Íslandsbanki

Condensed Consolidated Interim Financial Statements

First quarter 2020

Unaudited

Contents

Íslandsbanki Factsheet 1Q20

Our profile

Íslandsbanki is a universal bank and a leader in financial services in Iceland with a history of 145 years of servicing key industries. The Bank has a 25-40% market share across all domestic business segments.

Íslandsbanki's purpose is to move Iceland forward by empowering our customers to succeed. Driven by the vision to be #1 for service, Íslandsbanki's relationship banking business model is propelled by three business divisions that manage and build relationships with the Bank's customers.

Íslandsbanki has developed a wide range of online services such as the Íslandsbanki and Kass apps, enabling customers to do their banking anywhere and anytime. At the same time, the Bank continues to operate the most efficient branch network in Iceland through its strategically located 14 branches.

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

Our bank

14 branches

746 Number of FTEs at Íslandsbanki at period end

New unified banking app

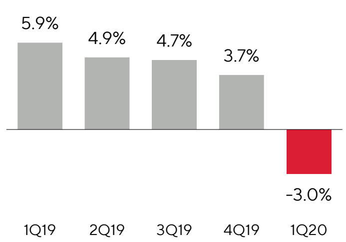
Market share*

31% individuals **35%** SMEs **34%** large companies

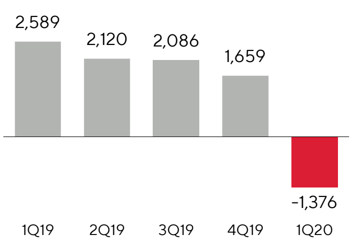
Credit rating

S&P Global Ratings **BBB/A-2** Stable outlook

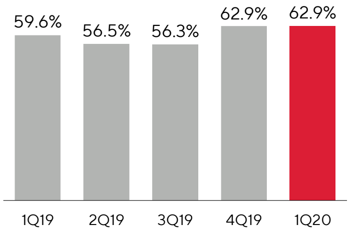
Return on equity



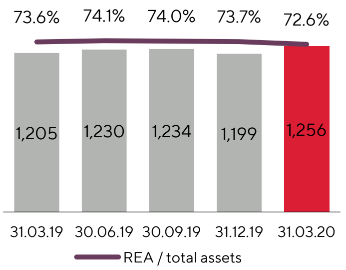
Profit (loss) after tax
(ISKm)



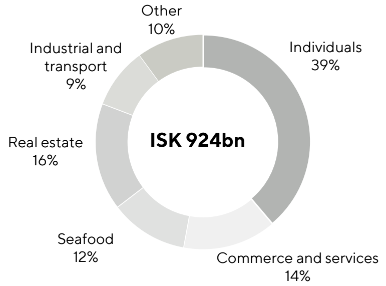
Cost / income ratio



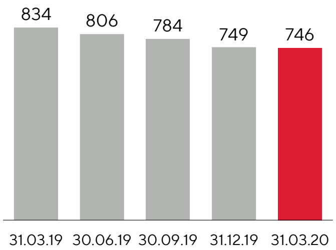
Total assets
(ISKbn)



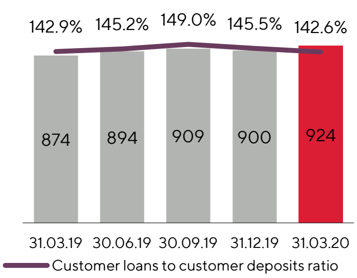
Loans to customers
(Sector split as of 31.03.20)



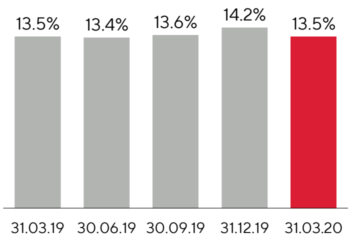
Number of FTEs at Íslandsbanki
(Excluding seasonal employees)



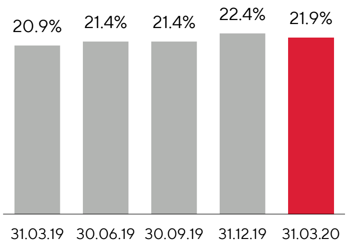
Loans to customers
(ISKbn)



Leverage ratio



Total capital ratio



*Based on Gallup survey regarding primary bank.

Directors' Report

These are the condensed consolidated interim financial statements for the period 1 January to 31 March 2020 (“the interim financial statements”) of Íslandsbanki hf. (“the Bank” or “Íslandsbanki”) and its subsidiaries (together referred to as "the Group").

Operations in the reporting period

Íslandsbanki is a universal bank offering comprehensive financial services to households, corporations, and institutional investors in Iceland. The Group is one of Iceland's largest banking and financial services groups, with a strong domestic market share.

The Group had a loss from its operations for the reporting period amounting to ISK 1,376 million. At the end of the reporting period, the Group employed 980 full-time members of staff, including 746 within the Bank itself.

A formal sale process of Borgun hf. began early in 2019, the sale was an open and transparent process led by Swiss based investment banking firm Corestar Partners and Íslandsbanki's Corporate Finance department. The Bank signed on 11 March 2020 an agreement to sell its 63.5% stake in Borgun hf. to Salt Pay Co Ltd., but this transaction is subject to Financial Supervisory Authority ("FME") approval of the purchaser's acquisition of a qualifying holding. Until FME approval, Íslandsbanki remains control of their 63.5% stake in Borgun hf.. The sale will have a limited impact on the Bank's operations and capital position. As a result of the sale agreement, the Bank will account for the equity stake as an asset held for sale and show the impact on the income statement in a single line as discontinued operations. Accordingly the comparative figures in the Directors' Report have been restated.

The Bank's earnings in the first quarter of 2020 are heavily affected by the economic crisis relating to the COVID-19 pandemic. Impairments increased substantially during the quarter as the expected credit losses are recognised early on through the IFRS 9 accounting standard. The Bank has transferred almost all of its exposures to the tourism industry from Stage 1 to Stage 2 and updated its economic forecasts, while at the same time trying to factor in the impact on Government programmes to mitigate the impact of the pandemic. As a result, the Bank has a negative impairment charge of ISK 3.5 billion in the first quarter. In addition to that, the Bank experienced losses in its trading activities and other equity and equity related investments of about ISK 1.7 billion.

Net interest income rose by 8.1% between years, on the back of a larger loan book and a higher net interest margin, which rose from 2.6% to 2.8% quarter on quarter. Net fee and commission income was however down by 5.9%, mainly due to a reduction in Personal Banking. Salaries and related expenses were down by 6.3% between years as a result of FTE reductions in 2019, while other operating expenses decreased by 11.1%.

The Group's loan book grew by 2.7% in the period, which can only be contributed to the depreciation of the Icelandic króna. The Bank's ratio of non-performing loans fell from 3.0% to 2.8%. Stage 2 loans under IFRS 9 did however increase from 2.6% to 11.3% as the credit risk related to loans to the tourism industry was deemed to have materially increased due to the COVID-19 pandemic.

Customer deposits increased by 4.8% from year-end 2019 with the largest increase in Corporate and Investment Banking. Bond issuance was modest in the quarter and only relating to regular covered bond auctions. The liquidity position of the Bank remains robust, with limited maturities in 2020 and therefore the need for issuance in foreign currency this year is minimal. The Bank is also very well capitalised, with a total capital ratio of 21.9% at the end of the period, compared to a 17% regulatory requirement, which was lowered as the counter-cyclical buffer was reduced from 2.0% to zero.

The COVID-19 pandemic significantly impacted the operations of the Bank for the first quarter. Most of the headquarters employees are working from home and customer access to branches has been restricted. Despite these unusual circumstances, the Bank has managed to be close to fully operational. Based on an employee survey at quarter end, our employees have adapted well to the working environment. Progress has been made in terms of increasing and improving digital channels for our customers and to enhance the usage of electronic signatures. The main focus onwards will be to continue to help and support our customers through the difficulties in the months ahead as the full impact of the pandemic will materialise.

The Annual General Meeting ("AGM") for the operating year 2019 was held on 19 March 2020. At the AGM shareholders approved that a dividend to shareholders for the operating year 2019 shall not be paid in light of uncertainties due to unprecedented circumstances in the financial markets. It was also approved that the Board may convene a special shareholder meeting later in the year where a proposal regarding payment of dividends of profit for previous fiscal years could be suggested.

Outlook

The Icelandic economy is facing significant headwinds after 8 years of robust economic growth as the impact of the COVID-19 pandemic and measures to contain it materialise. The tourist sector, which until recently generated around 1/3 of Iceland’s export revenues and employed nearly 14% of its labour force, has been severely affected by global restrictions on travel and it is uncertain when conditions in the sector normalise. Containment measures have also led to a temporary closure of some services businesses and a drop in private consumption.

Directors' Report

The setback in exports, private consumption and private investment is unavoidably going to translate to a considerable fall in GDP in 2020. Mitigating this, however, will be a significant contraction in imports as well as a boost to public investment. Icelandic authorities have introduced a range of measures to soften the economic impact of the pandemic, ranging from targeted assistance for affected businesses to broader fiscal stimulus and easing of financial and monetary conditions. The duration of the economic setback will hinge on when travel conditions normalise and economic activity resumes on a global scale. Assuming normalisation in 2H2020, there is a good probability of a return to healthy GDP growth in 2021.

The Bank's financial position is strong, with regards to capital and liquidity and therefore well placed to support its customers in this turbulent economic environment. Profitability will be adversely affected in 2020 as a result of increased impairments, fall in security prices and lower interest rate environment. The Bank will however strive to get back on track to reach its profitability targets from 2021 onwards.

Statement by the Board of Directors and the CEO

The interim financial statements for the period 1 January to 31 March 2020 have been prepared on a going concern basis in accordance with the International Accounting Standard (IAS) 34 Interim Financial Reporting as adopted by the European Union; the Act on Annual Accounts, no. 3/2006; the Act on Financial Undertakings, no. 161/2002; and rules on accounting for credit institutions, where applicable.

To the best of our knowledge, these interim financial statements provide a true and fair view of the Group's operating profits and cash flows in the reporting period and its financial position as of 31 March 2020.

The Board of Directors and the CEO have today discussed and approved the Condensed Consolidated Interim Financial Statements for the period 1 January to 31 March 2020.

Kópavogur, 6 May 2020

Board of Directors:

Hallgrímur Snorrason, Chairman

Heiðrún Jónsdóttir, Vice-Chairman

Anna Þórðardóttir

Árni Stefánsson

Flóki Halldórsson

Frosti Ólafsson

Guðrún Þorgeirsdóttir

Chief Executive Officer:

Birna Einarsdóttir

Consolidated Interim Income Statement

	Notes	2020 1.1-31.3	2019 1.1-31.3
Interest income*		13,645	15,006
Interest expense		(5,065)	(7,069)
Net interest income	11	8,580	7,937
Fee and commission income		2,763	2,872
Fee and commission expense		(272)	(225)
Net fee and commission income	12	2,491	2,647
Net financial income (expense)	13	(1,738)	442
Net foreign exchange gain (loss)	14	55	(121)
Other operating income	15	19	1,141
Other net operating income		(1,664)	1,462
Total operating income		9,407	12,046
Salaries and related expenses	16	(3,247)	(3,464)
Other operating expenses	17	(2,445)	(2,749)
Contribution to the Depositors' and Investors' Guarantee Fund		(228)	(312)
Bank tax		(359)	(880)
Total operating expenses		(6,279)	(7,405)
Profit before net impairment on financial assets		3,128	4,641
Net impairment on financial assets	18	(3,490)	(907)
Profit (loss) before tax		(362)	3,734
Income tax expense	19	(769)	(1,196)
Profit (loss) for the period from continuing operations		(1,131)	2,538
Discontinued operations, net of income tax	20	(245)	51
Profit (loss) for the period		(1,376)	2,589
Profit (loss) attributable to:			
Shareholders of Íslandsbanki hf.		(1,251)	2,651
Non-controlling interests		(125)	(62)
Profit (loss) for the period		(1,376)	2,589
Earnings per share from continuing operations			
Basic and diluted earnings per share attributable to the shareholders of Íslandsbanki hf.	21	(0.10)	0.26

*Of which interest income amounting to ISK 13,092 million (2019: ISK 14,428 million) is calculated using the effective interest method.
Comparative figures have been restated as the subsidiary Borgun hf. has been classified as disposal group held for sale (see Note 4).
The notes on pages 11 to 57 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK million

Consolidated Interim Statement of Comprehensive Income

	2020 1.1-31.3	2019 1.1-31.3
Profit (loss) for the period	(1,376)	2,589
Items that will not be reclassified to profit or loss		
Changes in fair value of financial assets, net of tax	(309)	514
Changes in fair value of financial liabilities, net of tax	1,165	(495)
Other comprehensive income for the period, net of tax	856	19
Total comprehensive income (expense) for the period	(520)	2,608

The notes on pages 11 to 57 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK million

Consolidated Interim Statement of Financial Position

	Notes	31.3.2020	31.12.2019
Assets			
Cash and balances with Central Bank	22	123,062	146,638
Loans to credit institutions	23	84,263	54,376
Bonds and debt instruments	6	69,368	52,870
Derivatives	24	4,772	5,621
Loans to customers	25	923,850	899,632
Shares and equity instruments	6	12,496	18,426
Investments in associates		712	746
Property and equipment	27	8,015	9,168
Intangible assets		3,736	4,330
Other assets	28	5,154	6,608
Non-current assets and disposal groups held for sale	29	20,263	1,075
Total Assets		1,255,691	1,199,490
Liabilities			
Deposits from Central Bank and credit institutions	30	33,773	30,925
Deposits from customers	31	647,795	618,313
Derivative instruments and short positions	24	12,045	6,219
Debt issued and other borrowed funds	33	322,280	306,381
Subordinated loans	34	24,456	22,674
Tax liabilities		8,155	7,853
Other liabilities	36	14,392	27,063
Non-current liabilities and disposal groups held for sale	29	13,253	-
Total Liabilities		1,076,149	1,019,428
Equity			
Share capital		10,000	10,000
Share premium		55,000	55,000
Reserves		8,016	7,065
Retained earnings		104,349	105,569
Total Shareholders' Equity		177,365	177,634
Non-controlling interests		2,177	2,428
Total Equity		179,542	180,062
Total Liabilities and Equity		1,255,691	1,199,490

The notes on pages 11 to 57 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK million

Consolidated Interim Statement of Changes in Equity

	Share capital	Share premium	Statutory reserve	Restricted reserves	Fair value reserve	Liability credit reserve	Retained earnings	Total shareholders' equity	Non-controlling interests	Total equity
Equity as at 1.1.2020	10,000	55,000	2,500	3,525	1,432	(392)	105,569	177,634	2,428	180,062
Loss for the period							(1,251)	(1,251)	(125)	(1,376)
Net change in fair value of financial assets					(219)		36	(183)	(126)	(309)
Net change in fair value of financial liabilities						1,165	-	1,165		1,165
Restricted due to capitalised development costs				(73)			73	-		-
Restricted due to fair value changes				99			(99)	-		-
Restricted due to subsidiaries and associates				(21)			21	-		-
Equity as at 31.3.2020	10,000	55,000	2,500	3,530	1,213	773	104,349	177,365	2,177	179,542
Equity as at 1.1.2019	10,000	55,000	2,500	3,750	625	(376)	102,496	173,995	2,318	176,313
Profit (loss) for the period							2,651	2,651	(62)	2,589
Dividends paid							(5,300)	(5,300)		(5,300)
Net change in fair value of financial assets					326			326	188	514
Net change in fair value of financial liabilities						(495)		(495)		(495)
Restricted due to capitalised development costs				(66)			66	-		-
Restricted due to fair value changes				525			(525)	-		-
Restricted due to subsidiaries and associates				(13)			13	-		-
Equity as at 31.3.2019	10,000	55,000	2,500	4,196	951	(871)	99,401	171,177	2,444	173,621

Authorised share capital of the Bank is 10,000 million ordinary shares of ISK 1 each. At 31.3.2020 paid up share capital totalled ISK 65,000 million which is the total stated share capital of the Bank. The Bank has one class of ordinary shares which carry no right to fixed income. The Annual General Meeting ("AGM") for the operating year 2019 was held on 19 March 2020. At the AGM shareholders approved that a dividend to shareholders for the operating year 2019 shall not be paid in light of uncertainties due to unprecedented circumstances in the financial markets. It was also approved that the Board may convene a special shareholder meeting later in the year where a proposal regarding payment of dividends of profit for previous fiscal years could be suggested.

The notes on pages 11 to 57 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK million

Consolidated Interim Statement of Cash Flows

	Notes	2020 1.1-31.3	2019 1.1-31.3
Profit (loss) for the period		(1,376)	2,589
Non-cash items included in profit (loss) for the period*		8,612	5,767
Changes in operating assets and liabilities*		(2,553)	(25,864)
Dividends received		12	23
Income tax and bank tax paid		(1,096)	(809)
Net cash provided by (used in) operating activities		3,599	(18,294)
Proceeds from sales of property and equipment		8	7
Purchase of property and equipment		(351)	(121)
Purchase of intangible assets		(28)	(19)
Net cash used in investing activities		(371)	(133)
Proceeds from borrowings		8,260	37,993
Repayment of borrowings		(6,027)	(21,712)
Repayment of lease liabilities		(97)	(93)
Dividends paid		-	(4,134)
Net cash provided by financing activities		2,136	12,054
Net increase (decrease) in cash and cash equivalents		5,364	(6,373)
Effects of foreign exchange rate changes		177	9
Cash and cash equivalents at the beginning of the year		152,481	143,203
Cash and cash equivalents at the end of the period		158,022	136,839

Reconciliation of cash and cash equivalents			
Cash on hand	22	4,367	4,088
Cash balances with Central Bank	22	118,695	124,951
Bank accounts	23	37,649	24,434
Mandatory reserve and special restricted balances with Central Bank	22	(8,828)	(16,634)
Cash and cash equivalents attributable to discontinued operations		6,139	-
Cash and cash equivalents at the end of the period		158,022	136,839

*For further breakdown see the following page.

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

The Group presents a statement of cash flows that includes an analysis of all cash flows in total, including both continuing and discontinued operations.

Interest received from 1 January to 31 March 2020 amounted to ISK 13,636 million (2019: ISK 14,954 million) and interest paid in the same period 2020 amounted to ISK 5,982 million (2019: ISK 5,471 million). Interest paid is defined as having been paid when it has been deposited into the customer account and is available for the customer's disposal.

The notes on pages 11 to 57 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK million

Consolidated Interim Statement of Cash Flows

	2020 1.1-31.3	2019 1.1-31.3
Depreciation, amortisation and write-offs	448	394
Share of loss of associates	19	-
Accrued interest and fair value changes on debt issued and subordinated loans	2,359	2,527
Net impairment on financial assets	3,272	907
Foreign exchange (gain) loss	(1)	30
Net gain from sales of property and equipment	(2)	(2)
Unrealised fair value loss (gain) recognised in profit or loss	1,320	(110)
Discontinued operations, net of income tax	29	(12)
Bank tax	359	880
Income tax	760	1,153
Other changes	49	-
Non-cash items included in profit (loss) for the period	8,612	5,767

Mandatory reserve and special restricted balances with Central Bank	6,451	478
Loans to credit institutions	(6,169)	(22,109)
Bonds and debt instruments	(13,828)	(9,521)
Loans to customers	(9,879)	(21,801)
Shares and equity instruments	2,594	(1,530)
Other assets	(4,656)	(11,982)
Non-current assets and liabilities held for sale	(17)	38
Deposits from Central Bank and credit institutions	1,763	618
Deposits from customers	16,860	28,896
Derivative instruments and short positions	3,874	(368)
Other liabilities	454	11,417
Changes in operating assets and liabilities	(2,553)	(25,864)

Non-cash transactions 2020
During the period the Bank repurchased own debt securities amounting to ISK 3,152 million with cash settlement after the period-end.

Non-cash transactions 2019
The Bank paid dividends amounting to ISK 5,300 million. Thereof were non-cash transactions amounting to ISK 1,166 million in withheld capital income tax due in May 2019.

During the period the Bank repurchased own debt securities amounting to ISK 288 million by issuing new debt.

The notes on pages 11 to 57 are an integral part of these Condensed Consolidated Interim Financial Statements.

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Condensed Consolidated Interim Financial Statements

1. Corporate information

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

The condensed consolidated interim financial statements for the first quarter of 2020 ("the interim financial statements") comprise the financial statements of Íslandsbanki hf. ("the Bank" or "Íslandsbanki") and its subsidiaries together referred to as "the Group".

At the end of the period the Bank was wholly owned by the Icelandic Government. The shares are administered by the Icelandic State Financial Investments in accordance with Act no. 88/2009 on Icelandic State Financial Investments.

The interim financial statements were approved and authorised for issue by the Board of Directors and the CEO of Íslandsbanki hf. on 6 May 2020.

2. Basis of preparation

The interim financial statements have been prepared in accordance with the International Accounting Standard (IAS) 34 Interim Financial Reporting, as adopted by the European Union and additional requirements in the Act on Annual Accounts no. 3/2006, the Act on Financial Undertakings no. 161/2002 and rules on accounting for credit institutions.

The interim financial statements do not include all the information required for annual financial statements and should be read in conjunction with the audited consolidated financial statements of the Group for the year ended 31 December 2019, as well as the unaudited Pillar 3 Report for the year 2019. Both are available on the Bank's website: www.islandsbanki.is.

The accounting policies and the basis of measurement are unchanged in comparison with Notes 64 and 66 in the consolidated financial statements for the year 2019 except for the changes presented in Note 3.

The subsidiary Borgun hf. has been classified as non-current assets and disposal groups held for sale. Accordingly the comparative figures in the Consolidated Interim Income Statement for the first quarter of 2019 have been restated (see Note 4).

The interim financial statements are presented in Icelandic króna (ISK), which is the functional currency of Íslandsbanki hf. All amounts presented in ISK have been rounded to the nearest million, except when otherwise indicated. At 31 March 2020 the exchange rate of the ISK against the USD was 141.72 and 155.30 for the EUR (year-end 2019: USD 121.10 and EUR 135.83).

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

Significant accounting estimates and judgements

The preparation of the interim financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses recognised. Actual results may differ from those estimates.

Estimates and underlying assumptions are regularly reviewed and revised by management as deemed necessary. Changes in accounting estimates are recognised when they occur.

As described in Note 2 in the consolidated financial statements for the year 2019 key areas where management has made difficult, complex or subjective judgements, include those relating to impairment of financial assets, the fair value of financial instruments and intangible assets.

Impairment of financial assets, changes from year-end 2019

Note 66.3 in the consolidated financial statements for the year 2019 contains a description of the Group's accounting policies for impairment of financial assets in accordance with IFRS 9.

At the end of the first quarter of 2020, the following changes have been made.

The Group's Chief Economist has provided a new macroeconomic forecast on 25 March 2020 which takes into account the effects of the COVID-19 pandemic.

2. Cont'd

Change in economic indicators %	2019	2020	2021	2022	2023	2024
Economic growth	1,9	(5,0)	3,7	2,5	2,3	2,3
Housing prices in Iceland	3,4	1,6	0,8	3,0	3,5	3,5
Purchasing power	1,8	1,8	1,8	1,7	2,1	2,1
ISK exchange rate index	8,6	8,5	1,9	(2,5)	-	-
Policy rate, Central Bank of Iceland	3,9	2,2	2,8	3,3	3,5	3,5
Inflation	3,0	2,6	2,8	2,5	2,4	2,4
Capital formation	(6,3)	(11,3)	9,5	2,3	2,4	2,8
thereof capital formation in industry	(17,5)	(22,0)	16,3	5,0	3,5	3,5

The Group has noted the guidelines provided by the Financial Supervision Committee of the Icelandic Central Bank, in particular the following: "It is important that the selection of scenarios in the application of IFRS 9 reflect the general expectation that the current situation is temporary, whereas the impact assessment must be conducted on a medium- and long-term basis." The Group uses three economic scenarios: a base economic scenario based on the macroeconomic forecast, a better scenario, and a worse scenario to capture the complete range of possible outcomes.

The Group's model to calculate PD scaling factors was applied to these economic scenarios and the resulting scaling factors were then reviewed by the All Risk Committee with respect to all of the economic indicators and any other relevant information available. The All Risk Committee determined that it was appropriate to adjust the weights of the scenarios, generally the scenarios are weighted 25%-50%-25% (good, base, bad) but it was determined appropriate to set the weights at 20%-50%-30%, as this would best represent the probability-weighted average over all possible scenarios.

Additionally, an assessment was made whether there were common risk factors for any subsets of the Group's financial assets where a general adjustment was warranted. It was determined that loans to the tourism industry was such a subset. Companies in the tourism industry, to which the Group has granted credit, were classified into four classes based on an assessment of how much an increase in credit risk these companies face in the short, medium and long term. Where the increase was found to be significant, the exposure was transferred to Stage 2 and an overlay factor was applied to the expected credit loss.

The effect of the change in the macroeconomic scenarios and the scenario weights is an increase in the credit loss allowance of ISK 365 million. The common risk factor in tourism was found to apply to loans to customers with a net carrying amount of ISK 76 billion and the effect of the stage transfer and credit loss overlay was ISK 2.6 billion. Additionally, changes in impairment for a few specific customers resulted in an additional credit loss allowance of ISK 260 million. Other changes in credit loss allowance were insignificant (see Note 18).

3. Changes to accounting policies

The accounting policies in the interim financial statements are consistent with those applied in the consolidated financial statements for the year 2019, except for amendments described below. The amendments did not have a significant impact on the interim financial statements.

Interest Rate Benchmark Reform

The Group adopted amendments to IFRS 9 – Financial Instruments, IAS 39 – Financial Instruments: Recognition and Measurement, and IFRS 7 – Financial Instruments: Disclosures, as of 1 January 2020. The amendments modify certain hedge accounting requirements, relating to the method that is used to assess the effectiveness of a hedging relationship, to provide relief from potential effect of uncertainty caused by the Interest Rate Benchmark Reform, prior to the transition to alternative interest rates (see Note 24 and Note 33).

To manage the transition to alternative interest rates the Bank has set up a working group responsible for the overall transition. A comprehensive review of legacy contracts has been carried out by the Legal department and new contract language been introduced to accommodate the benchmark reform. The work on systems and processes, along with education and communication to major stakeholders, is ongoing. It is expected that financial effects of the transition will be minimal to the Group. The Bank is continually monitoring developments in the benchmark reform work in jurisdictions affected and will adjust its implementation accordingly, should the need arise.

4. Investments in subsidiaries

		31.3.2020	31.12.2019
Borgun hf., a payment acquirer and issuing processor, Ármúli 30, 108 Reykjavík	Iceland	63.5%	63.5%
B-Payment Group Szolgáltató Zrt., a payment processing company, H-1132 Budapest	Hungary	100%	100%
Borgun-VS ehf., a holding company, Ármúli 30, 108 Reykjavík	Iceland	100%	-
Íslandssjóðir hf., an investment fund management company, Hagasmári 3, 201 Kópavogur	Iceland	100%	100%
Hringur-eignarhaldsfélag ehf., a holding company, Dalshraun 3, 220 Hafnarfjörður	Iceland	100%	100%
Allianz Ísland hf., an insurance agent, Dalshraun 3, 220 Hafnarfjörður	Iceland	100%	100%

In addition Íslandsbanki has control over nine other non-significant subsidiaries.

Borgun hf.

A formal sale process of Borgun hf. began early in 2019, as was announced by Íslandsbanki on 11 January 2019. The sale was an open and transparent process led by Swiss based investment banking firm Corestar Partners and Íslandsbanki's Corporate Finance department.

On 11 March 2020 Íslandsbanki signed an agreement to sell its 63.5% stake in Borgun hf. to Salt Pay Co Ltd. but this transaction is subject to Financial Supervisory Authority ("FME") approval of the purchaser's acquisition of a qualifying holding. Until FME approval, Íslandsbanki remains control of their 63.5% stake in Borgun hf.

In accordance with IFRS 5 - Non-current assets and disposal groups held for sale Borgun hf. has been classified as disposal group held for sale in the interim financial statements, resulting in a change in the presentation. In the statement of financial position total assets of Borgun hf. are recognised in the line item "Non-current assets and disposal groups held for sale" and total liabilities in the line item "Non-current liabilities and disposal groups held for sale". Net loss of Borgun hf. is recognised in profit or loss in the line item "Discontinued operations, net of income tax". The comparative figures in the Consolidated Interim Income Statement for the first quarter of 2019 have been restated and Borgun hf. is no longer presented seperatly in the Operating segments note.

Restated Consolidated Interim Income Statement for the first quarter of 2019	Published accounts	Borgun hf. reclassified	Restated accounts
Interest income	15,227	(221)	15,006
Interest expense	(7,075)	6	(7,069)
Net interest income	8,152	(215)	7,937
Fee and commission income	5,011	(2,139)	2,872
Fee and commission expense	(1,794)	1,569	(225)
Net fee and commission income	3,217	(570)	2,647
Net financial income	448	(6)	442
Net foreign exchange loss	(30)	(91)	(121)
Other operating income	1,144	(3)	1,141
Other net operating income	1,562	(100)	1,462
Total operating income	12,931	(885)	12,046
Salaries and related expenses	(4,051)	587	(3,464)
Other operating expenses	(3,039)	290	(2,749)
Contribution to the Depositors' and Investors' Guarantee Fund	(312)	-	(312)
Bank tax	(880)	-	(880)
Total operating expenses	(8,282)	877	(7,405)
Profit before net impairment on financial assets	4,649	(8)	4,641
Net impairment on financial assets	(919)	12	(907)
Profit before tax	3,730	4	3,734
Income tax expense	(1,153)	(43)	(1,196)
Profit for the period from continuing operations	2,577	(39)	2,538
Discontinued operations, net of income tax	12	39	51
Profit for the period	2,589	-	2,589

Amounts are in ISK million

4. Cont'd

Interim Income Statement of Borgun hf.	2020 1.1-31.3	2019 1.1-31.3
Net interest income	171	218
Net fee and commission income	466	358
Other operating income	(47)	100
Total operating income	590	676
Salaries and related expenses	(545)	(587)
Other operating expenses	(358)	(290)
Net impairment on financial assets	(41)	(12)
Loss before tax	(354)	(213)
Income tax expense	10	43
Loss for the period	(344)	(170)
Inter-company eliminations	128	209
Profit (loss) of Borgun hf. included in discontinued operations for the period	(216)	39
Amounts included in other comprehensive income for the period		
Changes in fair value of financial assets, net of tax	(309)	514
Total comprehensive income (expense) for the period	(525)	553

Interim Statement of Financial Position of Borgun hf.	31.3.2020
Cash and balances with Central Bank	4,542
Loans to credit institutions	2,235
Loans to customers	4,802
Shares and equity instruments	3,223
Property and equipment	1,279
Intangible assets	422
Other assets	3,347
Total assets	19,850
Inter-company eliminations	(632)
Total assets of Borgun hf. included in non-current assets and disposal groups held for sale	19,218
Derivative instruments and short positions	539
Debt issued and other borrowed funds	123
Tax liabilities	11
Other liabilities	13,221
Total liabilities	13,894
Inter-company eliminations	(641)
Total liabilities of Borgun hf. included in non-current assets and disposal groups held for sale	13,253
Net assets of Borgun hf.	5,965

The following table summarises key cash flows information of Borgun hf. The amounts shown are before inter-company eliminations.	2020 1.1-31.3	2019 1.1-31.3
Net cash provided by (used in) operating activities	(1,130)	16
Net cash provided by (used in) investing activities	(20)	233
Net cash provided by financing activities	125	13
Net increase (decrease) in cash and cash equivalents	(1,025)	262

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5. Operating segments

Segment information is presented in accordance with the Group's management and internal reporting structure. The Bank has three main business segments: Personal Banking, Business Banking and Corporate & Investment Banking. Operating segments pay and receive interest to and from Treasury to reflect the allocation of capital, funding costs and the relevant risk premium. The accounting policies for the reportable segments are in line with the Group's accounting policies. The Group operates mainly in the Icelandic market.

Capital allocation to the business units is 16% of the risk exposure amount (REA) which corresponds to the Bank's CET1 target from the risk appetite statement. Income tax with breakdown for each segment is according to the current tax rate. Bank tax and contribution to the Icelandic Depositors' and Investors' Guarantee Fund are shown separately and allocated across segments. The allocation of the bank tax is 0.145%, as stated in law.

The Group comprises the following operating segments:

Personal Banking

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

Business Banking

Business Banking provides wide-ranging financial services to small- and medium-sized enterprises. Business Banking is organised around the branches where it can service its customers close to their own business. In addition, Business Banking operates Ergo, the asset based financing unit of the Bank.

Corporate & Investment Banking

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

Treasury and Proprietary Trading

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

Cost centres

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

Subsidiaries, eliminations and adjustments

Subsidiaries include Borgun hf., Íslandssjóðir hf., Allianz Ísland hf. and other less significant subsidiaries (see Note 4).

The subsidiary Borgun hf. has been classified as non-current assets and disposal groups held for sale, accordingly the comparative figures in this disclosure have been restated. Assets and liabilities of subsidiaries, that are classified as non-current assets and disposal groups held for sale, are included in the column “Other subsidiaries" and all inter-company eliminations for those subsidiaries are included in the column “Eliminations & adjustments".

Following is an overview showing the Group's performance with a breakdown by operating segments. Almost all operational results from cost centres have been allocated to the Bank's operating segments, comparative amounts have not been restated.

5. Cont'd

1 January to 31 March 2020	Personal Banking	Business Banking	Corporate & Investment Banking	Treasury & Proprietary Trading	Cost centres	The Bank total	Subsidiaries, eliminations & adjustments	The Group total
Net interest income	2,753	2,656	2,224	987	(65)	8,555	25	8,580
Net fee and commission income	809	466	916	(42)	1	2,150	341	2,491
Other net operating income	16	4	133	(1,848)	69	(1,626)	(38)	(1,664)
Total operating income	3,578	3,126	3,273	(903)	5	9,079	328	9,407
Salaries and related expenses	(611)	(453)	(412)	(80)	(1,501)	(3,057)	(190)	(3,247)
Other operating expenses	(596)	(281)	(233)	(53)	(1,134)	(2,297)	(148)	(2,445)
Contribution to the Depositors' and Investors' Guarantee Fund	(129)	(75)	(23)	(1)	-	(228)	-	(228)
Bank tax	(121)	(87)	(130)	(17)	(4)	(359)	-	(359)
Net impairment on financial assets	(64)	(2,321)	(1,042)	(63)	-	(3,490)	-	(3,490)
Cost allocation	(1,195)	(741)	(805)	68	2,673	-	-	-
Profit (loss) before tax	862	(832)	628	(1,049)	39	(352)	(10)	(362)
Income tax expense	(256)	194	(197)	(471)	(12)	(742)	(27)	(769)
Profit (loss) for the period from continuing operations	606	(638)	431	(1,520)	27	(1,094)	(37)	(1,131)
Net segment revenue from external customers	4,128	3,574	4,725	(3,400)	52	9,079	328	9,407
Net segment revenue from other segments	(550)	(448)	(1,452)	2,497	(47)	-	-	-
Fee and commission income	1,233	473	915	16	1	2,638	125	2,763
Depreciation, amortisation and write-offs	(51)	(23)	(5)	-	(281)	(360)	(2)	(362)
At 31 March 2020								
Loans to customers	331,041	235,747	357,061	1	-	923,850	-	923,850
Other assets	3,146	3,427	2,651	294,526	10,814	314,564	17,277	331,841
Total segment assets	334,187	239,174	359,712	294,527	10,814	1,238,414	17,277	1,255,691
Deposits from customers	295,270	179,387	128,270	48,499	-	651,426	(3,631)	647,795
Other liabilities	579	2,108	3,699	402,620	6,064	415,070	13,284	428,354
Total segment liabilities	295,849	181,495	131,969	451,119	6,064	1,066,496	9,653	1,076,149
Allocated equity	30,780	39,945	60,599	39,471	1,123	171,918	7,624	179,542
Risk exposure amount	191,352	239,392	392,678	54,510	6,358	884,290	27,085	911,375

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

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Notes to the Condensed Consolidated Interim Financial Statements

5. Cont'd

1 January to 31 March 2019	Personal Banking	Business Banking	Corporate & Investment Banking	Treasury & Proprietary Trading	Cost centres	The Bank total	Subsidiaries, eliminations & adjustments	The Group total
Net interest income	2,573	2,700	2,092	604	(55)	7,914	23	7,937
Net fee and commission income	1,052	415	877	(69)	1	2,276	371	2,647
Other net operating income	-	5	107	251	1,166	1,529	(67)	1,462
Total operating income	3,625	3,120	3,076	786	1,112	11,719	327	12,046
Salaries and related expenses	(643)	(496)	(460)	(67)	(1,619)	(3,285)	(179)	(3,464)
Other operating expenses	(540)	(282)	(168)	(58)	(1,525)	(2,573)	(176)	(2,749)
Contribution to the Depositors' and Investors' Guarantee Fund	(173)	(107)	(32)	-	-	(312)	-	(312)
Bank tax	(112)	(84)	(124)	(556)	(4)	(880)	-	(880)
Net impairment on financial assets	(224)	(550)	(101)	(34)	-	(909)	2	(907)
Cost allocation	(1,347)	(700)	(717)	62	2,702	-	-	-
Profit (loss) before tax	586	901	1,474	133	666	3,760	(26)	3,734
Income tax expense	(152)	(234)	(383)	(192)	(173)	(1,134)	(62)	(1,196)
Profit (loss) for the period from continuing operations	434	667	1,091	(59)	493	2,626	(88)	2,538
Net segment revenue from external customers	3,987	3,461	4,558	(1,435)	1,148	11,719	327	12,046
Net segment revenue from other segments	(362)	(341)	(1,482)	2,221	(36)	-	-	-
Fee and commission income	1,374	418	915	11	1	2,719	153	2,872
Depreciation, amortisation and write-offs	(18)	(72)	(6)	(1)	(263)	(360)	(1)	(361)
At 31 March 2019								
Loans to customers	305,652	228,266	335,441	217	-	869,576	3,954	873,530
Other assets	2,529	3,540	4,633	283,841	11,916	306,459	25,239	331,698
Total segment assets	308,181	231,806	340,074	284,058	11,916	1,176,035	29,193	1,205,228
Deposits from customers	273,836	171,677	113,589	55,825	-	614,927	(3,624)	611,303
Other liabilities	1,283	2,815	5,493	379,500	6,472	395,563	24,741	420,304
Total segment liabilities	275,119	174,492	119,082	435,325	6,472	1,010,490	21,117	1,031,607
Allocated equity	26,649	39,178	58,495	40,672	551	165,545	8,076	173,621
Risk exposure amount	179,216	238,013	376,389	68,475	3,624	865,717	21,184	886,901

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

5. Cont'd

Subsidiaries, eliminations & adjustments

1 January to 31 March 2020	Íslands-sjóðir hf.	Allianz Ísland hf.	Other subsidiaries	Eliminations & adjustments	Total
Net interest income	11	5	9	-	25
Net fee and commission income	273	255	(8)	(179)	341
Other net operating income	(21)	19	(1)	(35)	(38)
Total operating income	263	279	-	(214)	328
Salaries and related expenses	(144)	(46)	-	-	(190)
Other operating expenses	(56)	(128)	-	36	(148)
Profit (loss) before tax	63	105	-	(178)	(10)
Income tax expense	(15)	(12)	-	-	(27)
Profit (loss) for the period from cont. operations	48	93	-	(178)	(37)
Net segment revenue from external customers	331	224	-	(227)	328
Net segment revenue from other segments	(68)	55	-	13	-
Fee and commission income	390	255	-	(520)	125
Depreciation, amortisation and write-offs	-	-	-	(2)	(2)
At 31 March 2020					
Total assets	2,731	1,297	25,792	(12,543)	17,277
Total liabilities	259	405	13,363	(4,374)	9,653
Total equity	2,472	892	12,429	(8,169)	7,624

1 January to 31 March 2019	Íslands-sjóðir hf.	Allianz Ísland hf.	Other subsidiaries	Eliminations & adjustments	Total
Net interest income	12	6	3	2	23
Net fee and commission income	252	338	(8)	(211)	371
Other net operating income	75	-	5	(147)	(67)
Total operating income	339	344	-	(356)	327
Salaries and related expenses	(137)	(42)	-	-	(179)
Other operating expenses	(47)	(128)	(31)	30	(176)
Net impairment on financial assets	-	-	-	2	2
Profit (loss) before tax	155	174	(31)	(324)	(26)
Income tax expense	(32)	(35)	-	5	(62)
Profit (loss) for the period from cont. operations	123	139	(31)	(319)	(88)
Net segment revenue from external customers	378	343	-	(394)	327
Net segment revenue from other segments	(39)	1	-	38	-
Fee and commission income	356	338	-	(541)	153
Depreciation, amortisation and write-offs	-	-	-	(1)	(1)
At 31 March 2019					
Total assets	2,621	1,254	38,715	(13,397)	29,193
Total liabilities	223	388	24,600	(4,094)	21,117
Total equity	2,398	866	14,115	(9,303)	8,076

Amounts are in ISK million

6. Classification of financial assets and financial liabilities

At 31 March 2020	Mandatorily at FVTPL	Held for hedging	Designated as at FVTPL	Amortised cost	Carrying amount
Cash and balances with Central Bank	-	-	-	123,062	123,062
Loans to credit institutions	-	-	-	84,263	84,263
Listed bonds and debt instruments	41,830	-	-	-	41,830
Listed bonds and debt instruments used for economic hedging	27,030	-	-	-	27,030
Unlisted bonds and debt instruments	508	-	-	-	508
Derivatives	3,807	965	-	-	4,772
Loans to customers	-	-	-	923,850	923,850
Listed shares and equity instruments	4,086	-	-	-	4,086
Listed shares and equity instruments used for economic hedging	5,760	-	-	-	5,760
Unlisted shares and equity instruments	2,650	-	-	-	2,650
Other financial assets	-	-	-	4,936	4,936
Total financial assets	85,671	965	-	1,136,111	1,222,747
Deposits from Central Bank and credit institutions	-	-	-	33,773	33,773
Deposits from customers	-	-	-	647,795	647,795
Derivative instruments and short positions	12,045	-	-	-	12,045
Debt issued and other borrowed funds	-	47,448	55,128	219,704	322,280
Subordinated loans	-	-	-	24,456	24,456
Other financial liabilities	-	-	-	12,817	12,817
Total financial liabilities	12,045	47,448	55,128	938,545	1,053,166

At 31 December 2019	Mandatorily at FVTPL	Held for hedging	Designated as at FVTPL	Fair value through OCI	Amortised cost	Carrying amount
Cash and balances with Central Bank	-	-	-	-	146,638	146,638
Loans to credit institutions	-	-	-	-	54,376	54,376
Listed bonds and debt instruments	33,302	-	-	-	-	33,302
Listed bonds and debt instruments used for economic hedging	18,220	-	-	-	-	18,220
Unlisted bonds and debt instruments	1,348	-	-	-	-	1,348
Derivatives	4,700	921	-	-	-	5,621
Loans to customers	-	-	-	-	899,632	899,632
Listed shares and equity instruments	3,779	-	-	-	-	3,779
Listed shares and equity instruments used for economic hedging	8,681	-	-	-	-	8,681
Unlisted shares and equity instruments	2,851	-	-	3,115	-	5,966
Other financial assets	-	-	-	-	5,757	5,757
Total financial assets	72,881	921	-	3,115	1,106,403	1,183,320
Deposits from Central Bank and credit institutions	-	-	-	-	30,925	30,925
Deposits from customers	-	-	-	-	618,313	618,313
Derivative instruments and short positions	6,219	-	-	-	-	6,219
Debt issued and other borrowed funds	-	41,816	49,352	-	215,213	306,381
Subordinated loans	-	-	-	-	22,674	22,674
Other financial liabilities	-	-	-	-	24,772	24,772
Total financial liabilities	6,219	41,816	49,352	-	911,897	1,009,284

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7. Fair value information for financial instruments

Financial instruments carried at fair value

The fair value of a financial instrument is the transaction price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Where a market price is not readily available, the Group applies valuation techniques based on estimates and assumptions that are consistent with that which market participants would use in setting a price for the financial instrument.

The table below shows financial instruments carried at fair value at 31 March 2020 categorised into three levels of fair value hierarchy that reflect the type of inputs used in making the fair value measurements. The different levels have been defined as follows:

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

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

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

At 31 March 2020	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	68,860	-	508	69,368
Derivatives	-	4,772	-	4,772
Shares and equity instruments	9,742	26	2,728	12,496
Total financial assets	78,602	4,798	3,236	86,636
Short positions	331	-	-	331
Derivative instruments	-	11,714	-	11,714
Debt issued and other borrowed funds designated as at FVTPL	55,128	-	-	55,128
Total financial liabilities	55,459	11,714	-	67,173

At 31 December 2019	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	51,522	-	1,348	52,870
Derivatives	-	5,621	-	5,621
Shares and equity instruments	12,383	27	6,016	18,426
Total financial assets	63,905	5,648	7,364	76,917
Short positions	814	-	-	814
Derivative instruments	-	5,405	-	5,405
Debt issued and other borrowed funds designated as at FVTPL	49,352	-	-	49,352
Total financial liabilities	50,166	5,405	-	55,571

Changes in Level 3 assets measured at fair value	Bonds and debt instruments	Shares and equity instruments
Fair value at 1 January 2020	1,348	6,016
Purchases	28	7
Net loss on financial instruments recognised in profit or loss	(1,092)	(140)
Transfer to "Non-current assets and disposal groups held for sale"	-	(3,180)
Other changes	224	25
Fair value at 31 March 2020	508	2,728

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Notes to the Condensed Consolidated Interim Financial Statements

7. Cont'd

	Bonds and debt instruments	Shares and equity instruments
Fair value at 1 January 2019	1,514	4,688
Purchases	7	338
Sales and instalments	(537)	(52)
Net gain (loss) on financial instruments recognised in profit or loss	306	(118)
Net gain on financial instruments recognised in other comprehensive income	-	1,272
Other changes	58	(112)
Fair value at 31 December 2019	1,348	6,016

At the end of each reporting period the Group determines whether transfers have occured between levels in the hierarchy, by reassessing categorisation based on the lowest level input that is significant to the fair value measurement as a whole. No transfers between levels took place in the first quarter of 2020.

Valuation process

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

Valuation techniques

Where applicable, fair values are determined using quoted prices in active markets for identical assets and liabilities. In other cases, where there is no active market, the fair value is estimated using valuation techniques such as net present value and discounted cash flow models; comparison with similar instruments for which observable market data exists; net asset value (NAV) for investment fund units or expected recovery for distressed bonds. These valuation techniques are based on various assumptions and inputs such as risk-free rate, expected revenue growth and credit and liquidity spreads. In some cases, where significant inputs into these models are not observable, expert judgement and estimation for these inputs are required.

Level 1: Fair value established from quoted market prices.

Assets at this level are financial assets and financial liabilities containing actively traded bonds and equities that are listed either domestically or abroad.

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

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

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

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

The economic crisis relating to the COVID-19 pandemic is the main reason for the decrease in Level 3 assets during the period.

At 31 March 2020 the Group's Level 3 equities amounted to ISK 2,728 million:

-These include shares in seven professional investment funds and investment companies investing in unlisted equities and specialised investments in Iceland totalling ISK 1,383 million. The Group receives information from fund managers which use valuation models for the valuation of these equities.

-Other Level 3 equities amounting to ISK 1,345 million.

-Preferred Series C shares in Visa Inc., which Borgun hf. holds, were reclassified as held for sale during the period and transfered to "Non-current assets and disposal groups held for sale".

At 31 March 2020 the Group's Level 3 bonds amounted to ISK 508 million:

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

Amounts are in ISK million

7. Cont'd

Sensitivity analysis for Level 3 assets

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

The table below shows how profit (loss) and total comprehensive income would have been affected if one or more of the inputs for fair value measurement in Level 3 were changed.

At 31 March 2020

Effect on profit or (loss):	Carrying amount	Very favourable	Favourable	Unfavourable	Very unfavour-able
Level 3 Bonds and debt instruments	508	928	269	(242)	(483)
Level 3 Shares and equity instruments	2,728	1,392	464	(487)	(753)

At 31 December 2019

Effect on profit or (loss):	Carrying amount	Very favourable	Favourable	Unfavourable	Very unfavour-able
Level 3 Bonds and debt instruments	1,348	330	257	(296)	(1,348)
Level 3 Shares and equity instruments	2,901	2,399	645	(762)	(1,614)
Effect on comprehensive income:					
Level 3 Shares in Visa Inc.	3,115	1,246	623	(623)	(1,246)

8. Financial instruments not carried at fair value

Assets

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

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

Liabilities

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

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

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

The following table shows the fair value measurement and classification of the Group's assets and liabilities not carried at fair value. The different levels are defined in Note 7.

Amounts are in ISK million

8. Cont'd

At 31 March 2020	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Cash and balances with Central Bank	-	123,062	-	123,062	123,062
Loans to credit institutions	-	84,263	-	84,263	84,263
Loans to customers	-	-	929,230	929,230	923,850
Other financial assets	-	4,936	-	4,936	4,936
Total financial assets	-	212,261	929,230	1,141,491	1,136,111
Deposits from Central Bank and credit institutions	-	33,989	-	33,989	33,773
Deposits from customers	-	648,150	-	648,150	647,795
Debt issued and other borrowed funds	174,276	101,296	-	275,572	267,152
Subordinated loans	-	21,999	-	21,999	24,456
Other financial liabilities	-	12,817	-	12,817	12,817
Total financial liabilities	174,276	818,251	-	992,527	985,993

At 31 December 2019	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Cash and balances with Central Bank	-	146,638	-	146,638	146,638
Loans to credit institutions	-	54,376	-	54,376	54,376
Loans to customers	-	-	902,053	902,053	899,632
Other financial assets	-	5,757	-	5,757	5,757
Total financial assets	-	206,771	902,053	1,108,824	1,106,403
Deposits from Central Bank and credit institutions	-	31,027	-	31,027	30,925
Deposits from customers	-	618,592	-	618,592	618,313
Debt issued and other borrowed funds	165,044	100,334	-	265,378	257,029
Subordinated loans	22,626	-	-	22,626	22,674
Other financial liabilities	-	24,772	-	24,772	24,772
Total financial liabilities	187,670	774,725	-	962,395	953,713

9. Offsetting financial assets and financial liabilities

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

	Financial assets subject to netting arrangements			Amounts not set off but subject to master netting arrangements and similar agreements					
At 31 March 2020	Financial assets before netting	Netting with financial liabilities	Net financial assets	Financial liabilities	Cash collateral received	Financial instruments collateral received	Net amount after consideration of potential effect of netting arrangements	Assets outside the scope of offsetting disclosure requirements	Total financial assets recognised in the balance sheet
Reverse repurchase agreements	555	-	555	-	-	-	555	-	555
Derivatives	4,772	-	4,772	(1,151)	(3,185)	(625)	(189)	-	4,772
Total assets	5,327	-	5,327	(1,151)	(3,185)	(625)	366	-	5,327

Amounts are in ISK million

9. Cont'd

At 31 December 2019	Financial assets subject to netting arrangements: Financial assets before netting	Netting with financial liabilities	Net financial assets	Amounts not set off but subject to master netting arrangements and similar agreements: Financial liabilities	Cash collateral received	Financial instruments collateral received	Net amount after consideration of potential effect of netting arrangements	Assets outside the scope of offsetting disclosure requirements	Total financial assets recognised in the balance sheet
Reverse repurchase agreements ..	1,114	-	1,114	-	-	-	1,114	-	1,114
Derivatives	5,621	-	5,621	(1,374)	(3,146)	(88)	1,013	-	5,621
Total assets	6,735	-	6,735	(1,374)	(3,146)	(88)	2,127	-	6,735

At 31 March 2020	Financial liabilities subject to netting arrangements: Financial liabilities before netting	Netting with financial assets	Net financial liabilities	Amounts not set off but subject to master netting arrangements and similar agreements: Financial assets	Cash collateral pledged	Financial instruments collateral pledged	Net amount after consideration of potential effect of netting arrangements	Liabilities outside the scope of offsetting disclosure requirements	Total financial liabilities recognised in the balance sheet
Derivative instruments and short positions	12,045	-	12,045	(1,151)	(2,741)	-	8,153	-	12,045
At 31 December 2019									
Derivative instruments and short positions	6,219	-	6,219	(1,374)	(1,139)	-	3,706	-	6,219

10. Quarterly statements

	2020 Q1	2019 Q4	2019 Q3	2019 Q2	2019 Q1
Net interest income	8,580	8,291	8,190	8,404	7,937
Net fee and commission income	2,491	2,945	2,549	2,758	2,647
Net financial income (expense)	(1,738)	(840)	(602)	180	442
Net foreign exchange gain (loss)	55	116	159	(15)	(121)
Other operating income	19	920	37	27	1,141
Salaries and related expenses	(3,247)	(3,624)	(3,242)	(3,689)	(3,464)
Other operating expenses	(2,445)	(2,823)	(2,366)	(2,531)	(2,749)
Contribution to the Depositors' and Investors' Guarantee Fund	(228)	(216)	(210)	(198)	(312)
Bank tax	(359)	(814)	(900)	(934)	(880)
Net impairment on financial assets	(3,490)	(1,463)	(208)	(902)	(907)
Profit (loss) before tax	(362)	2,492	3,407	3,100	3,734
Income tax expense	(769)	(659)	(1,328)	(726)	(1,196)
Profit (loss) for the period from continuing operations	(1,131)	1,833	2,079	2,374	2,538
Discontinued operations, net of income tax	(245)	(174)	7	(254)	51
Profit (loss) for the period	(1,376)	1,659	2,086	2,120	2,589

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

11. Net interest income

	2020 1.1-31.3	2019 1.1-31.3
Cash and balances with Central Bank	1,002	1,266
Loans at amortised cost	12,090	13,162
Financial assets mandatorily at fair value through profit or loss	551	568
Other assets	2	10
Total interest income	13,645	15,006
Deposits from Central Bank and credit institutions	(221)	(107)
Deposits from customers	(2,463)	(4,043)
Debt issued and other borrowed funds at fair value through profit or loss	(142)	(180)
Debt issued and other borrowed funds at amortised cost	(2,047)	(2,219)
Subordinated loans	(166)	(80)
Other interest expense*	(26)	(440)
Total interest expense	(5,065)	(7,069)
Net interest income	8,580	7,937

*Thereof is lease liabilities' interest expense amounting to ISK 22 million (2019: ISK 24 million).

12. Net fee and commission income

	2020 1.1-31.3	2019 1.1-31.3
Asset management	565	548
Investment banking and brokerage	571	531
Payment processing	814	830
Loans and guarantees	383	378
Other fee and commission income	430	585
Total fee and commission income	2,763	2,872
Brokerage	(53)	(69)
Clearing and settlement	(219)	(134)
Other fee and commission expense	-	(22)
Total fee and commission expense	(272)	(225)
Net fee and commission income	2,491	2,647

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

13. Net financial income (expense)

	2020 1.1-31.3	2019 1.1-31.3
Net gain (loss) on financial assets and liabilities mandatorily at FVTPL	(1,728)	498
Net loss on financial liabilities designated as at FVTPL	(6)	(44)
Net loss on fair value hedges	(4)	(12)
Net financial income (expense)	(1,738)	442

Amounts are in ISK million

14. Net foreign exchange gain (loss)

	2020 1.1-31.3	2019 1.1-31.3
Cash and balances with Central Bank	177	9
Financial assets mandatorily at fair value through profit or loss	1,378	(199)
Loans at amortised cost	29,750	8,316
Other assets	19	1
Net foreign exchange gain for assets	31,324	8,127
Deposits	(13,705)	(3,614)
Debt issued and other borrowed funds designated as at FVTPL	(7,084)	(2,188)
Debt issued and other borrowed funds at amortised cost	(8,700)	(2,200)
Subordinated loans	(1,780)	(246)
Net foreign exchange loss for liabilities	(31,269)	(8,248)
Net foreign exchange gain (loss)	55	(121)

15. Other operating income

	2020 1.1-31.3	2019 1.1-31.3
Share of loss of associates, net of income tax	(19)	-
Legal dispute settlement	-	1,103
Legal fees	22	20
Rental income	10	10
Other net operating income	6	8
Other operating income	19	1,141

16. Salaries and related expenses

	2020 1.1-31.3	2019 1.1-31.3
Salaries	2,504	2,673
Contributions to pension funds	362	400
Social security charges and financial activities tax*	357	369
Other salary-related expenses	24	22
Salaries and related expenses	3,247	3,464

*Financial activities tax calculated on salaries is 5.5% (2019: 5.5%).

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

17. Other operating expenses

	2020 1.1-31.3	2019 1.1-31.3
Professional services	412	502
Software and IT expenses	1,100	1,180
Real estate and office equipment	136	150
Depreciation, amortisation and write-offs	362	361
Other administrative expenses	435	556
Other operating expenses	2,445	2,749

18. Net impairment on financial assets

	2020 1.1-31.3	2019 1.1-31.3
Expected credit loss, on-balance sheet items*	(3,339)	(908)
Expected credit loss, off-balance sheet items	(151)	7
Changes in provision due to court rulings	-	(6)
Net impairment on financial assets	(3,490)	(907)

*The main reasons for the additional expected credit loss allowance are: an increase related to COVID-19 pandemic (ISK 2,600 million), an increase due to a less favourable economic environment (ISK 365 million) and an increased expected credit loss for a few customers (ISK 260 million). For further information see Note 2.

19. Income tax expense

Recognised income tax is based on applicable tax laws. The income tax rate for legal entities in 2020 is 20% (2019: 20%). Special financial activities tax is calculated as 6% of taxable profits exceeding ISK 1 billion in accordance with the Act on Financial Activities Tax no. 165/2011. The effective income tax rate in the Group's income statement for the first quarter 2020 is negative 212.4% (2019: 32.1%).

	2020 1.1-31.3	2019 1.1-31.3
Current tax expense excluding discontinued operations	1,467	1,057
Special financial activities tax	370	237
Difference in prior year's calculated income tax	-	(7)
Changes in deferred tax assets and deferred tax liabilities	(1,068)	(91)
Income tax recognised in the income statement	769	1,196

	2020 1.1-31.3		2019 1.1-31.3	
Profit (loss) before tax	(362)		3,726	
20% income tax calculated on the profit (loss) of the period	(72)	20.0%	745	20.0%
Special financial activities tax	370	(102.2%)	237	6.4%
Expenses (income) not subject to tax	371	(102.5%)	(31)	(0.8%)
Non-deductible expenses	72	(20.0%)	177	4.7%
Other differences	28	(7.7%)	68	1.8%
Effective income tax expense	769	(212.4%)	1,196	32.1%

The Bank is taxed jointly with its subsidiary Íslandssjóðir hf.

Amounts are in ISK million

20. Discontinued operations, net of income tax

	2020 1.1-31.3	2019 1.1-31.3
Net loss from foreclosed assets	(47)	(1)
Net profit (loss) from disposal groups held for sale*	(217)	52
Income tax expense	19	-
Discontinued operations, net of income tax	(245)	51

*For further information about Borgun hf., see Note 4.

21. Earnings per share

	Discontinued operations			
	Excluded		Included	
	2020 1.1-31.3	2019 1.1-31.3	2020 1.1-31.3	2019 1.1-31.3
Profit (loss) attributable to shareholders of the Bank	(1,006)	2,600	(1,251)	2,651
Weighted average number of outstanding shares	10,000	10,000	10,000	10,000
Basic earnings per share	(0.10)	0.26	(0.13)	0.27

The Group's basic and diluted earnings (loss) per share are equal as the Group has not issued any options, warrants, convertibles, or other financial instruments that dilute earnings (loss) per share (2019: none).

22. Cash and balances with Central Bank

	31.3.2020	31.12.2019
Cash on hand	4,367	4,403
Balances with Central Bank	109,867	126,956
Balances with Central Bank subject to special restrictions*	2,102	1,679
Included in cash and cash equivalents	116,336	133,038
Mandatory reserve deposits with Central Bank	6,726	13,600
Cash and balances with Central Bank	123,062	146,638

*Balances as defined in Act no. 37/2016 on the treatment of króna-denominated assets subject to special restrictions and rules no. 490/2016 on special reserve requirements for new foreign currency inflows.

23. Loans to credit institutions

	31.3.2020	31.12.2019
Money market loans	46,571	33,254
Bank accounts	37,649	21,122
Other loans	43	-
Loans to credit institutions	84,263	54,376

Amounts are in ISK million

24. Derivative instruments and short positions

At 31 March 2020	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	1,532	133,003	3,331	71,426
Cross-currency interest rate swaps	528	13,463	3,269	61,110
Equity forwards	904	5,214	104	1,564
Foreign exchange forwards	1,039	14,834	369	4,912
Foreign exchange swaps	736	13,223	4,306	51,529
Bond forwards	33	5,915	335	23,625
Derivatives	4,772	185,652	11,714	214,166
Short positions in listed bonds	-	-	331	285
Total	4,772	185,652	12,045	214,451

At 31 December 2019				
Interest rate swaps	1,254	114,393	3,575	96,212
Cross-currency interest rate swaps	3,015	91,950	880	13,073
Equity forwards	141	4,664	298	4,001
Foreign exchange forwards	212	5,460	321	10,217
Foreign exchange swaps	867	30,990	298	24,928
Bond forwards	132	12,756	33	6,219
Derivatives	5,621	260,213	5,405	154,650
Short positions in listed bonds	-	-	814	734
Total	5,621	260,213	6,219	155,384

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

Short positions are in Icelandic Government bonds and bonds issued by institutions with government guarantees. As a primary dealer the Group has access to securities lending facilities provided by the Central Bank and the Housing Financing Fund. Majority of the securities lending facilities have a maturity of less than a year.

The Group applies hedge accounting only with respect to certain EUR denominated interest rate swaps, whereby the Group pays floating rate interest and receives fixed rate interest. The interest rate swaps are hedging the exposure of changes in the fair value of certain fixed-rate EUR denominated bonds (see Note 33) arising from changes in EURIBOR benchmark interest rates. The Group applies fair value hedge accounting to the hedging relationships and for the purpose of evaluating whether the hedging relationship is expected to be highly effective, the Group assumes that the benchmark interest rate is not altered as a result of IBOR reform. At 31 March 2020 the total fair value of the interest rate swaps was positive and amounted to ISK 965 million (2019: ISK 772 million) and their total notional amount was ISK 46,590 million (2019: ISK 41,250).

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25. Loans to customers

At 31 March 2020	Gross carrying amount			Expected credit loss			Net carrying
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	amount
Individuals	336,701	5,843	7,482	(1,303)	(229)	(955)	347,539
Commerce and services	67,792	58,406	6,359	(553)	(1,730)	(2,387)	127,887
Construction	39,995	1,051	5,248	(335)	(41)	(297)	45,621
Energy	8,055	-	-	(31)	-	-	8,024
Financial services	1,435	1	-	-	-	-	1,436
Industrial and transportation	71,800	11,617	3,449	(285)	(361)	(1,511)	84,709
Investment companies	19,103	6,395	389	(259)	(316)	(128)	25,184
Public sector and non-profit organisations	11,319	40	4	(22)	(2)	-	11,339
Real estate	125,590	22,528	3,038	(514)	(616)	(888)	149,138
Seafood	122,390	642	538	(254)	(5)	(338)	122,973
Loans to customers	804,180	106,523	26,507	(3,556)	(3,300)	(6,504)	923,850

At 31 December 2019							
Individuals	338,335	4,119	9,362	(1,319)	(168)	(1,148)	349,181
Commerce and services	115,679	6,999	6,515	(739)	(194)	(1,772)	126,488
Construction	39,248	849	4,924	(310)	(53)	(238)	44,420
Energy	7,913	-	-	(26)	-	-	7,887
Financial services	2,315	-	-	-	-	-	2,315
Industrial and transportation	77,492	3,338	3,503	(278)	(221)	(1,546)	82,288
Investment companies	19,542	4,369	265	(260)	(216)	(110)	23,590
Public sector and non-profit organisations	12,279	44	15	(23)	(2)	(1)	12,312
Real estate	140,604	3,831	2,345	(542)	(89)	(590)	145,559
Seafood	105,411	249	385	(148)	(10)	(295)	105,592
Loans to customers	858,818	23,798	27,314	(3,645)	(953)	(5,700)	899,632

26. Expected credit loss

Total allowances for expected credit losses

	Stage 1	Stage 2	Stage 3	Total
Cash and balances with Central Bank	4	-	-	4
Loans to credit institutions	125	-	-	125
Loans to customers	3,556	3,300	6,504	13,360
Other financial assets	8	3	-	11
Off-balance sheet loan commitments and financial guarantees	362	348	130	840
At 31 March 2020	4,055	3,651	6,634	14,340

Cash and balances with Central Bank	4	-	-	4
Loans to credit institutions	67	-	-	67
Loans to customers	3,645	953	5,700	10,298
Other financial assets	9	3	86	98
Off-balance sheet loan commitments and financial guarantees	403	55	231	689
At 31 December 2019	4,128	1,011	6,017	11,156

Amounts are in ISK million

26. Cont'd

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

Loans to customers

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2020	3,645	953	5,700	10,298
Transfer to Stage 1	482	(408)	(74)	-
Transfer to Stage 2	(566)	879	(313)	-
Transfer to Stage 3	(50)	(172)	222	-
Transfer to "Non-current assets and disposal groups held for sale"	(50)	(12)	(83)	(145)
Net remeasurement of loss allowance	(204)	2,002	1,122	2,920
New financial assets originated or purchased	482	71	42	595
Derecognitions and maturities	(183)	(13)	(39)	(235)
Write-offs	-	-	(200)	(200)
Recoveries of amounts previously written off	-	-	43	43
Foreign exchange	-	-	(9)	(9)
Unwinding of interests	-	-	93	93
At 31 March 2020	3,556	3,300	6,504	13,360

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2019	3,277	1,079	3,689	8,045
Transfer to Stage 1	1,725	(1,343)	(382)	-
Transfer to Stage 2	(1,336)	1,687	(351)	-
Transfer to Stage 3	(178)	(720)	898	-
Net remeasurement of loss allowance	(1,216)	145	2,727	1,656
New financial assets originated or purchased	1,803	278	353	2,434
Derecognitions and maturities	(430)	(169)	(188)	(787)
Write-offs	-	(4)	(1,616)	(1,620)
Recoveries of amounts previously written off	-	-	249	249
Foreign exchange	-	-	10	10
Unwinding of interests	-	-	311	311
At 31 December 2019	3,645	953	5,700	10,298

Off-balance sheet loan commitments and financial guarantees

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2020	403	55	231	689
Transfer to Stage 1	14	(7)	(7)	-
Transfer to Stage 2	(35)	141	(106)	-
Transfer to Stage 3	(2)	(4)	6	-
Net remeasurement of loss allowance	(68)	153	23	108
New loan commitments and financial guarantees	79	13	9	101
Derecognitions and maturities	(29)	(3)	(26)	(58)
At 31 March 2020	362	348	130	840
At 1 January 2019	410	142	84	636
Transfer to Stage 1	152	(81)	(71)	-
Transfer to Stage 2	(20)	39	(19)	-
Transfer to Stage 3	(9)	(18)	27	-
Net remeasurement of loss allowance	(455)	(27)	131	(351)
New loan commitments and financial guarantees	447	20	119	586
Derecognitions and maturities	(122)	(20)	(40)	(182)
At 31 December 2019	403	55	231	689

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

27. Property and equipment

At 31 March 2020	Land and buildings	Right-of-use assets: Buildings	Fixtures, equipment & vehicles	Total
Balance at the beginning of the year	4,096	4,634	4,068	12,798
Additions during the period	3	-	329	332
Disposals and write-offs during the period	-	-	(14)	(14)
Remeasurement	-	11	-	11
Transfer to "Non-current assets and disposal groups held for sale"	(953)	(20)	(807)	(1,780)
Historical cost	3,146	4,625	3,576	11,347
Balance at the beginning of the year	(1,447)	(420)	(1,763)	(3,630)
Depreciation during the period	(6)	(106)	(97)	(209)
Disposals and write-offs during the period	-	-	9	9
Transfer to "Non-current assets and disposal groups held for sale"	109	2	387	498
Accumulated depreciation	(1,344)	(524)	(1,464)	(3,332)
Carrying amount	1,802	4,101	2,112	8,015
Annual deprecion rates	0-2%	8-31%	8-35%	
Official real estate value of land and buildings				1,547
Insurance value of buildings				2,562
Insurance value of fixtures, equipment and vehicles				3,069

At 31 December 2019	Land and buildings	Right-of-use assets: Land, buildings & vehicles	Fixtures, equipment & vehicles	Total
Balance at the beginning of the year	4,054	-	3,984	8,038
Impact of adopting IFRS 16	-	4,505	-	4,505
Additions during the year	56	3	271	330
Disposals and write-offs during the year	(14)	-	(187)	(201)
Remeasurement	-	126	-	126
Historical cost	4,096	4,634	4,068	12,798
Balance at the beginning of the year	(1,402)	-	(1,365)	(2,767)
Depreciation during the year	(47)	(420)	(574)	(1,041)
Disposals and write-offs during the year	2	-	176	178
Accumulated depreciation	(1,447)	(420)	(1,763)	(3,630)
Carrying amount	2,649	4,214	2,305	9,168
Annual deprecion rates	0-2%	3-33%	8-35%	
Official real estate value of land and buildings				2,240
Insurance value of buildings				3,545
Insurance value of fixtures, equipment and vehicles				3,429

Amounts are in ISK million

28. Other assets

	31.3.2020	31.12.2019
Receivables	910	4,810
Unsettled securities transactions	3,462	279
Accruals	224	253
Prepaid expenses	360	468
Deferred tax assets	30	476
Other assets	168	322
Other assets	5,154	6,608

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

	31.3.2020	31.12.2019
Assets of disposal groups classified as held for sale:		
Borgun hf.	19,218	-
Miðengi ehf.	263	292
Repossessed collateral:		
Land and buildings	752	739
Industrial equipment and vehicles	30	44
Non-current assets and disposal groups held for sale	20,263	1,075
Borgun hf.	13,253	-
Non-current liabilities and disposal groups held for sale	13,253	-

For further information about Borgun hf. see Note 4.

30. Deposits from Central Bank and credit institutions

	31.3.2020	31.12.2019
Deposits from credit institutions	33,719	30,808
Repurchase agreements with Central Bank	54	117
Deposits from Central Bank and credit institutions	33,773	30,925

31. Deposits from customers

	31.3.2020	31.12.2019
Demand deposits and deposits with maturity up to 3 months	546,452	530,960
Term deposits with maturity of more than 3 months	101,343	87,353
Deposits from customers	647,795	618,313

Deposits from customers specified by owners	31.3.2020		31.12.2019	
	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	13,116	2%	12,553	2%
Municipalities	7,806	1%	5,619	1%
Companies	320,659	50%	299,204	48%
Individuals	306,214	47%	300,937	49%
Deposits from customers	647,795	100%	618,313	100%

Amounts are in ISK million

32. Pledged assets

	31.3.2020	31.12.2019
Financial assets pledged as collateral against liabilities	214,782	205,773
Financial assets pledged as collateral in foreign banks	2,738	402
Financial assets pledged as collateral in repurchase agreements	529	1,114
Pledged assets against liabilities	218,049	207,289

The Group has pledged assets against the issuance of covered bonds under Icelandic law, which are pledged on a pool of consumer mortgage loans.

The Group has also pledged cash in foreign banks and financial institutions, mainly as collateral for trades under ISDA agreements to hedge market risk.

33. Debt issued and other borrowed funds

	Issued	Maturity		Interest	31.3.2020	31.12.2019
Covered bonds in ISK	2019	2021	At maturity	Fixed rates	4,792	3,918
Covered bonds in ISK	2015-2019	2023	At maturity	Fixed rates	23,446	20,170
Covered bonds in ISK - CPI-linked	2014-2015	2020	At maturity	Fixed rates	4,408	4,359
Covered bonds in ISK - CPI-linked	2015-2017	2022	At maturity	Fixed rates	18,477	18,512
Covered bonds in ISK - CPI-linked	2012-2018	2024	At maturity	Fixed rates	35,504	35,752
Covered bonds in ISK - CPI-linked	2015-2018	2026	At maturity	Fixed rates	27,953	27,661
Covered bonds in ISK - CPI-linked	2019	2028	Amortising	Fixed rates	16,125	14,228
Covered bonds in ISK - CPI-linked	2017-2018	2030	At maturity	Fixed rates	25,703	25,463
Covered bonds					156,408	150,063
Senior unsecured bonds in EUR**	2016	2020	At maturity	Fixed rates	8,886	7,782
Senior unsecured bonds in SEK*	2019	2020	At maturity	Floating rates	1,764	4,557
Senior unsecured bonds in SEK	2018	2021	At maturity	Fixed rates	1,403	1,308
Senior unsecured bonds in SEK	2018-2019	2021	At maturity	Floating rates	20,398	18,913
Senior unsecured bonds in EUR	2019	2021	At maturity	Floating rates	1,783	1,559
Senior unsecured bonds in SEK	2018	2022	At maturity	Floating rates	14,016	12,990
Senior unsecured bonds in EUR**	2019	2022	At maturity	Fixed rates	46,242	41,570
Senior unsecured bonds in NOK	2019	2022	At maturity	Floating rates	13,639	13,856
Senior unsecured bonds in EUR***	2018	2024	At maturity	Fixed rates	47,448	41,816
Senior unsecured bonds in NOK	2019	2024	At maturity	Fixed rates	5,458	5,709
Senior unsecured bonds in ISK	2019	2024	Monthly	Floating rates	3,362	3,553
Bonds issued					164,399	153,613
Bills issued					1,396	2,705
Other debt securities					77	-
Other borrowed funds					1,473	2,705
Debt issued and other borrowed funds					322,280	306,381

*The Bank repurchased own bonds during the period amounting to ISK 3,152 million.

**These bond issuances are classified as being designated as at fair value through profit or loss. At 31 March 2020 the total carrying amount of the bonds amounted to ISK 55,128 million and included in the amount are fair value changes amounting to ISK 670 million. The carrying amount of the bond at 31 March 2020 was ISK 879 million lower than the contractual amount due at maturity.

Amounts are in ISK million

33. Cont'd

***The Group applies hedge accounting to this bond issuance and uses certain EUR denominated interest rate swaps as hedging instruments (see Note 24). The interest rate swaps are hedging the exposure of the Group's changes in the fair value of this fixed-rate EUR denominated bond arising from changes in EURIBOR benchmark interest rates. The Group applies fair value hedge accounting to the hedging relationships and for the purpose of evaluating whether the hedging relationship is expected to be highly effective, the Group assumes that the benchmark interest rate is not altered as a result of IBOR reform. At 31 March 2020 the total carrying amount of the bond issuance amounted to ISK 47,448 million and included in the amount are fair value changes amounting to ISK 905 million.

The Bank has issued additional covered bonds to hold for the purpose of securities lending with regards to market making agreements. These covered bond amounts are not included in the total.

34. Subordinated loans

	Issued	Maturity		Interest	31.3.2020	31.12.2019
Loans which qualify as Tier 2 capital:						
Subordinated loans in SEK	2017	2027	At maturity	Floating, STIBOR + 2.0%	10,479	9,714
Subordinated loans in SEK	2018	2028	At maturity	Floating, STIBOR + 2.5%	6,996	6,485
Subordinated loans in SEK	2019	2029	At maturity	Floating, STIBOR + 3.9%	6,981	6,475
Subordinated loans					24,456	22,674

35. Changes in liabilities arising from financing activities

			Non-cash changes			
	1.1.2020	Cash flows	Interest expense	Foreign exchange	Fair value changes	31.3.2020
Covered bonds in ISK	24,088	3,805	345	-	-	28,238
Covered bonds in ISK - CPI-linked	125,975	963	1,232	-	-	128,170
Senior unsecured bonds in ISK	3,553	(216)	25	-	-	3,362
Senior unsecured bonds FX	58,892	(3,594)	292	2,871	-	58,461
Senior unsecured bonds FX at fair value	49,352	-	142	7,084	(1,450)	55,128
Senior unsecured bonds used for hedging	41,816	(463)	132	5,829	134	47,448
Other borrowed funds	2,705	(1,253)	21	-	-	1,473
Subordinated loans	22,674	(164)	166	1,780	-	24,456
Total	329,055	(922)	2,355	17,564	(1,316)	346,736

			Non-cash changes			
	1.1.2019	Cash flows	Interest expense	Foreign exchange	Fair value changes	31.12.2019
Covered bonds in ISK	20,756	2,060	1,272	-	-	24,088
Covered bonds in ISK - CPI-linked	118,057	1,263	6,655	-	-	125,975
Senior unsecured bonds in ISK	-	3,528	25	-	-	3,553
Senior unsecured bonds FX	46,162	12,139	1,016	(425)	-	58,892
Senior unsecured bonds FX at fair value	68,154	(22,509)	734	1,667	1,306	49,352
Senior unsecured bonds used for hedging	40,714	(465)	497	786	284	41,816
Other borrowed funds	7,133	(4,809)	358	23	-	2,705
Subordinated loans	16,216	6,190	501	(233)	-	22,674
Total	317,192	(2,603)	11,058	1,818	1,590	329,055

Amounts are in ISK million

36. Other liabilities

	31.3.2020	31.12.2019
Accruals	2,650	3,217
Liabilities to retailers for credit cards	-	14,765
Lease liabilities	4,152	4,256
Provision for effects of court rulings	75	75
Expected credit loss for off-balance sheet loan commitments and financial guarantees	840	689
Withholding tax	697	1,559
Unsettled securities transactions	4,636	515
Deferred income	-	229
Sundry liabilities	1,342	1,758
Other liabilities	14,392	27,063

37. Custody assets

	31.3.2020	31.12.2019
Custody assets - not managed by the Group	2,896,570	2,898,686

38. Related party

Íslandsbanki is wholly owned by the Icelandic Government. The shares are administered by the Icelandic State Financial Investments (ISFI). As a result, the Icelandic Government and the Icelandic State Financial Investments are defined as related parties. The Group has applied the partial exemption for government-related entities, as described in IAS 24, and does not disclose those transactions in the related party note.

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

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

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

Cash and balances with the Central Bank are disclosed under Note 22 and Deposits from the Central Bank are disclosed under Note 30.

All loans to employees are provided on general business terms of the Group and the balances do not reflect collaterals held by the Group.

At 31 March 2020	Assets	Liabilities	Net balance	Commitments, guarantees & overdrafts
Board of Directors, key management personnel and other related parties	284	456	(172)	54
Associated companies	11	860	(849)	18
Balances with related parties	295	1,316	(1,021)	72

1 January - 31 March 2020	Interest income	Interest expense	Other income	Other expense
Board of Directors, key management personnel and other related parties	2	-	-	-
Associated companies	-	1	-	414
Transactions with related parties	2	1	-	414

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38. Cont'd

At 31 December 2019	Assets	Liabilities	Net balance	Commitments, guarantees & overdrafts
Board of Directors, key management personnel and other related parties	324	392	(68)	51
Associated companies	16	830	(814)	213
Balances with related parties	340	1,222	(882)	264

1 January - 31 March 2019	Interest income	Interest expense	Other income	Other expense
Board of Directors, key management personnel and other related parties	14	2	-	-
Associated companies	3	5	2	425
Transactions with related parties	17	7	2	425

At 31 March 2020 ISK 1 million were recognised as Stage 1 expected credit loss against balances outstanding with related parties (2019: ISK 2 million). No share option programmes were operated during the reporting period.

39. Contingencies

Contingent liabilities

Borgun hf. – Landsbanki case

Borgun hf., a subsidiary of Íslandsbanki, is a payment acquirer and issuing processor. Landsbankinn hf. sold its 31.2% stake in Borgun hf. in late 2014. Landsbankinn claims that Borgun's management did not disclose all available information that might have affected the value of Borgun hf. during the sales process, namely the worth of its stake in Visa Europe which was sold to Visa International shortly after the Borgun hf. sale. In order to reclaim the alleged loss, Landsbankinn filed a lawsuit against Borgun hf. and others on 12 January 2017, claiming the right to damages for having been deprived of the true value of the stake involved in the sale. Landsbankinn does not quantify the claim, but its estimate of the lost profit from having sold its shares in Borgun hf. is approximately ISK 1,930 million. Court appointed surveyors presented their assessment in November 2019. A reassessment has been demanded. It is uncertain when a ruling is to be expected.

In March 2020 the Group entered into an agreement on the sale of all its stake in Borgun hf. subject to closing, that has not yet taken place. Íslandsbanki has undertaken to reimburse up to 63.47% of losses incurred by Borgun hf. or the buyer as a result of the Landsbanki claim.

Seeing that the conclusion of the case is uncertain and the financial effect cannot be estimated the Group has not recognised a provision in relation to this matter.

Borgun hf. – Chargeback risk

Chargeback risk, is a risk that Borgun hf. faces when merchants have been paid and claims occur from third parties (e.g. cardholders). This can occur when the merchant can't provide the sold services or goods, e.g. due to the effects of the COVID-19 pandemic.

Merchants turnover, chargeback rates and other factors are closely monitored. Borgun hf. assesses the chargeback risk for each seller. The assessment takes into account the type of transaction, business history and other factors. Borgun hf. has procedures, internal rules and processes which aim is to limit chargeback risk. Merchants status and payments are monitored to reduce possible financial loss of Borgun hf. if the sellers are unable to fulfil their obligations. Borgun hf. has estimated that the chargeback risk can vary from ISK 200 million to ISK 1,000 million. The Group has not recognised a provision in relation to the chargeback risk.

40. Events after the reporting period

No events have arisen after the reporting period that require amendments or additional disclosures in the interim financial statements for the first quarter 2020.

Amounts are in ISK million

41. Risk management

Risk governance

The Group is exposed to various risk factors and managing these risks is an integral part of its operations. More information about the Group's risk management and risk assessment processes is available in the unaudited Pillar 3 2019 Report, which is available on the Bank's website: www.islandsbanki.is.

42. Credit risk

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

Credit concentration risk is the significantly increased risk that is driven by common underlying factors, e.g. industrial sector, economy, geographical location, type of financial instrument or due to connections or relations among counterparties. This includes exposures to parties under common control and significant exposures to groups of counterparties whose likelihood of default is driven by common underlying factors.

Credit risk arises principally from loans and advances to customers and other banks but also from balances with the Central Bank and off-balance sheet items such as financial guarantees, loan commitments and derivatives.

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

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

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

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43. Maximum credit exposure

The Group's credit risk exposure comprises both on-balance sheet and off-balance sheet items. Maximum exposure to credit risk for on-balance sheet assets is the net carrying amount as reported in the statement of financial position. The maximum exposure for off-balance sheet items is the amount that the Group might have to pay out against financial guarantees and loan commitments, less provisions that have been made because of these items. The maximum credit exposure for a derivative contract is calculated by adding potential future credit exposure to the positive market value of the contract.

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

The Group's credit exposure, before taking account of any collateral held or other credit enhancements, is as follows:

At 31 March 2020	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrial and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	123,062	-	-	-	-	-	-	-	-	-	123,062
Loans to credit institutions	-	-	-	-	-	84,263	-	-	-	-	-	84,263
Bonds and debt instruments	-	45,554	18	-	681	21,116	456	34	1,045	464	-	69,368
Derivatives	1	-	100	-	-	6,053	1,005	608	-	528	599	8,894
Loans to customers:	347,539	-	127,887	45,621	8,024	1,436	84,709	25,184	11,339	149,138	122,973	923,850
Overdrafts	13,017	-	13,180	3,435	28	1,425	6,183	784	332	3,377	3,168	44,929
Credit cards	13,578	-	1,237	222	5	11	377	22	90	53	26	15,621
Mortgages	285,670	-	-	-	-	-	-	-	-	-	-	285,670
Capital leases	5,649	-	30,764	2,788	15	-	7,273	152	37	979	215	47,872
Other loans	29,625	-	82,706	39,176	7,976	-	70,876	24,226	10,880	144,729	119,564	529,758
Other financial assets	583	11	215	15	-	3,802	21	155	47	79	8	4,936
Off-balance sheet items:	35,482	-	25,342	13,674	460	6,418	14,425	634	4,239	16,891	12,612	130,177
Financial guarantees	1,499	-	5,906	4,537	-	1,234	3,089	101	6	2,023	275	18,670
Undrawn loan commitments	-	-	1,622	5,977	148	-	5,004	-	-	9,483	2,457	24,691
Undrawn overdrafts	8,753	-	13,316	2,352	282	5,060	5,173	376	3,487	5,108	9,713	53,620
Credit card commitments	25,230	-	4,498	808	30	124	1,159	157	746	277	167	33,196
Maximum credit exposure	383,605	168,627	153,562	59,310	9,165	123,088	100,616	26,615	16,670	167,100	136,192	1,344,550

Amounts are in ISK million

43. Cont'd

At 31 December 2019	Individuals	Central governments	Commerce and services	Construction	Energy	Financial services	Industrial and transportation	Investment companies	Public sector and non-profit organisations	Real estate	Seafood	Total
Cash and balances with Central Bank	-	146,638	-	-	-	-	-	-	-	-	-	146,638
Loans to credit institutions	-	-	-	-	-	54,376	-	-	-	-	-	54,376
Bonds and debt instruments	-	33,007	-	-	125	16,131	1,296	52	1,027	1,232	-	52,870
Derivatives	-	-	706	-	1,836	5,788	189	530	-	208	228	9,485
Loans to customers:	349,181	-	126,488	44,420	7,887	2,315	82,288	23,590	12,312	145,559	105,592	899,632
Overdrafts	12,333	-	14,506	3,425	110	2,289	4,927	654	1,204	3,220	6,270	48,938
Credit cards	16,466	-	1,579	271	5	24	437	40	106	63	35	19,026
Mortgages	281,450	-	5	-	-	-	-	-	-	44	-	281,499
Capital leases	5,774	-	28,422	2,700	15	-	7,322	139	39	1,005	207	45,623
Other loans	33,158	-	81,976	38,024	7,757	2	69,602	22,757	10,963	141,227	99,080	504,546
Other financial assets	532	-	199	7	6	4,803	117	41	10	36	6	5,757
Off-balance sheet items:	33,964	-	24,605	16,035	2,974	6,579	18,865	548	3,461	19,036	9,738	135,805
Financial guarantees	1,477	-	6,035	4,914	-	1,172	2,907	95	5	2,004	252	18,861
Undrawn loan commitments	-	-	1,871	8,297	2,442	-	9,726	-	-	11,303	1,804	35,443
Undrawn overdrafts	9,842	-	12,476	2,063	503	5,291	5,135	314	2,733	5,456	7,525	51,338
Credit card commitments	22,645	-	4,223	761	29	116	1,097	139	723	273	157	30,163
Maximum credit exposure	383,677	179,645	151,998	60,462	12,828	89,992	102,755	24,761	16,810	166,071	115,564	1,304,563

44. Credit exposure covered by collateral

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

In some cases the Group uses guarantees as a credit enhancement but since guarantees effectively transfer credit risk from one counterparty to another they do not represent a reduction in maximum exposure to credit risk. Covenants in loan agreements are also an important credit enhancement but do not reduce maximum credit exposure.

Amounts are in ISK million

44. Cont'd

Valuation of collateral is based on market price, official valuation for tax purposes or expert opinion of the Group's employees, depending on availability. In the case of fishing vessels the associated fishing quota is included in the valuation. Collateral is allocated according to the gross carrying amount of loans and nominal off-balance sheet items, and is measured without including the effect of overcollateralisation. This means that if some loans have collateral values in excess of their gross carrying amount, then the excess is removed in order to reflect the Group's actual maximum exposure to credit risk. The total value of pledged assets can thus be higher than the cover indicates. The maximum credit risk exposure is measured on net carrying value basis, and therefore collateral allocation can in some instances be higher. For capital leases the Group remains the owner of the leased object. In total ISK 39,188 million of the collateral are leased objects.

The following tables show the maximum exposure to credit risk by class of financial asset and collateral held against those exposures. An overview of collateral held by the Group against credit exposure is shown below for exposures in Stages 1 and 2 (non credit-impaired) and exposures in Stage 3 (credit-impaired):

At 31 March 2020 **Collateral held against non credit-impaired exposures**	Maximum exposure to credit risk	Real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral	Net exposure	Associated ECL
Derivatives	8,894	-	-	1,459	-	-	1,459	7,435	-
Loans and commitments to customers:	1,032,761	623,455	100,519	7,930	52,724	78,423	863,051	169,710	7,566
Individuals	376,382	297,716	8	411	13,397	126	311,658	64,724	1,629
Commerce and services	149,168	63,517	783	805	29,784	25,344	120,233	28,935	2,543
Construction	53,304	40,134	11	865	2,038	3,795	46,843	6,461	500
Energy	8,484	5,586	-	368	7	5	5,966	2,518	34
Financial services	7,854	-	-	126	-	1,995	2,121	5,733	8
Industrial and transportation	97,189	46,129	10	159	6,999	15,892	69,189	28,000	705
Investment companies	25,558	7,700	-	3,958	79	12,992	24,729	829	579
Public sector and non-profit organisations	15,575	997	-	4	26	-	1,027	14,548	28
Real estate	163,866	148,248	5	1,209	299	1,154	150,915	12,951	1,268
Seafood	135,381	13,428	99,702	25	95	17,120	130,370	5,011	272
Total	1,041,655	623,455	100,519	9,389	52,724	78,423	864,510	177,145	7,566
Collateral held against credit-impaired exposures									
Loans and commitments to customers:	21,266	16,791	1,303	309	833	548	19,784	1,482	6,634
Individuals	6,639	5,848	17	3	151	6	6,025	614	991
Commerce and services	4,061	2,942	98	1	476	290	3,807	254	2,443
Construction	5,991	5,406	-	188	87	249	5,930	61	323
Industrial and transportation	1,945	260	1,158	117	76	-	1,611	334	1,519
Investment companies	260	246	-	-	7	-	253	7	128
Public sector and non-profit organisations	3	2	-	-	-	-	2	1	-
Real estate	2,163	1,957	-	-	12	-	1,969	194	890
Seafood	204	130	30	-	24	3	187	17	340
Total	21,266	16,791	1,303	309	833	548	19,784	1,482	6,634

Amounts are in ISK million

44. Cont'd

At 31 December 2019 **Collateral held against non credit-impaired exposures**	Maximum exposure to credit risk	Real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral	Net exposure	Associated ECL
Derivatives	9,485	-	-	1,757	-	-	1,757	7,728	-
Loans and commitments to customers:	1,012,821	622,021	87,217	7,001	49,865	80,043	846,147	166,674	5,056
Individuals	374,718	292,701	7	417	13,317	116	306,558	68,160	1,579
Commerce and services	146,149	63,151	777	961	27,124	25,891	117,904	28,245	1,030
Construction	55,236	40,432	4	653	2,130	3,968	47,187	8,049	495
Energy	10,861	5,655	-	366	8	5	6,034	4,827	34
Financial services	8,894	-	-	123	-	3,621	3,744	5,150	7
Industrial and transportation	99,188	49,944	12	107	6,757	18,566	75,386	23,802	534
Investment companies	23,982	7,748	-	3,281	71	11,930	23,030	952	478
Public sector and non-profit organisations	15,758	958	-	7	29	-	994	14,764	29
Real estate	162,795	148,919	5	1,072	301	1,125	151,422	11,373	702
Seafood	115,240	12,513	86,412	14	128	14,821	113,888	1,352	168
Total	1,022,306	622,021	87,217	8,758	49,865	80,043	847,904	174,402	5,056
Collateral held against credit-impaired exposures									
Loans and commitments to customers:	22,616	17,100	1,481	333	846	830	20,590	2,026	5,931
Individuals	8,427	7,191	17	12	166	2	7,388	1,039	1,245
Commerce and services	4,944	2,980	102	22	561	805	4,470	474	1,864
Construction	5,219	4,919	-	197	19	7	5,142	77	261
Industrial and transportation	1,965	253	1,331	102	72	16	1,774	191	1,559
Investment companies	156	149	-	-	-	-	149	7	111
Public sector and non-profit organisations	15	14	-	-	-	-	14	1	1
Real estate	1,800	1,567	-	-	9	-	1,576	224	595
Seafood	90	27	31	-	19	-	77	13	295
Total	22,616	17,100	1,481	333	846	830	20,590	2,026	5,931

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

45. Credit quality of financial assets

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

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

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

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

Risk classes 1-4 represent low risk, risk classes 5-6 moderate risk, risk classes 7-8 increased risk, risk class 9 high risk, and risk class 10 represents customers that are in default. Unrated are loans originating from subsidiaries of Íslandsbanki that do not have rating models, in addition to loans that are yet to be rated.

Further information on the risk classes, including the mapping from risk classes to the probability of default, can be found in Section 4.2.2 of the unaudited Pillar 3 2019 Report.

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

Due to COVID-19 pandemic the Group transferred a relatively large proportion of assets from Stage 1 to Stage 2 during the period. The Group did not re-evaluate the risk classes of the borrowers affected but instead applied an overlay factor to the expected credit loss (see Note 2).

At 31 March 2020

Loans to customers:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	230,462	6,982	-	237,444
Risk class 5-6	342,089	60,265	-	402,354
Risk class 7-8	197,964	28,120	-	226,084
Risk class 9	33,483	10,991	-	44,474
Risk class 10	-	-	26,507	26,507
Unrated	182	165	-	347
	804,180	106,523	26,507	937,210
Expected credit loss	(3,556)	(3,300)	(6,504)	(13,360)
Net carrying amount	800,624	103,223	20,003	923,850

Off-balance sheet loan commitments and financial guarantees:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	56,328	2,264	-	58,592
Risk class 5-6	44,732	8,416	-	53,148
Risk class 7-8	13,887	2,377	-	16,264
Risk class 9	1,052	516	-	1,568
Risk class 10	-	-	1,393	1,393
Unrated	47	5	-	52
	116,046	13,578	1,393	131,017
Expected credit loss	(362)	(348)	(130)	(840)
Total	115,684	13,230	1,263	130,177

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At 31 March 2020	Risk class 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Unrated	ECL	Total
Loans and commitments to customers:								
Individuals	77,344	144,153	123,592	32,813	7,635	104	(2,620)	383,021
Commerce and services	31,424	85,645	29,664	4,887	6,505	90	(4,986)	153,229
Construction	4,139	32,004	16,532	1,117	6,314	12	(823)	59,295
Energy	2,744	3,824	1,950	-	-	-	(34)	8,484
Financial services	7,810	31	15	-	-	6	(8)	7,854
Industrial and transportation	28,006	55,807	11,763	2,326	3,456	-	(2,224)	99,134
Investment companies	2,749	9,644	12,057	1,502	389	184	(707)	25,818
Public sector and non-profit organisations	12,645	2,704	244	7	4	2	(28)	15,578
Real estate	54,539	66,158	41,690	2,747	3,053	-	(2,158)	166,029
Seafood	74,636	55,532	4,841	643	544	1	(612)	135,585
Total	296,036	455,502	242,348	46,042	27,900	399	(14,200)	1,054,027

At 31 December 2019

Loans to customers:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	226,347	289	-	226,636
Risk class 5-6	388,936	1,385	-	390,321
Risk class 7-8	204,979	14,487	-	219,466
Risk class 9	33,880	7,544	-	41,424
Risk class 10	-	-	27,160	27,160
Unrated	4,676	93	154	4,923
	858,818	23,798	27,314	909,930
Expected credit loss	(3,645)	(953)	(5,700)	(10,298)
Net carrying amount	855,173	22,845	21,614	899,632

Off-balance sheet loan commitments and financial guarantees:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	58,327	25	-	58,352
Risk class 5-6	58,271	253	-	58,524
Risk class 7-8	15,334	1,757	-	17,091
Risk class 9	1,095	186	-	1,281
Risk class 10	-	-	1,233	1,233
Unrated	8	5	-	13
	133,035	2,226	1,233	136,494
Expected credit loss	(403)	(55)	(231)	(689)
Total	132,632	2,171	1,002	135,805

Amounts are in ISK million

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At 31 December 2019	Risk class 1-4	Risk class 5-6	Risk class 7-8	Risk class 9	Risk class 10	Unrated	ECL	Total
Loans and commitments to customers:								
Individuals	76,119	151,224	115,042	29,537	9,517	4,530	(2,824)	383,145
Commerce and services	29,718	81,536	31,572	3,968	6,810	383	(2,894)	151,093
Construction	3,354	33,345	17,924	1,120	5,468	-	(756)	60,455
Energy	5,045	3,846	2,004	-	-	-	(34)	10,861
Financial services	8,848	30	17	-	-	6	(7)	8,894
Industrial and transportation	26,474	59,108	11,775	2,363	3,526	-	(2,093)	101,153
Investment companies	2,803	9,198	11,090	1,367	268	1	(589)	24,138
Public sector and non-profit organisations	12,761	2,733	268	11	15	15	(30)	15,773
Real estate	52,934	64,623	42,304	3,631	2,400	-	(1,297)	164,595
Seafood	66,932	43,202	4,561	708	389	1	(463)	115,330
Total	284,988	448,845	236,557	42,705	28,393	4,936	(10,987)	1,035,437

46. Forbearance and write-offs

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

The relationship between forbearance and stages is discussed in Note 66.3. in the consolidated financial statements for the year 2019.

Once an asset has been classified as forborne, it will remain forborne for a minimum 24-month probation period. In order for a loan to be reclassified out of the forborne category, the customer has to meet all of the following criteria:
- All of the customer's facilities have to be considered performing; and
- The customer does not have any contract that is more than 30 days past due; and
- The probation period of two years has passed from the date of the forbearance event; and
- Regular payments of more than an insignificant amount of principal or interest have been made during at least half of the probation period

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

At 31 March 2020	Stage 1	Stage 2	Stage 3	Total
Individuals	1,457	1,317	1,337	4,111
Companies	1,377	8,522	11,741	21,640
Gross carrying amount	2,834	9,839	13,078	25,751
Individuals	(11)	(46)	(199)	(256)
Companies	(40)	(469)	(3,076)	(3,585)
Expected credit loss	(51)	(515)	(3,275)	(3,841)

At 31 December 2019	Stage 1	Stage 2	Stage 3	Total
Individuals	1,615	1,102	1,372	4,089
Companies	13,212	8,469	8,289	29,970
Gross carrying amount	14,827	9,571	9,661	34,059
Individuals	(12)	(41)	(182)	(235)
Companies	(77)	(249)	(2,167)	(2,493)
Expected credit loss	(89)	(290)	(2,349)	(2,728)

Amounts are in ISK million

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Gross carrying amount written off and still subject to enforcement activity	2020 1.1-31.3	2019 1.1-31.3
Individuals	128	140
Companies	72	67
Total	200	207

47. Large exposures disclosure

When the Group's total exposure to a group of connected clients is 10% or higher of the Group's capital base it is considered a large exposure. Both on-balance sheet and off-balance sheet items from all types of financial instruments are included in the exposure as defined by regulation no. 233/2017. The Group has internal criteria that define connections between clients. These criteria reflect the Group's interpretation of Article (1)(a) of the Act on Financial Undertakings no. 161/2002, where groups of connected clients are defined. Since the interim financial statements for the first quarter of 2020 are not audited, the official capital is based on reviewed own fund items at 31 December 2019.

The exposure is evaluated both before and after credit risk mitigating effects. After mitigating effects, the Group currently has two large exposures, an increase of two since last reporting date. No large exposure is therefore above the maximum 25% single large exposure limit set by the law.

The following tables show the Group's large exposures as a percentage of the Group's capital base, before and after eligible credit risk mitigating effects.

At 31 March 2020

Groups of connected clients:	Before	After
Group 1	66%	-
Group 2	17%	16%
Group 3	12%	10%

At 31 December 2019

Groups of connected clients:	Before	After
Group 1	75%	-

48. Liquidity risk

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

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

49. Liquidity coverage and Net stable funding ratio

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

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

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The following tables show the NSFR and the LCR for the Group at the end of March 2020 and at year-end 2019.

The calculations are based on consolidated figures including Borgun hf.

Net stable funding ratio	31.3.2020	31.12.2019
For all currencies	120%	119%
Foreign currencies	151%	156%

Liquidity coverage ratio	31.3.2020	31.12.2019
For all currencies	177%	155%
Foreign currencies	324%	325%

At 31 March 2020	For all currencies		Foreign currencies	
	Unweighted	Weighted	Unweighted	Weighted
Liquid assets level 1*	169,434	169,434	39,138	39,138
Liquid assets level 2	10,137	4,948	3,940	610
Total liquid assets	179,571	174,382	43,078	39,748
Deposits	508,940	158,272	91,407	40,031
Debt issued	1,527	1,527	734	734
Other outflows	75,879	31,910	18,736	8,324
Total outflows	586,346	191,709	110,877	49,089
Short-term deposits with other banks**	82,752	78,992	80,305	76,918
Other inflows	32,458	14,442	4,833	3,123
Restrictions on inflows	-	-	(1,980)	(43,224)
Total inflows	115,210	93,434	83,158	36,817
Liquidity coverage ratio		177%		324%

At 31 December 2019	For all currencies		Foreign currencies	
	Unweighted	Weighted	Unweighted	Weighted
Liquid assets level 1*	157,080	157,080	31,858	31,858
Liquid assets level 2	11,942	6,271	3,727	520
Total liquid assets	169,022	163,351	35,585	32,378
Deposits	482,322	139,354	78,089	33,961
Debt issued	1,361	1,361	650	650
Other outflows	81,493	30,997	18,012	5,248
Total outflows	565,176	171,712	96,751	39,859
Short-term deposits with other banks**	54,203	52,335	51,343	50,261
Other inflows	33,984	14,213	6,287	3,558
Restrictions on inflows	-	-	-	(23,925)
Total inflows	88,187	66,548	57,630	29,894
Liquidity coverage ratio		155%		325%

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

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

Amounts are in ISK million

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Deposits by liquidity coverage ratio category

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

	Deposits maturing within 30 days					
At 31 March 2020	Less stable	Weight (%)	Stable	Weight (%)	Term deposits	Total deposits
Retail	230,705	12%	86,654	5%	85,761	403,120
Operational relationships	2,854	25%	-	5%	-	2,854
Corporations	81,315	40%	366	20%	24,007	105,688
Sovereigns, Central Bank and public sector entities	8,614	40%	297	20%	1,133	10,044
Pension funds	41,610	100%	-	-	24,874	66,484
Domestic financial entities	33,927	100%	-	-	40,567	74,494
Foreign financial entities	8,351	100%	-	-	10,533	18,884
Total	407,376		87,317		186,875	681,568

	Deposits maturing within 30 days					
At 31 December 2019	Less stable	Weight (%)	Stable	Weight (%)	Term deposits	Total deposits
Retail	228,447	12%	83,773	5%	78,870	391,090
Operational relationships	2,446	25%	-	5%	-	2,446
Corporations	73,739	40%	337	20%	24,589	98,665
Sovereigns, Central Bank and public sector entities	6,813	40%	253	20%	620	7,686
Pension funds	35,405	100%	-	-	24,869	60,274
Domestic financial entities	28,494	100%	-	-	46,371	74,865
Foreign financial entities	8,038	100%	-	-	6,174	14,212
Total	383,382		84,363		181,493	649,238

50. Maturity analysis of assets and liabilities

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

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

Maturity analysis 31 March 2020

Financial liabilities	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Deposits from CB and credit institutions	33,773	5,817	2,383	17,512	8,636	-	-	34,348
Deposits from customers	647,795	475,552	73,436	67,423	16,609	57,125	-	690,145
Debt issued and other borrowed funds	322,280	-	7,905	31,921	275,358	89,338	-	404,522
Subordinated loans	24,456	-	180	521	2,869	28,281	-	31,851
Other financial liabilities:	12,817	4,048	3,421	1,225	1,786	2,377	-	12,857
Lease liabilities	4,152	-	119	358	1,786	2,377	-	4,640
Other liabilities	8,665	4,048	3,302	867	-	-	-	8,217
Total	1,041,121	485,417	87,325	118,602	305,258	177,121	-	1,173,723

Amounts are in ISK million

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Off-balance sheet liabilities show the amount of contractual obligations that the Group has taken towards customers, either by committing to lend out money in the future or as third party guarantees. The amounts shown reflect the maximum amount, not taking into account the Group's ability to reduce overdraft or credit card limits before the current undrawn amount is fully utilised by the customer. These obligations all fall into the first time bucket since contractually, on a case-by-case basis, the Group could be required to fulfil these obligations instantaneously.

Off-balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees	18,670	-	-	-	-	-	18,670
Undrawn loan commitments	24,691	-	-	-	-	-	24,691
Undrawn overdrafts	53,620	-	-	-	-	-	53,620
Credit card commitments	33,196	-	-	-	-	-	33,196
Total	130,177	-	-	-	-	-	130,177
Total non-derivative financial liabilities and off-balance sheet liabilities	615,594	87,325	118,602	305,258	177,121	-	1,303,900

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

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	50,898	39,906	73,511	-	-	164,315
Outflow	-	(55,759)	(42,191)	(77,036)	-	-	(174,986)
Total	-	(4,861)	(2,285)	(3,525)	-	-	(10,671)
Net settled derivatives	-	(399)	-	-	-	-	(399)
Total	-	(5,260)	(2,285)	(3,525)	-	-	(11,070)

Maturity classification of assets is based on contractual maturity. For bonds and debt instruments in the banking book the maturity classification is based on contractual maturity dates while for bonds and debt instruments held for trading the maturity classification is based on the estimated liquidation time of the asset.

Financial assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Cash and balances with Central Bank	123,062	26,526	94,432	-	-	2,102	-	123,060
Loans to credit institutions	84,263	34,912	49,335	16	-	-	-	84,263
Bonds and debt instruments	69,368	-	18,005	20,489	16,404	14,471	-	69,369
Loans to customers	923,850	4,333	87,595	87,074	323,236	421,612	-	923,850
Shares and equity instruments	12,496	-	-	-	-	-	15,729	15,729
Other financial assets	4,936	4,342	529	57	7	-	-	4,935
Total	1,217,975	70,113	249,896	107,636	339,647	438,185	15,729	1,221,206

Derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	25,113	19,781	26,359	-	-	71,253
Outflow	-	(23,441)	(18,169)	(25,391)	-	-	(67,001)
Total	-	1,672	1,612	968	-	-	4,252
Net settled derivatives	-	921	-	-	-	-	921
Total	-	2,593	1,612	968	-	-	5,173

Amounts are in ISK million

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The following tables show the comparative amounts for maturity analysis at year-end 2019.

Maturity analysis 31 December 2019

Financial liabilities	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Deposits from CB and credit institutions	30,925	1,992	16,363	8,468	4,580	-	-	31,403
Deposits from customers	618,313	453,959	78,232	54,994	16,612	62,222	-	666,019
Debt issued and other borrowed funds	306,381	-	6,991	24,861	267,776	90,610	-	390,238
Subordinated loans	22,674	-	158	463	2,865	26,482	-	29,968
Other financial liabilities:	24,772	17,581	2,124	1,276	1,759	2,448	-	25,188
Lease liabilities	4,256	-	116	349	1,759	2,448	-	4,672
Other liabilities	20,516	17,581	2,008	927	-	-	-	20,516
Total	1,003,065	473,532	103,868	90,062	293,592	181,762	-	1,142,816

Off-balance sheet liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees	18,861	-	-	-	-	-	18,861
Undrawn loan commitments	35,443	-	-	-	-	-	35,443
Undrawn overdrafts	51,338	-	-	-	-	-	51,338
Credit card commitments	30,163	-	-	-	-	-	30,163
Total	135,805	-	-	-	-	-	135,805
Total non-derivative financial liabilities and off-balance sheet liabilities	609,337	103,868	90,062	293,592	181,762	-	1,278,621

Derivative financial liabilities	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	57,542	36,133	43,218	-	-	136,893
Outflow	-	(59,615)	(37,222)	(44,915)	-	-	(141,752)
Total	-	(2,073)	(1,089)	(1,697)	-	-	(4,859)
Net settled derivatives	-	(323)	-	-	-	-	(323)
Total	-	(2,396)	(1,089)	(1,697)	-	-	(5,182)

Financial assets	Carrying amount	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Cash and balances with Central Bank	146,638	28,978	115,981	-	-	1,679	-	146,638
Loans to credit institutions	54,376	20,719	33,656	-	-	-	-	54,375
Bonds and debt instruments	52,870	7,768	23,998	10,120	10,983	-	-	52,869
Loans to customers	899,632	2,972	88,446	87,462	303,668	417,083	-	899,631
Shares and equity instruments	18,426	-	-	-	-	-	18,426	18,426
Other financial assets	5,757	1,889	525	118	17	-	3,259	5,808
Total	1,177,699	62,326	262,606	97,700	314,668	418,762	21,685	1,177,747

Derivative financial assets	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Gross settled derivatives							
Inflow	-	92,680	28,583	74,731	-	-	195,994
Outflow	-	(82,832)	(27,964)	(73,544)	-	-	(184,340)
Total	-	9,848	619	1,187	-	-	11,654
Net settled derivatives	-	273	-	-	-	-	273
Total	-	10,121	619	1,187	-	-	11,927

Amounts are in ISK million

51. Market risk

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

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

52. Interest rate risk

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

Interest rate risk in the trading book

The fixed income trading unit invests mainly in government bonds, bonds issued by the Housing Financing Fund (HFF) which are guaranteed by the Icelandic Government, domestic municipality bonds, and covered bonds issued by other Icelandic banks. Bonds and bills in the Group's liquidity portfolio are also categorised in the trading book. In the following table the total market value (MV) of long and short positions may not be the same as reported in Note 5 since netting between short and long positions is not applied here.

	31.3.2020			31.12.2019		
Trading bonds and debt instruments, long positions	MV	Duration	BPV	MV	Duration	BPV
Indexed	2,310	7.73	(1.79)	1,143	6.84	(0.78)
Non-indexed	39,303	0.41	(1.62)	31,855	0.41	(1.29)
Total	41,613	0.82	(3.41)	32,998	0.63	(2.07)

	31.3.2020			31.12.2019		
Trading bonds and debt instruments, short positions	MV	Duration	BPV	MV	Duration	BPV
Indexed	71	6.00	0.04	150	6.00	0.10
Non-indexed	64	2.00	0.01	615	4.00	0.28
Total	135	4.10	0.05	765	4.39	0.38
Net position of trading bonds and debt instruments	41,478	0.81	(3.36)	32,233	0.54	(1.69)

Amounts are in ISK million

52. Cont'd

Interest rate risk in the banking book

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

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

Sensitivity analysis for interest rate risk in the banking book

At 31 March 2020

Currency	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
ISK, indexed	9	(112)	(230)	(1,724)	2,016	415	374
ISK, non-indexed	(7)	23	(7)	277	(6)	(4)	276
EUR	(39)	68	(1,087)	1,037	-	(1)	(22)
SEK	8	-	-	-	-	-	8
USD	19	-	-	-	-	(1)	18
Other	11	(6)	-	(4)	-	(7)	(6)
Total	1	(27)	(1,324)	(414)	2,010	402	648

At 31 December 2019

Currency	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
ISK, indexed	55	60	(442)	(1,668)	1,995	193	193
ISK, non-indexed	7	(12)	11	89	(10)	(9)	76
EUR	(17)	(20)	(29)	118	-	(2)	50
SEK	10	-	-	-	-	-	10
USD	(42)	-	-	-	-	(1)	(43)
Other	12	(11)	-	41	-	(6)	36
Total	25	17	(460)	(1,420)	1,985	175	322

Amounts are in ISK million

Notes to the Condensed Consolidated Interim Financial Statements

53. Currency risk

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

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

Preferred Series C shares in Visa Inc. which Borgun hf. holds are included in the currency imbalance even though assets and liabilities of Borgun hf. are classified as held for sale. Including the shares gives a more accurate measurement of the Group's currency exposure. If all of Borgun's currency exposure classified as held for sale is included, the total currency imbalance is negative ISK 2.547 billion.

Currency analysis at 31 March 2020

Assets	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	CAD	Other foreign currencies	Total foreign currencies
Cash and balances with Central Bank	829	485	282	72	22	57	60	137	40	157	2,141
Loans to credit institutions	20,150	44,761	1,883	355	317	4,276	9,440	89	753	125	82,149
Bonds and debt instruments	14,770	18,876	7	-	-	-	4,064	-	-	-	37,717
Loans to customers	130,486	33,978	1,253	622	3,657	3	3,388	721	6,417	36	180,561
Shares and equity instruments	31	3,440	451	-	-	-	27	-	-	-	3,949
Other assets	105	363	-	-	-	19	-	-	-	-	487
Total assets	166,371	101,903	3,876	1,049	3,996	4,355	16,979	947	7,210	318	307,004
Liabilities											
Deposits from credit institutions	9,103	554	1	-	-	-	-	-	-	-	9,658
Deposits from customers	36,352	42,889	3,979	603	364	951	2,967	2,219	605	52	90,981
Debt issued and other borrowed funds	104,657	-	-	-	-	37,581	19,096	-	-	-	161,334
Subordinated loans	-	-	-	-	-	24,456	-	-	-	-	24,456
Other liabilities	224	318	-	-	-	6	62	91	-	-	701
Total liabilities	150,336	43,761	3,980	603	364	62,994	22,125	2,310	605	52	287,130
Net on-balance sheet position	16,035	58,142	(104)	446	3,632	(58,639)	(5,146)	(1,363)	6,605	266	19,874
Net off-balance sheet position	(17,662)	(59,519)	177	(424)	(3,622)	58,574	5,025	1,310	(6,559)	(250)	(22,950)
Net position	(1,627)	(1,377)	73	22	10	(65)	(121)	(53)	46	16	(3,076)

Amounts are in ISK million

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Currency analysis at 31 December 2019

Assets	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	CAD	Other foreign currencies	Total foreign currencies
Cash and balances with Central Bank	942	319	210	52	24	51	73	114	58	123	1,966
Loans to credit institutions	11,689	25,740	1,650	378	534	116	9,707	1,294	272	687	52,067
Bonds and debt instruments	12,930	10,937	3	-	-	-	8,232	-	-	-	32,102
Loans to customers	112,185	29,486	2,037	581	3,185	3	3,408	635	6,005	33	157,558
Shares and equity instruments	31	3,371	419	-	-	-	27	-	-	-	3,848
Other assets	390	1,866	338	6	-	73	2	20	-	458	3,153
Total assets	138,167	71,719	4,657	1,017	3,743	243	21,449	2,063	6,335	1,301	250,694
Liabilities											
Deposits from credit institutions	9,145	558	1	-	-	-	-	-	-	-	9,704
Deposits from customers	32,247	27,939	3,810	385	395	874	3,317	3,617	453	42	73,079
Debt issued and other borrowed funds	91,809	-	-	-	-	37,768	19,565	-	-	-	149,142
Subordinated loans	-	-	-	-	-	22,674	-	-	-	-	22,674
Other liabilities	1,728	944	558	35	3	162	5	47	2	665	4,149
Total liabilities	134,929	29,441	4,369	420	398	61,478	22,887	3,664	455	707	258,748
Net on-balance sheet position	3,238	42,278	288	597	3,345	(61,235)	(1,438)	(1,601)	5,880	594	(8,054)
Net off-balance sheet position	(4,344)	(41,574)	(231)	(610)	(3,345)	61,127	1,255	1,726	(5,840)	(203)	7,961
Net position	(1,106)	704	57	(13)	-	(108)	(183)	125	40	391	(93)

Amounts are in ISK million

54. Inflation risk

The Group is exposed to inflation risk since the value of CPI-linked assets exceeds CPI-linked liabilities. The value of these assets and liabilities changes according to changes in the CPI at any given time and all changes in the CPI affect profit and loss. A 1% increase in the index would lead to an ISK 321 million increase in the balance sheet and a 1% decrease would lead to a corresponding decrease, other risk factors held constant.

	31.3.2020	31.12.2019
Bonds and debt instruments	2,990	2,103
Loans to customers	292,791	295,725
Total CPI-linked assets	295,781	297,828
Deposits from customers	100,555	98,766
Debt issued and other borrowed funds	128,170	125,975
Off-balance sheet position	34,912	63,827
Total CPI-linked liabilities	263,637	288,568
CPI imbalance	32,144	9,260

55. Derivatives

The Group uses derivatives to hedge currency exposure, interest rate risk in the banking book as well as inflation risk. However, the Group is subject to indirect exposure through customers' margin trading. Margin trading is subject to continuous monitoring and collateral requirements. Other derivatives held for trading or for other purposes are insignificant.

56. Capital management

The following table shows the capital base, risk exposure amount, the resulting capital ratios, and leverage for the Group at 31 March 2020 and 31 December 2019.

The Group's regulatory capital requirement is calculated according to CRD IV as implemented through Act no. 161/2002 on Financial Undertakings and regulation no. 233/2017 on prudential requirements for financial undertakings. Capital requirement calculations for credit risk and market risk are based on the standardised approach whereas the capital requirement calculations for operational risk are based on the basic indicator approach.

Article 501 of the capital requirements regulation (EU) no. 575/2013 of the European parliament came into effect in Iceland on 1 January 2020. This article stipulates capital requirements deduction for credit risk on exposures to SMEs and lowers the risk exposure amount by ISK 13.6 billion, corresponding to a 30 basis point increase in the Group's capital ratio

The Group aims at managing its capital position and the corresponding capital ratios above the overall regulatory capital requirement. According to the latest SREP report from the Financial Supervisory Authority, applicable as of 30th of September 2019, the overall capital requirement is 18.8%. The Group's capital target includes a 0.5-2.0% management buffer on top of the overall capital requirement.

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

	31.3.2020	31.12.2019
CET1 capital		
Ordinary share capital	10,000	10,000
Share premium	55,000	55,000
Reserves	8,016	7,065
Retained earnings	104,349	105,569
Non-controlling interests	2,177	2,428
Fair value changes due to own credit standing	(773)	392
Tax assets	(30)	(476)
Intangible assets	(3,736)	(4,330)
Total CET1 capital	175,003	175,648

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	31.3.2020	31.12.2019
Tier 2 capital		
Qualifying subordinated liabilities	24,456	22,674
Total capital base	199,458	198,322
Risk exposure amount		
- due to credit risk	811,936	789,180
- due to market risk	12,350	7,919
Market risk, trading book	9,095	6,488
Currency risk	3,255	1,431
- due to credit valuation adjustment	1,665	2,027
- due to operational risk	85,424	85,424
Total risk exposure amount	911,375	884,550
Capital ratios		
Tier 1 ratio	19.2%	19.9%
Total capital ratio	21.9%	22.4%
Official Tier 1 ratio	19.2%	19.9%
Official capital ratio	21.9%	22.4%
Leverage ratio		
Exposure amount		
On-balance sheet exposures	1,247,153	1,189,062
Off-balance sheet exposures	37,218	38,849
Derivative exposures	8,352	9,461
Leverage ratio total exposure measure	1,292,723	1,237,372
Tier 1 capital	175,003	175,648
Leverage ratio	13.5%	14.2%

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