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

Risk management disclosures

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

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

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

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

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

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

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

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

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

43. Credit risk

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

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

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

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

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

Exposure to credit risk

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

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

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

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

Notes to the Consolidated Financial Statements

43. 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				
2022	Maximum exposure	Cash and securities	Real estate	Vessels	Other collateral	Total collateral
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	26,494	798,632	51,751	105,483	982,360
Individuals	*582,371*	*517*	*531,783*	*16*	*18,960*	*551,276*
Mortgages	*513,605*	*9*	*513,564*	*-*	*32*	*513,605*
Other	*68,766*	*508*	*18,219*	*16*	*18,928*	*37,671*
Corporates	*502,386*	*25,977*	*266,849*	*51,735*	*86,523*	*431,084*
Real estate activities	*105,304*	*916*	*101,801*	*-*	*368*	*103,085*
Construction	*55,208*	*211*	*41,181*	*47*	*2,493*	*43,932*
Fishing industry	*91,427*	*1,126*	*14,306*	*49,535*	*13,038*	*78,005*
Information and communication technology	*24,622*	*110*	*1,441*	*-*	*14,822*	*16,373*
Wholesale and retail trade	*85,005*	*30*	*51,741*	*-*	*26,856*	*78,627*
Financial and insurance activities	*41,378*	*23,059*	*6,423*	*-*	*7,470*	*36,952*
Industry, energy and manufacturing	*44,154*	*295*	*25,658*	*-*	*13,243*	*39,196*
Transportation	*14,058*	*87*	*1,128*	*1,043*	*3,199*	*5,457*
Services	*19,155*	*132*	*11,049*	*1,104*	*3,975*	*16,260*
Public sector	*10,576*	*11*	*2,107*	*6*	*173*	*2,297*
Agriculture and forestry	*11,499*	*-*	*10,014*	*-*	*886*	*10,900*
Other assets with credit risk	8,667	-	-	-	-	-
Financial guarantees	20,312	2,378	3,872	37	3,288	9,575
Undrawn loan commitments and unused overdrafts	163,147	-	-	-	-	-
Fair value through OCI	115,806	-	-	-	-	-
Government bonds	*96,908*	-	-	-	-	-
Bonds issued by financial institutions and corporates	*18,898*	-	-	-	-	-
Balance at the end of the year	1,550,240	28,872	802,504	51,788	108,771	991,935

2021	Maximum exposure	Cash and securities	Real estate	Vessels	Other collateral	Total collateral
Cash and balances with Central Bank	69,057	-	-	-	-	-
Loans to credit institutions at amortized cost	28,156	-	-	-	-	-
Loans to customers at amortized cost	936,237	29,159	704,442	42,797	85,030	861,428
Individuals	*526,498*	*712*	*481,088*	*15*	*15,139*	*496,954*
Mortgages	*463,458*	*22*	*463,402*	*-*	*34*	*463,458*
Other	*63,040*	*690*	*17,686*	*15*	*15,105*	*33,496*
Corporates	*409,739*	*28,447*	*223,354*	*42,782*	*69,891*	*364,474*
Real estate activities	*90,321*	*329*	*87,256*	*-*	*1,752*	*89,337*
Construction	*37,010*	*486*	*33,597*	*48*	*1,876*	*36,007*
Fishing industry	*78,094*	*1,967*	*12,850*	*40,999*	*21,056*	*76,872*
Information and communication technology	*16,736*	*939*	*1,219*	*-*	*1,684*	*3,842*
Wholesale and retail trade	*65,298*	*154*	*49,874*	*29*	*9,107*	*59,164*
Financial and insurance activities	*45,798*	*24,433*	*1,814*	*-*	*12,877*	*39,124*
Industry, energy and manufacturing	*27,919*	*7*	*15,206*	*-*	*11,040*	*26,253*
Transportation	*14,162*	*-*	*1,556*	*1,556*	*3,395*	*6,507*
Services	*17,269*	*119*	*8,559*	*143*	*6,235*	*15,056*
Public sector	*6,918*	*13*	*2,120*	*7*	*193*	*2,333*
Agriculture and forestry	*10,214*	*-*	*9,303*	*-*	*676*	*9,979*
Other assets with credit risk	12,721	-	-	-	-	-
Financial guarantees	15,858	1,184	5,618	41	3,888	10,731
Undrawn loan commitments and unused overdrafts	171,799	-	-	-	-	-
Fair value through OCI	133,825	-	-	-	-	-
Government bonds	*112,824*	-	-	-	-	-
Bonds issued by financial institutions and corporates	*21,001*	-	-	-	-	-
Balance at the end of the year	1,367,653	30,343	710,060	42,838	88,918	872,159

Amounts are in ISK millions

43. 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). As of 30.9.2022, the Bank has adopted a new real estate valuation model, which replaces the government tax value and is used when the observed market value becomes older than 2 years. The new model gives an estimate of current value on a monthly basis.

			Thereof credit impaired loans	
	2022	2021	2022	2021
Less than 50%	172,790	90,080	1,817	831
50-60%	91,201	57,359	511	594
60-70%	90,224	95,531	826	989
70-80%	86,856	123,985	408	1,084
80-90%	69,629	89,446	429	663
90-100%	2,111	3,902	153	303
More than 100%	1,171	3,559	118	75
Not classified	25	33	-	-
Gross carrying amount at the end of the year	514,007	463,895	4,262	4,539

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 credit impaired loans	
	2022	2021	2022	2021
Less than 55%	429,186	357,042	3,530	3,319
55-70%	64,839	79,505	507	819
70-80%	15,424	20,989	128	237
80-90%	3,743	4,579	62	106
90-100%	503	854	19	47
More than 100%	287	893	16	11
Not classified	25	33	-	-
Gross carrying amount at the end of the year	514,007	463,895	4,262	4,539

Collateral for financial assets in stage 3

At the end of the year, the gross carrying amount of assets in stage 3 was ISK 12,903 million (31.12.2021: ISK 17,703 million) with ISK 10,627 million in collateral (31.12.2021: ISK 14,421 million), thereof ISK 9,434 million in real estate (31.12.2021: 12,875 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 is nil (31.12.2021: ISK 422 million) and nil in other assets (31.12.2021: ISK 34 million). The assets are held for sale, see Note 29.

Amounts are in ISK millions

43. Credit risk, continued

Large exposures

A large exposure is defined as an exposure to a group of financially related borrowers which is equal to or exceeds 10% of the Group's Tier 1 capital according to the Financial Undertakings Act No. 161/2002. The legal maximum for individual large exposures is 25% of Tier 1 capital, net of eligible credit risk mitigation.

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

	2022		2021	
No.	Gross	Net	Gross	Net
1	11.5%	11.5%	<10%	<10%
2	10.3%	10.3%	11.5%	11.4%
Sum of large exposure gross and net > 10%	21.8%	21.8%	11.5%	11.4%

Credit quality

The Group uses internal credit ratings and external credit ratings, if available, to monitor credit risk. The Group's internal credit rating system rates customers through application of statistical models based on a variety of information that has been determined to be predictive of default. This includes demographic, behavioral, financial and economic data, coupled with qualitative expert judgment for large corporate exposures. Six exposure type models rate individuals' exposures – mortgages, consumer loans, auto loans, guarantees, loans to individuals for work purposes and other loans. The models are validated annually and recalibrated and updated with current data with the aim of maintaining their predictive power. Year-on-year changes in risk classification of loans may in part be due to model refinement. External ratings are primarily used for marketable securities and loans to credit institutions. For further information on the rating scales used, see Note 58.

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

43. Credit risk, continued

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

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

43. Credit risk, continued

2021	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	69,057	28,125	133,838
Non-investment grade	-	31	-
Gross carrying amount	69,057	28,156	133,838
Loss allowance	-	-	(13)
Book value	69,057	28,156	133,825

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

Amounts are in ISK millions

43. 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		
2022	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Book value
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

2021							
Loans to credit instit., securities & cash	231,051	(13)	-	-	-	-	231,038
Loans to individuals	508,428	(490)	13,777	(246)	6,181	(1,152)	526,498
Mortgages	*450,305*	*(127)*	*9,055*	*(84)*	*4,536*	*(228)*	*463,457*
Other	*58,123*	*(363)*	*4,722*	*(162)*	*1,645*	*(924)*	*63,041*
Loans to corporates	352,500	(823)	51,429	(1,560)	11,522	(3,329)	409,739
Real estate activities	*80,318*	*(160)*	*7,092*	*(45)*	*3,472*	*(356)*	*90,321*
Construction	*34,382*	*(49)*	*2,411*	*(24)*	*317*	*(27)*	*37,010*
Fishing industry	*69,632*	*(58)*	*8,193*	*(199)*	*653*	*(127)*	*78,094*
Information and communication technology	*15,949*	*(58)*	*792*	*(39)*	*128*	*(36)*	*16,736*
Wholesale and retail trade	*46,824*	*(162)*	*17,362*	*(1,032)*	*3,420*	*(1,114)*	*65,298*
Financial and insurance activities	*37,275*	*(135)*	*8,411*	*(45)*	*733*	*(441)*	*45,798*
Industry, energy and manufacturing	*25,937*	*(49)*	*1,900*	*(10)*	*170*	*(29)*	*27,919*
Transportation	*12,474*	*(32)*	*1,065*	*(2)*	*1,649*	*(992)*	*14,162*
Services	*14,125*	*(70)*	*2,796*	*(153)*	*721*	*(150)*	*17,269*
Public Sector	*6,499*	*(29)*	*343*	*(4)*	*110*	*(1)*	*6,918*
Agriculture and forestry	*9,085*	*(21)*	*1,064*	*(7)*	*149*	*(56)*	*10,214*
Balance at the end of the year	1,091,979	(1,326)	65,206	(1,806)	17,703	(4,481)	1,167,275

Amounts are in ISK millions

43. Credit risk, continued

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

Transfers of financial assets between impairment stages

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

Net remeasurement of loss allowance

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

New financial assets, originated or purchased

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

Derecognitions and maturities

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

Write-offs

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

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.

Amounts are in ISK millions

43. Credit risk, continued

Impairment loss allowance for loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(1,313)	(1,806)	(4,480)	(1)	(7,600)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(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)	-	(1,775)

Impairment loss allowance for loans to customers - Corporates	Stage 1	Stage 2	Stage 3	POCI	Total
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	Stage 1	Stage 2	Stage 3	POCI	Total
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)

Amounts are in ISK millions

43. Credit risk, continued

2021

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

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

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

*** During the year an amount of ISK 2,059 million was written off but is still subject to enforcement activities subject to Icelandic law.

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

Impairment loss allowance for loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(1,844)	(3,305)	(6,824)	(84)	(12,057)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(1,585)	1,309	276	-	-
Transfers to Stage 2 (lifetime ECL)	190	(281)	92	(1)	-
Transfers to Stage 3 (credit impaired financial assets)	58	377	(435)	-	-
Net remeasurement of loss allowance	2,774	21	(1,164)	-	1,631
New financial assets, originated or purchased	(1,481)	(267)	(327)	-	(2,075)
Derecognitions and maturities	569	330	1,523	(289)	2,133
Write-offs	6	10	2,379	373	2,768
Total loss allowance for loans to customers	(1,313)	(1,806)	(4,480)	(1)	(7,600)

Impairment loss allowance for loans to customers - Individuals					
Balance at the beginning of the year	(807)	(395)	(1,189)	(84)	(2,475)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(614)	454	160	-	-
Transfers to Stage 2 (lifetime ECL)	112	(162)	51	(1)	-
Transfers to Stage 3 (credit impaired financial assets)	43	157	(200)	-	-
Net remeasurement of loss allowance	921	(333)	(472)	-	116
New financial assets, originated or purchased	(341)	(67)	(107)	-	(515)
Derecognitions and maturities	190	90	284	(289)	275
Write-offs	6	10	322	373	711
Total loss allowance for loans to individuals	(490)	(246)	(1,151)	(1)	(1,888)

Amounts are in ISK millions

43. 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	(1,037)	(2,910)	(5,635)	-	(9,582)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(971)	855	116	-	-
Transfers to Stage 2 (lifetime ECL)	78	(119)	41	-	-
Transfers to Stage 3 (credit impaired financial assets)	15	220	(235)	-	-
Net remeasurement of loss allowance	1,853	354	(692)	-	1,515
New financial assets, originated or purchased	(1,140)	(200)	(220)	-	(1,560)
Derecognitions and maturities	379	240	1,239	-	1,858
Write-offs	-	-	2,057	-	2,057
Total loss allowance for loans to corporates	(823)	(1,560)	(3,329)	-	(5,712)

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

Macroeconomic forecast

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

	Base case		
	2023	2024	2025
Unemployment rate	3.8%	3.8%	4.0%
Housing prices	3.3%	1.4%	4.0%
Private consumption	2.0%	2.7%	2.7%
GDP	2.1%	2.6%	2.4%

	Optimistic			Pessimistic		
	2023	2024	2025	2023	2024	2025
Unemployment rate	2.8%	3.1%	3.4%	6.7%	5.5%	4.4%
Housing prices	5.4%	4.1%	6.7%	-0.4%	-1.4%	3.1%
Private consumption	4.1%	3.5%	3.0%	-1.1%	2.9%	3.0%
GDP	3.3%	3.1%	2.6%	-0.6%	2.9%	2.6%

Sensitivity analysis

Regarding macroeconomic outlook, see Note 3, Significant accounting estimates and judgements. The Group calculates loss for three different scenarios, optimistic, neutral and pessimistic and the loss allowance is the weighted average of the results. As a sensitivity analysis, it can be noted that the loss allowance in stage 1 and 2 for each of these scenarios separately is ISK 1.8 billion, ISK 3.1 billion and ISK 8.4 billion for the optimistic, base case and pessimistic scenarios, respectively. At year end 2021 the corresponding calculated loss allowance was ISK 1.8 billion, ISK 3.3 billion and ISK 5.9 billion, respectively.

Amounts are in ISK millions

43. Credit risk, continued

Forbearance

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

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

	Stage 1		Stage 2		Stage 3		Total	
2022	Gross carrying amount	Loss allowance	Gross carrying carrying	Loss allowance	Gross carrying amount	Loss allowance	Gross carrying carrying	Loss allowance
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)
2021								
Individuals	10,972	(20)	1,962	(28)	2,695	(445)	15,629	(493)
Companies	10,912	(54)	17,440	(1,353)	7,104	(2,526)	35,456	(3,933)
Tourism	5,495	(40)	15,710	(1,148)	5,155	(2,055)	26,360	(3,243)
Other than tourism	5,417	(14)	1,730	(205)	1,949	(471)	9,096	(690)
Total	21,884	(74)	19,402	(1,381)	9,799	(2,971)	51,085	(4,426)

Groups with special focus due to the Covid-19 pandemic

At the onset of the Covid-19 pandemic, three groups of customers were identified as a focus for an assessment of the impact of the pandemic on the Group; i) Tourism; where there was a high probability of impact due to public health restrictions; ii) Customers which had active Covid-19 related payment moratoria in the quarter leading up to the reporting date; and iii) Recipients of loans through government sponsored loan schemes initiated as a consequence of the pandemic. The exposure to these groups is shown in the following table, broken down by industry sector; the last remaining Covid-19 related payment moratoria expired in Q3 2022. Also shown is the amount secured by real estate as this is the largest type of collateral for loans to customers. The same customer can be in more than one group.

31.12.2022	Tourism dependent	Covid-19 related payment moratoria	Recipient governmen sponsored loans	All focus groups	Thereof secured by real estate
Individuals	4,251	-	63	4,312	3,968
Real estate and construction	11,976	-	3,120	14,554	14,369
Services	5,659	-	2,952	6,015	2,291
Transportation	6,842	-	79	6,848	382
Industry, energy and manufacturing	134	-	285	341	91
Wholesale and retail trades	46,612	-	16,715	47,224	39,595
Other sectors	1,548	-	1,001	2,540	1,151
Gross carrying amount	77,022	-	24,215	81,834	61,847
Loss allowance	(2,152)	-	(1,331)	(2,213)	
Book value	74,870	-	22,884	79,621	
31.12.2021					
Individuals	4,212	612	161	4,917	4,535
Real estate and construction	10,545	2,627	1,176	11,058	10,870
Services	5,838	33	2,315	6,353	2,251
Transportation	8,679	-	867	8,685	358
Industry, energy and manufacturing	152	550	536	1,119	826
Wholesale and retail trades	43,766	12,588	18,336	44,527	39,681
Other sectors	1,347	-	1,065	2,409	1,282
Gross carrying amount	74,539	16,410	24,456	79,068	59,803
Loss allowance	(3,614)	(955)	(1,675)	(3,683)	
Book value	70,925	15,455	22,781	75,385	

Book value of Covid-19 impacted loans was ISK 79,621 million or 7.3% of loans to customers (31.12.2021: ISK 75,385 million and 8.1%).

Amounts are in ISK millions

44. Market risk

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

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

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

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

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

Interest rate risk

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

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

At the beginning of the Covid-19 pandemic, the Icelandic Central Bank lowered interest rates to historic lows which resulted in sharp increase in demand for non-indexed mortgages with floating rates in 2020 and first half of 2021. Inflation in Iceland, currently at 9.6%, has exceeded the Central Bank’s target of 2.5% since June 2020 and is expected to remain over the target throughout 2023. The Central Bank has responded by increasing interest rates by 525bps from its lowest value of 75bps at the start of 2021. From the second half of 2021 to the start of 2022, this resulted in a sharp increase in demand for non-indexed fixed rate mortgages with corresponding increase in interest rate risk. The risk exposure has been receding over the course of 2022 as the duration of these loans shortens.

Interest rate risk

The following table shows the Group's interest-bearing assets and liabilities by interest fixing periods. The figures for loans to customers and borrowings are shown on a fair value basis, see Note 24, and are therefore different from the amounts shown in these Consolidated Financial Statements. The fair value reflects the likelihood of prepayment. Defaulted loans are presented at book value, which is based on the value of the underlying collateral, and are therefore assumed to be independent of interest adjustment periods and placed in the 'Up to 3 months' category.

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	662,473	101,121	239,995	4,342	9,740	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	146,604	14,240	8,464	-	-	169,308
Assets	1,048,450	158,817	257,530	10,688	13,177	1,488,662
Liabilities						
Due to credit institutions and Central Bank	11,697	-	-	-	-	11,697
Deposits	753,439	1,922	-	-	-	755,361
Derivatives	153,489	23,097	6,442	-	-	183,028
Borrowings	35,373	3,411	298,896	32,446	11,300	381,426
Subordinated liabilities	-	6,819	29,387	12,104	-	48,310
Liabilities	953,998	35,249	334,725	44,550	11,300	1,379,822
Net interest gap	94,452	123,568	(77,195)	(33,862)	1,877	108,840

Amounts are in ISK millions

44. Market risk, continued

2021 *Assets*	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	65,501	-	-	-	-	65,501
Loans to credit institutions	30,272	-	-	-	-	30,272
Loans to customers	578,253	107,607	235,275	4,920	11,124	937,179
Bonds and debt instruments	41,898	63,023	39,435	6,133	1,363	151,852
Bonds and debt instruments used for hedging	-	81	6,351	3,868	3,743	14,043
Derivatives	66,977	13,645	137,214	3,766	-	221,602
Assets	782,901	184,356	418,275	18,687	16,230	1,420,449
Liabilities						
Due to credit institutions and Central Bank	5,000	-	-	-	-	5,000
Deposits	655,476	-	-	-	-	655,476
Derivatives	206,663	13,639	1,049	-	-	221,351
Borrowings	11,308	34,217	275,315	34,665	11,965	367,470
Subordinated liabilities	-	-	35,860	-	-	35,860
Liabilities	878,447	47,856	312,224	34,665	11,965	1,285,157
Net interest gap	(95,547)	136,499	106,051	(15,978)	4,265	135,291

Sensitivity analysis of interest rate risk

The following table shows the sensitivity of the Group's net present value (NPV) of interest-bearing assets and liabilities and variation of annual net interest income (NII), due to changes in interest rates by currencies. The variation is calculated on the basis of simultaneous parallel shifts upwards or downwards of yield curves. The choice of shifts is not an estimate of risk likelihood. Behavioral maturities are taken into account in the NPV calculations, including prepayment likelihood and expected behavior of non-maturing deposits. The change to NII is however primarily based on contractual interest rate adjustments where it is simplistically assumed that all rates are equally sensitive to the presumed change in market rates. Behavioral maturity assumptions are however applied for non-maturing deposits and a zero percentage floor is applied to deposit interest rates. Changes were made to the NII calculations in 2022, for the reference date. The interest rate shifts in both directions take account of the floor on interest rates so that when the floor has an effect then the shifts are restricted.

	2022		2021	
NPV change in the banking book	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	(1,994)	2,782	(2,250)	2,418
ISK, Non index-linked	(1,106)	886	2,308	(2,322)
Foreign currencies	(36)	32	338	(461)
NPV change in the trading book				
ISK, CPI index-linked	173	(156)	93	(85)
ISK, Non index-linked	211	(199)	(41)	43
Foreign currencies	(38)	38	74	(74)
NII change				
ISK, CPI index-linked	(947)	947	(881)	85
ISK, Non index-linked	(2,022)	981	(3,808)	774
Foreign currencies	(83)	71	(12)	15

Amounts are in ISK millions

44. 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

2022 *Assets, CPI index-linked*	Up to 1 year	1 to 5 years	Over 5 years	Total
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 index-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

2021 *Assets, CPI index-linked*	Up to 1 year	1 to 5 years	Over 5 years	Total
Loans to customers	7,500	41,730	172,662	221,892
Financial instruments	5,753	2,541	7,549	15,843
Assets, CPI index-linked	13,253	44,271	180,211	237,735
Liabilities, CPI index-linked				
Deposits	84,902	9,296	3,036	97,234
Borrowings	297	62,355	39,355	102,007
Subordinated liabilities	-	-	5,337	5,337
Other	1,134	222	1,316	2,672
Off-balance sheet position	1,221	3,246	-	4,467
Liabilities, CPI indexed linked	87,554	75,119	49,044	211,717
Net on-balance sheet position	(73,080)	(27,602)	131,167	30,485
Net off-balance sheet position	(1,221)	(3,246)	-	(4,467)
CPI balance	(74,301)	(30,848)	131,167	26,018
CPI balance for prudential consolidation, excluding insurance operations *	(73,444)	(33,167)	124,030	17,419

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

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

44. 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

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	8,239	274	123	11	4	-	1	8,652
Financial assets	1,118,120	190,007	78,685	5,221	28,979	20,276	5,069	1,446,357
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	5,799	1,234	1,775	257	223	589	222	10,099
Borrowings	158,071	216,045	-	-	-	15,303	3,144	392,563
Subordinated liabilities	18,891	772	13,396	-	-	4,383	9,889	47,331
Financial liabilities	856,863	270,686	63,512	3,325	3,249	23,569	16,844	1,238,048
Net on-balance sheet position	261,257	(80,679)	15,173	1,896	25,730	(3,293)	(11,775)	
Net off-balance sheet position	(51,950)	81,095	(15,967)	(1,950)	(25,649)	3,161	11,260	
Net position *	209,307	416	(794)	(54)	81	(132)	(515)	
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	23,199
Non-financial liabilities and equity								
Tax liabilities	10,303	-	-	-	-	-	-	10,303
Other non-financial liabilities	32,816	51	6	-	1	-	-	32,874
Shareholders' equity	187,682	-	-	-	-	-	-	187,682
Non-controlling interest	649	-	-	-	-	-	-	649
Non-financial liabilities and equity	231,450	51	6	-	1	-	-	231,508
Management reporting of currency risk **	760	493	(734)	32	80	(121)	(509)	

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

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

Amounts are in ISK millions

44. Market risk, continued

2021								
Financial assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	67,690	608	280	154	75	34	216	69,057
Loans to credit institutions	523	8,145	7,499	6,820	3,647	1,313	2,325	30,272
Loans to customers	780,384	99,748	39,007	768	10,820	1,629	3,881	936,237
Financial instruments	133,340	53,847	18,657	216	9	19,553	35	225,657
Other financial assets	11,936	280	93	1	8	2	400	12,720
Financial assets	993,873	162,628	65,536	7,959	14,559	22,531	6,857	1,273,943
Financial liabilities								
Due to credit inst. and Central Bank	3,982	81	845	9	49	-	34	5,000
Deposits	573,316	26,542	37,278	2,559	10,529	3,030	2,222	655,476
Financial liabilities at fair value	4,463	991	86	135	97	89	16	5,877
Other financial liabilities	4,559	359	2,755	157	604	36	215	8,685
Borrowings	163,044	172,815	-	-	-	18,619	2,159	356,637
Subordinated liabilities	6,245	752	13,224	-	-	4,461	10,406	35,088
Financial liabilities	755,609	201,540	54,188	2,860	11,279	26,235	15,052	1,066,763
Net on-balance sheet position	238,264	(38,912)	11,348	5,099	3,280	(3,704)	(8,195)	
Net off-balance sheet position	(27,584)	40,030	(15,587)	(6,577)	(1,889)	3,703	7,904	
Net position *	210,680	1,118	(4,239)	(1,478)	1,391	(1)	(291)	
Non-financial assets								
Investment property	6,560	-	-	-	-	-	-	6,560
Investments in associates	668	-	-	-	-	-	-	668
Intangible assets	9,463	-	-	-	-	-	-	9,463
Tax assets	2	-	-	-	-	-	-	2
Assets and disposal groups held for sale	13,975	78	25	1,903	3	1	62	16,047
Other non financial assets	6,915	124	35	78	-	26	3	7,181
Non-financial assets	37,583	202	60	1,981	3	27	65	39,921
Non-financial liabilities and equity								
Tax liabilities	7,102	-	-	-	-	-	-	7,102
Liabilities associated with disposal groups held for sale	16,136	129	50	174	304	77	65	16,935
Other non-financial liabilities	28,366	81	30	-	3	-	(14)	28,466
Shareholders' equity	193,925	-	-	-	-	-	-	193,925
Non-controlling interest	673	-	-	-	-	-	-	673
Non-financial liabilities and equity	246,202	210	80	174	307	77	51	247,101
Management reporting of currency risk **	2,061	1,110	(4,259)	329	1,087	(51)	(277)	

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

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

Amounts are in ISK millions

44. 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).

	2022		2021	
Currency	-10%	+10%	-10%	+10%
EUR	(49)	49	(111)	111
USD	73	(73)	426	(426)
GBP	(3)	3	(33)	33
DKK	(8)	8	(109)	109
NOK	12	(12)	5	(5)
Other	51	(51)	28	(28)

Equity risk

Equity risk is the risk that the fair value of equities decreases. For information on assets seized and held for sale and equity exposures, see Notes 30 and 23 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.

	2022		2021	
Equity	-10%	+10%	-10%	+10%
Trading book - listed	(165)	165	(266)	266
Banking book - listed	(477)	477	(414)	414
Banking book - unlisted	(430)	430	(662)	662

Derivatives

Derivatives are a part of the Group's customer product offering. The types of derivatives currently offered are forward contracts, swaps and options. Eligible underlying market factors are interest rates, foreign exchange rates, equities and commodities. Exposure limits, hedging requirements and collateral requirements are determined in accordance with the Group's risk appetite and monitored by Risk Management on a daily basis. The Group also uses derivatives to hedge market risk on its balance sheet. Note 24 provides a breakdown of the Group's derivative positions by type.

Amounts are in ISK millions

45. 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 72% 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

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	1,880	4,935	1,364	-	-	8,667	8,667
Financial assets	53,384	329,665	204,242	484,206	1,153,824	41,749	2,267,070	1,446,372
Financial liabilities								
Due to credit inst. and Central Bank	7,233	4,484	-	-	-	-	11,717	11,697
Deposits	545,764	102,796	84,239	20,568	3,795	-	757,162	755,361
Financial liabilities at fair value	-	1,647	2,973	18,487	-	-	23,107	20,997
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	8,141	593	1,256	-	-	10,099	10,099
Borrowings	-	21,755	14,169	338,265	50,794	-	424,983	392,563
Subordinated liabilities	-	1,402	1,634	19,685	36,111	-	58,832	47,331
Financial liabilities	553,106	140,225	103,608	398,261	90,700	-	1,285,900	1,238,048
Net position for assets and liab.	(499,722)	189,440	100,634	85,945	1,063,124	41,749	981,170	208,324
Off-balance sheet items								
Financial guarantees	-	2,194	10,024	2,058	6,036	-	20,312	20,312
Unused overdraft	-	57,259	-	-	-	-	57,259	57,259
Undrawn loan commitments	-	47,464	27,308	27,686	3,430	-	105,888	105,888
Off-balance sheet items	-	106,917	37,332	29,744	9,466	-	183,459	183,459
Net contractual cash flow	(499,722)	82,523	63,302	56,201	1,053,658	41,749	797,711	24,865

Arion Bank Consolidated Financial Statements 2022 Amounts are in ISK millions

45. Liquidity and Funding risk, continued

2021 *Financial assets*	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity	Total	Book value
Cash and balances with CB	25,975	36,547	6,633	-	-	-	69,155	69,057
Loans to credit institutions	25,663	2,509	51	2,123	-	-	30,346	30,272
Loans to customers	3,033	100,588	137,323	345,777	790,442	-	1,377,163	936,237
Financial instruments	16,091	39,164	60,412	46,502	14,898	56,857	233,924	225,657
Derivatives - assets leg	-	*33,562*	*10,841*	*35,105*	*1,100*	-	*80,608*	*74,952*
Derivatives - liabilities leg	-	*(32,614)*	*(10,779)*	*(31,674)*	*(985)*	-	*(76,052)*	*(72,047)*
Other financial instruments	*16,091*	*38,216*	*60,350*	*43,071*	*14,783*	*56,857*	*229,368*	*222,752*
Other financial assets	679	6,720	3,734	1,588	-	-	12,721	12,721
Financial assets	71,441	185,528	208,153	395,990	805,340	56,857	1,723,309	1,273,944
Financial liabilities								
Due to credit inst. and Central Bank	3,230	1,811	-	-	-	-	5,041	5,000
Deposits	499,362	63,407	80,999	9,557	3,152	-	656,477	655,476
Financial liabilities at fair value	-	3,943	537	2,644	4	-	7,128	5,877
Derivatives - assets leg	-	*(53,896)*	*(3,855)*	*(5,590)*	*(519)*	-	*(63,860)*	*(63,483)*
Derivatives - liabilities leg	-	*57,839*	*4,392*	*8,234*	*523*	-	*70,988*	*69,360*
Other financial liabilities	74	6,010	725	1,033	843	-	8,685	8,685
Borrowings	-	13,996	40,498	258,049	73,001	-	385,544	356,637
Subordinated liabilities	-	1,192	946	42,763	1	-	44,902	35,088
Financial liabilities	502,666	90,359	123,705	314,046	77,001	-	1,107,777	1,066,763
Net position for assets and liab.	(431,225)	95,169	84,448	81,944	728,339	56,857	615,532	207,181
Off-balance sheet items								
Financial guarantees	-	974	5,501	1,942	7,441	-	15,858	15,858
Unused overdraft	-	63,108	-	-	-	-	63,108	63,108
Undrawn loan commitments	-	62,529	23,636	22,410	116	-	108,691	108,691
Off-balance sheet items	-	126,611	29,137	24,352	7,557	-	187,657	187,657
Net contractual cash flow	(431,225)	(31,442)	55,311	57,592	720,782	56,857	427,875	19,524

Net Stable Funding Ratio

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

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

	2022	2021
Available stable funding	1,109,623	1,001,543
Required stable funding	931,991	827,953
Net stable funding ratio	119%	121%

Amounts are in ISK millions

45. 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.

In 2022, the Bank complied with the Central Bank of Iceland's liquidity rules no. 266/2017, which effectively adopt the liquidity rules of the EU Capital Requirements Regulation (CRR). The Bank was required to maintain a 100% minimum LCR ratio for both the aggregate position in all foreign currencies and all currencies. For the LCR in ISK, the requirement was 40% in 2022. 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 will remain at 100% but the requirement for the LCR in ISK will change to 50% and there will be no minimum requirement for the aggregate position in all foreign currencies. Instead the bank will be required to maintain an 80% minimum for the LCR in EUR.

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

2022	ISK	Foreign currency	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%

2021	ISK	Foreign currency	Total
Liquid assets level 1 *	96,563	83,777	180,340
Liquid assets level 2	16,406	-	16,406
Liquid assets	112,969	83,777	196,746
Deposits	107,698	34,682	142,380
Borrowings	433	55	488
Other cash outflows	10,157	6,882	17,039
Cash outflows	118,288	41,619	159,907
Short-term deposits with other banks **	2,287	25,246	27,533
Other cash inflows	32,799	2,575	35,374
Cash inflows	35,086	27,821	62,907
Liquidity coverage ratio (LCR) ***	136%	607%	203%

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

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

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

Amounts are in ISK millions

45. Liquidity and Funding risk, continued

Composition of liquid assets

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

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

2021					
Cash and balances with Central Bank	67,690	280	608	479	69,057
Short-term deposits with financial institutions	2,287	7,170	6,176	11,900	27,533
Domestic bonds eligible as collateral with Central Bank	48,178	-	-	-	48,178
Foreign government bonds	-	14,272	49,016	19,117	82,405
Liquidity reserve	118,155	21,722	55,800	31,496	227,173

LCR deposit categorization

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

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

LCR categorization - amounts and LCR outflow weights	Deposits maturing within 30 days					
2022	Less stable	Weight %	Stable	Weight %	Term deposits*	Total deposits
Individuals	100,033	11%	116,328	5%	109,180	325,541
Small and medium enterprises	53,783	11%	19,116	5%	8,663	81,562
Operational relationship	14,986	25%	-	5%	-	14,986
Corporations	121,674	40%	3,139	20%	19,109	143,922
Sovereigns, central banks and PSE	45,145	40%	-	-	790	45,935
Pension funds	57,701	100%	-	-	14,743	72,444
Domestic financial entities	72,685	100%	-	-	8,846	81,531
Foreign financial entities	1,137	100%	-	-	-	1,137
Total	467,144		138,583		161,331	767,058
2021						
Individuals	89,425	11%	125,515	5%	91,170	306,110
Small and medium enterprises	48,511	11%	18,210	5%	5,056	71,777
Corporations	109,573	40%	2,792	20%	20,293	132,658
Sovereigns, central banks and PSE	30,985	40%	-	-	784	31,769
Pension funds	42,258	100%	-	-	13,424	55,682
Domestic financial entities	45,576	100%	-	-	15,613	61,188
Foreign financial entities	1,292	100%	-	-	-	1,292
Total	367,619		146,517		146,340	660,476

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

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

46. 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	2022	2021
Total equity	188,331	194,598
Non-controlling interest not eligible for inclusion in CET1 capital	(649)	(673)
Common Equity Tier 1 capital before regulatory adjustments	187,682	193,925
Intangible assets	(6,425)	(8,435)
Additional value adjustments	(224)	(240)
Foreseeable dividend and buyback *	(15,980)	(26,773)
Adjustment under IFRS 9 transitional arrangements as amended	1,142	920
Common Equity Tier 1 capital	166,195	159,397
Non-controlling interest eligible for inclusion in T1 capital	105	133
Additional Tier 1 capital	13,396	13,225
Tier 1 capital	179,696	172,755
Tier 2 instruments	33,935	21,863
Tier 2 instruments of financial sector entities (significant investments)	(1,155)	(1,056)
Tier 2 capital	32,780	20,807
Total own funds	212,476	193,562
Risk-weighted exposure amount (REA)		
Credit risk, loans and off-balance sheet items	707,479	623,395
Credit risk, securities and other	57,651	69,553
Counterparty credit risk	14,645	7,761
Market risk due to currency imbalance	1,387	4,691
Market risk due to trading book positions	7,493	8,958
Credit valuation adjustment	6,010	2,379
Operational risk	89,166	96,085
Total risk-weighted exposure amount	883,831	812,822
Capital ratios		
CET1 ratio	18.8%	19.6%
Tier 1 ratio	20.3%	21.2%
Capital adequacy ratio	24.0%	23.8%

* On 31 December 2022, the foreseeable dividend corresponds to 50% of profits as per the Bank's dividend policy. The deduction includes an ongoing and approved buyback from December 2022 and the remaining part of authorized buyback of own shares from the Central Bank from 5 September 2022. On 31 December 2021, the foreseeable dividend and buyback was the aggregation of an expected dividend of ISK 22.5 billion and the remainder of the buyback program amounting to ISK 4.3 billion based on permission from the FSA from 7 October 2021.

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.

Amounts are in ISK millions

46. Capital management, continued

Capital ratios of the parent company	2022	2021
CET1 ratio	18.8%	20.2%
Tier 1 ratio	20.3%	21.9%
Capital adequacy ratio	23.9%	24.4%

The following table outlines the implementation of the capital buffer requirements in accordance with the Icelandic Financial Undertakings Act No. 161/2002, as prescribed by the Financial Stability Council (FSC) and approved by the FSA.

Capital buffer requirement, % of REA	2022	2021
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%	-
Combined capital buffer requirement	9.5%	7.5%

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

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

Capital requirement, % of REA	CET1	Tier 1	Total
Pillar 1 capital requirement	4.5%	6.0%	8.0%
Pillar 2R capital requirement **	2.0%	2.6%	3.5%
Combined buffer requirement *	9.3%	9.3%	9.3%
Regulatory capital requirement	15.8%	17.9%	20.8%
Available capital	18.8%	20.3%	24.0%

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

** The SREP result based on the Group's Financial Statement at 31 December 2021. The Pillar 2R requirement is 3.5% of risk-weighted exposure amount based on the Group's prudential consolidation under CRR, which excludes Vördur.

Leverage ratio

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

	2022	2021
On-balance sheet exposures	1,415,353	1,256,916
Derivative exposures	32,118	4,796
Securities financing transaction exposures	10,174	720
Off-balance sheet exposures	59,723	102,016
Total exposure	1,517,368	1,364,448
Tier 1 capital	179,696	172,755
Leverage ratio	11.8%	12.7%

Amounts are in ISK millions

46. Capital management, continued

MREL

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

Minimum requirement for own funds and eligible liabilities	2022	2021
Own funds	212,476	193,365
Eligible liabilities	155,667	140,239
Own funds and eligible liabilities	368,143	333,604
Combined buffer requirement (CBR)	82,196	58,523
Own funds and eligible liabilities not used for CBR	285,947	275,081
Risk-weighted exposure amount (REA)	883,832	812,822
Own funds and eligible liabilities not used for CBR (% REA)	32.4%	33.8%
MREL requirement (% REA)	23.0%	-
Total liabilities and own funds (TLOF)	1,446,370	1,277,543
Own funds and eligible liabilities not used for CBR (% TLOF)	19.8%	21.5%
MREL requirement (% TLOF)	14.7%	-

Solvency II

Excess of assets over liabilities in accordance with Solvency II	9,175	9,090
Subordinated liabilities	1,169	1,069
Foreseeable dividends	-	-
Own funds	10,344	10,159
Solvency capital requirements (SCR)	7,114	6,902
SCR ratio	145.4%	147.2%

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

47. 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

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

Green Financing Instruments	2022	2021
Deposits	21,274	8,209
Borrowings	97,405	47,148
Book value	118,679	55,357

Identified eligible green assets by category	2022	2021
Sustainable fishery and aquaculture	51,936	42,245
Clean transportation	4,879	2,255
Green buildings	64,232	55,881
Energy efficiency	8,189	-
Pollution prevention and control and wastewater management	6,174	5,591
Book value	135,410	105,972

* Based on fisheries certificates in relation to the official quota year (1 September 2021 to 31 August 2022).

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 2021, except for when there have been made amendmends to current IFRS valid from 1 January 2022, 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 2022 but they do not have a material effect on these Consolidated Financial Statements.

49. 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.

50. 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.

50. 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.

51. 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.

52. 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.

53. 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).

54. 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.

55. 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.

56. Net insurance income

Premiums recognized as income comprise the premiums contracted during the fiscal year including premiums transferred from last years but excluding next periods premiums, which are recognized as provision for unearned premiums. Provision for unearned premiums is a part of the technical provision in the Statement of Financial Position.

Claims recognized in the Income Statement are the periods claims including increases or decreases due to claims from previous fiscal years. Outstanding claims included in technical provision in the Statement of Financial Position are the total amount of reported but unpaid claims as well as actuarial provision for claims occurred but unreported.

57. 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.

58. 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.

58. 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.

58. 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.

58. 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 amount.
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 Bank 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.

58. 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 Bank'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.

58. 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 Bank 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).

58. 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 43. 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.

58. 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.

59. Hedge accounting

From the applying of IFRS 9 from 1 January 2018, the Group has chosen to continue to apply the hedge accounting requirements of IAS 39, in line with exemption from IFRS 9. However, the Group will provide the expanded disclosures on hedge accounting introduced by IFRS 9's amendments to IFRS 7, as the accounting policy election does not provide an exemption from the new disclosure requirements under IFRS 7.

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.

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.

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.

60. 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.

61. 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.

62. 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.

63. 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.

64. 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.

65. 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.

66. Deposits

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

67. 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.

68. 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.

69. 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.

70. 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.

Technical provision

Estimate is made in accordance with Solvency II rules. Data from the company's claim system are extrapolated to predict the final amount of the claims that will be paid at the end of the reporting period with corresponding expected payments from reporting date until the settlement of claims that occurred prior to the reporting date. In addition, estimation of settlement cost, risk and other factors is made in accordance with the instructions in Solvency II rules. This approach is consistent with the valuation of insurance liabilities in IFRS 4.

71. 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.

71. 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.

72. 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.

73. 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.

74. 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.

75. 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.

76. Standards issued but not yet effective

New standards, amendments to standards and interpretations have been issued but are not yet effective for the year ended 31 December 2022, and have not been applied in preparing these Consolidated Financial Statements. Relevant to the Group's reporting is IFRS 17 Insurance contracts.

IFRS 17 Insurance Contracts

IFRS 17 Insurance Contracts came into effect on 1 January 2023. The standard applies 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 company is of the opinion that the impact of the standard on the company’s results is not significant but there will be a change to the presentation of the information on operations. The insurance reserve in the balance sheet at the beginning of 2023 will be considerably lower than the reserve according to current methods. Firstly, the presentation of the premium reserve is such that only pre-paid premiums are considered part of the premium reserve, which results in a considerable decrease in the reserve and a corresponding decrease in receivables. Secondly, the calculation of the claims reserve changes somewhat and will not have a significant impact on the reserve amount.

5-year overview

Income Statement

	2022	2021	2020	2019	2018
Net interest income	40,277	32,063	31,158	30,317	29,319
Net fee and commission income	16,065	14,673	11,642	9,950	10,350
Net insurance income	2,614	3,442	3,071	2,886	2,589
Net financial income	(3,095)	6,220	2,745	3,212	2,302
Share of profit of associates and net impairment	270	22	-	756	27
Other operating income	1,067	1,805	2,148	877	1,584
Operating income	57,198	58,225	50,764	47,998	46,171
Salaries and related expense	(15,856)	(14,638)	(12,332)	(14,641)	(14,278)
Other operating expense	(11,055)	(11,237)	(12,109)	(12,222)	(12,000)
Operating expenses	(26,911)	(25,875)	(24,441)	(26,863)	(26,278)
Bank levy	(1,749)	(1,516)	(1,301)	(2,984)	(3,386)
Net impairment	144	3,169	(5,044)	(382)	(3,525)
Earnings before income tax	28,682	34,003	19,978	17,769	12,982
Income tax expense	(9,809)	(6,782)	(3,231)	(3,714)	(4,046)
Net earnings from continuing operations	18,873	27,221	16,747	14,055	8,936
Discontinued operations, net of tax	6,543	1,394	(4,278)	(12,955)	(1,159)
Net earnings	25,416	28,615	12,469	1,100	7,777

Statement of Financial Position

Assets

	2022	2021	2020	2019	2018
Cash and balances with Central Bank	114,118	69,057	42,136	95,717	83,139
Loans to credit institutions	45,501	30,272	28,235	17,947	56,322
Loans to customers	1,084,757	936,237	822,941	773,955	833,826
Financial instruments	193,329	225,657	227,251	117,406	114,557
Investment property	7,862	6,560	6,132	7,119	7,092
Investments in associates	787	668	891	852	818
Intangible assets	8,783	9,463	9,689	8,367	6,397
Tax assets	135	2	2	2	90
Assets and disposal groups held for sale	61	16,047	16,811	43,626	48,584
Other assets	14,223	19,901	18,618	16,864	13,502
Total Assets	1,469,556	1,313,864	1,172,706	1,081,855	1,164,327

Liabilities and Equity

	2022	2021	2020	2019	2018
Due to credit institutions and Central Bank	11,697	5,000	13,031	5,984	9,204
Deposits	755,361	655,476	568,424	492,916	466,067
Financial liabilities at fair value	20,997	5,877	5,240	2,570	2,320
Tax liabilities	10,303	7,102	4,262	4,404	5,119
Liabilities associated with disposal groups held for sale	-	16,935	16,183	28,631	26,337
Other liabilities	42,973	37,151	32,714	32,697	30,107
Borrowings	392,563	356,637	298,947	304,745	417,782
Subordinated liabilities	47,331	35,088	36,060	20,083	6,532
Total liabilities	1,281,225	1,119,266	974,861	892,030	963,468
Shareholders' equity	187,682	193,925	197,672	189,644	200,729
Non-controlling interest	649	673	173	181	130
Total equity	188,331	194,598	197,845	189,825	200,859
Total Liabilities and Equity	1,469,556	1,313,864	1,172,706	1,081,855	1,164,327

Amounts are in ISK millions

Appendix

Unaudited

Corporate Governance Statement of Arion Bank for 2022

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 2022. 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, and again in August 2022. 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 16 March 2022, 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 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 offering smart and reliable financial solutions which create future value for our customers, shareholders, 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 legislation 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:

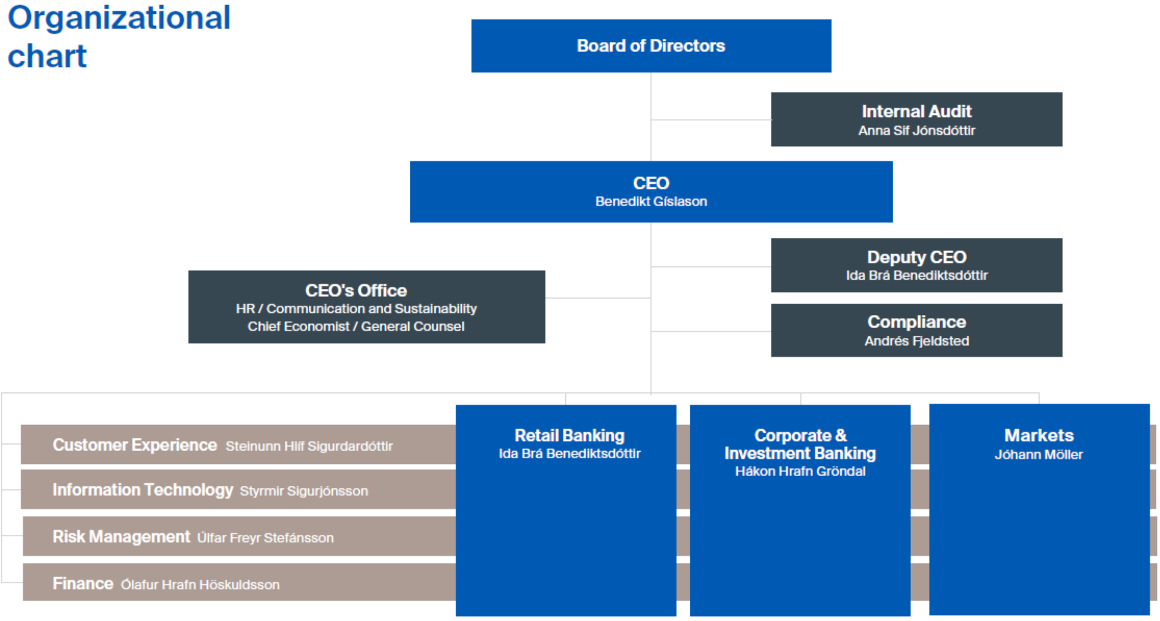
- Integrity and ethical values
- The attitude of senior management and tone from the top
- Organizational structure
- Assignment of authority and responsibility
- Employee skills, human resources policy and its implementation

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.

Organizational chart



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 companies is carefully calculated risk-taking according to a predetermined strategy. Arion Bank thus takes risk compatible with its risk appetite, which is regularly reviewed and approved by the Board of Directors. The Bank's risk appetite, set by the Board, is translated into exposure limits and targets that 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 that Arion Bank understands its risk profile and has systems in place to assess, quantify and monitor its total risk exposure.

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 CEO 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.

Core values and code of ethics

Arion Bank's core values is the name used to describe the Bank's core values. The core 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 core values are: We find solutions, we make a difference, we get things done, and, we 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 Risk

Sustainability risk refers to the risk of certain activities or practices compromising the ability of future generations or segments of society to meet their own needs, e.g. due to negative effects on the environment, natural or cultural resources or social conditions.

Sustainability risk is a driver of other risk types, such as credit risk and market risk. It can materialize in the short term, the medium term, and the long term. Environmental risks comprise of transition risks and physical risks and the Bank assesses both inside-out risks (the impact from the Bank's operations) and outside-in risks (impact through and from the Bank's credit and investment portfolios).

Climate and environmental risks are assessed in the Bank's Internal Capital Adequacy Assessment Process and considered in the Bank's stress testing program.

Arion Bank has been a partner of Festa, the Icelandic Center for Corporate Social Responsibility, for several years and since 2014 has been a signatory to the CEO Statement of Support for the Women's Empowerment Principles (UN Women and UN Global Compact). In 2015 the Bank signed the City of Reykjavík and Festa's Declaration on Climate Change and has published its environmental accounts since 2016. Arion Bank has been a signatory to the UN Global Compact, the UN's initiative to encourage businesses to adopt sustainable and socially responsible practices, since the end of 2016. The Bank has also complied with the UN's Principles for Responsible Banking (UN PRI) since the end of 2017. In September 2019 the Bank became a signatory to the UN Principles for Responsible Banking (UN PRB), the goal of which is to align banking with international goals and commitments such as the UN Sustainable Development Goals and the Paris Climate Agreement.

Arion Bank became a signatory to the Partnership for Carbon Accounting Financials (PCAF) in autumn 2021. This is a global partnership of financial institutions that work together to develop and implement a harmonized approach to assess and disclose the greenhouse gas (GHG) emissions which they finance through their loans and investments. One of Arion Bank's sustainability goals in 2022 was to estimate financed emissions from lending and investments in 2021, and the Bank published its first report containing such an analysis at the end of the 2022. The analysis indicates where the main opportunities are for the Bank and its customers to reduce carbon emissions over the coming years and decades.

Arion Bank supports the UN Sustainable Development Goals and has selected six goals which it 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.

Arion Bank's activities are governed by the provisions of the Annual Accounts Act on non-financial reporting, which, among other things, apply to the status and influence of the company in respect of environmental, social and human resources issues. Non-financial reporting in the annual report is based on the Global Reporting Initiative, (GRI), and the ESG reporting guide for the Nasdaq Nordic exchanges.

The Board of Directors has the ultimate responsibility for ensuring effective management of sustainability risk. The CEO establishes and maintains an appropriate formal framework for managing and mitigating sustainability risks. The framework must be in accordance with the Bank's risk appetite and regulatory requirements.

Further information on sustainability at Arion Bank can be found in the Bank's 2022 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, 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 16 March 2022, five 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 two 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 2022 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 six times in 2022.

- **Board Risk Committee (BRIC):** The Committee's main role is, inter alia, to evaluate the Bank's risk policy and risk appetite 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 eight times in 2022.

- **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 five times in 2022.

- **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 2022.

- **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.

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 member

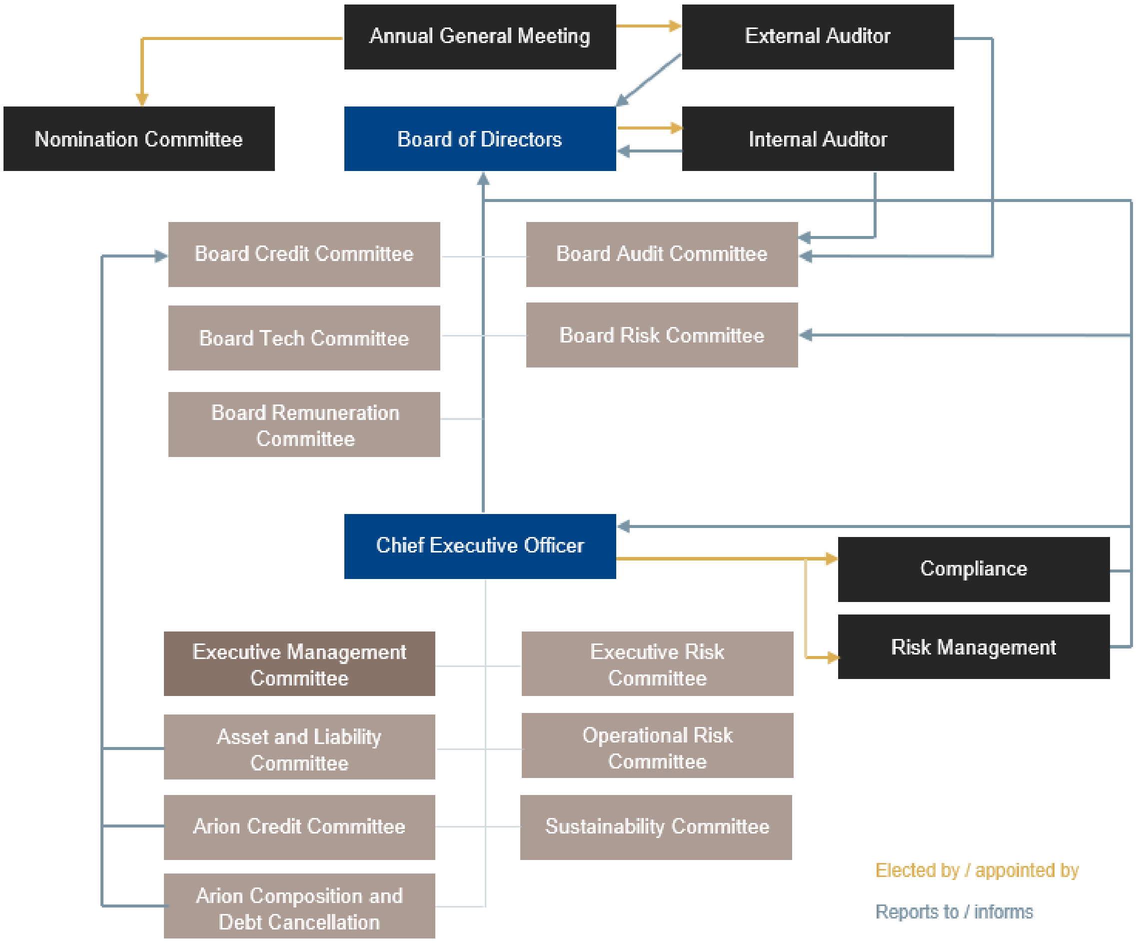
Director	Period	Board (13)	BAC (6)	BRIC (8)	BCC (5)	BRC (5)	BTC (4)
Brynjólfur Bjarnason	1 Jan - 31 Dec	13	6	-	5	5	4
Paul Horner	1 Jan - 31 Dec	13	6	8	5	-	4
Gunnar Sturluson	1 Jan - 31 Dec	12	6	7	5	-	4
Liv Fiksdahl	1 Jan - 31 Dec	13	6	-	-	5	4
Steinunn Kr. Thórdardóttir	1 Jan - 31 Dec	13	-	8	-	5	4
Thröstur Ríkhardsson	1 Jan - 31 Dec	1	-	-	-	-	-
Heimir Thorsteinsson[1]	1 Jan - 31 Dec	-	6	-	-	-	-

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 November 2022.

[1] Heimir Thorsteinsson is certified public accountant and appointed as an external member of the BAC.

The Board of Directors of Arion Bank

ARION BANK GOVERNANCE OVERVIEW



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 2007 and 2010 he was the chief executive officer of Skipti. Brynjólfur was chief executive officer of Síminn from 2002 to 2007 and chief executive officer of Grandi hf. from 1984 to 2002. Between 1976 and 1983 he was managing director of the publisher AB bókaútgáfa. He was also head of the economics department of VSÍ from 1973 to 1976. Brynjólfur has broad experience as a director and has served on numerous boards and been chairman of several of them.

Brynjólfur is currently an Alternate on the Board of Fergusson ehf. and a board member of Marinvest ehf. and ISAL hf.

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.

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 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. 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.

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, 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 Intrum AB. At Intrum AB she is also a member of the Transformation Committee.

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 in 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 in the role of a founder and managing director. 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 regards 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 Akton AS, a board member of Cloud Insurance AS and the chairman of the board for the Norwegian-Icelandic Chamber of Commerce. Steinunn is a member of the nomination committee of Síminn. 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.

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

Communication between the shareholders 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.

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 H. Káradóttir, General Counsel.
- 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
- Styrmir Sigurjónsson, Managing Director of Information Technology & CTO[2]
- 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 8 February 2023.

[2] Styrmir Sigurjónsson, MD of Informational Technology has decided to leave Arion Bank. He will continue in his role until a new managing director is appointed.

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