Íslandsbanki

Consolidated Financial Statements 2021

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Factsheet 4Q21

Íslandsbanki

Our profile

With a history that dates from 1875, Íslandsbanki is an Icelandic universal bank with a strong customer focus. The Bank believes in moving Iceland forward by empowering its customers to succeed - reflecting a commitment to run a solid business that is a force for good in society.

Driven by the ambition to be #1 for service, Íslandsbanki's banking model is led by three business divisions that build and manage relationships with its customers. Íslandsbanki maintains a strong market share with the most efficient branch network in the country, supporting at the same time its customers' move to more digital services.

The Bank operates in a highly attractive market and, with its technically strong foundations and robust balance sheet, is well positioned for the opportunities that lie ahead.

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

The Bank's shares are listed on the Nasdaq Iceland Main Market.

The Bank

12 branches

702 number of FTEs at Íslandsbanki at period end

Sustainability 4Q21

- Sustainable lending up by 134% during 2021
- Íslandsbanki awards ISK 35m in grants from Entrepreneurship Fund
- Íslandsbanki awarded the Equality Scale from the Icelandic Association of Business Women (FKA)

Digital milestones 4Q21

- New core lending system fully implemented, increasing efficiency
- Authenticated requests for youth custody accounts and securities trading are now available on the external web
- Credit card numbers are now securely visible in the app

Market share[1]

32% retail customers

37% SMEs

35% large companies

Ratings and certifications

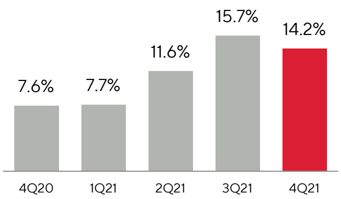
S&P Global Ratings

BBB/A-2 Stable outlook

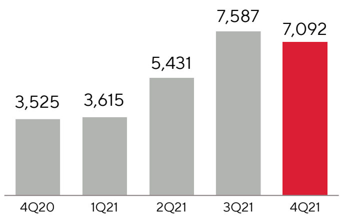
EQUAL PAY CERTIFICATE 2018 - 2021

EXEMPLARY IN CORPORATE GOVERNANCE

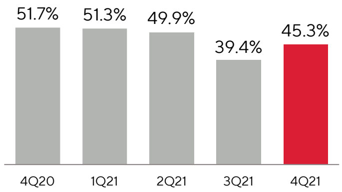
Return on equity



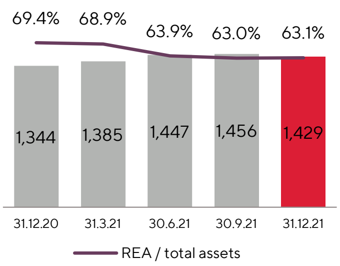
Profit after tax
(ISKm)



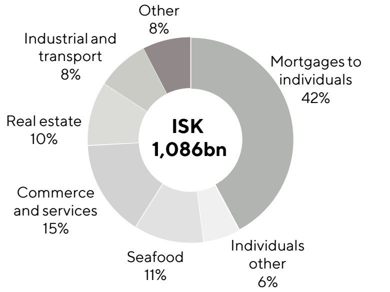
Cost-to-income ratio[2]



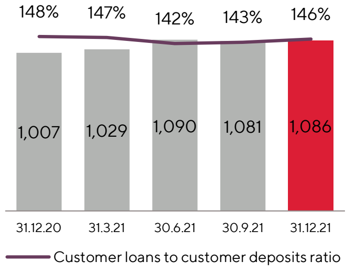
Total assets
(ISKbn)



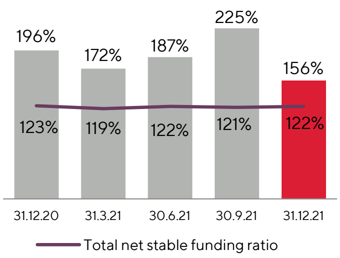
Loans to customers
(Sector split as of 31.12.21)



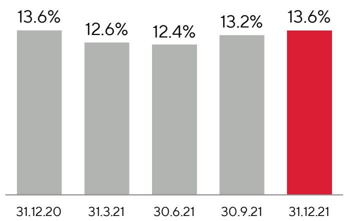
Loans to customers
(ISKbn)



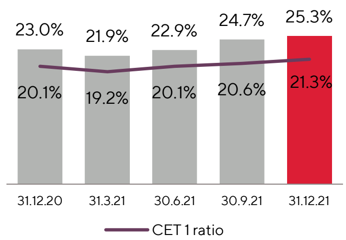
Total liquidity coverage ratio



Leverage ratio



Total capital ratio



The information above has not been reviewed or audited by the Bank's auditor.

1. Based on Gallup surveys regarding primary bank. 6 months rolling average for retail customers, December 2021 survey for SMEs and 2021 average for large companies.
2. IPO costs in 1Q21 were not adjusted for in 1Q21 published results.

Directors' Report

These are the audited consolidated financial statements for Íslandsbanki hf. ("the Bank" or "Íslandsbanki") and its subsidiaries (together referred to as "the Group") for the year 2021.

Operations in 2021

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's profit from operations for the year 2021 amounted to ISK 23,725 million and the return on equity was 12.3%, surpassing the Bank's target of >10% ROE. At year-end, the Group employed 735 full-time members of staff, including 702 within the Bank itself, 57% female and 43% male.

Net interest income rose by 2.0% from the previous year, as balance sheet growth outweighed the lower interest rate environment. The net interest margin did however decline from 2.6% to 2.4%. Net fee and commission income rose by 22.1%, with a strong performance in all business units and especially strong growth in two of the Bank's subsidiaries, Íslandssjóðir hf. (Iceland Funds hf.) and Allianz Ísland hf. Salaries and related expenses rose by 3.7% between years due to general wage agreement increases in Iceland, one-off costs relating to the Bank's Initial Public Offering ("IPO") and redundancy costs but partly offset by a lower number of employees. Other operating expenses fell by 0.3% due to lower IT costs and general cost control but partly offset by one-off costs relating to the IPO of the Bank. The Group's cost-to-income ratio fell from 54.3% to 46.2% between years. Net impairment reversals amounted to ISK 3,018 million as the tourism sector fared somewhat better from the COVID-19 pandemic than was initially feared.

The Group's loan book grew by 7.9% during the year as the demand for mortgages continued at a strong pace. Loans in Personal Banking grew by 19.6%, while loans in Business Banking grew by 2.1% and fell by 2.0% in Corporate and Investment Banking. The Group's ratio of non-performing loans fell from 2.9% at year-end 2020 to 2.0% at the end of 2021 due to both partial and full repayment of loans. Stage 2 loans under IFRS 9 have come down to 9.6% of the loan book, compared with 15,6% at year-end 2020, as many customers have recommenced payments of interest and in many cases principal as well. Loans that have been subject to forbearance will remain in Stage 2 until 12 months have passed since repayments recommenced.

Capital and funding

Deposits from customers rose by 9.5% during the year, mainly due to a strong increase in Business Banking where deposits grew by 26.3%. Deposits in Personal Banking grew by 6.1% as people increased savings due to the pandemic. The Bank continues to be a steady issuer of covered bonds in the domestic market and overall issuance in 2021 amounted to ISK 39 billion. In September the Bank issued its inaugural Additional Tier 1 notes as a part of its effort to optimise its capital structure. The issue of SEK 750 million perpetual notes with a 5-year call was placed with investors across Scandinavia and continental Europe and was considerably oversubscribed. The liquidity position of the Bank remains robust with all liquidity ratios well above both internal and regulatory requirements.

The Group is very well capitalised, with a total capital ratio of 25.3% at the end of the year, compared with the current 17.8% regulatory requirement and a CET1 ratio of 21.3%. The total capital ratio increased by 2.3 percentage points during the year despite the robust loan growth. This is a result of strong earnings, the Bank's AT1 issuance in September and a reduction in the risk exposure amount ("REA") due to the implementation of EU regulation no. 2019/876 ("CRR II") in Iceland. The most material effect of the new regulation was the amendment of the SME supporting factor, lowering the Group's REA by ISK 35 billion.

Íslandsbanki retains its long-term total capital target of 19.5-21.0%, assuming a long-term capital requirement of 19.0%, including a 2.0% countercyclical buffer which will come into effect in September 2022. With a total capital ratio of 25.3%, the Bank therefore continues to be substantially over-capitalised.

The Board of Directors proposes to the Annual General Meeting (AGM) that ISK 11.9 billion will be paid in dividends to shareholders, which is 50% of 2021 profits and in line with the Bank's dividend policy.

In addition to the annual dividend payment, the Bank plans to seek approval from its annual general meeting and the Central Bank to buy back own shares. The Bank aims to buy back ISK 15 billion of own shares in the coming months. This is in line with the Bank's plans to optimise its capital structure and return some of the excess capital to shareholders. The Board may convene a special shareholders' meeting later in the year to propose payment of additional dividends, or to execute share buybacks, if the Bank's CET1 capital continues to exceed targets.

Outlook

The recovery of the Icelandic economy continued to gather steam throughout 2021, notwithstanding the impact of the COVID-19 pandemic and related measures. Unemployment fell substantially over the year, from 12.1% in December 2020 to 4.9% by year-end 2021. GDP rebounded from the second quarter onwards, with year-on-year GDP growth for the first nine months measuring 4.1%. Thus far, growth has been driven mainly by domestic demand, in particular private consumption and business investment. However, exports are also gaining momentum led by almost 45% year-on-year growth in the number of tourists visiting Iceland in 2021 following a steep decline in

2020. Inflation has proven more persistent than expected, with a rapid rise in house prices (15.9% year-on-year as of December 2021) increasingly contributing to headline inflation that measured 5.1% over the last year. The Central Bank has responded to improving economic prospects and persistent inflation by raising its main policy rate from 0.75% as of the end of April to 2.0% at year-end.

For 2022, the Bank's Chief Economist expects GDP growth to measure 4.7%. The growth will most likely be led by expanding exports as tourism rebounds and goods exports (in particular capelin and aquaculture products) grow at a healthy pace. Domestic economic activity is also expected to continue growing following a fading pandemic impact, albeit at a more moderate pace than in 2021. Unemployment is assumed to continue declining throughout the year and reach pre-pandemic levels by the end of the year. The Central Bank is expected to continue raising its policy rate to 3.25% by year-end. A stronger ISK, the moderating pace of house price rises and the fading impact of global supply disruptions, combined with increasing monetary restraint by the Central Bank, will likely combine to ease inflationary pressures and inflation is expected to be within reach of the Central Bank's inflation target by early 2023.

The outlook for the Bank's operations remains favourable and having a strong balance sheet enables the Bank to support its clients in the tourism industry and other sectors badly impacted by the pandemic. The Bank plans for income to grow in line with nominal GDP on average through the business cycle and to keep costs relatively flat from 2021 to 2023. The Bank has updated its financial targets and is targeting a return of equity exceeding 10%, while giving a guidance of 8-10% ROE in 2022. Considerable uncertainty remains regarding impairments and earnings would be close to the bottom end of the guidance range with normalised cost of risk. The CET1 capital target has been simplified to being about 16.5% and the Bank has plans to optimise its capital structure in the coming 12-24 months.

Risk management

The Bank is exposed to various risks. The management of these risks is an integral part of the Bank's operations, and the Bank has focused on building up a responsible internal risk culture among the Bank's employees. The ultimate responsibility for ensuring an adequate risk management framework lies with the Board of Directors. The Board defines and communicates the acceptable level of risk through the Bank's risk management policies and the CEO is responsible for ensuring that risks are managed within those limits.

The Board hereby declares that Íslandsbanki has an overall satisfactory risk management in relation to the Bank's profile and strategy.

The Bank's risk management framework and policies are discussed under Notes 46-65 to the consolidated financial statements and in the unaudited Pillar 3 Report.

Ownership

The Bank had a successful IPO in June 2021. At year-end 2021 the shareholders of the Bank numbered around 15,700, which is the largest shareholder base of any listed company in Iceland. The Icelandic Government is the largest shareholder, representing 65% of the outstanding shares and votes, having owned 100% of the outstanding shares at the end of 2020. Shares held by the Government are administered by the Icelandic State Financial Investments ("ISFI") in accordance with Act no. 88/2009. In the agreement on the platform for the current coalition government it is stated that the Government will continue to reduce state ownership in the financial system and utilise the capital tied up in such operations for the development of infrastructure.

At the end of 2021, 92% of the Bank's shares were owned by domestic parties and 8% by international investors. For further information on the Bank's shareholders see Note 42.

Corporate governance

The Board of Directors of Íslandsbanki is committed to excellence in its governance framework so that it complies with the best corporate governance practices in the financial market at all times.

The Board of Directors comprises seven non-executive directors and two alternate members. The Board undertakes the Bank's affairs and is responsible for setting the Bank's general strategy as well as instructing the CEO on its further implementation and execution. The Board has a supervisory role overseeing that the Bank's organisation and activities are at all times in accordance with relevant laws, regulations and good business practices. Furthermore, the Board shall monitor the execution of its policies, the sound control of accounting and financial management, and ensure that group internal audit, compliance, risk management and internal controls are effective at all times.

In accordance with the Bank's Articles of Association the Bank operates a Nomination Committee whose role is to nominate individuals to the Bank's Board of Directors at the AGM, or as the case may be at a shareholders' meeting where Board elections are on the agenda. The members of the Nomination Committee shall be three and they shall be elected for one year at a time by the Board of Directors. The committee shall be independent in its work and the majority of the committee's members shall be independent of the Bank and its management. Along with the Bank's Nomination Committee, the ISFI operates a special three-member Selection Committee which, on behalf of the State, nominates candidates for the supervisory boards or boards of directors of banks or undertakings that are managed by ISFI.

Directors' Report

The Board has approved a policy on the suitability of the Board of Directors, the CEO and key function holders. The objective of the policy is that the Bank's Board of Directors, CEO and key employees meet the relevant suitability requirements at all times and the framework for their appointment and/or employment is in accordance with the relevant legal requirements for the Bank's operation. The policy states that the composition of the Board, the Executive Committee and key employees shall at any time be diverse, with regard to educational and professional background, gender and age. Human Resources reports annually to the Board on the Bank's actions in implementing the policy. Currently the Board consists of seven members, three female and four male. Board members are of various ages, born in the years 1947-1982. Board members have a broad range of education, e.g., in the fields of economics, law, engineering, auditing, business administration, and securities trading. Board members also have extensive industry experience in the areas of operations, management, and consulting.

The Board appoints three subcommittees, each one comprising Board members and operating under the terms of a mandate letter from the Board as well as the Rules of Procedure of the Board. The mandate letters of Board subcommittees are available on the Bank's website.

The CEO is responsible for the day-to-day operations of the Bank and that the Bank's business is, at all times, in accordance with the Bank's Articles of Association, policies of the Board and the relevant law. The CEO engages the Bank's Compliance Officer and appoints members of the Executive Committee and other Senior Management Committees.

The Executive Committee, comprising seven members, including the CEO, is composed of three women and four men. Members of the Executive Committee were born in the years 1961-1976 and possess diverse education and extensive experience. The role of the Executive Committee is to maintain an overall view of the Bank's operations and to coordinate key aspects of its activities. The CEO ensures that the Board is regularly provided with accurate information on the Bank's finances, development, and operations.

The Bank's Finance division is responsible for the preparation of the consolidated financial statements which are prepared in accordance with the International Financial Reporting Standards ("IFRS"). The Board's Audit Committee reviews the Group's annual and interim consolidated financial statements before their submission for Board approval and endorsement. The Board's Audit Committee regularly discusses the Bank's financial statements and evaluates its internal control processes. Management reporting is generally presented to the Board 10 times a year. The external auditors review the second quarter interim consolidated financial statements and audit annual consolidated financial statements. In 2021 the external auditors also reviewed the first quarter interim consolidated financial statements in preparation for the Bank 's IPO.

The Board of Directors follows the Corporate Governance Guidelines (6th ed.) issued by the Iceland Chamber of Commerce, Nasdaq Iceland, and SA-Business Iceland, available on www.corporategovernance.is. The regulatory framework for corporate governance practices within Íslandsbanki consists of the law applicable to its operations, including those imposed by the Central Bank of Iceland and Nasdaq Iceland. The applicable laws include, inter alia, the Act on Financial Undertakings no. 161/2002, the Act on Recovery and Resolution of Credit Institutions and Investment Firms no. 70/2020, the Act on Markets for Financial Instruments Act no. 115/2021, the Act on Measures against Money Laundering and the Financing of Terrorist Activities no. 140/2018 and the Act on Public Limited Companies no. 2/1995. The relevant law is available on the Icelandic legislature's website, www.althingi.is.

A more detailed description of Íslandsbanki's governance framework and associated practices can be found in the Bank's Corporate Governance Statement enclosed in an unaudited appendix to the consolidated financial statements and on the Bank's website, www.islandsbanki.is.

Sustainability

Íslandsbanki aims to be a leader in the area of sustainable development and a force for good. Alongside its vision of being a leader in service to customers, the Bank will focus on integrating sustainability considerations into its activities, in addition to its profit objectives. The Bank takes account of ESG criteria in its risk management and actively explores business opportunities related to sustainability. Íslandsbanki aims to increase the general public's financial knowledge and interest in the subject and, to this end, it offers interesting and accessible seminars on finance and economics.

Íslandsbanki's Sustainability Policy was approved by its Board in late 2019. The policy aims at making the Bank a model of exemplary operations in the Icelandic business community, based on internationally recognised environmental, social, and governance ("ESG") criteria. The ESG criteria are a set of references used by investors to evaluate investments based on responsible investment methodology.

The Sustainability Policy creates a comprehensive framework for its activities in the area of environmental affairs, respect for human rights, responsible lending, investments, purchasing, and grants, as well as integrating with and supporting the Bank's other policies. Íslandsbanki sets quantifiable ESG targets in its operations and discloses its performance relative to targets, in accordance with the Nasdaq ESG Guidelines and relevant Global Reporting Initiatives ("GRI") standards, in a separate report issued concurrent with the Bank's annual financial statements. Íslandsbanki's carbon footprint from operations has been measured based on the Greenhouse Gas Protocol and detailed information about emissions can be found in the Annual and Sustainability Report for 2021. The Sustainability Report for the year 2021 includes the key information on the environmental, social and governance criteria for Íslandsbanki in accordance with the Nasdaq ESG guidelines from 2019. The Bank puts emphasis on an increased flow of transparent information on sustainability. Auditing firm Ernst & Young was engaged to review and confirm with limited assurance the Bank's environmental information disclosure for 2021 for the first time. In addition, the Bank has now for the first time published calculations of financed emissions, that is the carbon footprint of loans and investments, for the years 2019 and 2020, in accordance with the Partnership for Carbon Accounting Financials ("PCAF") standard.

In 2021 Íslandsbanki performed an impact analysis to assess positive and negative impacts from the Bank's activities, products, and services. The analysis followed best practice provided by the Principles of Responsible Banking ("PRB"). In conclusion, combining Íslandsbanki's scale of activities and Iceland's key sustainability challenges, the top two priority impact areas have been identified as climate change and gender equality. Those areas were already two of the four SDGs that were prioritised as a result of an analysis and broad stakeholder engagement in 2019.

Íslandsbanki has in place a Code of Conduct for employees and the Board of Directors which is available on the Bank's website and in addition the Bank's Sustainability Policy emphasises these matters. The aim of the Code is to promote good operational practices, reporting of misconduct and actions to prevent conflict of interest. Employees confirm annually that they have read and understood the rules and commit their adherence to the rules. At the end of 2021 more than 98% of employees had confirmed the rules. The Bank emphasises respect for human rights and avoids business transactions where human rights are violated, including discrimination on the basis of gender, religion, or race according to the Sustainability Policy and the Suppliers' Code of Conduct. The Bank is committed to engage in active dialogue with its suppliers on enhancing their focus on sustainable business practices.

The Bank makes every effort to combat bribery and corruption. For that purpose, the Bank has e.g. implemented a policy on conflict of interest and rules on measures against conflict of interest in which there is a chapter on gifts and complimentary trips. The rules are intended to ensure that the impartiality and credibility of employees cannot be brought into question with respect to the treatment and handling of individual matters. Moreover, the Bank has in place a policy on actions against money laundering and terrorist financing. The Bank's policy on anti-money laundering takes a clear stance against payments on bribery and corruption. In practice the Bank emphasises on being compliant with Act no. 140/2018 on measures against money laundering and financing of terrorism which involves combating bribery and corruption.

Collaboration with international and local partners with regards to sustainability is highly important. Over the years, Íslandsbanki has participated in international commitments and supported domestic cooperative efforts in the area of sustainability. Being a part of international collaborations such as the UN PRB, the Nordic CEOs for a Sustainable Future and most recently being a founding member of the Net-Zero Banking Alliance is particularly valuable and informative for a relatively small bank. On the other hand, being one of the largest companies in Iceland means that the Bank can contribute significantly towards domestic partnerships such as at Festa - Center for Sustainability, IcelandSif and the Green Building Council Iceland to name a few.

The Board of Directors approves the Sustainability Policy and sets the Bank's strategy and risk appetite in terms of sustainability risk. The Board is regularly updated on corporate sustainability matters and the usage of the Bank's Sustainable Financing Framework. The Corporate Governance and Human Resource subcommittee of the Board assists the Board in fulfilling its oversight responsibilities concerning sustainability.

In line with the Sustainability Policy, the Board of Directors has approved seven sustainability goals for its operations, to be completed by 2025. The goals are based on ESG criteria and supported by annual targets set by business units as part of their 5-year planning process. Íslandsbanki is committed to supporting Iceland's ambitious Climate Action Plan and the Paris Agreement Goals. To that end, the Bank announced in April 2021 its commitment to become net zero on financed emissions by 2040. The Bank's own operations have been carbon neutral for the past two years, and with this decision, its commitment will also extend to financed emissions which includes the carbon footprint of Íslandsbanki's entire loan and asset portfolio. At the same time, the Bank pledged to set science-based carbon reduction targets in line with the SBTi framework. Work on a detailed plan for Íslandsbanki's path to net zero 2040 is already underway and will be aligned with the guidelines to ensure a rigorous and transparent approach.

Sustainability risk has been more effectively integrated into key processes relating to lending, investments, and product development during the year. At year-end, 34% of all credit risk exposure (excluding individual banking and small enterprises which are not in scope) has been assessed with respect to ESG risk related factors. All loans that fall under the Sustainable Finance Framework have been assessed as well as some of the largest exposures of the Bank. Now that the process and assessment method has been tested the emphasis in 2022 will be to increase the share of ESG risk assessed exposure even further. More detailed coverage can be found in the Bank's Pillar 3 Report for 2021 which contains a separate chapter on sustainability risk and climate risk in compliance with TCDF (Task Force on Climate-related Financial Disclosures) criteria.

The CEO is responsible for executing the strategy and has appointed a Sustainability Committee as a main building block of the governance structure. The committee is the formal forum for discussions on all issues related to sustainability risk, sustainable procurement, and business opportunities. The committee is independent from credit committees and needs to approve proposals for credit cases before they are included in the Sustainable Financing Framework. The Committee is chaired by the CEO and has senior representatives from business units, Strategy, Finance, and Risk Management.

The Bank's sustainability and ESG milestones in 2021 are further described in the unaudited Annual and Sustainability Report and the Bank's unaudited Pillar 3 Report for the year 2021 which includes a chapter on sustainability and climate risk adhering to international TCFD criteria.

Directors' Report

Statement by the Board of Directors and the CEO

The audited consolidated financial statements for the year ended 31 December 2021 have been prepared on a going concern basis in accordance with the International Financial Reporting Standards (IFRS) 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 consolidated financial statements provide a true and fair view of the Group's operating profits and cash flows in 2021 and its financial position as of 31 December 2021. Furthermore, in our opinion the financial statements and the Directors' report give fair view of the main operational developments and achievements and describe the principal risks and uncertainties that the Group faces in its operations.

In our opinion, the Consolidated Financial Statements of Íslandsbanki hf. for the year 2021 identified as "549300PZMFIQR79Q0T97-2021-12-31-en.zip" are prepared in all material respects, in compliance with the European Single Electronic Format Regulation (ESEF).

The Board of Directors and the CEO have today discussed and approved the 2021 Consolidated Financial Statements of Íslandsbanki.

Kópavogur, 10 February 2022

Board of Directors:

Hallgrímur Snorrason, Chairman

Heiðrún Jónsdóttir, Vice-Chairman

Anna Þórðardóttir

Árni Stefánsson

Frosti Ólafsson

Guðrún Þorgeirsdóttir

Jökull H. Úlfsson

Chief Executive Officer:

Birna Einarsdóttir

Building a better working world

Independent Auditor's Report

To the Board of Directors and shareholders of Íslandsbanki hf.

Opinion

We have audited the consolidated financial statements of Íslandsbanki hf. and its subsidiaries (the Group) which comprise the consolidated statement of financial position as at 31 December 2021 and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flow for the year then ended and a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2021, and its consolidated financial performance and its consolidated cash flows for the year then ended, in accordance with the International Financial Reporting Standards, as adopted by the European Union and additional requirements in the Icelandic Act on Annual Accounts, Act on Financial Undertakings and rules on accounting for credit institutions, where applicable.

Our opinion in this report on the consolidated accounts are consistent with the content of the additional report that has been submitted to the parent company's audit committee in accordance with the Audit Regulation (537/2014) Article 11.

Basis for Opinion

We conducted our audit in accordance with the International Standards on Auditing (ISAs). Our responsibilities are further described in the Auditor's Responsibilities for the Audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in Iceland, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

To the best of our knowledge, we have not provided any prohibited non-audit services as described in article 5(1) of Regulation (EU) no. 537/2014.

Appointment of auditor

We were initially appointed as auditor of Íslandsbanka hf. on 25 March 2015 for the financial year 2015 and we have been reappointed every year since then.

Key Audit Matters

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

We have fulfilled our responsibilities described in the "Auditor's responsibilities for the audit of the financial statements" section, including in relation to the key audit matters below. Accordingly, our audit included the design and performance of procedures to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the financial statements.

Why significant	How our audit addressed the Key Audit Matter
Provision for expected credit losses (ECL)	

Loans to customers represent ISK 1,086,327 million or 76% of total assets at 31 December 2021 against which expected credit losses (ECL) of ISK 13,565 million have been recorded.
 	
There is significant uncertainty about the economic impact of the COVID-19 pandemic and the impact on expected credit losses, in particular due to loans to customers in the tourism and related industries.
 	
The determination of the provision for credit impairment is based on estimates and judgement by management. Key areas of judgement include:
 	
• management overlays and assumptions related to the economic effects of the COVID-19 pandemic;
• the interpretation of the requirements to determine impairment under application of IFRS 9, which is reflected in the Group's expected credit loss model;
• the identification of loans with significant deterioration in credit quality;
• assumptions used in the expected credit loss model such as the financial condition of the counterparty, expected future cash flows and forward-looking macroeconomic factors.
 	
Due to the use of judgement and estimates, in particular due to the uncertainty related to the COVID-19 pandemic, and the relative size of loans to customers on the balance sheet, we consider the provision for expected credit losses (ECL) a Key Audit Matter.
	Our procedures focused on the following to respond to the Key Audit Matter, among others:
	
	• Assessing the Group's expected credit loss model, focusing on the following areas:
	   ◦ alignment of the expected credit loss model and its underlying methodology with the requirements of IFRS 9;
	   ◦ approach to the incorporation of forward-looking macroeconomic factors;
	   ◦ management overlays and assumptions related to the economic effects of COVID-19 pandemic on the expected credit loss model;
	
	• Testing the effectiveness of relevant controls relating, among others, to the:
	   ◦ data used to determine the provision for credit impairment, including transactional data captured at loan origination and ongoing internal credit quality assessment;
	   ◦ expected credit loss model, including model build and approval, ongoing monitoring/validation, model governance and mathematical accuracy;
	   ◦ review and approval of forward-looking macro-economic factors; and
	   ◦ registration and valuation of collateral used in the calculation of expected credit loss.
	
	• Testing of a sample of loans and procedures to evaluate among others:
	   ◦ timely identification of loans with significant deterioration in credit quality;
	   ◦ expected loss calculation by re-performing and assessing the reasonableness of the ECL model calculations;
	   ◦ appropriateness of forward-looking macroeconomic factors; and
	   ◦ COVID-19 pandemic effects of a sample of borrowers in the tourism and related industries and impact on collateral.
	
	In addition, we assessed the adequacy of the disclosures in the consolidated financial statements. Refer to Notes 3 and 66.4 for credit impairment.

Why significant	How our audit addressed the Key Audit Matter
Reliability of information from IT systems relevant to financial reporting	
The Group is highly dependent on IT systems due to the significant number of transactions that are processed daily and due to the complexity of the various systems needed to support the Group´s operations. In the process of preparing the consolidated financial statements the Group uses data from many complex IT systems. The reliability of the data, among others, the accuracy and completeness, is important to support the reliability of financial reporting. Because of the importance of the data from the IT systems supporting the financial reporting we consider their reliability a Key Audit Matter.	Our procedures focused on the following to respond to the Key Audit Matter, among others: • Obtained an understanding of the Group's IT systems and the IT-environment relevant for financial reporting. • Reviewed the design, implementation and effectiveness of control activities, as appropriate, related to change management, access management and computer operations for the systems considered important for the audit. • For those systems, considered important in the audit and are outsourced, we obtained and assessed the ISAE 3402 report which is issued by the services organisation and reviewed by an independent auditor. EY IT specialists were involved in the audit.

Other information

This document also contains other information than the consolidated financial statements and our auditor's report thereon. The other information is: The unaudited highlights, Directors´ Report, unaudited quarterly statements in Note 6 and unaudited Íslandsbanki's Corporate Governance Statement 2021 in appendix. Management and Board of Directors are responsible for the other information.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon except for confirmation regarding Directors' Report as stated below.

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

Responsibilities of CEO and Board of Directors for the consolidated financial statements

The Chief Executive Officer (CEO) and Board of Directors are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards, as adopted by the European Union and additional requirements in the Icelandic Act on Annual Accounts, Act on Financial Undertakings and rules on accounting for credit institutions, where applicable.

The CEO and Board of Directors are responsible for such internal control that management determines is necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

The Board of Directors is responsible for overseeing the Group's consolidated financial reporting process.

Auditor's Responsibilities for the Audit of the consolidated financial statements

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

As part of an audit in accordance with the International Standards on Auditing (ISAs), we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

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

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

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

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

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

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

Report on other legal and regulatory requirements

Report on European single electronic format (ESEF Regulation)

As part of our audit of the consolidated financial statements of Íslandsbanki hf. we performed procedures to be able to issue an opinion on whether the consolidated financial statements of Íslandsbanki hf. for the year 2021 with the file name "549300PZMFIQR79Q0T97-2021-12-31-en.zip" is prepared, in all material respects, in compliance with act no. 20/2021 on disclosure obligation of issuers of securities and the obligation to flag relating to requirements regarding European single electronic format regulation EU 2019/815 which include requirements related to the preparation of the consolidated financial statements in XHTML format and iXBRL markup.

The Board of Directors and CEO are responsible for preparing the consolidated financial statements in compliance with act no. 20/2021 disclosure obligation of issuers of securities and the obligation to flag. This responsibility includes preparing the consolidated financial statements in a XHTML format in accordance with EU regulation 2019/815 on the ESEF regulation.

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

In our opinion, consolidated financial statements of Íslandsbanki hf. for the 2021 with the file name "549300PZMFIQR79Q0T97-2021-12-31-en.zip" is prepared, in all material respects, in compliance with the ESEF Regulation.

Report on the Board of Directors Report

Pursuant to the legal requirements of Article 104, Paragraph 2 of the Icelandic Financial Statement Act no. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the consolidated financial statements includes all information required by the Icelandic Financial Statement Act.

Reykjavík, 10 February 2022

Margrét Pétursdóttir
State Authorised Public Accountant

Ernst & Young ehf.
Borgartúni 30
105 Reykjavík

Consolidated Income Statement

	Notes	2021	2020
Interest income calculated using the effective interest rate method		56,220	53,378
Other interest income		2,405	2,317
Interest expense		(24,582)	(22,324)
Net interest income	7	34,043	33,371
Fee and commission income		15,167	12,651
Fee and commission expense		(2,318)	(2,126)
Net fee and commission income	8	12,849	10,525
Net financial income (expense)	9	2,499	(1,391)
Net foreign exchange gain	10	479	451
Other operating income	11	302	197
Other net operating income		3,280	(743)
Total operating income		50,172	43,153
Salaries and related expenses	12	(13,397)	(12,917)
Other operating expenses	13	(9,799)	(9,829)
Contribution to the Depositors' and Investors' Guarantee Fund		(688)	(679)
Bank tax	66.20	(1,683)	(1,588)
Total operating expenses		(25,567)	(25,013)
Profit before net impairment on financial assets		24,605	18,140
Net impairment on financial assets	14	3,018	(8,816)
Profit before tax		27,623	9,324
Income tax expense	15	(5,119)	(2,472)
Profit for the year from continuing operations		22,504	6,852
Discontinued operations held for sale, net of income tax	16	1,221	(97)
Profit for the year		23,725	6,755

Profit attributable to shareholders of Íslandsbanki hf.		23,732	7,061
Loss attributable to non-controlling interests		(7)	(306)
Profit for the year		23,725	6,755
Earnings per share from continuing operations			
Basic and diluted earnings per share attributable to shareholders of Íslandsbanki hf.*	17	11.26	3.58

*The calculation for earnings per share for comparative period has been restated (see Note 17).

The notes on pages 19 to 86 are an integral part of these Consolidated Financial Statements.

Íslandsbanki hf. Consolidated Financial Statements 2021 13 Amounts are in ISK million

Consolidated Statement of Comprehensive Income

	2021	2020
Profit for the year	23,725	6,755
Net gain (loss) on financial assets	(39)	114
Net gain (loss) on financial liabilities	(816)	108
Items that will not be reclassified to the income statement	(855)	222
Foreign currency translation	329	(329)
Items that may subsequently be reclassified to the income statement	329	(329)
Other comprehensive expense for the year, net of tax	(526)	(107)
Comprehensive income for the year	23,199	6,648

Comprehensive income attributable to shareholders of Íslandsbanki hf.	23,453	7,492
Comprehensive expense attributable to non-controlling interests	(254)	(844)
Comprehensive income for the year	23,199	6,648

The notes on pages 19 to 86 are an integral part of these Consolidated Financial Statements.

Íslandsbanki hf. Consolidated Financial Statements 2021 14 Amounts are in ISK million

Consolidated Statement of Financial Position

	Notes	31.12.2021	31.12.2020
Assets			
Cash and balances with Central Bank	22	113,667	78,948
Loans to credit institutions	23	43,988	89,920
Bonds and debt instruments	18	132,289	128,216
Derivatives	24	2,445	6,647
Loans to customers	25	1,086,327	1,006,717
Shares and equity instruments	18	31,677	14,851
Investments in associates	27	939	775
Property and equipment	28	7,010	7,341
Intangible assets	29	3,351	3,478
Other assets	30	5,784	4,125
Non-current assets and disposal groups held for sale	31	1,344	3,173
Total Assets		1,428,821	1,344,191
Liabilities			
Deposits from Central Bank and credit institutions	32	13,384	39,758
Deposits from customers	33	744,036	679,455
Derivative instruments and short positions	24	9,467	6,936
Debt issued and other borrowed funds	35	402,226	387,274
Subordinated loans	36	35,762	27,194
Tax liabilities	38	6,432	5,450
Other liabilities	39	12,848	11,893
Non-current liabilities and disposal groups held for sale	31	956	27
Total Liabilities		1,225,111	1,157,987
Equity			
Share capital		10,000	10,000
Share premium		55,000	55,000
Reserves		6,086	6,181
Retained earnings		132,624	113,529
Total Shareholders' Equity		203,710	184,710
Non-controlling interests		-	1,494
Total Equity		203,710	186,204
Total Liabilities and Equity		1,428,821	1,344,191

The notes on pages 19 to 86 are an integral part of these Consolidated Financial Statements.

Íslandsbanki hf. Consolidated Financial Statements 2021 15 Amounts are in ISK million

Consolidated Statement of Changes in Equity

	Share capital	Share premium	Statutory reserve	Restricted reserves	Fair value reserve	Liability credit reserve	Foreign currency translation reserve	Retained earnings	Total shareholders' equity	Non-controlling interests	Total equity
Equity as at 1 January 2021	10,000	55,000	2,500	3,556	572	(238)	(209)	113,529	184,710	1,494	186,204
Profit (loss) for the year								23,732	23,732	(7)	23,725
Net gain (loss) on financial assets					(572)			900	328	(367)	(39)
Net loss on financial liabilities						(816)			(816)		(816)
Foreign currency translation							209		209	120	329
Comprehensive income (expense) for the year	-	-	-	-	(572)	(816)	209	24,632	23,453	(254)	23,199
Dividends paid								(3,400)	(3,400)		(3,400)
Restricted due to capitalised development costs				(291)				291	-		-
Restricted due to fair value changes				1,318				(1,318)	-		-
Restricted due to associates				57				(57)	-		-
Dissolution of a subsidiary								(1,053)	(1,053)	(1,240)	(2,293)
Equity as at 31 December 2021	10,000	55,000	2,500	4,640	-	(1,054)	-	132,624	203,710	-	203,710
Equity as at 1 January 2020	10,000	55,000	2,500	3,525	1,432	(392)	-	105,569	177,634	2,428	180,062
Profit (loss) for the year								7,061	7,061	(306)	6,755
Net gain (loss) on financial assets					(860)			1,392	532	(418)	114
Net gain (loss) on financial liabilities						154		(46)	108		108
Foreign currency translation							(209)		(209)	(120)	(329)
Comprehensive income (expense) for the year	-	-	-	-	(860)	154	(209)	8,407	7,492	(844)	6,648
Restricted due to capitalised development costs				(291)				291	-		-
Restricted due to fair value changes				282				(282)	-		-
Restricted due to subsidiaries and associates				40				(40)	-		-
Other changes due to IFRS 15								(115)	(115)		(115)
Changes in non-controlling interests								(301)	(301)	(90)	(391)
Equity as at 31 December 2020	10,000	55,000	2,500	3,556	572	(238)	(209)	113,529	184,710	1,494	186,204

Authorised share capital of the Bank is 2,000 million ordinary shares of ISK 5 each. At year-end 2021 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 2020 was held on 18 March 2021. At the AGM shareholders approved the Board's proposal to pay dividends to shareholders amounting to ISK 3,400 million which is equivalent to ISK 1.70 per share (2020: none). The dividends were paid on 30 March 2021.

The notes on pages 19 to 86 are an integral part of these Consolidated Financial Statements.

Íslandsbanki hf. Consolidated Financial Statements 2021 16 Amounts are in ISK million

Consolidated Statement of Cash Flows

	2021	2020
Profit for the year	23,725	6,755
Non-cash items included in profit for the year*	16,930	28,780
Changes in operating assets and liabilities*	(37,868)	(109,535)
Dividends received	54	30
Paid income tax, special financial activities tax, and bank tax	(5,382)	(6,754)
Net cash used in operating activities	(2,541)	(80,724)
Net investment in subsidiaries and an associate	2,727	(2,176)
Proceeds from sales of property and equipment	29	24
Purchase of property and equipment	(206)	(552)
Purchase of intangible assets	(442)	(260)
Net cash provided by (used in) investing activities	2,108	(2,964)
Proceeds from borrowings	86,048	80,778
Repayment and repurchases of borrowings	(65,691)	(33,673)
Repayment of lease liabilities	(425)	(390)
Dividends paid	(3,400)	-
Subsidiary's capital decrease and share buyback paid to non-controlling interests	(1,130)	-
Net cash provided by financing activities	15,402	46,715
Net increase (decrease) in cash and cash equivalents	14,969	(36,973)
Effects of foreign exchange rate changes	(40)	160
Cash and cash equivalents at the beginning of the year	115,668	152,481
Cash and cash equivalents at year-end	130,597	115,668

Reconciliation of cash and cash equivalents	Notes		
Cash on hand	22	3,882	3,814
Cash balances with Central Bank	22	109,785	75,134
Bank accounts	23	26,187	46,269
Mandatory reserve, special restricted and pledged balances with Central Bank	22	(9,257)	(9,549)
Cash and cash equivalents at year-end		130,597	115,668

*For further breakdown see the following page.

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

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 in 2021 amounted to ISK 55,051 million (2020: ISK 49,410 million) and interest paid in 2021 amounted to ISK 18,691 million (2020: ISK 20,455 million). Interest 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 19 to 86 are an integral part of these Consolidated Financial Statements.

Íslandsbanki hf. Consolidated Financial Statements 2021 17 Amounts are in ISK million

Consolidated Statement of Cash Flows

	2021	2020
Depreciation, amortisation, and write-offs	1,395	1,765
Share of profit and reversal of impairment of associates	(133)	(45)
Accrued interest and fair value changes on debt issued and subordinated loans	14,817	12,621
Net impairment on financial assets	(2,723)	9,056
Foreign exchange gain	(479)	(387)
Net gain from sales of property and equipment	(18)	(427)
Unrealised fair value (gain) loss recognised in profit or loss	(1,526)	1,545
Discontinued operations held for sale, net of income tax	(1,221)	524
Bank tax	1,683	1,588
Income tax expense	5,119	2,472
Other changes	16	68
Non-cash items included in profit for the year	16,930	28,780

Mandatory reserve, special restricted and pledged balances with Central Bank	292	5,730
Loans to credit institutions	25,827	(7,725)
Bonds and debt instruments	(4,986)	(73,163)
Loans to customers	(83,704)	(100,076)
Shares and equity instruments	(15,272)	(885)
Other assets	(2,428)	(995)
Non-current assets and liabilities held for sale	1,380	1,168
Deposits from Central Bank and credit institutions	(25,889)	7,714
Deposits from customers	66,371	51,984
Derivative instruments and short positions	(341)	8,942
Other liabilities	882	(2,229)
Changes in operating assets and liabilities	(37,868)	(109,535)

Significant non-cash transactions 2021

During the year the Group repurchased own debt securities amounting to ISK 1,511 million by issuing new debt.

Significant non-cash transactions 2020

During the year the Bank sold its stake in Borgun hf. where ISK 415 million of the sale price was due and paid in 2021. Prior to the sale, shares in BVS ehf., a company holding series C preferred shares in Visa Inc., which were not part of the sale of Borgun hf., were transferred to the old owners of Borgun hf. As a result, the Bank received a 63.47% stake in BVS ehf.

The notes on pages 19 to 86 are an integral part of these Consolidated Financial Statements.

Íslandsbanki hf. Consolidated Financial Statements 2021 18 Amounts are in ISK million

Notes to the Consolidated Financial Statements

Notes to the Consolidated 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 registered office is at Hagasmári 3, 201 Kópavogur, Iceland.

The consolidated financial statements for the year ended 31 December 2021 ("the consolidated financial statements") comprise the financial statements of Íslandsbanki hf. ("the Bank" or "Íslandsbanki") and its subsidiaries together referred to as "the Group".

The Group provides a wide range of financial services such as retail banking, corporate banking, investment banking, wealth management and asset financing. The Group operates mainly in the Icelandic market.

The consolidated financial statements were approved and authorised for issue by the Board of Directors and the CEO of Íslandsbanki hf. on 10 February 2022.

2. Basis of preparation

The consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRS") 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 consolidated 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 year-end 2021 the exchange rate of the ISK against the USD was 130.38 and for the EUR 147.60 (2020: USD 127.21 and EUR 156.10).

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 consolidated financial statements have been prepared on a going concern basis.

Basis of measurement

The consolidated financial statements are prepared on a historical cost basis, except for the following assets and liabilities, which are measured at fair value: bonds and debt instruments, shares and equity instruments, short positions in listed bonds, derivative financial instruments, and certain bonds issued by the Group.

Recognised financial liabilities designated as hedged items in qualifying fair value hedge relationships are measured at amortised cost adjusted for changes in fair value attributable to the risk being hedged.

Non-current assets and disposal groups held for sale are measured at the lower of its carrying amount and fair value less costs to sell.

3. Significant accounting estimates and judgements

In preparing these consolidated financial statements management has made judgements, estimates, and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income, and expenses. The management bases its judgements on previous experience and other factors that are considered reasonable under the circumstances, but actual results may differ from those estimates.

Management continuously evaluates these judgements, estimates, and assumptions. Changes in accounting estimates are recognised when they occur.

Key sources of estimation uncertainty include the allowance for credit losses and the determination of fair value of financial instruments.

Impairment of financial assets

The main assumptions used for calculating the allowance for credit losses that are subject to significant judgement include the following:

- Probability of default (PD), loss given default (LGD), and exposure at default (EAD)
- Macroeconomic variables for multiple scenarios build on available information
- Assessment of significant increase in credit risk (SIRC)

3 Cont'd

The probability of default (PD), exposure at default (EAD), and loss given default (LGD) inputs used to estimate expected credit losses are modelled based on variables that are most closely related with credit losses in the relevant portfolio. This includes macroeconomic variables, demographic variables, variables related to past payment history among other variables. These variables are sourced both internally and externally. Significant judgements required for measuring expected credit loss (ECL) include the following:

- Determining criteria for assessing what constitutes a significant increase in credit risk
- Establishing the forward-looking scenarios and their relative weightings
- Choosing appropriate models and assumptions for the measurement of ECL

The Group continues to make temporary changes to the impairment model due to the COVID-19 pandemic. The Group's impairment process allows for temporary changes to the impairment model to account for circumstances when it becomes evident that existing or expected risk factors have not been appropriately considered in the credit risk rating or modelling process. The COVID-19 pandemic has created such circumstances for the tourism industry and therefore an adjustment is warranted. To account for the material uncertainty in the operating environment of companies in the tourism industry, not reflected in their current risk class, they have been further classified into four impact groups as described in Note 50. Where the increase was found to be significant (groups 2-4), the exposure was transferred to Stage 2. In addition, an overlay factor was applied to the expected credit losses, comparable to an increase in up to three risk classes, and a higher haircut was applied to value of collateral for the higher impact groups in the more severe scenarios. The common risk factor in tourism was found to apply to loans to customers with a gross carrying amount of ISK 103,930 million at year-end 2021, resulting in a expected credit losses of ISK 5,295 million.

The All Risk Committee determined that it was appropriate to adjust the weights of the scenarios due to the COVID-19 pandemic, generally the scenarios are weighted 25%-50%-25% (good, base, bad) but it was determined appropriate to set the weights at 15%-50%-35%, as this would best represent the probability-weighted average over all possible scenarios. When deciding on the appropriate weights for the three scenarios, management used sensitivity analysis that indicated that a shift of 5% weight from the baseline to the pessimistic scenario would increase the impairment allowance by ISK 500 million while a 5% shift from the baseline to the optimistic scenario would decrease the allowance by ISK 200 million.

Substantial uncertainty remains with regards to the impact of the COVID-19 pandemic on the credit quality of the Group's credit exposures in future periods and therefore the assessment of expected credit losses.

The allowance for credit losses is further discussed in Notes 25-26, in Notes 47-54 on risk management, and in Note 66.4.

Fair value of financial instruments

The objective of the fair value measurement is to arrive at the price at which an orderly transaction would take place between market participants at the measurement date under current market conditions. The best evidence of fair value is a quoted price for the instrument being measured in an actively traded market. Where an active market or quoted prices are not available the fair value of financial instruments are decided upon by using valuation techniques. Financial instruments measured at fair value are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. Level 3 financial assets are measured at fair value using valuation techniques based on significant unobservable inputs. The valuation of Level 3 financial assets is a subjective area as the assumption on which the valuation is based on is not easily observable and subject to management's assessment. Changes made to the evaluation criteria could have a significant impact on the Group's results and financial position. The valuation methods are discussed in Notes 19-20 and in Note 66.4.

4. Changes to accounting policies

The Group adopted amendments to IFRS 9 – Financial Instruments, IAS 39 – Financial Instruments: Recognition and Measurement, IFRS 7 – Financial Instruments: Disclosures, and IFRS 16 – Leases (together referred to as "Interest Rate Benchmark Reform – Phase 2"), as of 1 January 2021. The amendments provided practical relief from certain requirements in the standards relating to the replacement of benchmark interest rates in contracts with new alternative benchmark interest rates. The amendments did not have a significant impact on the consolidated financial statements.

Other amendment to an IFRS standard that became effective from 1 January 2021 did not have a material impact on the consolidated financial statements.

Changes to IFRS standards issued but not effective at the reporting date

A new IFRS standard and amendments to several IFRS standards have been issued but are not yet effective. The Group did not early adopt any of them and intends to adopt them when they become effective. The Group currently does not expect a material impact on its future consolidated financial statements as a result of these changes.

5. Operating segments

Segment information is presented in accordance with the Group's management and internal reporting structure. The segments' operating result are reported to the Board of Directors and the Chief Executive Officer, who are responsible for allocating resources to the reportable segments and assessing their financial performance.

An operating segment is a distinguishable component of the Group, for which discrete financial information is available, that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. Each operating segment is engaged in providing products or services which are subject to risk and return that are different from those of other operating segments. The accounting policies for the reportable segments are in line with the Group's accounting policies. The Group operates mainly in the Icelandic market.

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. Capital allocation to the business units is based on the pillar 1 regulatory capital requirement, the pillar 2-R capital requirement calculated according to the Bank's ICAAP and the combined buffer requirement as stipulated in the Act on Financial Undertakings no.161/2002. Income tax and bank tax with breakdown for each segment is according to the current tax rates.

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 and contact the contact centre.

Business Banking

Business Banking provides small and medium-sized enterprises (SMEs) with comprehensive financial services and Ergo, the Bank's asset financing service, is also part of the division. Business Banking serves customers in business centres and branches close to their business. Via online banking and app, customers have full overview of their business and day-to-day operations are easy to manage.

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 the banking book.

Cost centres

Cost centres comprise the CEO's office (Human Resources, Marketing & Communications, Strategy, and Legal), IT, Risk Management, Compliance and Finance excluding Treasury and Proprietary Trading. Group Internal Audit is also 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 Íslandssjóðir hf., Allianz Ísland hf. and other less significant subsidiaries (see Note 27).

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". All inter-company eliminations are included in the column “Eliminations & adjustments".

Following is an overview showing the Group's performance with a breakdown by operating segments.

Notes to the Consolidated Financial Statements

5. Cont'd

2021	Personal Banking	Business Banking	Corporate & Investment Banking	Treasury & Proprietary Trading	Cost centres	The Bank total	Subsidiaries, eliminations & adjustments	The Group total
Net interest income	12,027	10,867	9,282	2,034	(178)	34,032	11	34,043
Net fee and commission income	3,850	2,111	4,384	(72)	(62)	10,211	2,638	12,849
Other net operating income	189	61	759	2,694	203	3,906	(626)	3,280
Total operating income	16,066	13,039	14,425	4,656	(37)	48,149	2,023	50,172
Salaries and related expenses	(2,388)	(1,815)	(1,689)	(256)	(6,465)	(12,613)	(784)	(13,397)
Other operating expenses	(2,354)	(1,037)	(797)	(235)	(4,854)	(9,277)	(522)	(9,799)
Contribution to the Depositors' and Investors' Guarantee Fund	(538)	(135)	(15)	-	-	(688)	-	(688)
Bank tax	(723)	(344)	(516)	(86)	(14)	(1,683)	-	(1,683)
Net impairment on financial assets	318	2,401	121	94	4	2,938	80	3,018
Cost allocation	(4,539)	(3,113)	(3,170)	320	10,502	-	-	-
Profit (loss) before tax	5,842	8,996	8,359	4,493	(864)	26,826	797	27,623
Income tax expense	(1,707)	(2,428)	(2,308)	1,421	221	(4,801)	(318)	(5,119)
Profit (loss) for the year from continuing operations	4,135	6,568	6,051	5,914	(643)	22,025	479	22,504
Net segment revenue from external customers	26,175	14,806	19,843	(12,748)	73	48,149	2,023	50,172
Net segment revenue from other segments	(10,109)	(1,767)	(5,418)	17,404	(110)	-	-	-
Fee and commission income	5,669	2,136	4,486	231	2	12,524	2,643	15,167
Depreciation, amortisation, and write-offs	(166)	(58)	(15)	-	(1,145)	(1,384)	(11)	(1,395)
At 31 December 2021								
Loans to customers	502,354	237,388	346,835	59	-	1,086,636	(309)	1,086,327
Other assets	3,609	2,004	1,335	325,158	9,108	341,214	1,280	342,494
Total segment assets	505,963	239,392	348,170	325,217	9,108	1,427,850	971	1,428,821
Deposits from customers	344,776	239,871	141,204	21,477	-	747,328	(3,292)	744,036
Other liabilities	1,603	1,630	4,728	465,397	5,711	479,069	2,006	481,075
Total segment liabilities	346,379	241,501	145,932	486,874	5,711	1,226,397	(1,286)	1,225,111
Allocated equity	37,549	33,738	59,055	70,217	894	201,453	2,257	203,710
Risk exposure amount	247,970	211,814	376,896	56,983	5,903	899,566	2,080	901,646

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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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	10,749	10,536	8,530	3,734	(215)	33,334	37	33,371
Net fee and commission income	3,049	1,917	4,075	(317)	7	8,731	1,794	10,525
Other net operating income	305	50	922	(1,420)	287	144	(887)	(743)
Total operating income	14,103	12,503	13,527	1,997	79	42,209	944	43,153
Salaries and related expenses	(2,416)	(1,940)	(1,583)	(280)	(5,926)	(12,145)	(772)	(12,917)
Other operating expenses	(2,584)	(1,164)	(870)	(263)	(4,488)	(9,369)	(460)	(9,829)
Contribution to the Depositors' and Investors' Guarantee Fund	(482)	(161)	(35)	(1)	-	(679)	-	(679)
Bank tax	(613)	(340)	(514)	(105)	(16)	(1,588)	-	(1,588)
Net impairment on financial assets	(517)	(5,485)	(2,805)	(8)	-	(8,815)	(1)	(8,816)
Cost allocation	(4,690)	(2,967)	(3,020)	323	10,354	-	-	-
Profit (loss) before tax	2,801	446	4,700	1,663	3	9,613	(289)	9,324
Income tax expense	(887)	(204)	(1,356)	112	(5)	(2,340)	(132)	(2,472)
Profit (loss) for the year from continuing operations	1,914	242	3,344	1,775	(2)	7,273	(421)	6,852
Net segment revenue from external customers	20,911	14,750	19,922	(13,597)	223	42,209	944	43,153
Net segment revenue from other segments	(6,808)	(2,247)	(6,395)	15,594	(144)	-	-	-
Fee and commission income	4,797	1,948	4,152	(9)	7	10,895	1,756	12,651
Depreciation, amortisation, and write-offs	(300)	(163)	(18)	-	(1,178)	(1,659)	(7)	(1,666)
At 31 December 2020								
Loans to customers	419,882	232,580	353,953	302	-	1,006,717	-	1,006,717
Other assets	3,212	2,199	795	320,578	10,893	337,677	(203)	337,474
Total segment assets	423,094	234,779	354,748	320,880	10,893	1,344,394	(203)	1,344,191
Deposits from customers	324,815	189,847	137,791	31,674	-	684,127	(4,672)	679,455
Other liabilities	1,327	1,481	4,908	463,943	5,915	477,574	958	478,532
Total segment liabilities	326,142	191,328	142,699	495,617	5,915	1,161,701	(3,714)	1,157,987
Allocated equity	34,850	37,804	63,432	45,708	899	182,693	3,511	186,204
Risk exposure amount	229,610	235,371	392,804	60,037	5,960	923,782	9,739	933,521

Íslandsbanki hf. Consolidated Financial Statements 2021 24 Amounts are in ISK million

5. Cont'd

Subsidiaries, eliminations & adjustments

2021	Íslands-sjóðir hf.	Allianz Ísland hf.	Other subsidiaries	Eliminations & adjustments	Total
Net interest income	1	6	15	(11)	11
Net fee and commission income	1,733	938	(30)	(3)	2,638
Other net operating income	338	16	38	(1,018)	(626)
Total operating income	2,072	960	23	(1,032)	2,023
Salaries and related expenses	(590)	(191)	(3)	-	(784)
Other operating expenses	(197)	(455)	(40)	170	(522)
Net impairment on financial assets	-	-	-	80	80
Profit (loss) before tax	1,285	314	(20)	(782)	797
Income tax expense	(256)	(62)	-	-	(318)
Profit (loss) for the year from continuing operations	1,029	252	(20)	(782)	479
Net segment revenue from external customers	2,332	952	-	(1,261)	2,023
Net segment revenue from other segments	(260)	8	23	229	-
Fee and commission income	2,226	938	-	(521)	2,643
Depreciation, amortisation, and write-offs	-	(1)	(1)	(9)	(11)
At 31 December 2021					
Total assets	2,926	1,333	7,285	(10,573)	971
Total liabilities	401	716	1,386	(3,789)	(1,286)
Total equity	2,525	617	5,899	(6,784)	2,257

2020	Íslands-sjóðir hf.	Allianz Ísland hf.	Other subsidiaries	Eliminations & adjustments	Total
Net interest income	11	12	22	(8)	37
Net fee and commission income	1,185	724	(30)	(85)	1,794
Other net operating income	172	10	9	(1,078)	(887)
Total operating income	1,368	746	1	(1,171)	944
Salaries and related expenses	(584)	(188)	-	-	(772)
Other operating expenses	(183)	(420)	(1)	144	(460)
Net impairment on financial assets	-	-	-	(1)	(1)
Profit (loss) before tax	601	138	-	(1,028)	(289)
Income tax expense	(119)	(11)	-	(2)	(132)
Profit (loss) for the year from continuing operations	482	127	-	(1,030)	(421)
Net segment revenue from external customers	1,651	646	-	(1,353)	944
Net segment revenue from other segments	(283)	100	1	182	-
Fee and commission income	1,664	725	-	(633)	1,756
Depreciation, amortisation, and write-offs	-	8	-	(15)	(7)
At 31 December 2020					
Total assets	2,249	1,425	9,080	(12,957)	(203)
Total liabilities	271	600	36	(4,621)	(3,714)
Total equity	1,978	825	9,044	(8,336)	3,511

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Notes to the Consolidated Financial Statements

6. Quarterly statements (unaudited)

2021	Q1	Q2	Q3	Q4	Total
Net interest income	8,190	8,417	8,792	8,644	34,043
Net fee and commission income	2,862	2,907	3,427	3,653	12,849
Net financial income	293	619	941	646	2,499
Net foreign exchange gain	130	95	95	159	479
Other operating income	123	82	82	15	302
Salaries and related expenses	(3,574)	(3,594)	(2,953)	(3,276)	(13,397)
Other operating expenses	(2,278)	(2,894)	(2,135)	(2,492)	(9,799)
Contribution to the Depositors' and Investors' Guarantee Fund	(183)	(162)	(173)	(170)	(688)
Bank tax	(410)	(451)	(433)	(389)	(1,683)
Net impairment on financial assets	(518)	1,140	1,757	639	3,018
Profit before tax	4,635	6,159	9,400	7,429	27,623
Income tax expense	(1,036)	(769)	(1,898)	(1,416)	(5,119)
Profit for the period from continuing operations	3,599	5,390	7,502	6,013	22,504
Discontinued operations held for sale, net of income tax	16	41	85	1,079	1,221
Profit for the period	3,615	5,431	7,587	7,092	23,725

7. Net interest income

	2021	2020
Cash and balances with Central Bank	948	1,750
Loans to credit institutions	128	215
Loans to customers	55,144	51,413
Financial assets mandatorily at fair value through profit or loss	2,388	2,314
Other assets	17	3
Interest income	58,625	55,695
Deposits from Central Bank and credit institutions	(306)	(736)
Deposits from customers	(6,815)	(7,700)
Debt issued and other borrowed funds designated as at fair value through profit or loss	(729)	(608)
Debt issued and other borrowed funds at amortised cost	(14,104)	(11,179)
Subordinated loans	(829)	(763)
Other liabilities*	(1,799)	(1,338)
Interest expense	(24,582)	(22,324)
Net interest income	34,043	33,371

*Thereof is lease liabilities' interest expense amounting to ISK 84 million (2020: ISK 87 million).
Net interest margin on total assets 2.4% (2020: 2.6%).

8. Net fee and commission income

	2021	2020
Asset management	3,100	2,382
Investment banking and brokerage	3,544	2,805
Payment processing	4,979	4,378
Loans and guarantees	2,191	2,186
Other fee and commission income	1,353	900
Fee and commission income	15,167	12,651

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8. Cont'd

	2021	2020
Brokerage	(471)	(360)
Clearing and settlement	(1,834)	(1,766)
Other fee and commission expense	(13)	-
Fee and commission expense	(2,318)	(2,126)
Net fee and commission income	12,849	10,525

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

9. Net financial income (expense)

	2021	2020
Net gain (loss) on financial assets and financial liabilities mandatorily at fair value through profit or loss	1,641	(1,321)
Net gain (loss) on financial liabilities designated as at fair value through profit or loss	845	(72)
Net gain on fair value hedges	13	2
Net financial income (expense)	2,499	(1,391)

The following table shows the categorisation of the net financial income (expense).

Shares and related derivatives	1,088	165
Dividend income	54	18
Bonds and related derivatives	56	(1,586)
Other derivatives	443	82
Net gain (loss) on financial assets and financial liabilities mandatorily at fair value through profit or loss	1,641	(1,321)
Debt issued and other borrowed funds designated as at fair value through profit or loss	845	(72)
Net gain (loss) on financial liabilities designated as at fair value through profit or loss	845	(72)
Clean fair value gain on interest rate swaps designated as hedging instruments	(457)	54
Fair value loss on bonds issued by the Group attributable to interest rate risk	470	(52)
Net gain on fair value hedges	13	2

10. Net foreign exchange gain

	2021	2020
Cash and balances with Central Bank	(40)	160
Loans at amortised cost	(6,515)	22,673
Financial assets mandatorily at fair value through profit or loss	(7,435)	13,652
Other assets	(8)	10
Net foreign exchange gain (loss) for assets	(13,998)	36,495
Deposits	2,273	(10,279)
Debt issued and other borrowed funds designated as at fair value through profit or loss	5,148	(6,468)
Debt issued and other borrowed funds at amortised cost	4,695	(14,802)
Subordinated loans	2,361	(4,495)
Net foreign exchange gain (loss) for liabilities	14,477	(36,044)
Net foreign exchange gain	479	451

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Notes to the Consolidated Financial Statements

11. Other operating income

	2021	2020
Share of profit of associates, net of income tax	73	44
Reversal of impairment for an associate	60	-
Gain from sale of property and equipment	18	-
Legal fees	69	90
Rental income	41	39
Other net operating income	41	24
Other operating income	302	197

12. Personnel and salaries

	2021	2020
Salaries	10,307	9,940
Contributions to pension funds	1,605	1,505
Social security charges and financial activities tax*	1,382	1,391
Other salary-related expenses	103	81
Salaries and related expenses	13,397	12,917

*Financial activities tax calculated on salaries is 5.5% in 2021 (2020: 5.5%).

	2021		2020	
	The Bank	The Group	The Bank	The Group
Average number of employees	759	794	774	910
Positions at year-end	702	735	745	779

Total amount of compensation to the Board of Directors, the CEO, and Executive Board are specified as follows:

	2021	2020
Hallgrímur Snorrason, Chairman of the Board	11.9	10.5
Heiðrún Jónsdóttir, Vice-Chairman of the Board	9.8	8.9
Anna Þórðardóttir, member of the Board	8.5	7.9
Árni Stefánsson, member of the Board	8.5	7.9
Frosti Ólafsson, member of the Board	8.0	5.9
Guðrún Þorgeirsdóttir, member of the Board	8.0	5.9
Jökull H. Úlfsson, member of the Board	6.1	-
Friðrik Sophusson, former Chairman of the Board	-	2.5
Tómas Már Sigurðsson, former Vice-Chairman of the Board	-	2.0
Auður Finnbogadóttir, former member of the Board	-	1.7
Flóki Halldórsson, former member of the Board	-	4.7
Alternate board members*	5.1	0.4
Total salaries	65.9	58.3

*Included in compensation to alternate board members is board membership for part of the year 2021.

Contribution to pension funds for the Board of Directors amounted to ISK 8.5 million in 2021 (2020: ISK 8.8 million).

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12. Cont'd

	2021		2020	
	Total fixed salaries*	Contri-butions to pension funds	Total fixed salaries	Contri-butions to pension funds
Birna Einarsdóttir, CEO	46.1	11.6	48.7	11.6
Ásmundur Tryggvason, Managing Director of Corporate & Investment Banking	40.1	6.1	43.3	6.1
Guðmundur Kristinn Birgisson, Chief Risk Officer	36.7	5.3	36.5	5.2
Jón Guðni Ómarsson, Chief Financial Officer	38.9	6.2	42.0	5.9
Riaan Dreyer, Director of Information Technology	39.4	6.1	37.7	5.6
Sigríður Hrefna Hrafnkelsdóttir, Managing Director of Personal Banking	37.9	5.2	37.7	5.3
Una Steinsdóttir, Managing Director of Business Banking**	39.5	5.5	50.8	7.4
Total	278.6	46.0	296.7	47.1

The amounts in the table above comprise salaries for the managing directors for their executive board responsibilities. Included in total fixed salaries are non-monetary benefits such as the use of cars owned by the Group.

As of 1 January 2017, the Bank has not had an active remuneration policy in place as stated in the Bank's compensation policy. In 2021 there were no paid performance-based salaries (2020: ISK 12.7 million) and there were no unpaid performance-based salaries at year-end 2021. There were no share based payments in the years 2021 and 2020.

*Many employees of the Bank were subject to additional workload during 2021 because of the Bank's IPO and listing of shares on Nasdaq Iceland. In total, the Bank paid ISK 110.3 million to employees for overtime, of which the Bank's CEO received a payment of ISK 10.9 million and other members of the executive board received ISK 30.3 million. Contributions to pension funds for overtime payments amounted to ISK 1.7 million for the Bank's CEO and ISK 3.4 million for other members of the executive board. The overtime payments are not included in the table above.

**Included in salaries for the year 2020 is an employment anniversary payment for 30 years of service. The payment is in accordance with the collective agreement of the Confederation of Icelandic Bank and Finance Employees (SSF).

13. Other operating expenses

	2021	2020
Professional services	2,153	1,539
Software and IT expenses	4,214	4,581
Real estate and office equipment	556	627
Depreciation, amortisation, and write-offs	1,395	1,666
Other administrative expenses	1,481	1,416
Other operating expenses	9,799	9,829
Auditors' fees		
Audit of the financial statements	95	92
Review of interim financial statements	31	18
Other services	8	6
Auditors' fees	134	116

14. Net impairment on financial assets

	2021	2020
Net change in expected credit losses, on-balance sheet items*	2,964	(8,450)
Net change in expected credit losses, off-balance sheet items	54	(366)
Net impairment on financial assets	3,018	(8,816)

*The main reasons for the reduced expected credit loss allowance are: a decrease related to the COVID-19 pandemic, mostly due to a more favorable outlook in the tourism industry (ISK 1,836 million), addition due to a less favorable economic environment (ISK 56 million) and a decrease related to a new model for risk assessment of loans to individuals (ISK 500 million). For further information see Note 3.

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Notes to the Consolidated Financial Statements

15. Income tax expense

Recognised income tax is based on applicable tax laws. The income tax rate for legal entities in 2021 was 20% (2020: 20%). Special financial activities tax is calculated as 6% of the Bank's taxable profit 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 year 2021 is 18.5% (2020: 26.5%).

	2021	2020
Current tax expense excluding discontinued operations	3,339	3,052
Special financial activities tax	853	801
Adjustments in prior year's calculated income tax	24	68
Changes in deferred tax assets and deferred tax liabilities	903	(1,449)
Income tax recognised in the income statement	5,119	2,472
Income tax recognised in other comprehensive income	-	(16)

	2021		2020	
Profit before tax	27,623		9,324	
20% income tax calculated on the profit for the year	5,525	20.0%	1,865	20.0%
Special financial activities tax	853	3.1%	801	8.6%
Income not subject to tax	(1,611)	(5.8%)	(566)	(6.1%)
Non-deductible expenses	338	1.2%	318	3.4%
Other differences	14	0.05%	54	0.6%
Effective income tax expense	5,119	18.5%	2,472	26.5%

The Bank is taxed jointly with its subsidiary Íslandssjóðir hf.

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

	2021	2020
Net profit from foreclosed assets	191	37
Net profit (loss) from disposal groups held for sale	473	(542)
Net profit from sale or dissolution of subsidiaries	687	427
Income tax expense	(130)	(19)
Discontinued operations held for sale, net of income tax	1,221	(97)

17. Earnings per share

	Continued operations		Discontinued operations		Profit for the year	
	2021	2020	2021	2020	2021	2020
Profit attributable to shareholders of the Bank	22,511	7,158	1,221	(97)	23,732	7,061
Weighted average number of outstanding shares*	2,000	2,000	2,000	2,000	2,000	2,000
Basic earnings per share	11.26	3.58	0.61	(0.05)	11.87	3.53

The Group's basic and diluted earnings per share are equal as the Group has not issued any options, warrants, convertibles, or other financial instruments that dilute earnings per share (2020: none).

*In 2021 the share capital of ISK 10,000 million was divided into 2,000 million outstanding shares of ISK 5 each. As a result, the calculation for earnings per share for comparative period has been restated.

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Notes to the Consolidated Financial Statements

18. Classification of financial assets and financial liabilities

At 31 December 2021	Mandatorily at FVTPL	Hedge accounting	Designated as at FVTPL	Amortised cost	Carrying amount
Cash and balances with Central Bank	-	-	-	113,667	113,667
Loans to credit institutions	-	-	-	43,988	43,988
Listed bonds and debt instruments	96,343	-	-	-	96,343
Listed bonds and debt instruments used for economic hedging	35,896	-	-	-	35,896
Unlisted bonds and debt instruments	50	-	-	-	50
Derivatives	1,900	545	-	-	2,445
Loans to customers	-	-	-	1,086,327	1,086,327
Listed shares and equity instruments	3,246	-	-	-	3,246
Listed shares and equity instruments used for economic hedging	24,406	-	-	-	24,406
Unlisted shares and equity instruments	4,025	-	-	-	4,025
Other financial assets	-	-	-	5,573	5,573
Total financial assets	165,866	545	-	1,249,555	1,415,966
Deposits from Central Bank and credit institutions	-	-	-	13,384	13,384
Deposits from customers	-	-	-	744,036	744,036
Derivative instruments and short positions	9,467	-	-	-	9,467
Debt issued and other borrowed funds	-	45,036	89,460	267,730	402,226
Subordinated loans	-	-	-	35,762	35,762
Other financial liabilities	-	-	-	10,457	10,457
Total financial liabilities	9,467	45,036	89,460	1,071,369	1,215,332

At 31 December 2020	Mandatorily at FVTPL	Hedge accounting	Designated as at FVTPL	Amortised cost	Carrying amount
Cash and balances with Central Bank	-	-	-	78,948	78,948
Loans to credit institutions	-	-	-	89,920	89,920
Listed bonds and debt instruments	90,603	-	-	-	90,603
Listed bonds and debt instruments used for economic hedging	37,468	-	-	-	37,468
Unlisted bonds and debt instruments	145	-	-	-	145
Derivatives	5,639	1,008	-	-	6,647
Loans to customers	-	-	-	1,006,717	1,006,717
Listed shares and equity instruments	2,933	-	-	-	2,933
Listed shares and equity instruments used for economic hedging	9,109	-	-	-	9,109
Unlisted shares and equity instruments	2,809	-	-	-	2,809
Other financial assets	-	-	-	3,692	3,692
Total financial assets	148,706	1,008	-	1,179,277	1,328,991
Deposits from Central Bank and credit institutions	-	-	-	39,758	39,758
Deposits from customers	-	-	-	679,455	679,455
Derivative instruments and short positions	6,936	-	-	-	6,936
Debt issued and other borrowed funds	-	48,032	94,438	244,804	387,274
Subordinated loans	-	-	-	27,194	27,194
Other financial liabilities	-	-	-	9,721	9,721
Total financial liabilities	6,936	48,032	94,438	1,000,932	1,150,338

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19. 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 following table shows financial instruments carried at fair value at 31 December 2021 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 December 2021	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	132,239	-	50	132,289
Derivatives	-	2,445	-	2,445
Shares and equity instruments	27,625	-	4,052	31,677
Total financial assets	159,864	2,445	4,102	166,411
Short positions	1,951	-	-	1,951
Derivative instruments	-	7,516	-	7,516
Debt issued and other borrowed funds designated as at FVTPL	89,460	-	-	89,460
Total financial liabilities	91,411	7,516	-	98,927

At 31 December 2020	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	128,071	-	145	128,216
Derivatives	-	6,647	-	6,647
Shares and equity instruments	11,931	30	2,890	14,851
Non-current assets and disposal groups held for sale	-	-	1,266	1,266
Total financial assets	140,002	6,677	4,301	150,980
Short positions	737	-	-	737
Derivative instruments	-	6,199	-	6,199
Debt issued and other borrowed funds designated as at FVTPL	94,438	-	-	94,438
Total financial liabilities	95,175	6,199	-	101,374

Changes in Level 3 assets measured at fair value	Bonds and debt instruments	Shares and equity instruments	Non-current assets
Fair value at 1 January 2021	145	2,890	1,266
Purchases	32	178	-
Sales and share capital reduction	(116)	(186)	(1,201)
Net gain (loss) on financial instruments recognised in profit or loss	(11)	1,170	-
Net loss on financial instruments recognised in other comprehensive income	-	-	(65)
Fair value at 31 December 2021	50	4,052	-

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	Bonds and debt instruments	Shares and equity instruments	Non-current assets
Fair value at 1 January 2020	1,348	6,016	-
Purchases	18	7	-
Sales	-	-	(2,028)
Net loss on financial instruments recognised in profit or loss	(1,256)	(2)	-
Net gain on financial instruments recognised in other comprehensive income	-	-	114
Transfer to "Non-current assets and disposal groups held for sale"	-	(3,180)	3,180
Other changes	35	49	-
Fair value at 31 December 2020	145	2,890	1,266

At the end of each reporting period the Group determines whether transfers have occurred 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 during the year.

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. If a market for a financial instrument is not active, the Group establishes its fair value using valuation techniques. Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which observable market prices exist, net asset value (NAV) for investment fund units, expected recovery for distressed bonds, Black-Scholes option pricing model and other valuation models.

Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group and the counterparty where appropriate. 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

Financial instruments at this level are financial assets and financial liabilities containing actively traded bonds and shares that are listed either domestically or abroad.

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

Financial instruments at this level are assets and liabilities containing domestic bonds, shares 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

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

At 31 December 2021 the Group's Level 3 shares amounted to ISK 4,052 million:

-These include shares in seven professional investment funds and investment companies investing in unlisted shares and specialised investments in Iceland totalling ISK 2,120 million. The Group receives information from fund managers which use valuation models for the valuation of these shares.

-Other Level 3 shares amount to ISK 1,932 million.

At 31 December 2021 the Group's Level 3 bonds amounted to ISK 50 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.

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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 following table 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 December 2021 **Effect on profit or (loss):**	Carrying amount	Very favourable	Favourable	Unfavourable	Very unfavour-able
Level 3 Bonds and debt instruments	50	89	24	(21)	(50)
Level 3 Shares and equity instruments	4,052	3,415	1,475	(975)	(1,676)

At 31 December 2020 **Effect on profit or (loss):**	Carrying amount	Very favourable	Favourable	Unfavourable	Very unfavour-able
Level 3 Bonds and debt instruments	145	1,015	773	(132)	(145)
Level 3 Shares and equity instruments	2,890	1,897	539	(571)	(878)
Effect on comprehensive income:					
Level 3 Non-current assets and disposal groups held for sale	1,266	1,898	949	(633)	(1,266)

20. 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" 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 and payments due to leasing contracts 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 19.

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At 31 December 2021	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Cash and balances with Central Bank	-	113,667	-	113,667	113,667
Loans to credit institutions	-	43,988	-	43,988	43,988
Loans to customers	-	-	1,089,920	1,089,920	1,086,327
Other financial assets	-	5,573	-	5,573	5,573
Total financial assets	-	163,228	1,089,920	1,253,148	1,249,555
Deposits from Central Bank and credit institutions	-	13,441	-	13,441	13,384
Deposits from customers	-	744,098	-	744,098	744,036
Debt issued and other borrowed funds	225,763	97,311	-	323,074	312,766
Subordinated loans	-	37,581	-	37,581	35,762
Other financial liabilities	-	10,457	-	10,457	10,457
Total financial liabilities	225,763	902,888	-	1,128,651	1,116,405

At 31 December 2020	Level 1	Level 2	Level 3	Total fair value	Carrying amount
Cash and balances with Central Bank	-	78,948	-	78,948	78,948
Loans to credit institutions	-	89,920	-	89,920	89,920
Loans to customers	-	-	1,010,315	1,010,315	1,006,717
Other financial assets	-	3,692	-	3,692	3,692
Total financial assets	-	172,560	1,010,315	1,182,875	1,179,277
Deposits from Central Bank and credit institutions	-	39,827	-	39,827	39,758
Deposits from customers	-	679,607	-	679,607	679,455
Debt issued and other borrowed funds	194,849	112,165	-	307,014	292,836
Subordinated loans	-	26,003	-	26,003	27,194
Other financial liabilities	-	9,721	-	9,721	9,721
Total financial liabilities	194,849	867,323	-	1,062,172	1,048,964

21. 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 December 2021	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	100	-	100	-	-	-	100	-	100
Derivatives	2,445	-	2,445	(927)	(885)	(73)	560	-	2,445
Total assets	2,545	-	2,545	(927)	(885)	(73)	660	-	2,545

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At 31 December 2020	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 ..	898	-	898	-	-	-	898	-	898
Derivatives	6,647	-	6,647	(761)	(4,330)	(187)	1,369	-	6,647
Total assets	7,545	-	7,545	(761)	(4,330)	(187)	2,267	-	7,545

	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
At 31 December 2021									
Derivative instruments and short positions	9,467	-	9,467	(927)	(945)	-	7,595	-	9,467
At 31 December 2020									
Derivative instruments and short positions	6,936	-	6,936	(761)	(504)	-	5,671	-	6,936

22. Cash and balances with Central Bank

	31.12.2021	31.12.2020
Cash on hand	3,882	3,814
Balances with Central Bank	100,528	65,585
Balances with Central Bank subject to special restrictions	-	1,288
Included in cash and cash equivalents	104,410	70,687
Balances pledged as collateral to Central Bank	589	288
Mandatory reserve deposits with Central Bank	8,668	7,973
Cash and balances with Central Bank	113,667	78,948

23. Loans to credit institutions

	31.12.2021	31.12.2020
Money market loans	17,759	43,646
Bank accounts	26,187	46,269
Other loans	42	5
Loans to credit institutions	43,988	89,920

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24. Derivative instruments and short positions

At 31 December 2021	Assets	Notional values related to assets	Liabilities	Notional values related to liabilities
Interest rate swaps	1,253	131,732	3,182	88,920
Cross-currency interest rate swaps	157	14,392	473	16,587
Equity forwards	126	4,500	2,958	13,782
Foreign exchange forwards	97	15,719	278	12,674
Foreign exchange swaps	359	33,914	599	42,795
Bond forwards	453	34,594	26	7,043
Derivatives	2,445	234,851	7,516	181,801
Short positions in listed bonds	-	-	1,951	1,447
Total	2,445	234,851	9,467	183,248

At 31 December 2020				
Interest rate swaps	1,888	181,914	3,581	62,275
Cross-currency interest rate swaps	2,861	63,067	45	3,171
Equity forwards	7	813	1,488	6,702
Foreign exchange forwards	70	4,010	362	8,582
Foreign exchange swaps	1,738	32,227	435	24,101
Foreign exchange options	-	-	1	25
Bond forwards	83	10,907	287	29,596
Derivatives	6,647	292,938	6,199	134,452
Short positions in listed bonds	-	-	737	550
Total	6,647	292,938	6,936	135,002

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 municipalities, banks, and public companies. As a primary dealer the Group has access to securities lending facilities provided by the Central Bank and other issuers. 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 35) 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 December 2021 the total fair value of the interest rate swaps was positive and amounted to ISK 545 million (2020: ISK 1,008 million) and their total notional amount was ISK 44,280 million (2020: ISK 46,830).

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25. Loans to customers

At 31 December 2021	Gross carrying amount			Expected credit losses			Net carrying
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	amount
Individuals	510,024	7,197	5,704	(1,368)	(199)	(625)	520,733
Commerce and services	110,618	55,299	5,252	(844)	(2,696)	(2,407)	165,222
Construction	34,238	1,704	1,298	(341)	(72)	(54)	36,773
Energy	9,529	-	-	(36)	-	-	9,493
Financial services	1,980	1	-	(3)	-	-	1,978
Industrial and transportation	61,386	24,593	6,481	(281)	(292)	(2,260)	89,627
Investment companies	21,066	2,636	606	(295)	(297)	(39)	23,677
Public sector and non-profit organisations	9,862	144	1	(18)	(1)	(1)	9,987
Real estate	97,395	10,989	2,177	(485)	(225)	(537)	109,314
Seafood	116,451	3,204	57	(159)	(22)	(8)	119,523
Loans to customers	972,549	105,767	21,576	(3,830)	(3,804)	(5,931)	1,086,327

At 31 December 2020							
Individuals	423,570	9,011	7,561	(1,608)	(254)	(903)	437,377
Commerce and services	60,062	64,350	5,958	(511)	(3,151)	(2,448)	124,260
Construction	36,551	5,420	997	(283)	(195)	(138)	42,352
Energy	7,997	701	-	(17)	(8)	-	8,673
Financial services	1,539	-	-	-	-	-	1,539
Industrial and transportation	46,526	30,971	3,989	(243)	(783)	(1,899)	78,561
Investment companies	15,287	5,504	3,628	(268)	(427)	(284)	23,440
Public sector and non-profit organisations	10,869	58	1	(17)	-	-	10,911
Real estate	112,189	42,169	6,794	(461)	(1,655)	(1,534)	157,502
Seafood	120,845	1,365	319	(237)	(9)	(181)	122,102
Loans to customers	835,435	159,549	29,247	(3,645)	(6,482)	(7,387)	1,006,717

26. Expected credit losses

Total allowances for expected credit losses

	Stage 1	Stage 2	Stage 3	Total
Cash and balances with Central Bank	3	-	-	3
Loans to credit institutions	89	-	-	89
Loans to customers	3,830	3,804	5,931	13,565
Other financial assets	18	6	-	24
Off-balance sheet loan commitments and financial guarantees	545	298	158	1,001
At 31 December 2021	4,485	4,108	6,089	14,682
Cash and balances with Central Bank	2	-	-	2
Loans to credit institutions	109	-	-	109
Loans to customers	3,645	6,482	7,387	17,514
Other financial assets	15	4	-	19
Off-balance sheet loan commitments and financial guarantees	347	483	225	1,055
At 31 December 2020	4,118	6,969	7,612	18,699

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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 2021	3,645	6,482	7,387	17,514
Transfer to Stage 1	1,995	(1,780)	(215)	-
Transfer to Stage 2	(476)	1,650	(1,174)	-
Transfer to Stage 3	(48)	(1,259)	1,307	-
Net remeasurement of loss allowance	(3,550)	(2,254)	(779)	(6,583)
New financial assets originated or purchased	2,759	1,497	3,645	7,901
Derecognitions and maturities	(495)	(529)	(3,695)	(4,719)
Write-offs	-	(3)	(1,206)	(1,209)
Recoveries of amounts previously written off	-	-	293	293
Foreign exchange	-	-	(44)	(44)
Unwinding of interest	-	-	412	412
At 31 December 2021	3,830	3,804	5,931	13,565
At 1 January 2020	3,645	953	5,700	10,298
Transfer to Stage 1	3,577	(2,827)	(750)	-
Transfer to Stage 2	(1,743)	3,200	(1,457)	-
Transfer to Stage 3	(171)	(1,314)	1,485	-
Transfer to "Non-current assets and disposal groups held for sale"	(50)	(12)	(83)	(145)
Net remeasurement of loss allowance	(3,316)	6,024	1,201	3,909
New financial assets originated or purchased	2,104	597	2,516	5,217
Derecognitions and maturities	(401)	(139)	(404)	(944)
Write-offs	-	-	(1,498)	(1,498)
Recoveries of amounts previously written off	-	-	159	159
Foreign exchange	-	-	37	37
Unwinding of interest	-	-	481	481
At 31 December 2020	3,645	6,482	7,387	17,514

Off-balance sheet loan commitments and financial guarantees

	Stage 1	Stage 2	Stage 3	Total
At 1 January 2021	347	483	225	1,055
Transfer to Stage 1	132	(114)	(18)	-
Transfer to Stage 2	(28)	92	(64)	-
Transfer to Stage 3	(4)	(16)	20	-
Net remeasurement of loss allowance	(491)	(292)	2	(781)
New loan commitments and financial guarantees	673	242	29	944
Derecognitions and maturities	(84)	(97)	(36)	(217)
At 31 December 2021	545	298	158	1,001
At 1 January 2020	403	55	231	689
Transfer to Stage 1	230	(146)	(84)	-
Transfer to Stage 2	(74)	252	(178)	-
Transfer to Stage 3	(11)	(53)	64	-
Net remeasurement of loss allowance	(466)	269	103	(94)
New loan commitments and financial guarantees	376	166	128	670
Derecognitions and maturities	(111)	(60)	(39)	(210)
At 31 December 2020	347	483	225	1,055

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27. Investments in subsidiaries and associates

Investments in subsidiaries		31.12.2021	31.12.2020
Íslandssjóðir hf., a fund management company, Hagasmári 3, 201 Kópavogur	Iceland	100%	100%
Allianz Ísland hf., an insurance agent, Dalshraun 3, 220 Hafnarfjörður	Iceland	100%	100%

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

Investments in associates		31.12.2021	31.12.2020
Auðkenni ehf., an information security company, Borgartún 31, 105 Reykjavík*	Iceland	23.8%	23.8%
JCC ehf., a cash centre service company, Sundaborg 15, 108 Reykjavík**	Iceland	33.3%	33.3%
Reiknistofa bankanna hf., an IT service centre company, Katrínartún 2, 105 Reykjavík	Iceland	30.1%	30.1%

*On 1 July 2021, Íslandsbanki hf. signed an agreement to sell its 23.8% stake in Auðkenni ehf. to the Icelandic State Treasury. This sale is, however, subject to approval by the Icelandic Competition Authority. The Group has not recognised the sale at year-end 2021.

**On 10 December 2021, Íslandsbanki hf. signed an agreement to sell its 33.3% stake in JCC ehf. to Reiknistofa bankanna hf. The transfer date was 1 January 2022 and therefore the Group has not recognised the sale at year-end 2021.

	2021	2020
Investments in associates at the beginning of the year	775	746
Additions during the year	31	-
Share of profit of associates	73	44
Reversal of impairment	60	-
Transfer to "Non-current assets and disposal groups held for sale"	-	(15)
Investments in associates	**939**	**775**

Summarised financial information in respect of the Group's associates is set out below:

	2021	2020
Revenue	5,661	6,388
Profit	286	296
Assets	5,522	5,651
Liabilities	(2,590)	(2,808)
Net assets	2,932	2,843
Group's share of net assets of associates	**939**	**775**

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28. Property and equipment

At 31 December 2021	Land and buildings	Right-of-use assets: Buildings	Fixtures, equipment & vehicles	Total
Balance at the beginning of the year	3,058	4,729	3,119	10,906
Additions during the year	43	133	163	339
Disposals and write-offs during the year	-	(110)	(286)	(396)
Remeasurement	-	169	-	169
Historical cost	3,101	4,921	2,996	11,018
Balance at the beginning of the year	(1,340)	(906)	(1,319)	(3,565)
Depreciation during the year	(20)	(438)	(370)	(828)
Disposals and write-offs during the year	-	110	275	385
Accumulated depreciation	(1,360)	(1,234)	(1,414)	(4,008)
Carrying amount	1,741	3,687	1,582	7,010
Annual depreciation rates	0-2%	8-32%	8-33%	
Official real estate value of land and buildings	1,589			
Insurance value of buildings	2,486			
Insurance value of fixtures, equipment and vehicles			1,985	

At 31 December 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 year	35	-	441	476
Disposals and write-offs during the year	(120)	(69)	(583)	(772)
Remeasurement	-	184	-	184
Transfer to "Non-current assets and disposal groups held for sale"	(953)	(20)	(807)	(1,780)
Historical cost	3,058	4,729	3,119	10,906
Balance at the beginning of the year	(1,447)	(420)	(1,763)	(3,630)
Depreciation during the year	(19)	(421)	(398)	(838)
Disposals and write-offs during the year	17	(67)	455	405
Transfer to "Non-current assets and disposal groups held for sale"	109	2	387	498
Accumulated depreciation	(1,340)	(906)	(1,319)	(3,565)
Carrying amount	1,718	3,823	1,800	7,341
Annual depreciation rates	0-2%	8-31%	8-33%	
Official real estate value of land and buildings	1,497			
Insurance value of buildings	2,369			
Insurance value of fixtures, equipment and vehicles			1,991	

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29. Intangible assets

At 31 December 2021	Purchased software	Developed software	Total
Balance at the beginning of the year	1,623	3,383	5,006
Additions during the year	442	-	442
Write-offs during the year	(486)	-	(486)
Historical cost	1,579	3,383	4,962
Balance at the beginning of the year	(636)	(892)	(1,528)
Amortisation during the year	(190)	(360)	(550)
Write-offs during the year	467	-	467
Accumulated amortisation	(359)	(1,252)	(1,611)
Carrying amount	1,220	2,131	3,351
Amortisation rates	10-25%	10%	

At 31 December 2020	Purchased software	Developed software	Goodwill	Total
Balance at the beginning of the year	1,782	3,383	318	5,483
Additions during the year	257	-	-	257
Write-offs during the year	(139)	-	-	(139)
Transfer to "Non-current assets and disposal groups held for sale"	(277)	-	(318)	(595)
Historical cost	1,623	3,383	-	5,006
Balance at the beginning of the year	(528)	(625)	-	(1,153)
Amortisation during the year	(346)	(267)	-	(613)
Write-offs during the year	110	-	-	110
Transfer to "Non-current assets and disposal groups held for sale"	128	-	-	128
Accumulated amortisation	(636)	(892)	-	(1,528)
Carrying amount	987	2,491	-	3,478
Amortisation rates	10-25%	10%	-	

30. Other assets

	31.12.2021	31.12.2020
Receivables	1,582	1,767
Unsettled securities transactions	3,412	1,550
Accruals	252	200
Prepaid expenses	332	181
Deferred tax assets	94	259
Other assets	112	168
Other assets	5,784	4,125

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

	31.12.2021	31.12.2020
Repossessed collateral:		
Land and buildings	269	1,548
Industrial equipment and vehicles	-	7
Assets of disposal groups held for sale	1,075	1,618
Non-current assets and disposal groups held for sale	1,344	3,173

At year-end 2021 the Group classified the assets and liabilities of Miðengi ehf. (100%) and Reykjavík DC hf. (100%) as assets and liabilities of disposal groups held for sale.

Assets and liabilities of disposal groups held for sale:	31.12.2021	31.12.2020
Shares	1	1,266
Receivables	60	224
Land, fixtures and equipment	467	100
Right-of-use assets	537	-
Other assets	10	28
Total assets	1,075	1,618
Payables	316	-
Tax liabilities	88	26
Lease liabilities	538	-
Other liabilities	14	1
Total liabilities	956	27

32. Deposits from Central Bank and credit institutions

	31.12.2021	31.12.2020
Deposits from credit institutions	13,233	39,650
Repurchase agreements with Central Bank	151	108
Deposits from Central Bank and credit institutions	13,384	39,758

33. Deposits from customers

	31.12.2021	31.12.2020
Demand deposits and deposits with maturity up to 3 months	658,543	582,746
Term deposits with maturity of more than 3 months	85,493	96,709
Deposits from customers	744,036	679,455

	31.12.2021		31.12.2020	
Deposits from customers specified by owners	Amount	% of total	Amount	% of total
Central government and state-owned enterprises	10,750	1%	8,145	1%
Municipalities	7,125	1%	7,561	1%
Companies	371,893	50%	326,799	48%
Individuals	354,268	48%	336,950	50%
Deposits from customers	744,036	100%	679,455	100%

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34. Pledged assets

	31.12.2021	31.12.2020
Financial assets pledged as collateral against liabilities	291,744	236,901
Financial assets pledged as collateral with the Central Bank	7,440	5,088
Financial assets pledged as collateral in foreign banks	1,861	167
Pledged assets against liabilities	301,045	242,156

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 owns covered bonds for its own use which accounts for a portion of the pledged assets. The carrying amount of these bonds at 31 December 2021 was ISK 23,650 million.

The Group has also pledged assets with the Central Bank to ensure the clearing of the Icelandic payment system as well as other contracts with the Central Bank. Moreover, it has pledged cash in foreign banks and financial institutions, mainly as collateral for trades under ISDA agreements to hedge market risk.

35. Debt issued and other borrowed funds

	Issued	Maturity		Interest	31.12.2021	31.12.2020
Covered bonds in ISK	2019-2020	2021	At maturity	Fixed rates	-	5,076
Covered bonds in ISK	2015-2021	2023	At maturity	Fixed rates	39,020	29,496
Covered bonds in ISK	2020-2021	2027	Amortising	Fixed rates	25,750	5,386
Covered bonds in ISK - CPI-linked*	2015-2017	2022	At maturity	Fixed rates	18,722	19,228
Covered bonds in ISK - CPI-linked	2012-2018	2024	At maturity	Fixed rates	38,231	36,797
Covered bonds in ISK - CPI-linked	2015-2018	2026	At maturity	Fixed rates	29,833	28,571
Covered bonds in ISK - CPI-linked	2019-2021	2028	Amortising	Fixed rates	25,902	25,606
Covered bonds in ISK - CPI-linked	2017-2018	2030	At maturity	Fixed rates	27,363	26,285
Covered bonds					204,821	176,445
Senior unsecured bonds in SEK	2018	2021	At maturity	Fixed rates	-	1,553
Senior unsecured bonds in SEK	2018-2019	2021	At maturity	Floating rates	-	6,630
Senior unsecured bonds in SEK	2018	2021	At maturity	Floating rates	-	14,832
Senior unsecured bonds in EUR	2019	2021	At maturity	Floating rates	-	1,795
Senior unsecured bonds in SEK*	2018	2022	At maturity	Floating rates	-	15,574
Senior unsecured bonds in EUR**	2019	2022	At maturity	Fixed rates	44,803	47,494
Senior unsecured bonds in NOK	2019	2022	At maturity	Floating rates	14,841	14,982
Senior unsecured bonds in EUR***	2018	2024	At maturity	Fixed rates	45,036	48,032
Senior unsecured bonds in NOK	2019	2024	At maturity	Fixed rates	6,122	6,187
Senior unsecured bonds in ISK	2019	2024	Amortising	Floating rates	2,100	2,664
Senior unsecured bonds in EUR**	2020	2023	At maturity	Fixed rates	44,657	46,944
Senior unsecured bonds in ISK	2020-2021	2025	At maturity	Fixed rates	6,603	2,709
Senior unsecured bonds in NOK	2021	2024	At maturity	Floating rates	9,248	-
Senior unsecured bonds in SEK	2021	2024	At maturity	Floating rates	6,479	-
Senior unsecured bonds in NOK	2021	2025	At maturity	Floating rates	11,044	-
Senior unsecured bonds in SEK	2021	2025	At maturity	Floating rates	6,472	-
Bonds issued					197,405	209,396
Bills issued					-	1,433
Debt issued and other borrowed funds					402,226	387,274

*The Group repurchased own bonds during the period amounting to ISK 16,384 million.

**These bond issuances are classified as being designated as at fair value through profit or loss. At 31 December 2021 the total carrying amount of the bonds amounted to ISK 89,460 million and included in the amount are fair value changes amounting to ISK 641 million. The carrying amount of the bonds at 31 December 2021 was ISK 180 million higher than the contractual amount due at maturity.

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***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 December 2021 the total carrying amount of the bond issuance amounted to ISK 45,036 million and included in the amount are fair value changes amounting to ISK 354 million.

The Group has issued additional covered bonds for its own use, for example for the purpose of securities lending with regards to market making agreements. These covered bond amounts are not included in the total.

36. Subordinated loans

	Issued	Maturity	Callable	Interest	31.12.2021	31.12.2020
Subordinated loans in SEK	2017	2027	2022	Floating, STIBOR + 2.0%	10,786	11,646
Subordinated loans in SEK	2018	2028	2023	Floating, STIBOR + 2.5%	7,187	7,775
Subordinated loans in SEK	2019	2029	2024	Floating, STIBOR + 3.9%	7,163	7,773
Tier 2 subordinated loans					25,136	27,194
Subordinated loans in SEK	2021	Perpetual	2026	Floating, STIBOR + 4.75%	10,626	-
Additional Tier 1 subordinated loans					10,626	-
Subordinated loans					35,762	27,194

37. Changes in liabilities arising from financing activities

			Non-cash changes			
	1.1.2021	Cash flows	Interest expense	Foreign exchange	Fair value changes	31.12.2021
Covered bonds in ISK	39,958	22,380	2,432	-	-	64,770
Covered bonds in ISK - CPI-linked	136,487	(6,467)	10,031	-	-	140,051
Senior unsecured bonds in ISK	5,373	3,202	128	-	-	8,703
Senior unsecured bonds FX	61,553	(6,158)	960	(2,149)	-	54,206
Senior unsecured bonds FX at fair value	94,438	(734)	729	(5,148)	175	89,460
Senior unsecured bonds in hedge accounting	48,032	(525)	545	(2,546)	(470)	45,036
Other borrowed funds	1,433	(1,441)	8	-	-	-
Subordinated loans	27,194	10,100	829	(2,361)	-	35,762
Total	414,468	20,357	15,662	(12,204)	(295)	437,988

			Non-cash changes			
	1.1.2020	Cash flows	Interest expense	Foreign exchange	Fair value changes	31.12.2020
Covered bonds in ISK	24,088	14,400	1,470	-	-	39,958
Covered bonds in ISK - CPI-linked	125,975	2,532	7,980	-	-	136,487
Senior unsecured bonds in ISK	3,553	1,728	92	-	-	5,373
Senior unsecured bonds FX	58,892	(7,093)	1,013	8,741	-	61,553
Senior unsecured bonds FX at fair value	49,352	38,069	608	6,468	(59)	94,438
Senior unsecured bonds in hedge accounting	41,816	(463)	566	6,061	52	48,032
Other borrowed funds	2,705	(1,330)	58	-	-	1,433
Subordinated loans	22,674	(738)	763	4,495	-	27,194
Total	329,055	47,105	12,550	25,765	(7)	414,468

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38. Tax assets and tax liabilities

	31.12.2021		31.12.2020	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	5,896	-	5,448
Deferred tax assets and tax liabilities	94	536	259	2
Tax in the balance sheet	94	6,432	259	5,450

	Assets	Liabilities
Deferred tax assets and tax liabilities 1.1.2020	476	1,183
Calculated income tax for 2020	229	1,902
Income tax payable in 2021	-	(3,109)
- thereof income tax recognised in other comprehensive income	-	12
Changes in deferred tax assets and deferred tax liabilities due to equity	-	26
Transfer to "Non-current assets and disposal groups held for sale"	(446)	-
Deferred tax assets and tax liabilities 31.12.2020	259	2
Calculated income tax for 2021	(165)	4,099
Income tax payable in 2022	-	(3,361)
Changes in deferred tax assets and deferred tax liabilities due to equity	-	(204)
Deferred tax assets and tax liabilities 31.12.2021	94	536

				Balance at 31 December		
2021	Net balance at 1 January	Recognised in profit or (loss)	Recognised in equity	Net	Deferred tax assets	Deferred tax liabilities
Property and equipment	(978)	48	-	(930)	-	(930)
Intangible assets	(490)	6	-	(484)	-	(484)
Assets and liabilities in foreign currency	(420)	44	-	(376)	-	(376)
Deferred foreign exchange difference	1,105	(1,380)	-	(275)		(275)
Derivatives	(90)	685	-	595	595	
Lease liabilities	797	(39)	-	758	758	-
Debt issued and other borrowed funds	240	(268)	204	176	176	-
Other items	93	1	-	94	94	-
	257	(903)	204	(442)	1,623	(2,065)
Set-off of deferred tax assets together with liabilities of the same taxable entities					(1,529)	1,529
Tax assets (liabilities)	257	(903)	204	(442)	94	(536)

					Balance at 31 December		
2020	Net balance at 1 January	Transfer to non-current assets	Recognised in profit or (loss)	Recognised in equity	Net	Deferred tax assets	Deferred tax liabilities
Property and equipment	(1,097)	32	87	-	(978)	-	(978)
Intangible assets	(511)	-	21	-	(490)	-	(490)
Assets and liabilities in foreign currency	(276)	-	(144)	-	(420)	-	(420)
Deferred foreign exchange difference	(426)	(9)	1,540	-	1,105	1,105	-
Derivatives	(42)	22	(70)	-	(90)	-	(90)
Lease liabilities	851	-	(54)	-	797	797	-
Debt issued and other borrowed funds	268	4	6	(38)	240	240	-
Other items	30	-	63	-	93	93	-
Tax loss carry forwards	496	(496)	-	-	-	-	-
	(707)	(447)	1,449	(38)	257	2,235	(1,978)
Set-off of deferred tax assets together with liabilities of the same taxable entities						(1,976)	1,976
Tax assets (liabilities)	(707)	(447)	1,449	(38)	257	259	(2)

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39. Other liabilities

	31.12.2021	31.12.2020
Accruals	2,463	2,311
Lease liabilities	3,838	3,962
Provision for effects of court rulings	288	288
Expected credit losses for off-balance sheet loan commitments and financial guarantees	1,001	1,055
Withholding tax	1,288	915
Unsettled securities transactions	2,005	1,379
Sundry liabilities	1,965	1,983
Other liabilities	12,848	11,893

40. Custody assets

	31.12.2021	31.12.2020
Custody assets - not managed by the Group	3,411,059	2,863,328

41. Leases

The Group as a lessee

The Group's significant leases are leases for offices, branches, and storage. Most leases are CPI-linked real estate leases with duration of 5-10 years with extension options. Lease commitments are recognised on-balance sheet except for short-term leases and leases of low-value assets. During the year 2021 the total expense for leases of low-value assets and short-term leases amounted to ISK 22 million (2020: ISK 23 million), the total cash outflow for leases amounted to ISK 536 million (2020: ISK 500 million) and total interest expense from lease liabilities amounted to ISK 87 million (2020: ISK 87 million).

At year-end 2021 the Group recognised ISK 4,224 million in right-of-use assets which are presented in the line items "Property and equipment" and "Non-current assets and disposal groups held for sale". Lease liabilities amounting to ISK 4,376 million are presented in the line items "Other liabilities" and "Non-current liabilities and disposal groups held for sale".

The Group as a lessor

Net investment in finance lease receivables

	31.12.2021	31.12.2020
Due within 1 year	14,680	14,030
Due in 1-5 years	32,954	31,152
Due in more than 5 years	2,512	3,132
Total gross investment in the lease	50,146	48,314
Due within 1 year	12,562	12,263
Due in 1-5 years	29,738	28,380
Due in more than 5 years	2,279	2,716
Total present value of lease payments*	44,579	43,359
Unearned interest income	5,567	4,955

*The Group presents finance lease receivables in the line item "Loans to customers".

Expected credit loss allowance	424	990
Interest income from finance lease receivables during the year	2,191	2,439

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42. Íslandsbanki's shareholders

The following table shows the ten largest shareholders of Íslandsbanki:

		31.12.2021	31.12.2020
The Icelandic Government	Iceland	65.00%	100%
Capital Group	USA	4.35%	-
LSR Pension Fund	Iceland	4.08%	-
Live Pension Fund	Iceland	3.67%	-
Gildi Pension Fund	Iceland	3.14%	-
Stapi Pension Fund	Iceland	1.03%	-
Iceland Funds	Iceland	0.94%	-
Almenni Pension Fund	Iceland	0.82%	-
RWC Asset Management LLP	UK	0.77%	-
Brú Pension Fund	Iceland	0.76%	-
Other shareholders with less than 0.76% shareholding	Iceland	15.44%	-
Total		100%	100%

In late June 2021 the Bank's shares were listed on Nasdaq Iceland following its successful IPO. At year-end 2021 the number of shareholders of the Bank was around 15,700 (2020: one). At year-end 2021, 92% of the Bank's shares were owned by domestic parties and 8% by international investors.

At year-end 2021 the Bank's employees held a shareholding of 0.14% in the Bank (2020: 0%).

43. Related party

Íslandsbanki has a related party relationship with the Icelandic Government as the largest shareholder with control over the Group. 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.

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 32.

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 December 2021	Assets	Liabilities	Net balance	Commitments, guarantees & overdrafts
Shareholders with control over the Group	-	-	-	2
Board of Directors, key management personnel and other related parties	356	413	(57)	57
Associated companies	3	478	(475)	206
Balances with related parties	359	891	(532)	265

2021	Interest income	Interest expense	Other income	Other expense
Shareholders with control over the Group	-	-	281	-
Board of Directors, key management personnel and other related parties	23	10	2	7
Associated companies	1	-	2	1,468
Transactions with related parties	24	10	285	1,475

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At 31 December 2020	Assets	Liabilities	Net balance	Commitments, guarantees & overdrafts
Shareholders with control over the Group	-	-	-	3
Board of Directors, key management personnel and other related parties	440	393	47	45
Associated companies	31	342	(311)	228
Balances with related parties	471	735	(264)	276

2020	Interest income	Interest expense	Other income	Other expense
Board of Directors, key management personnel and other related parties	16	9	4	-
Associated companies	-	7	-	1,627
Transactions with related parties	16	16	4	1,627

At year-end 2021 total of ISK 1 million (2020: none) were recognised as Stage 1 expected credit losses. No share option programmes were operated during the year. For related party remuneration see Note 12.

44. Contingencies

Contingent liabilities

Borgun hf. – Landsbankinn hf.

Borgun hf., (currently SaltPay IIB hf.) a former 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 during the sales process, namely the value of its stake in Visa Europe which was sold to Visa International shortly after the Borgun sale. In order to reclaim the alleged loss, Landsbankinn filed a lawsuit against Borgun 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 is approximately ISK 1,930 million. Court appointed senior assessors presented their reassessment in April 2021 which corroborates the previous assessment of Borgun's obligation to disclose. Furthermore, the senior assessors estimated that Borgun's share in Visa as of 31 December 2013 would have amounted to at least ISK 387 million. The hearing of the case in front of the District Court of Reykjavík is now scheduled on 18 May 2022.

On 11 March 2020, the Bank signed an agreement to sell its 63.47% stake in Borgun hf. to SaltPay Co Ltd. and concluded the sale on 7 July 2020. In the agreement the Bank undertook to reimburse 63.47% of losses incurred by Borgun or the buyer as a result of an unfavourable outcome in the Landsbankinn case, however such reimbursement was never to exceed the Bank's share in the purchase price. The Group has not recognised a provision as a result of this event.

105 Miðborg slhf. - ÍAV hf.

In February 2021 the alternative investor fund 105 Miðborg slhf., operated by Íslandssjóðir hf. (Iceland Funds hf.), a wholly owned subsidiary of the Bank, terminated its contractor agreement with ÍAV hf., a contractor that had been retained for a real estate project at Kirkjusandur in the centre of Reykjavík. The main reason for the termination was the alleged non-performance and delays in the construction of one building on the premises. The contractor, ÍAV, has claimed approximately ISK 3,829 million in damages plus late payment interest and legal costs from 105 Miðborg and Iceland Funds for the alleged unlawful termination. The case was filed on 11 May 2021 at the District Court of Reykjavík. Additionally, 105 Miðborg has filed a case against ÍAV claiming approximately ISK 3,878 million in damages plus late payment interest and legal cost due to alleged delays and significant breaches of contract. The Bank owns a 6.25% stake in 105 Miðborg. The Group has not recognised a provision in respect of this matter.

The Consumers' Association of Iceland

In December 2021 three customers, sponsored by the Consumers' Association of Iceland, commenced litigation against the Bank, demanding that the court rules that certain provisions of their residential mortgages, governing variable interest rates, be deemed illegal and unenforceable and demand the repayment any of overpaid interest.

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Firstly, two of the cases, were brought by customers owing CPI linked mortgages, that contain a certain interest resetting provision, that the Supreme Court found in its ruling on case no. 623/2016, could not be used by the Bank to reset interest rates. Following the judgement, the Bank repaid its customers any interest that the Bank had charged in excess of the originally agreed interest rate and returned the affected loans to their original interest rates. In the case now brought to the courts, the customers maintain that instead of the originally agreed interest rates, their loans should incur interest rates pursuant to article 4 of Act no. 38/2001 on interest and price indexation. An unfavourable finding by the court may have an influence on the Bank's portfolio of loans and fully paid loans that contained the resetting provision, disputed in case no. 623/2016. The Group estimates that the financial impact of an unfavourable ruling in an adverse scenario could lie in the range of ISK 3 to 5 billion.

Secondly, a case has been brought against the Bank by a customer owing a non-index linked mortgage bearing variable interest rates. The plaintiff maintains that the terms governing the variable interest rates are invalid and may not be used by the Bank as basis for setting interest rates, and that therefore the originally agreed interest rate should remain fixed during the term of the loan. An unfavourable ruling in this case may affect all indexed and non-index linked mortgages bearing variable interest rates, as well as any loans bearing fixed interest rates to be reset on a predefined date.

It is disputed in the three cases whether the terms of the Bank's mortgages, and the method used by the Bank to set variable interest rates, is in compliance with the Act on Mortgage Lending to Consumers no. 118/2016. That act is in this respect similar to the terms of Act no. 33/2013 on Consumer Credit. An unfavourable finding could therefore affect other loans to consumers bearing variable interest rates. Further to this the Bank has received information requests from a legal firm representing over 1,200 customers of Icelandic commercial banks and loan institutions, they deem to have a comparable right.

In the event of an unfavourable ruling and a subsequent finding that the affected loans should bear a fixed rate of interest instead of a variable interest rate, the Bank's interest rate risk would rise significantly, that could lead to a significant financial loss in the event of adverse developments of interest rates in the capital markets. The Group believes that this is a very unlikely scenario. The Group has reviewed the terms of its mortgages, other loan contracts and the methods used for the setting and resetting of variable interest rates in light of the above claims. The Group believes that the claims of the plaintiffs are unfounded.

The Group has not recognised a provision with regards to this matter.

45. Events after the reporting period

No events have arisen after the reporting period and up to the approval of the consolidated financial statements for the year 2021 that require additional disclosures.

46. Risk management

Risk governance

The Group is exposed to various risk factors and managing these risks is an integral part of its operations. The Bank emphasises sound governance principles. The risk management and internal control framework of the Group is based on a three lines of defence model, as referred to in the European Banking Authority Guidelines on Internal Governance, and aims for informed decision-making and strong risk awareness. The framework is intended to ensure effective and efficient operations, adequate control of risks, prudent conduct of business, reliability of financial and non-financial information reported internally and externally, and compliance with laws, regulations, supervisory requirements and the Group’s internal rules.

The first line of defence consists of the Bank's business and support units; the second line of defence comprises the Bank's internal control units, Risk management and Compliance; and the third line of defence is Internal Audit which gives the Board an independent assessment of the quality of corporate governance, risk management and internal controls.

The Group's management body has a dual structure. The Board of Directors of the Bank has a supervising role in setting and monitoring the execution of set policies, the sound control of accounting and financial management and ensuring that Group Internal audit, Compliance and Risk management are effective. The Chief Executive Officer (CEO), the Chief Risk Officer (CRO), other members of the senior management and the senior management committees are responsible for implementing risk management practises and internal monitoring in accordance with Board authorisation.

The ultimate responsibility for ensuring an adequate risk management and internal control framework at the Group lies with the Board of Directors. The Board defines and communicates the risk governance framework and the acceptable level of risk through risk management policies and the Risk Appetite Statement. To assist the Board in fulfilling its oversight responsibilities, the Board has appointed three board subcommittees.

46. Cont'd

The CEO is responsible for the day-to-day operations of the Bank, pursuant to set policies and resolutions of the Board. Moreover, it is the task of the CEO to ensure that the Group's operations are consistent with applicable legislation and the Group's Articles of Association which includes maintaining adequate and effective risk management and internal control functions. The CEO appoints the Chief Risk Officer, the Compliance Officer as well as other members of the Executive Board. The CEO also engages the members of the senior management committees.

The CRO heads the Risk management function and is responsible for defining the daily tasks of the department and to assess the adequacy of its professional skills. In addition, the CRO is responsible for monitoring the risk management framework at the Group and for verifying that the Bank has the right resources and an appropriate organisation to manage its risks efficiently.

The CRO is selected and appointed by the CEO, subject to Board confirmation. The CRO reports directly to the Board and the Board Risk Committee on the overall risk profile of the Group and cannot be removed without the Board's prior approval.

The CRO is independent from the business units, is a member of the Executive Board and reports directly to the CEO. The CRO provides an independent view on the Group's exposure to risk. The CRO has the right but not the responsibility to veto certain risk-taking decisions of the senior management committees if an internal control unit considers the proposal inconsistent with the Bank's risk appetite, policies or procedures.

Risk management is mandated to identify, understand, measure and monitor the risks that the Group is exposed to. It provides independent information, analyses and expert judgement on risk exposures, and advice on proposals and risk decisions made by the management and business or support units as to whether they are consistent with the risk appetite and risk polices set by the Board.

Where necessary, Risk management makes recommendations to senior management and the Board to improve or clarify risk policies, procedures and limits.

Risk Management provides a holistic view on risk, and compliance to limits to internal and external stakeholders, and ensures an appropriate escalation in the event of limit breaches.

Business and support units are, however, responsible for maintaining their independent view on the risks inherent in their operations and reporting to senior management any foreseeable breaches from limits, policies or strategic direction.

Risk management provides the senior management and the Board with all relevant risk related information to enable it to define the Bank's risk appetite.

The General Counsel is appointed by and reports directly to the CEO. The General Counsel provides legal advice to the Bank's senior management, including the Board of Directors, and manages the Bank's legal department which provides comprehensive legal advice to the Bank's business segments and support units.

The Chief Audit Executive (CAE) is appointed by the Board, reports directly to Board and directs Group Internal Audit with a mandate from the Board. The CAE is responsible for internal audit matters within the Group, including internal audit tasks which have been outsourced.

The Compliance Officer heads the compliance function and is responsible for defining the daily tasks of the department and assessing the adequacy of its professional skills. The Compliance Officer is responsible for monitoring the compliance risk management framework for the Bank and maintaining oversight for compliance risk throughout the Bank.

The Bank's Compliance Officer is selected and engaged by the CEO, subject to Board confirmation. The Compliance Officer cannot be removed without the Board's prior approval. The Financial Supervisory Authority of the Central Bank and Chief Audit Executive shall be notified of the dismissal or departure of the Compliance Officer. The Compliance Officer reports directly to the Board on the overall compliance risk profile of the Bank.

Each employee is responsible for understanding the risk related to their day-to-day work, for knowing and understanding the respective internal and external rules and procedures, for using the alert procedures in the event of possible fraudulent activities and for conducting business in accordance with the Bank's code of conduct.

The Bank's senior management committee structure is twofold. Firstly the two executive committees, the Executive Board and the All Risk Committee, that are responsible for the implementation of the Board approved business strategy, risk appetite and policies. Secondly the four business committees, the Asset and Liability Committee (ALCO), the Senior Credit Committee (SCC), the Investment Committee (IC), the Operational and Security Committee (OSC), and the Sustainability Committee (SC), which are responsible for the approval of business or operational proposals subject to internal rules and guidelines issued by the executive committees and the Board.

46. Cont'd

The members of the senior management committees are appointed by the CEO, and their mandate and rules of procedure are documented in a charter issued by the CEO.

More information about the Group's risk management and risk assessment processes is available in the unaudited Pillar 3 2021 Report, which is available on the Bank's website: www.islandsbanki.is.

47. 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.

48. Maximum credit exposure and collateral

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 multiplying the sum of potential future credit exposure and the positive market value of the contract by a factor 1.4. This multiplication factor along with a new method for calculating potential future credit exposure was introduced with the implementation of CRR II in Iceland, leading to an increase in maximum credit exposure due to derivatives.

Collateral and other credit mitigants vary between types of obligors and credit facilities. 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. Exception from this are Government guarantees issued in response to the COVID-19 pandemic which are shown under other collateral. Of these, ISK 2,419 million are subject to 100% Government guarantee, ISK 1,181 million to 85% Government guarantee and ISK 542 million to 70% Government guarantee. Covenants in loan agreements are also an important credit enhancement but do not reduce maximum credit exposure.

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. The total value of pledged assets can thus be higher than the cover indicates. For capital leases the Group remains the owner of the leased object.

The industry breakdown under loans to customers 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. In 2021, the industry classification was changed for a number of customers in order to better reflect the underlying operations. This is most notable where certain companies were previously classified as "Real estate" but are now classified as "Commerce and services" or "Industrial and transportation". Comparative figures have not been restated.

The following table shows the maximum exposure to credit risk by collateral held against those exposures:

48. Cont'd

At 31 December 2021 **Collateral held against credit exposure**	Maximum exposure to credit risk	Residential real estate	Commercial real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral	Total credit exposure not covered by collateral	Associated ECL
Cash and balances with Central Bank	113,667	-	-	-	-	-	-	-	113,667	3
Loans to credit institutions	43,988	-	-	-	-	-	-	-	43,988	89
Bonds and debt instruments	132,289	-	-	-	-	-	-	-	132,289	-
Derivatives	21,547	-	-	-	9,722	-	-	9,722	11,825	-
Loans to customers:	1,086,327	510,100	250,581	86,387	6,664	50,536	72,774	977,042	109,285	13,565
Individuals	520,733	460,898	9,317	21	205	15,756	198	486,395	34,338	2,192
-thereof mortgages	457,800	454,684	1,417	-	194	-	-	456,295	1,505	1,023
Commerce and services	165,222	16,083	66,667	721	262	25,422	20,997	130,152	35,070	5,947
Construction	36,773	12,619	15,532	7	118	2,605	2,621	33,502	3,271	467
Energy	9,493	27	7,638	-	2	6	13	7,686	1,807	36
Financial services	1,978	-	475	-	-	-	1,472	1,947	31	3
Industrial and transportation	89,627	1,511	46,292	2,375	104	6,268	13,578	70,128	19,499	2,833
Investment companies	23,677	1,328	4,637	-	5,421	72	11,720	23,178	499	631
Public sector and non-profit organisations	9,987	85	738	-	-	45	3	871	9,116	20
Real estate	109,314	16,715	87,266	-	480	264	2,655	107,380	1,934	1,247
Seafood	119,523	834	12,019	83,263	72	98	19,517	115,803	3,720	189
Other financial assets	5,573	-	-	-	-	-	-	-	5,573	24
Off-balance sheet items:	164,262	4,230	32,611	12,306	1,902	-	20,515	71,564	92,698	1,001
Financial guarantees	18,830	-	6,614	370	1,434	-	1,503	9,921	8,909	453
Undrawn loan commitments	58,809	4,230	15,118	3,993	2	-	10,058	33,401	25,408	252
Undrawn overdrafts	56,573	-	9,512	7,874	351	-	8,505	26,242	30,331	172
Credit card commitments	30,050	-	1,367	69	115	-	449	2,000	28,050	124
Total	1,567,653	514,330	283,192	98,693	18,288	50,536	93,289	1,058,328	509,325	14,682

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At 31 December 2020 Collateral held against credit exposure	Maximum exposure to credit risk	Residential real estate	Commercial real estate	Vessels	Cash & securities	Vehicles & equipment	Other collateral	Total credit exposure covered by collateral	Total credit exposure not covered by collateral	Associated ECL
Cash and balances with Central Bank	78,948	-	-	-	-	-	-	-	78,948	2
Loans to credit institutions	89,920	-	-	-	-	-	-	-	89,920	109
Bonds and debt instruments	128,216	-	-	-	-	-	-	-	128,216	-
Derivatives	9,913	-	-	-	5,318	-	-	5,318	4,595	-
Loans to customers:	1,006,717	404,924	280,452	90,008	12,920	49,193	77,013	914,510	92,207	17,514
Individuals	437,377	363,231	23,713	26	153	14,469	154	401,746	35,631	2,765
-thereof mortgages	377,155	355,807	16,101	-	138	-	-	372,046	5,109	1,257
Commerce and services	124,260	15,172	43,441	809	106	25,638	24,009	109,175	15,085	6,110
Construction	42,352	6,642	29,143	11	692	2,184	1,646	40,318	2,034	616
Energy	8,673	-	6,527	-	1	14	2	6,544	2,129	25
Financial services	1,539	357	69	-	6	-	1,091	1,523	16	-
Industrial and transportation	78,561	1,220	29,493	1,875	218	6,347	17,515	56,668	21,893	2,925
Investment companies	23,440	1,159	6,238	-	4,502	86	10,990	22,975	465	979
Public sector and non-profit organisations	10,911	108	853	-	-	28	-	989	9,922	17
Real estate	157,502	16,790	128,995	5	7,240	351	1,041	154,422	3,080	3,650
Seafood	122,102	245	11,980	87,282	2	76	20,565	120,150	1,952	427
Other financial assets	3,692	-	-	-	-	-	-	-	3,692	19
Off-balance sheet items:	152,388	2,246	33,447	8,533	1,535	1,051	25,313	72,125	80,263	1,055
Financial guarantees	23,189	-	5,843	107	1,307	-	1,918	9,175	14,014	492
Undrawn loan commitments	40,026	2,246	12,938	500	3	1,051	12,919	29,657	10,369	201
Undrawn overdrafts	56,746	-	13,117	7,853	132	-	9,979	31,081	25,665	201
Credit card commitments	32,427	-	1,549	73	93	-	497	2,212	30,215	161
Total	1,469,794	407,170	313,899	98,541	19,773	50,244	102,326	991,953	477,841	18,699

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49. Credit quality of financial assets

The following tables provide 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 statements, 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. A new risk assessment model for individuals was introduced in the third quarter of 2021.

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 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 2021 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.

At 31 December 2021

Loans to customers:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	398,524	1,775	-	400,299
Risk class 5-6	377,063	42,650	-	419,713
Risk class 7-8	180,421	53,444	-	233,865
Risk class 9	16,445	7,889	-	24,334
Risk class 10	-	-	21,576	21,576
Unrated	96	9	-	105
	972,549	105,767	21,576	1,099,892
Expected credit losses	(3,830)	(3,804)	(5,931)	(13,565)
Net carrying amount	968,719	101,963	15,645	1,086,327

Off-balance sheet loan commitments and financial guarantees:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	77,769	1,065	-	78,834
Risk class 5-6	43,831	4,550	-	48,381
Risk class 7-8	21,854	14,446	-	36,300
Risk class 9	472	690	-	1,162
Risk class 10	-	-	544	544
Unrated	38	4	-	42
	143,964	20,755	544	165,263
Expected credit losses	(545)	(298)	(158)	(1,001)
Total	143,419	20,457	386	164,262

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At 31 December 2020

Loans to customers:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	232,806	1,209	-	234,015
Risk class 5-6	346,781	62,788	-	409,569
Risk class 7-8	217,368	80,867	-	298,235
Risk class 9	38,290	14,684	-	52,974
Risk class 10	-	-	29,247	29,247
Unrated	190	1	-	191
	835,435	159,549	29,247	1,024,231
Expected credit losses	(3,645)	(6,482)	(7,387)	(17,514)
Net carrying amount	831,790	153,067	21,860	1,006,717

Off-balance sheet loan commitments and financial guarantees:	Stage 1	Stage 2	Stage 3	Total
Risk class 1-4	64,781	1,341	-	66,122
Risk class 5-6	51,169	6,461	-	57,630
Risk class 7-8	10,852	16,227	-	27,079
Risk class 9	1,142	553	-	1,695
Risk class 10	-	-	809	809
Unrated	99	8	-	107
	128,043	24,590	809	153,442
Expected credit losses	(347)	(483)	(225)	(1,055)
Total	127,696	24,107	584	152,387

50. Loans to customers in the tourism industry likely to be vulnerable to the COVID-19 pandemic

Companies susceptible to the impact of the COVID-19 pandemic were classified into four groups based on an assessment of how much of an increase in credit risk these companies face in the short, medium and long term. In addition, to account for the material uncertainty in the operating environment of companies in the tourism industry, not reflected in their current risk class, they are further classified into four groups based on an assessment of how vulnerable they are to various assumptions on when tourists can be expected to start visiting Iceland again.

Impact group 1: Viable even though fewer tourists arrive than expected
Impact group 2: Viable with forbearance even though fewer tourists arrive than expected
Impact group 3: Viable if the number of tourists is similar to general expectations
Impact group 4: Viable only if the tourism industry fares better than expected

Where the increase was found to be significant (groups 2-4), the exposure was transferred to Stage 2. In addition, an overlay factor was applied to the expected credit losses, comparable to an increase in up to three risk classes, and a higher haircut was applied to value of collateral for the higher impact groups in the more severe scenarios.

At 31 December 2021

Loans to customers in the tourism industry:	Stage 1	Stage 2	Stage 3	Total
Group 1	21,992	19,425	-	41,417
Group 2	-	42,212	567	42,779
Group 3	-	14,500	2,024	16,524
Group 4	-	294	2,916	3,210
	21,992	76,431	5,507	103,930
Expected credit losses	(155)	(3,195)	(1,945)	(5,295)
Net carrying amount	21,837	73,236	3,562	98,635

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Off-balance sheet loan commitments and financial guarantees to customers in the tourism industry:

	Stage 1	Stage 2	Stage 3	Total
Group 1	1,642	1,596	-	3,238
Group 2	-	14,446	38	14,484
Group 3	-	1,293	43	1,336
Group 4	-	32	10	42
	1,642	17,367	91	19,100
Expected credit losses	(8)	(174)	(42)	(224)
Total	1,634	17,193	49	18,876

At 31 December 2020

Loans to customers in the tourism industry:	Stage 1	Stage 2	Stage 3	Total
Group 1	1,903	308	-	2,211
Group 2	-	30,503	406	30,909
Group 3	-	58,610	2,579	61,189
Group 4	-	3,317	3,612	6,929
	1,903	92,738	6,597	101,238
Expected credit losses	(24)	(4,483)	(2,529)	(7,036)
Net carrying amount	1,879	88,255	4,068	94,202

Off-balance sheet loan commitments and financial guarantees to customers in the tourism industry:

	Stage 1	Stage 2	Stage 3	Total
Group 1	50	2	-	52
Group 2	-	13,416	51	13,467
Group 3	-	5,118	163	5,281
Group 4	-	429	17	446
	50	18,965	231	19,246
Expected credit losses	(3)	(363)	(101)	(467)
Total	47	18,602	130	18,779

51. Forbearance

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 66.4.

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 tourism industry is an important economic sector in Iceland but due to the nature of the tourism business, its effects are not only limited to hotels, car rentals, and tour guides. The Group therefore monitors the tourism industry internally as a quasi-sector instead of a new separate sector. Real estate companies that do not operate directly in the tourism sector but rely in part on rental income from such activities explain around half of the forbearance amount for companies not in the tourism.

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

At 31 December 2021	Stage 1	Stage 2	Stage 3	Total
Individuals	3,920	3,989	1,453	9,362
Companies	17,500	68,081	9,076	94,657
- In the tourism quasi-sector	3,216	56,340	4,636	64,192
- Other than the tourism quasi-sector	14,284	11,741	4,440	30,465
Gross carrying amount	21,420	72,070	10,529	104,019

	Stage 1	Stage 2	Stage 3	Total
Individuals	(25)	(78)	(135)	(238)
Companies	(102)	(2,719)	(3,543)	(6,364)
- In the tourism quasi-sector	(21)	(2,397)	(1,734)	(4,152)
- Other than the tourism quasi-sector	(81)	(322)	(1,809)	(2,212)
Expected credit losses	(127)	(2,797)	(3,678)	(6,602)

At 31 December 2020	Stage 1	Stage 2	Stage 3	Total
Individuals	932	5,249	2,068	8,249
Companies	209	104,523	13,608	118,340
- In the tourism quasi-sector	-	62,295	5,747	68,042
- Other than the tourism quasi-sector	209	42,228	7,861	50,298
Gross carrying amount	1,141	109,772	15,676	126,589

	Stage 1	Stage 2	Stage 3	Total
Individuals	(10)	(127)	(176)	(313)
Companies	(1)	(4,114)	(4,147)	(8,262)
- In the tourism quasi-sector	-	(2,787)	(1,888)	(4,675)
- Other than the tourism quasi-sector	(1)	(1,327)	(2,259)	(3,587)
Expected credit losses	(11)	(4,241)	(4,323)	(8,575)

52. Assets obtained by taking possession of collateral

Details of non-financial assets obtained by the Group during the year by taking possession of collateral held as security against loans.

	31.12.2021	31.12.2020
Property and land	258	1,754
Industrial equipment and vehicles	80	86
Total	338	1,840

The Group pursues realisation of the collateral in an orderly manner. The Group does not generally use the non-cash collateral for its own operations.

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53. Write-offs

When the Group has no reasonable expectations of recovering a credit exposure or when it is uneconomical to pursue legal collection, the financial asset is written off. A write-off does not change the debt obligation which is therefore still subject to enforcement activity. Any recoveries of amounts previously written off are credited to the income statement.

Gross carrying amount written off and still subject to enforcement activity	2021	2020
Individuals	353	393
Companies	722	1,091
Total	1,075	1,484

54. Large exposures disclosure

When the Group's total exposure to a group of connected clients is 10% or higher of the Group's Tier 1 capital it is considered a large exposure. Note that the regulatory definition changed in 2021. Previously, exposures were considered large when the value of the exposure exceeded 10% of total capital base instead of Tier 1 capital. 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 on prudential requirements for financial undertakings. 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.

The exposure is evaluated both before and after credit risk mitigating effects. After mitigating effects, the Group currently has no large exposures. No large exposure is above the maximum 25% large exposure limit set by the law.

The Group's largest exposure before eligible credit risk mitigating effects is the Icelandic Government. Biggest part of the exposure is due to Icelandic Government Bonds in the Group's liquidity portfolio.

The following table shows the Group's large exposures before and after eligible credit risk mitigating effects as a percentage of the Tier 1 capital as at 31 December 2021, and the Group's total capital base as at 31 December 2020.

At 31 December 2021

Groups of connected clients:	Before	After
Group 1	100%	7%

At 31 December 2020

Groups of connected clients:	Before	After
Group 1	65%	-
Group 2	13%	10%

55. 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.

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56. 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 ratios and the rules on funding ratios. In addition, the Group complies with the Financial Supervisory Authority of the Central Bank's guidelines no. 2/2010 on best practices in liquidity management and liquidity coverage ratio rules no. 266/2017.

The minimum LCR ratio that the Group is required to maintain is 100% for the total LCR and LCR in foreign currencies. For LCR in ISK, the requirement is 30% in 2021, 40% in 2022 and 50% as of 2023. The Group is required to maintain a 100% minimum NSFR ratio.

The following tables show the NSFR and the LCR for the Group at year-end 2021 and 2020.

Net stable funding ratio	31.12.2021	31.12.2020
For all currencies	122%	123%
Foreign currencies	157%	179%

Liquidity coverage ratio	31.12.2021	31.12.2020
For all currencies	156%	196%
ISK	141%	95%
Foreign currencies	235%	463%

	For all currencies		ISK		Foreign currencies	
At 31 December 2021	Unweighted	Weighted	Unweighted	Weighted	Unweighted	Weighted
Liquid assets level 1*	214,480	214,480	184,282	184,282	30,198	30,198
Liquid assets level 2	45,559	16,404	41,415	16,404	4,144	-
Total liquid assets	260,039	230,884	225,697	200,686	34,342	30,198
Deposits	618,940	173,789	542,616	145,478	76,324	28,311
Debt issued	15,464	15,464	66	66	15,398	15,398
Other outflows	99,162	37,587	69,796	29,940	29,366	7,647
Total outflows	733,566	226,840	612,478	175,484	121,088	51,356
Short-term deposits with other banks**	43,997	42,135	3,040	2,118	40,957	40,017
Other inflows	51,161	36,692	43,385	30,540	7,776	6,152
Restrictions on inflows	-	-	-	-	-	(7,653)
Total inflows	95,158	78,827	46,425	32,658	48,733	38,516
Liquidity coverage ratio		156%		141%		235%
At 31 December 2020						
Liquid assets level 1*	182,104	182,104	138,078	138,078	44,027	44,027
Liquid assets level 2	14,648	2,941	14,470	2,941	178	-
Total liquid assets	196,752	185,045	152,548	141,019	44,205	44,027
Deposits	542,123	147,611	472,073	120,974	70,049	26,636
Debt issued	2,271	2,271	47	47	2,225	2,225
Other outflows	99,949	44,756	68,500	35,605	31,449	9,151
Total outflows	644,343	194,638	540,620	156,626	103,723	38,012
Short-term deposits with other banks**	88,495	88,328	2,077	2,077	86,419	86,252
Other inflows	29,842	11,981	21,342	6,221	8,500	5,760
Restrictions on inflows	-	-	-	-	(17,126)	(63,503)
Total inflows	118,337	100,309	23,419	8,298	77,793	28,509
Liquidity coverage ratio		196%		95%		463%

*Level 1 liquid assets include cash and balances with the Central Bank, domestic bonds and foreign government bonds in accordance with rules no. 266/2017 on liquidity ratio.
**Short-term deposits with other banks with maturity less than 30 days.

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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.

At 31 December 2021	Deposits maturing within 30 days					
	Less stable	Weight (%)	Stable	Weight (%)	Term deposits	Total deposits
Individuals	78,319	13%	204,340	5%	66,643	349,302
Small and medium enterprises	58,774	12%	57,685	5%	6,185	122,644
Operational relationships	3,260	25%	-	5%	-	3,260
Corporations	110,682	40%	2,913	20%	29,279	142,874
Sovereigns, Central Bank and public sector entities	8,168	40%	1,115	20%	559	9,842
Pension funds	45,346	100%	-	-	18,269	63,615
Domestic financial entities	41,894	100%	-	-	12,522	54,416
Foreign financial entities	6,444	100%	-	-	5,023	11,467
Total	352,887		266,053		138,480	757,420

At 31 December 2020	Deposits maturing within 30 days					
	Less stable	Weight (%)	Stable	Weight (%)	Term deposits	Total deposits
Individuals	69,694	14%	195,379	5%	69,344	334,417
Small and medium enterprises	50,816	13%	52,246	5%	6,627	109,689
Operational relationships	3,155	25%	-	5%	-	3,155
Corporations	77,705	40%	1,959	20%	24,965	104,629
Sovereigns, Central Bank and public sector entities	6,340	40%	1,174	20%	934	8,448
Pension funds	39,105	100%	-	-	23,754	62,859
Domestic financial entities	38,284	100%	-	-	41,647	79,931
Foreign financial entities	6,266	100%	-	-	9,819	16,085
Total	291,365		250,758		177,090	719,213

57. Maturity analysis of financial assets and financial liabilities

The following tables show the maturity profile of the Group's financial assets and the undiscounted cash flows of its financial liabilities. Maturity classification of assets is based on contractual maturity.

Bonds and debt instruments are based on contractual maturity and therefore do not represent the estimated liquidation time of the trading book.

The tables show undiscounted 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.

The following tables also show 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.

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At 31 December 2021	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	113,667	39,278	74,389	-	-	-	-	113,667
Loans to credit institutions	43,988	24,327	19,661	-	-	-	-	43,988
Bonds and debt instruments	132,289	-	25,420	38,495	63,315	5,059	-	132,289
Loans to customers	1,086,327	1,153	89,452	114,436	304,623	576,663	-	1,086,327
Shares and equity instruments	31,677	-	-	-	-	-	31,677	31,677
Other financial assets	5,573	5,044	373	156	-	-	-	5,573
Total financial assets	1,413,521	69,802	209,295	153,087	367,938	581,722	31,677	1,413,521
Deposits from CB and credit institutions	13,384	5,403	4,022	-	4,101	-	-	13,526
Deposits from customers	744,036	621,391	62,356	43,950	25,254	28,357	-	781,308
Debt issued and other borrowed funds	402,226	-	22,948	78,045	315,021	54,676	-	470,690
Subordinated loans	35,762	-	292	732	5,893	27,285	-	34,202
Other financial liabilities:	10,457	4,210	1,739	1,157	1,858	2,047	-	11,011
Lease liabilities	3,838	-	129	387	1,829	2,047	-	4,392
Other liabilities	6,619	4,210	1,610	770	29	-	-	6,619
Total financial liabilities	1,205,865	631,004	91,357	123,884	352,127	112,365	-	1,310,737

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	-	40,945	6,895	29,424	-	-	77,264
Outflow	-	(43,261)	(5,668)	(26,927)	-	-	(75,856)
Total	-	(2,316)	1,227	2,497	-	-	1,408
Net settled derivatives	-	569	-	-	-	-	569
Total derivative financial assets	-	(1,747)	1,227	2,497	-	-	1,977
Derivative financial liabilities							
Gross settled derivatives							
Inflow	-	49,328	14,773	33,280	-	-	97,381
Outflow	-	(54,901)	(15,854)	(36,950)	-	-	(107,705)
Total	-	(5,573)	(1,081)	(3,670)	-	-	(10,324)
Net settled derivatives	-	(2,955)	-	-	-	-	(2,955)
Total derivative financial liabilities	-	(8,528)	(1,081)	(3,670)	-	-	(13,279)
Total net financial assets and financial liabilities	(561,202)	124,719	31,511	21,978	469,357	31,677	118,040

At 31 December 2020	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	78,948	29,600	48,060	-	-	1,288	-	78,948
Loans to credit institutions	89,920	46,102	43,818	-	-	-	-	89,920
Bonds and debt instruments	128,216	-	38,169	34,776	48,047	7,224		128,216
Loans to customers	1,006,717	2,562	81,090	96,084	334,520	492,461	-	1,006,717
Shares and equity instruments	14,851	-	-	-	-	-	14,851	14,851
Other financial assets	3,692	2,483	560	643	6	-	-	3,692
Total financial assets	1,322,344	80,747	211,697	131,503	382,573	500,973	14,851	1,322,344

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At 31 December 2020	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	39,758	6,073	20,044	10,278	3,368	-	-	39,763
Deposits from customers	679,455	539,932	65,532	56,764	23,409	27,016	-	712,653
Debt issued and other borrowed funds	387,274	-	12,677	31,569	327,003	93,434	-	464,683
Subordinated loans	27,194	-	176	477	3,096	29,903	-	33,652
Other financial liabilities:	9,721	3,570	1,453	1,227	1,783	2,123	-	10,156
Lease liabilities	3,962	-	123	369	1,783	2,123	-	4,398
Other liabilities	5,759	3,571	1,330	858	-	-	-	5,759
Total financial liabilities	1,143,402	549,575	99,882	100,315	358,659	152,476	-	1,260,907

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	-	41,288	46,627	39,643	-	-	127,558
Outflow	-	(38,823)	(45,090)	(36,516)	-	-	(120,429)
Total	-	2,465	1,537	3,127	-	-	7,129
Net settled derivatives	-	90	-	-	-	-	90
Total derivative financial assets	-	2,555	1,537	3,127	-	-	7,219
Derivative financial liabilities							
Gross settled derivatives							
Inflow	-	29,311	18,714	29,943	-	-	77,968
Outflow	-	(30,236)	(20,113)	(33,957)	-	-	(84,306)
Total	-	(925)	(1,399)	(4,014)	-	-	(6,338)
Net settled derivatives	-	(1,752)	-	-	-	-	(1,752)
Total derivative financial liabilities	-	(2,677)	(1,399)	(4,014)	-	-	(8,090)
Total net financial assets and financial liabilities	(468,828)	117,047	34,124	31,055	348,497	14,851	76,746

Off-balance sheet liabilities

The following table shows the amount of contractual obligations of off-balance sheet liabilities 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.

At 31 December 2021	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	No maturity	Total
Financial guarantees	19,283	-	-	-	-	-	19,283
Undrawn loan commitments	59,061	-	-	-	-	-	59,061
Undrawn overdrafts	56,745	-	-	-	-	-	56,745
Credit card commitments	30,174	-	-	-	-	-	30,174
Total off-balance sheet liabilities	165,263	-	-	-	-	-	165,263
At 31 December 2020							
Financial guarantees	23,681	-	-	-	-	-	23,681
Undrawn loan commitments	40,227	-	-	-	-	-	40,227
Undrawn overdrafts	56,947	-	-	-	-	-	56,947
Credit card commitments	32,588	-	-	-	-	-	32,588
Total off-balance sheet liabilities	153,443	-	-	-	-	-	153,443

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58. 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.

59. 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 and Construction Authority 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 18 since netting between short and long positions is not applied here.

	31.12.2021			31.12.2020		
Trading bonds and debt instruments, long positions	MV	Duration	BPV	MV	Duration	BPV
Indexed	548	6.59	(0.36)	4,103	1.87	(0.77)
Non-indexed	95,996	0.91	(8.75)	86,829	0.66	(5.70)
Total	96,544	0.94	(9.11)	90,932	0.71	(6.47)
Trading bonds and debt instruments, short positions						
Indexed	215	9.00	0.20	224	6.00	0.12
Non-indexed	148	1.00	0.02	351	5.00	0.17
Total	363	5.74	0.22	575	5.39	0.29
Net position of trading bonds and debt instruments	96,181	0.92	(8.89)	90,357	0.68	(6.18)

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The following table shows the interest rate sensitivity of the Group's trading book from a parallel 100 basis points change in all yield curves.

Sensitivity analysis for trading bonds and debt instruments

		31.12.2021		31.12.2020	
		Effect on profit or (loss)			
Currency	Parallel shift in yield curve (basis points)	Downward shift	Upward shift	Downward shift	Upward shift
ISK, indexed	100	57	(57)	78	(78)
ISK, non-indexed	100	781	(781)	393	(393)
EUR	100	35	(35)	108	(108)
USD	100	15	(15)	12	(12)
Other total	100	46	(46)	61	(61)
Total		934	(934)	652	(652)

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 December 2021

Currency	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
ISK, indexed	5	178	(99)	(2,245)	2,802	(839)	(198)
ISK, non-indexed	(7)	(19)	(96)	(1,559)	668	(35)	(1,048)
EUR	23	(49)	(621)	721	-	-	74
SEK	32	-	-	-	-	-	32
USD	11	(6)	-	-	-	-	5
Other	36	(2)	-	(7)	-	-	27
Total	100	102	(816)	(3,090)	3,470	(874)	(1,108)

At 31 December 2020

Currency	0-3 months	3-12 months	1-2 years	2-5 years	5-10 years	Over 10 years	Total
ISK, indexed	-	(108)	236	(2,554)	4,388	(1,232)	730
ISK, non-indexed	(13)	(28)	(43)	(945)	(218)	(4)	(1,251)
EUR	60	(58)	(34)	123	-	(1)	90
SEK	(5)	-	-	-	-	-	(5)
USD	27	-	-	-	-	(1)	26
Other	(2)	(12)	-	(8)	-	(6)	(28)
Total	67	(206)	159	(3,384)	4,170	(1,244)	(438)

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60. 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.

At 31 December 2021	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	CAD	Other foreign currencies	Total foreign currencies
Cash and balances with Central Bank	659	350	183	43	15	47	65	89	26	164	1,641
Loans to credit institutions	12,297	15,080	967	400	724	261	10,095	331	586	189	40,930
Bonds and debt instruments	9,612	3,910	32	-	-	5,040	10,320	-	-	-	28,914
Loans to customers	124,674	41,409	1,071	994	2,903	59	3,263	3,011	3,863	20	181,267
Shares and equity instruments	2,311	386	343	-	-	1,881	-	-	-	-	4,921
Other assets	13	390	-	-	-	4	-	1	-	-	408
Total assets	149,566	61,525	2,596	1,437	3,642	7,292	23,743	3,432	4,475	373	258,081
Deposits from credit institutions	7,802	336	15	-	-	-	8	2	-	-	8,163
Deposits from customers	38,846	29,637	3,763	442	708	831	2,813	2,258	340	29	79,667
Debt issued and other borrowed funds	133,709	-	-	-	-	12,951	41,255	-	-	-	187,915
Subordinated loans	-	-	-	-	-	35,762	-	-	-	-	35,762
Other liabilities	629	226	-	-	-	3	-	43	-	-	901
Total liabilities	180,986	30,199	3,778	442	708	49,547	44,076	2,303	340	29	312,408
Net on-balance sheet position	(31,420)	31,326	(1,182)	995	2,934	(42,255)	(20,333)	1,129	4,135	344	(54,327)
Net off-balance sheet position	31,200	(30,849)	893	(990)	(2,924)	42,157	20,148	(1,114)	(4,113)	(408)	54,000
Net position	(220)	477	(289)	5	10	(98)	(185)	15	22	(64)	(327)

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At 31 December 2020	EUR	USD	GBP	CHF	JPY	SEK	NOK	DKK	CAD	Other foreign currencies	Total foreign currencies
Cash and balances with Central Bank	779	281	148	45	17	54	56	101	31	119	1,631
Loans to credit institutions	28,586	44,519	1,301	422	248	880	9,487	415	375	100	86,333
Bonds and debt instruments	25,052	3,932	7	-	-	3,894	11,195	-	-	-	44,080
Loans to customers	127,317	31,584	1,160	521	3,330	84	3,215	2,788	7,468	29	177,496
Shares and equity instruments	32	1,551	338	-	-	152	32	-	-	-	2,105
Other assets	606	124	-	-	-	34	-	-	3	-	767
Total assets	182,372	81,991	2,954	988	3,595	5,098	23,985	3,304	7,877	248	312,412
Deposits from credit institutions	10,958	788	23	-	-	-	1	-	-	-	11,770
Deposits from customers	26,757	30,607	3,917	517	386	1,017	3,132	2,277	392	20	69,022
Derivative instruments and short positions	-	-	-	-	-	9	-	-	-	-	9
Debt issued and other borrowed funds	143,255	-	-	-	-	38,589	21,169	-	-	-	203,013
Subordinated loans	-	-	-	-	-	27,194	-	-	-	-	27,194
Other liabilities	415	114	-	-	-	19	-	29	1	-	578
Total liabilities	181,385	31,509	3,940	517	386	66,828	24,302	2,306	393	20	311,586
Net on-balance sheet position	987	50,482	(986)	471	3,209	(61,730)	(317)	998	7,484	228	826
Net off-balance sheet position	463	(46,840)	920	(484)	(3,198)	61,672	268	(829)	(7,468)	(276)	4,228
Net position	1,450	3,642	(66)	(13)	11	(58)	(49)	169	16	(48)	5,054

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The following table shows the effect of a 10% depreciation or appreciation of foreign exchange rates where the Group had positions at year-end, with all other variables held constant.

Sensitivity analysis for currency risk	31.12.2021		31.12.2020	
	Effect on profit or (loss)			
Currency	-10%	10%	-10%	10%
EUR	22	(22)	(145)	145
USD	(48)	48	(364)	364
GBP	29	(29)	7	(7)
CHF	(1)	1	1	(1)
JPY	(1)	1	(1)	1
SEK	10	(10)	6	(6)
NOK	19	(19)	5	(5)
DKK	(2)	2	(17)	17
CAD	(2)	2	(2)	2
Other foreign currencies	6	(6)	5	(5)
Total	32	(32)	(505)	505

61. Shares and equity instruments

The Group's equity exposure in the trading book arises from flow trading and market making with shares listed on the Nasdaq Iceland Stock Exchange. Shares and equity instruments in the banking book are classified as mandatorily at fair value through profit or loss or are classified as held for sale.

The following table shows how a 10% shift in equity prices would affect the Group's equity and net financial income. Securities used for hedging are excluded.

Sensitivity analysis for shares and equity instruments		31.12.2021		31.12.2020	
		Effect on profit or (loss)			
Portfolio	Change in equity prices	Downward shift	Upward shift	Downward shift	Upward shift
Trading book	10%	(123)	123	(113)	113
Banking book	10%	(605)	605	(462)	462
Total		(728)	728	(575)	575

62. 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% rise or fall in the index would lead to a negligble change in the balance, other risk factors held constant.

	31.12.2021	31.12.2020
Bonds and debt instruments	1,169	4,684
Loans to customers	247,426	268,062
Total CPI-linked assets	248,595	272,746

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	31.12.2021	31.12.2020
Deposits from customers	93,806	90,353
Debt issued and other borrowed funds	140,051	136,487
Off-balance sheet exposures	14,697	19,725
Total CPI-linked liabilities	248,554	246,565
CPI imbalance	41	26,181

63. 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.

64. Capital management

The following tables show the capital base, the risk exposure amount ("REA"), the resulting capital ratios, and the leverage ratio for the Group at 31 December 2021 and 31 December 2020.

The Group's regulatory capital requirement is calculated according to CRD IV as implemented through the Act on Financial Undertakings no. 161/2002 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. The Group has reviewed the methodology for operational risk and calculates the capital requirements according to the standardised approach instead of the basic indicator approach.

EU regulation 2019/876 was implemented in Iceland on 28 June 2021 by amending regulation no. 233/2017. The most material effect was the amendment of the SME supporting factor, which relaxes the conditions for obligors to be classified as small or medium sized enterprises allowing the supporting factor to be applied to a larger part of the Group's loan portfolio, lowering the REA. Another material amendment was the change in methodology for calculating the exposure amount for counterparty credit risk, which lead to an increase in the REA.

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 of the Central Bank, the Bank shall as of 30 June 2021 maintain an additional capital requirement of 2.5% of risk exposure amount. The Group’s overall capital requirement, taking into account capital buffers, is 17.8%. In September 2022 a countercyclical capital buffer of 2% will be reintroduced, increasing from its current level of 0%. 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%.

	31.12.2021	31.12.2020
Own funds		
Ordinary share capital	10,000	10,000
Share premium	55,000	55,000
Reserves	6,086	6,181
Retained earnings	132,624	113,529
Non-controlling interests	-	1,494
IFRS 9 reversal due to transitional rules	2,768	5,164
Fair value changes due to own credit standing	1,054	238
Target dividend payment	(11,863)	-
Tax assets	(94)	(259)
Intangible assets	(3,351)	(3,478)
CET1 capital	192,224	187,869

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64. Cont'd

	31.12.2021	31.12.2020
Additional Tier 1 capital	10,626	-
Tier 1 capital	202,850	187,869
Tier 2 capital	25,136	27,194
Total capital base	227,986	215,063
Risk exposure amount		
- due to credit risk	802,147	830,141
- due to market risk	17,100	16,626
Market risk, trading book	16,223	11,306
Currency risk	877	5,320
- due to credit valuation adjustment	1,829	1,728
- due to operational risk	80,570	85,026
Total risk exposure amount	901,646	933,521
Capital ratios		
CET 1 ratio	21.3%	20.1%
Tier 1 ratio	22.5%	20.1%
Total capital ratio	25.3%	23.0%
Leverage ratio		
Exposure amount		
On-balance sheet exposures	1,422,930	1,333,807
Off-balance sheet exposures	49,220	41,067
Derivative exposures	21,615	9,922
Leverage ratio total exposure measure	1,493,765	1,384,797
Tier 1 capital	202,850	187,869
Leverage ratio	13.6%	13.6%

65. Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The Group’s definition of operational risk includes reputational risk, legal risk, model risk, conduct risk, and compliance risk among other risk factors.

The ultimate responsibility for ensuring an adequate operational risk management and internal control framework at Íslandsbanki lies with the Board of Directors. The Board has approved an Operational Risk Policy which outlines the Bank's framework for operational risk management. Risk Management is responsible for implementing the Bank’s operational risk framework, for developing, maintaining the Operational Risk Policy, and for communicating the policy to the Bank‘s employees.

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Notes to the Consolidated Financial Statements

66. Significant accounting policies

The accounting policies set out below have been applied consistently by the Group for the periods presented in these consolidated financial statements.

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66.1 Basis of consolidation

The consolidated financial statements of the Group comprise the financial statements of Íslandsbanki hf., as the parent company, and its subsidiaries.

Consolidation

The Group consolidates its subsidiaries on the basis of control. The consolidation begins when the Group obtains control of the subsidiary and ceases when the Group no longer has control of the subsidiary.

In preparing the consolidated financial statements, Íslandsbanki combines its financial statements with those of its subsidiaries, line by line, by adding together like items of assets, liabilities, equity, income, expenses, and cash flows. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with the Group's accounting policies. All intra-group balances, income and expenses relating to transactions between group entities are eliminated in full on consolidation. This also applies to subsidiaries classified as disposal groups held for sale (see Note 66.11).

A change in the Group's ownership interest in a subsidiary, without a loss of control, is accounted for as an equity transaction.

Control

Subsidiaries are defined as companies in which Íslandsbanki, directly or indirectly, has control. Control over an entity is evidenced by the Group's ability to exercise its power in order to affect any variable returns that the Group is exposed to through its involvement with the entity. When assessing whether to consolidate an entity the Group evaluates a range of control factors, including:

- The purpose and design of the entity
- The relevant activities and how these are determined
- Whether the Group's rights result in the ability to direct the relevant activities
- Whether the Group has exposure or right to variable returns, and
- Whether the Group has the ability to use its power to affect its return

Generally, there is a presumption that a majority of voting rights results in control. However, in individual circumstances, the Group may still exercise control with less than 50% shareholding, or may not be able to exercise control with over 50% of an entity's shares. When assessing whether the Group has power over the investment and therefore controls the variability of this return, the Group considers all relevant facts and circumstances, including the contractual arrangements with the other vote holders of the entity, rights arising from other contractual arrangements, the Group's voting rights and potential voting rights.

The Group reassesses its control over subsidiaries on a regular basis.

Business combinations

The Group accounts for each business combination by applying the acquisition method. Under the acquisition method, the Group identifies itself as the acquirer, determines the acquisition date, recognises and measures the identifiable assets acquired, the liabilities assumed and any non-controlling interests in the acquiree, and recognises and measures any goodwill or gain from a bargain purchase.

Non-controlling interests

Non-controlling interests represent equity in subsidiaries not attributable, directly or indirectly, to the Group.

For each business combination the Group measures non-controlling interests, at the acquisition date, at either fair value or their proportionate share of the acquiree's identifiable net assets.

The Group presents non-controlling interests within equity in the statement of financial position, separately from the equity attributable to equity holders of Íslandsbanki. Profit or loss and each component of other comprehensive income are attributed to equity holders of Íslandsbanki and to non-controlling interests even if this results in the non-controlling interests having a deficit balance. This also applies to subsidiaries classified as disposal groups held for sale.

Loss of control

If the Group loses control of a subsidiary, it derecognises the related assets, liabilities, non-controlling interests, and other components of equity, while any resultant gain or loss is recognised in profit or loss in the line item "Other operating income", or in the line item "Discontinued operations held for sale, net of income tax" if the subsidiary is classified as disposal group held for sale.

Any investment retained by the Group in the former subsidiary is recognised at its fair value at the date when control is lost.

66.1 Cont'd

Funds management

The Group acts as a manager for Undertakings for Collective Investment in Transferable Securities (UCITS) and investment funds as well as other funds for collective investment that accept capital from investors. Such funds are financed by issuing unit share certificates or shares. The Group does not have any contractual financial responsibility with respect to such custom units. The funds are not consolidated unless they are under the control of the Group.

The Group reviews all the facts and circumstances in order to decide if these funds should be consolidated. The Group is deemed to be a principal and hence controls and consolidates the funds, when it acts as fund manager and cannot be removed without cause, has variable returns through significant unit holdings and/or guarantees, and is able to influence the returns of the funds by exercising its power.

66.2 Investments in associates

Associates are entities over which the Group has significant influence to participate in the financial and operating policy decisions of an entity but does not have control over those policies. It is presumed that the Group has significant influence if the Group holds 20-50% of the voting power of an entity. Considerations made in determining significant influence are similar to those used to determine control over subsidiaries (see Note 66.1).

The Group accounts for its investments in associates using the equity method. Under the equity method, investments in associates are initially recognised at cost. After the acquisition date the carrying amount of each investment is adjusted to recognise changes in the Group's share of net assets. Distributions received from an associate reduce the carrying amount of the investment. If goodwill is in place related to acquisitions of associates then it is included in the carrying amount of the investments and is not tested for impairment separately.

The consolidated financial statements of the Group include the Group's share of the profit or loss and other comprehensive income of associates, from the date that significant influence commences until the date that significant influence ceases.

When the Group's share of losses of an associate exceeds its interest in the associate, the carrying amount of that associate is reduced to nil and recognition of further losses is discontinued, except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the Group resumes recognising its share of profits only after its share of profits equals the share of losses not recognised.

After application of the equity method, the Group determines whether it is necessary to recognise an impairment loss on its investments in associates. At each reporting date, the Group determines whether there is objective evidence that individual investments in associates are impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying amount, and the impairment loss is recognised in profit or loss.

Upon loss of significant influence over an associate, the Group measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognised in profit or loss in the line item "Other operating income".

Income and expenses from investments in associates are recognised in profit or loss in the line item "Other operating income".

66.3 Foreign currencies

The financial statements of each of the Group's entities are measured using the functional currency of the respective entity.

Foreign currency transactions

On initial recognition transactions in foreign currencies are translated into functional currencies at the spot exchange rate at the date of the transactions. At the end of each reporting period monetary assets and liabilities denominated in foreign currencies are retranslated into functional currencies using the closing rate. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated into the functional currency using the exchange rate at the date when the fair value was determined.

All foreign currency differences arising on currency translation from one currency to another are recognised in profit or loss in the line item "Net foreign exchange gain (loss)".

66.4 Financial assets and financial liabilities

Recognition

The Group recognises a financial asset and a financial liability in its statement of financial position on the trade date, which is the date on which the Group becomes party to the contractual provisions of the instrument, except for loans which are recognised on the date when cash is advanced by the Group to the borrowers. At initial recognition, the Group measures a financial asset or a financial liability at its fair value plus, in the case of a financial asset or a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or the financial liability.

Derecognition

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

The Group derecognises financial assets in the following circumstances:
• When the contractual rights to the cash flows from the financial assets expire, or
• When the Group transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which:
- The Group transfers substantially all the risks and rewards of ownership of the financial assets, or
- The Group neither transfers nor retains substantially all the risks and rewards of ownership of the financial assets and it does not retain control of the financial assets.

Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

The Group enters into transactions whereby it transfers assets recognised in its statement of financial position, but retains either all or substantially all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the statement of financial position of the Group. Transfers of assets with retention of all or substantially all risks and rewards include, for example, repurchase transactions and securities lending.

The Group does not derecognise from its statement of financial position securities which the Group sells under agreements to repurchase at a specified future date ("repos") at a fixed price or at the sale price plus a lender's return. The Group recognises the cash received as a liability in its statement of financial position. The difference between the sale and repurchase prices is recognised as interest expense over the life of the agreement using the effective interest method.

Securities lending and borrowing transactions are usually collateralised by securities or cash. The transfer of securities to counterparties is only reflected in the statement of financial position if the risks and rewards of ownership are also transferred. Cash advanced or received as collateral is recorded as an asset or liability.

In transactions in which the Group neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset and it retains control over the asset, the Group continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

Modifications

Substantial modifications of terms of existing financial assets, or replacements with new ones with significantly different terms, result in the Group derecognising the original financial assets and recognising new financial assets at fair value.

Classification and measurement of financial assets

For the purpose of measuring its financial assets, the Group classifies them at inception in one of the following categories:
• Financial assets at amortised cost
• Financial assets at fair value through other comprehensive income
• Financial assets at fair value through profit or loss
• Derivative assets in hedge accounting

The measurement basis of individual financial assets is determined based on an assessment of the cash flow characteristics of the assets and the business models under which they are managed.

The business models

The business models are determined by the Group's key management personnel in the way that assets are managed and their performance is reported to them. The Group determines its business models at a level that reflects the way groups of financial assets are managed together to achieve a particular business objective. This condition is not an instrument-by-instrument approach to classification, but is determined at a higher level of aggregation. The Group's business models fall into the following three categories: Held to collect, Held to collect and for sale, and Other fair value business models, where assets are held for trading or managed on a fair value basis and are neither Held to collect nor Held to collect and for sale.

Notes to the Consolidated Financial Statements

66.4 Cont'd

Solely payments of principal and interest (SPPI)

Financial assets held within the business models Held to collect and Held to collect and for sale, are assessed to evaluate if their contractual cash flows are comprised of solely payments of principal and interest. SPPI payments are those which are consistent with a basic lending arrangement. Principal is the fair value of the financial asset at initial recognition and changes over the life of the financial asset, for example if there are repayments of principal. Interest relates to basic lending returns, including compensation for the time value of money and credit risk associated with the principal amount outstanding over a period of time. Interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, servicing or administrative costs), as well as a profit margin that is consistent with a basic lending arrangement.

Where the contractual terms introduce exposure to risk or variability of cash flows that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets at amortised cost

A financial asset is classified as being subsequently measured at amortised cost if the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest and the asset is held within a business model whose objective is to collect contractual cash flows, i.e. Held to collect.

Financial assets at amortised cost are measured using the effective interest method. Amortised cost is calculated by taking into account the amount at which the assets are measured at initial recognition less principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount (such as due to discounts or premiums on acquisition and fees and costs that are an integral part of the effective interest rate), and minus any reduction for impairment. Accrued interest is included in the carrying amount of the financial asset in the statement of financial position. Impairment losses and reversals of impairment losses are recognised in profit or loss in the line item "Net impairment on financial assets".

Financial assets at fair value through other comprehensive income (FVOCI)

For shares and equity instruments that are not held for trading, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses, including any related foreign exchange component, in other comprehensive income rather than profit or loss. This election is made on an instrument-by-instrument basis. Shares and equity instruments at FVOCI are not subject to an impairment assessment. Dividends are to be presented in profit or loss, as long as they represent a return on investment. On derecognition there is no recycling of fair value gains and losses to profit or loss.

Financial assets at fair value through profit or loss (FVTPL)

Financial assets classified at fair value through profit or loss are all other financial assets which are not classified at amortised cost or at fair value through other comprehensive income. This includes financial assets classified mandatorily at fair value through profit or loss and financial assets which are irrevocably designated by the Group at initial recognition as at fair value through profit or loss that would otherwise meet the requirements to be measured at amortised cost or at FVOCI. The Group designates financial assets as at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise. During the year the Group did not classify any financial assets as designated at fair value through profit or loss.

Financial assets at fair value through profit or loss are initially recognised and subsequently measured at fair value in the statement of financial position. Changes in fair value are recognised in profit or loss in the line item "Net financial income (expense)", except for interest earned, which is recognised in the line item "Net interest income" and foreign exchange gains and losses, which are included in the line item "Net foreign exchange gain (loss)".

Derivative assets in hedge accounting

Derivative assets in hedge accounting consist of derivatives with positive fair value which are designated and accounted for as hedging instruments (see Note 66.7)

Classification and measurement of financial liabilities

For the purpose of measuring its financial liabilities, the Group classifies them at inception in one of the following categories, except for loan commitments and financial guarantees (see Note 66.12):

- Financial liabilities at amortised cost
- Financial liabilities mandatorily at fair value through profit or loss
- Financial liabilities designated as at fair value through profit or loss
- Derivative liabilities in hedge accounting

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Financial liabilities at amortised cost

Financial liabilities at amortised cost are non-derivative financial liabilities. Financial liabilities at amortised cost include deposits, debt issued and other borrowed funds, and subordinated loans.

Financial liabilities at amortised cost are recognised initially at fair value net of transaction costs incurred, and subsequently are carried at amortised cost using the effective interest method. Amortised cost is calculated by taking into account the amount at which the financial liabilities are measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount (such as due to discounts or premiums and fees and costs that are an integral part of the effective interest rate). Accrued interest is included in the carrying amount of the liabilities in the statement of financial position.

The amortised cost of certain bonds issued by the Group, which are designated as hedged items in qualifying fair value hedge relationships, is adjusted for changes in the fair value of the bonds attributable to interest rate risk (see Note 66.7).

Financial liabilities mandatorily at fair value through profit or loss

Financial liabilities mandatorily at fair value through profit or loss are financial liabilities incurred principally for the purpose of generating profits from short-term price fluctuations or from the dealer's margin. Financial liabilities mandatorily at fair value through profit or loss consist of short positions in listed bonds and derivatives with negative fair value which are not classified as financial guarantees or are not designated as hedging instruments.

Financial liabilities mandatorily at fair value through profit or loss are initially recognised and subsequently measured at fair value in the statement of financial position. Changes in fair value are recognised in profit or loss in the line item "Net financial income (expense)", except for interest incurred, which is recognised in the line item "Net interest income" on an accrual basis and foreign exchange gains and losses which are included in the line item "Net foreign exchange gain (loss)".

Financial liabilities designated as at fair value through profit or loss

Financial liabilities designated as at fair value through profit or loss are recognised at fair value and changes in fair value attributable to changes in the credit risk of those liabilities are recognised in other comprehensive income and are not subsequently reclassified to profit or loss. The remaining fair value changes are included in profit or loss in the line item "Net financial income (expense)", except for interest incurred, which is recognised in the line item "Net interest income" using the contractual interest rate and foreign exchange gains and losses which are included in the line item "Net foreign exchange gain (loss)".

The Group calculates the fair value attributable to changes in credit risk as the difference between the changes in fair value of the financial liability and the amount of changes in fair value attributable to changes in market interest rates. The change in fair value attributable to changes in market interest rates on financial liabilities is calculated by discounting contractual cash flows at the end of the period with the discount rate of the appropriate market interest rate.

Upon initial recognition, the Group determines if the recognition of gains and losses in other comprehensive income creates or enlarges an accounting mismatch in profit or loss, if applicable the whole fair value change is presented in profit or loss.

Derivative liabilities in hedge accounting

Derivative liabilities in hedge accounting consist of derivatives with negative fair value which are designated and accounted for as hedging instruments (see Note 66.7).

Reclassification

Financial assets are reclassified between measurement categories if the objective of the business model in which the financial assets are held changes after initial recognition and if the change is significant to the Group's operations.
Financial liabilities are not reclassified.

Determination of 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.

When available, the Group measures the fair value of financial assets and financial liabilities using quoted prices in an active market for that instrument. A market is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring transactions. The fair value is based on the most recent observed market prices at the reporting date.

66.4 Cont'd

If a market for a financial instrument is not active, the Group establishes its fair value using valuation techniques. Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which observable market prices exist, Black-Scholes option pricing model and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group and the counterparty where appropriate.

Periodically, the Group tests the valuation techniques and calibrates against historical data and using prices from observable current market transactions for the same instrument, or based on other available observable market data.

Changes in the fair value of financial assets and financial liabilities are recognised in profit or loss in the line item "Net financial income (expense)".

The Group has an established control framework with respect to the measurement of fair values. The business unit owning the positions is responsible for their valuations and for submitting the valuation to the Bank's Investment Committee for approval. Risk Management provides an independent review of the results, the valuation methods used and of the use of significant unobservable inputs. The final decision on the validity of the valuation is in the hands of the Bank's Investment Committee.

Impairment of financial assets

The impairment model of IFRS 9 is forward-looking and impairment under IFRS 9 should reflect a probability weighted average of possible outcomes. In addition, the expected credit loss model in IFRS 9 employs a dual measurement approach, under which the loss allowance for expected credit losses (ECL) is measured at each reporting date as either 12-month expected credit losses or lifetime expected credit losses, depending on whether there has been a significant increase in credit risk (SICR) of the financial instrument since initial recognition. To satisfy the provisions of the IFRS 9 standard, a significant amount of modelling must be involved. The models, which the Group uses for the calculation of the impairment amount, are developed according to the Group's modelling framework. This framework imposes structure on the initial model development work, the model documentation including educational material as needed for users, the approval process for models, the implementation of models and the lifetime support for models, including validation and back-testing. The Group's impairment process, which encompasses all the steps needed to derive the appropriate impairment allowance for each accounting period, is documented and approved by the All Risk Committee.

Stage assignment

At each reporting date, all assets subject to the impairment methodology must be divided into three groups, termed "Stages", reflecting the extent of credit deterioration since initial recognition. This division then influences how the impairment is measured and how interest is recognised.

Stage 1

All assets that have not experienced a SICR are assigned to Stage 1. For these assets, an impairment allowance is recognised which is equal to the expected credit loss arising from credit events occurring within 12 months of the reporting date (12-month ECL). Interest is recognised on the gross carrying amount of the assets.

Stage 2

Assets that the Group determines to have experienced a SICR, but are not credit-impaired, are classified as Stage 2. For these assets, an impairment allowance is recognised which is equal to the expected credit loss arising from all credit events occurring within the expected lifetime of the assets (lifetime ECL). Interest is recognised on the gross carrying amount of the assets.

The Group's definition of a SICR is on the level of an individual asset. The Group assesses that there has been a significant increase in credit risk of an asset if the probability of a credit impairment event, i.e. transfer to Stage 3, occurring over the lifetime of the asset has increased significantly from the origination of the assets. For this purpose, origination does not refer to any modification events which have not resulted in derecognition of the asset. The assessment is based on a defined set of triggers. This includes, as a backstop, the trigger that the asset is more than thirty days past due. Other triggers are internal assessments of outlook, events such as forbearance events which are less severe than a credit event, external credit related information and a significant deterioration in risk assessment compared with the risk assessment done in relation to the origination of the asset. The definition of a SICR depends only on the probability of a credit event occurring, it does not take into account collateralisation or any other information related to the expected loss arising from the event. As soon as all triggers for Stage 2 for a particular asset are no longer activated then the asset moves back to Stage 1. Additionally, assets are classified as forborne for two years after a forbearance event has occurred, but forbearance events only cause assets to be in Stage 2 for twelve months and then they migrate back to Stage 1 unless other triggers apply.

66.4 Cont'd

The Group does not employ the low credit risk exemption in the Stage assignment process. In alignment with its operating procedures, the Group has chosen as its accounting policy to measure the impairment allowance for lease receivables at an amount equal to the lifetime ECL only for those assets which have a SICR or are credit-impaired. For other lease receivables the impairment allowance is equal to the 12-month ECL.

Stage 3
This Stage is for assets which are credit-impaired according to the Group's assessment. These assets are therefore experiencing an ongoing credit event. Thus, the 12-month ECL and lifetime ECL are the same amount, and this amount is recognised as impairment allowance. For assets in this Stage, interest is recognised on the net carrying amount of assets, i.e. net of impairment allowance.

The Group's definition of being credit-impaired is on a customer level, rather than on the level of an individual asset. According to the definition, a customer is credit-impaired when either of the following holds:
a) The Group assesses that it is unlikely that the customer can service all of their commitments to the Group in accordance with the terms of the agreements without recourse to default provisions in the agreements, or
b) The customer is more than 90 days past due on any of their commitments

The assessment in point a) is made based on a defined set of triggers, which includes serious breach of covenants, serious registrations on an internal watchlist, initiation of serious collection actions and serious external credit related information.

Furthermore, there is a defined set of conditions which must be satisfied so that customers that have been assessed as being credit-impaired are no longer subject to this assessment. This includes probation periods and an examination of the future prospects of the customer.

Expected credit loss (ECL)
The ECL for each asset is calculated using models for the probability of a credit impairment event occurring (PD), the loss percentage expected in case of such an event (LGD) and the outstanding amount at the time of the event (EAD). In its simplest form the ECL can be calculated as the product of these factors, however, for several reasons, the actual formula must be more complicated than this.

The PD models are either fully automated statistical models, expert models, or hybrid models. For the models with a component involving expert input there is a process in place to ensure proper review of the model outcome and periodic reassessment of obligors. The inputs into the models include demographic variables, information from financial statements and past payment behaviour, among other variables.

The effect of the economy on the PD is accounted for with the use of scaling factors which map through-the-cycle PD values to point-in-time PD values. The Group has a model to predict these scaling factors based on an economic forecast. The economic forecast is provided by the Group's Chief Economist. The forecast predicts a range of macroeconomic indicators over a horizon of five years. The model is applied to a subset of these indicators and produces a set of scaling factors. The scaling factors are then reviewed by the All Risk Committee with respect to all of the indicators and any other relevant information available and the committee approves their use for the calculation of the impairment. This process is carried out at least quarterly.

The Group uses three economic scenarios. In addition to the base forecast, scaling factors are produced for a good and bad case. This is done in order to represent the whole range of possible future economic developments. The actual impairment allowance is the weighted average of the ECL in these different scenarios.

The All Risk Committee determined that it was appropriate to adjust the weights of the scenarios due to the COVID-19 pandemic, generally the scenarios are weighted 25%-50%-25% (good, base, bad) but it was determined appropriate to set the weights at 15%-50%-35%, as this would best represent the probability-weighted average over all possible scenarios.

The table below shows macroeconomic indicators of the Group's Chief Economist's macroeconomic forecast

Change in economic indicators %	**Estimate 2021**	**Forecast 2022**	**Forecast 2023**	**Forecast 2024**	**Forecast 2025**
Economic growth	4.2	3.6	3.0	2.4	2.4
Housing prices in Iceland	11.3	6.9	3.4	3.5	3.5
Purchasing power	3.6	1.4	1.9	1.6	1.5
ISK exchange rate index	(3.6)	(5.1)	(0.9)	0.0	0.0
Policy rate, Central Bank of Iceland	1.0	2.2	3.2	3.5	3.5
Inflation	5.0	2.6	2.8	2.4	2.5
Capital formation	7.5	2.3	2.0	3.5	3.5
thereof capital formation in industry	9.5	0.9	2.2	3.5	3.5

66.4 Cont'd

The LGD model considers several scenarios for how a facility may develop once a credit event has occurred. One possibility is that the facility cures without a loss. If not, the recoveries may be based on the seizing of collateral and to estimate such recoveries, several scenarios for the development of the value of the collateral are considered. Finally, there may be recoveries even though a formal collateral is not in place. These different recovery scenarios are weighted differently depending on the economic scenario under consideration. This leads to a non-linear interaction and thus a difference between the probability weighted average ECL and the ECL in the most likely scenario.

For EAD it is necessary to account for expected prepayments on term loans and for the expected utilisation of commitments such as credit cards, overdrafts, financial guarantees, and credit lines. The expected lifetime of agreements may also extend beyond the contractual lifetime for contracts which are generally extended.

Temporary changes have been made to the impairment model due to the COVID-19 pandemic those changes are described in Note 3.

Write-off policy
When the Group has no reasonable expectations of recovering a credit exposure or when it is uneconomical to pursue legal collection, the financial asset is written off. A write-off does not change the debt obligation which is therefore still subject to enforcement activity. Any recoveries of amounts previously written off are credited to the income statement.

The impairment process
In the Group's impairment framework, the Stage assignment and ECL for each financial asset is calculated from the aforementioned models. The outcome is reviewed by the business units and they can propose changes if they provide sufficient supporting material. The impairment and any proposals for changes are reviewed by an Impairment Council appointed by the All Risk Committee and the impairment allowance is approved by the All Risk Committee on a quarterly basis.

The principle of materiality applies to the above discussion on impairment, whereby exceptions related to non-materiality and immaterial adjustments are not discussed.

66.5 Cash and cash equivalents

Cash and cash equivalents are carried at amortised cost in the statement of financial position and at the reporting date the expected credit loss is considered to be low. Impairment losses and reversals of impairment losses are recognised in profit or loss in the line item "Net impairment on financial assets".

Cash and cash equivalents in the statement of cash flows consist of cash on hand, balances with the Central Bank, demand deposits with credit institutions, and short-term loans to credit institutions. Cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition.

66.6 Derivative financial instruments

Derivatives are primarily used in trading activities but are also used to manage the Group's exposure to various risks, such as interest rate risk, inflation risk, and currency risk. Derivatives are classified as financial assets or financial liabilities, measured at fair value and presented in the statement of financial position in separate line items as assets or liabilities, depending on whether their fair value at the reporting date is positive (assets) or negative (liabilities).

The Group applies hedge accounting. Accordingly, some of the Group's derivative financial assets and financial liabilities are accounted for as financial assets or financial liabilities mandatorily at fair value through profit or loss while others are accounted for as derivative assets or liabilities in hedge accounting (see Note 66.4 and Note 66.7).

When derivatives are embedded in other financial instruments or host contracts, such combinations are known as hybrid instruments with the effect that some of the cash flows of a hybrid instrument vary in a way similar to a stand-alone derivative. These embedded derivatives are measured and presented in the consolidated financial statements as if they were free-standing derivatives. The Group accounts for an embedded derivative separately from the host contract when, the host contract is not an asset in the scope of IFRS 9, is not carried at fair value through profit or loss, the terms of the embedded derivative would meet the definition of a derivative if they were contained in a separate contract, and the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract. When the Group is required to separate and account for embedded derivatives as if they were stand-alone contracts, the Group presents the fair value of the embedded derivatives in the statement of financial position in the same line items in which the Group presents the related host contracts.

66.7 Hedge accounting

The Group elected, as a policy choice permitted under IFRS 9, to continue to apply hedge accounting in accordance with IAS 39.

On initial designation of the hedges, the Group formally documented the relationship between the hedging instruments and hedged items, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationships. The Group makes an assessment, both at inception of the hedge relationships and on an ongoing basis, of whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value of the hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within the range of 80-125%. In the assessment the Group assumes that the benchmark interest rate is not altered as result of the transition to alternative benchmark interest rates.

The Group applies fair value hedge accounting with respect to designated hedging relationships consisting of certain fixed-rate euro denominated bonds issued by the Group as the hedged items and certain euro denominated interest rate swaps as the hedging instruments, whereby the Group pays floating rate interest and receives fixed rate interest. The hedging relationships are designated and accounted for as fair value hedges because the interest rate swaps are hedging the exposure of the Group to changes in the fair value of the bonds arising from changes in interest rates. The Group recognises the changes in the fair value of the interest rate swaps immediately in profit or loss together with the changes in the fair value of the bonds which are attributable to the interest rate risk. The changes in the clean fair value of the swaps and the bonds are included in the line item “Net financial income (expense)”, the accrued interest on the bonds and the swaps is included in the line item “Net interest income” and foreign exchange gains and losses on the bond are included in the line item "Net foreign exchange gain (loss)".

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

66.8 Property and equipment

Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses (see Note 66.19). Where parts of an item of property and equipment have different useful lives, those components are accounted for and depreciated as separate items of property and equipment.

Subsequent costs

The Group recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred, if it is probable that the future economic benefits embodied with the item will go to the Group and the cost of the item can be measured reliably. All other costs are recognised in profit or loss as incurred.

Depreciation

Items of property and equipment are depreciated from the date they are available for use, except for land, which is not depreciated. The depreciable amount of each item of property and equipment is determined after deducting its residual value. Depreciation is recognised in profit or loss in the line item "Other operating expenses" on a straight-line basis over the estimated useful lives of each part of an item of property and equipment.

The depreciation method, useful lives, and residual values are reviewed at each reporting date and adjusted if appropriate.

The estimated useful lives are as follows:

Buildings	50 years
Right-of-use-assets	1-10 years
Fixtures	6-12 years
Equipment	3-5 years
Vehicles	3 years

Notes to the Consolidated Financial Statements

66.9 Intangible assets

Software

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

Expenditure on internally developed software is recognised as an asset when the Group is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits, and can reliably measure the costs to complete the development. The capitalised costs include all costs directly attributable to developing the software and capitalised borrowing costs. Internally developed software is carried at capitalised cost less accumulated amortisation and impairment losses.

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

Software is amortised on a straight-line basis over its estimated useful life from the date that it is available for use. The amortisation is recognised in profit or loss in the line item "Other operating expenses". The estimated useful life of software is three to ten years.

66.10 Leases

At the inception of a contract, the Group assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The Group has elected not to separate non-lease components and account for lease and non-lease components of a contract as a single lease component.

The Group as a lessee

The Group applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The Group recognises a lease liability and a right-of-use asset at the lease commencement date. The Group has elected not to recognise right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The Group recognises lease payments associated with these leases as an expense on a straight-line basis over the lease term.

Lease liabilities

The lease liability is initially measured at the present value of the lease payments, both fixed and variable, discounted using the entity's incremental borrowing rate. The incremental borrowing rate is the rate of interest the Group would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The incremental borrowing rate is subject to estimation when no observable rates are available. The lease liability is measured at amortised cost using the effective interest method and remeasured when there is a change in future payments, e.g. arising from a change in an index or an assessment of whether extension or termination options will be exercised. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made.

The lease term is determined by the Group as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised. An assessment of whether the entity will exercise an extension or termination option is made by management annually. If the assessment of whether the Group will exercise an extension or termination option changes after the commencement date the lease liability is remeasured and a corresponding adjustment is made to the carrying amount of the right-of-use asset.

Right-of-use assets

The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred less any lease incentives received. For any remeasurement of the lease liability a corresponding adjustment is made to the carrying amount of the right-of-use asset or recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero. The right-of-use-asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. Right-of-use assets are subject to impairment.

If a lease modification increases the scope of the lease by adding a right to use of one or more underlying assets and the consideration for the lease increases by an amount commensurate with the stand-alone price for the increased scope and any adjustments to the price that reflects the circumstances of the particular contract, then the modification is accounted for as a separate lease. For lease modifications that are not accounted for as separate leases the lease term of the modified lease is redetermined and the lease liability remeasured using the revised lease payments and discounted using the incremental borrowing rate at the effective date of modification. Any adjustment of the lease liability is then correspondingly made to the right-of-use asset.

66.10 Cont'd

The Group presents right-of-use assets in the line item "Property and equipment" and lease liabilities in the line item "Other liabilities" in the statement of financial position. Maturity analysis of lease liabilities is disclosed in Note 57. Interest on lease liabilities is recognised in profit or loss in the line item "Net interest income". Depreciation of right-of-use assets is recognised in profit or loss in the line item "Other operating expenses".

The Group as a lessor

The Group classifies leases based on the substance of the arrangements and the extent of the transfer of risks and rewards incidental to ownership of the leased asset. A lease is classified as an operating lease if the lessor does not transfer substantially all the risks and rewards incidental to ownership. A lease is classified as a finance lease if the lessor transfers substantially all the risks and rewards incidental to ownership.

When the Group is the lessor in a capital lease, the Group recognises a receivable equal to the net investment in the lease and presents it in the line item "Loans to customers" in the statement of financial position. The Group applies its accounting policies for derecognition and impairment of financial assets also to its capital lease receivables. The Group recognises the finance income from capital lease receivables in profit or loss in the line item "Net interest income" over the period of the capital lease so as to give a constant periodic rate of return on the net investment in the capital lease.

When the Group is a lessor in arrangements which involve the legal form of capital leases, but which in substance do not involve leases, the Group classifies them within loans at amortised cost.

66.11 Non-current assets and disposal groups held for sale

Non-current assets and disposal groups are either classified as held for sale when the Group expects to recover their carrying amount principally through a sale transaction rather than through continuing use or as held for distribution to owners when the Group is committed to distribute the asset, or disposal group, to the owners.

For this to be the case, the assets, or disposal groups, must be available for immediate sale, or distribution, in their present condition and their sale, or distribution, must be highly probable. The sale must only by subject to terms that are usual and customary for sales of such assets, or disposal groups.

Non-current assets and disposal groups are presented in a separate line in the statement of financial position. Non-controlling interests in a disposal group are presented within equity.

Immediately before the initial classification as held for sale or distribution the assets, or components of disposal groups, are remeasured in accordance with applicable accounting policies. Thereafter, the non-current assets, or disposal groups, are measured at the lower of their carrying amount and fair value less costs to sell or costs to distribute.

Income and expenses of non-current assets and disposal groups held for sale are recognised in profit or loss in the line item "Discontinued operations held for sale, net of income tax" (see Note 66.21).

66.12 Loan commitments and financial guarantees

Loan commitments are firm commitments of the Group to provide credit under a binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates. Expected credit loss of loan commitments (see Note 66.4) is recognised in the statement of financial position in the line item "Other liabilities". Loan commitment fees received by the Group are recognised in profit or loss in the line item "Fee and commission income".

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Financial guarantees are issued by the Group to credit institutions and other parties on behalf of its customers so that they can secure loans, overdrafts, and banking facilities.

Liabilities arising from financial guarantees issued by the Group are initially measured at their fair value, being the premium received. Subsequently the liabilities are carried at the higher of the amount representing the initial fair value of the guarantee and the expected credit loss allowance of the guarantee (see Note 66.4). Any changes in the liabilities arising from financial guarantees are recognised in profit or loss. The premium received is recognised in profit or loss in the line item "Fee and commission income" over the life of the guarantee.

Notes to the Consolidated Financial Statements

66.13 Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, if it is probable that the Group will be required to settle the obligation with an outflow of resources, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that the reimbursement will be received and the amount of the receivable can be measured reliably.

66.14 Employee benefits

All Group entities are required to pay, on a mandatory and contractual basis, contributions to public and private pension funds. The Group has no further payment obligations once these contributions have been paid. The Group recognises these contributions as salary related expenses when they become due.

Short-term employee benefits include salaries, cash bonuses, non-monetary benefits and compensated absences. Short-term employee benefit obligations are expensed by the Group as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

The Group does not have a defined benefit pension plan or an active remuneration policy.

66.15 Equity

Share capital

The share capital disclosed in the consolidated financial statements represents the total nominal value of ordinary shares issued by the Bank. Incremental costs directly attributable to the issuance of ordinary shares are recognised as a deduction from equity, net of any tax effects.

Dividends on shares

Dividends payable to shareholders of the Bank are recognised as a liability and deducted from equity in the period in which the dividends are approved by the shareholders at the Bank's Annual General meeting. Dividends payable to non-controlling shareholders in subsidiaries are recognised as a liability and deducted from equity in the period in which the dividends are approved by the shareholders' meeting of the subsidiaries. Dividends declared after the reporting date are not recognised as a liability at the reporting date.

Statutory reserve

According to the Act on Public Limited Companies no. 2/1995 the statutory reserve shall amount to 25% of the share capital of the Bank.

Restricted reserves

The Group is to transfer, if applicable, certain amounts from retained earnings to restricted reserves which can therefore not be distributed as dividends to shareholders. These restricted reserves are specified as follows:

Restricted reserve due to capitalised development costs

When the Group capitalises development cost it transfers a corresponding amount from retained earnings to a restricted reserve. In the future the restricted amount is to be transferred back to retained earnings as the capitalised development cost is amortised in profit or loss.

Restricted reserve due to fair value changes of financial assets

The Group transfers fair value changes of financial assets at fair value through profit or loss, net of tax if applicable, from retained earnings to a restricted reserve. Amounts recognised in the reserve are transferred back to retained earnings upon sale of the financial asset.

Restricted reserve due to unrealised profit of associates

If share of profit of an associated company is in excess of dividend received or which can be claimed, the Group transfers the difference to a restricted reserve in equity. If the Group's shareholding in an associate is sold or written off the applicable amount recognised in the reserve is transferred to retained earnings.

66.15 Cont'd

Fair value reserve

Fair value reserve comprises all unrealised gains or losses related to fair value changes of equity instruments classified at fair value through other comprehensive income. On derecognition of the equity instruments fair value changes are not reclassified to profit and loss.

Liability credit reserve

Changes in fair value attributable to changes in the credit risk of financial liabilities designated as at fair value through profit or loss are recognised in liability credit reserve. On derecognition the fair value changes are not reclassified to profit or loss.

Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign subsidiaries.

66.16 Interest income and interest expense

For all financial assets and financial liabilities measured at amortised cost, interest income and interest expense are recognised in profit or loss using the effective interest method.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, when appropriate, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows, considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation generally includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, as well as transaction costs and all other premiums or discounts.

The effective interest rate is established on initial recognition of financial assets and financial liabilities and their carrying amount is subsequently adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate. The change in carrying amount is recorded as interest income or interest expense. For floating rate instruments, interest income or interest expense is generally recognised based on the current market rate plus or minus amortisation or accretion of the discount or premium based on the original effective interest rate.

Interest on impaired financial assets is calculated by applying the original effective interest rate of the financial asset. For financial assets in Stage 1 and Stage 2 interest is recognised on the gross carrying amount of the assets and for financial assets in Stage 3 interest is recognised on the gross carrying amount of the assets, net of impairment allowance (see Note 66.4).

Interest income and interest expense include gains and losses on derecognition of financial assets and financial liabilities measured at amortised cost.

For financial assets and financial liabilities at fair value through profit and loss, interest income and interest expense are recognised through profit or loss on an accrual basis, except for financial liabilities designated as at fair value through profit or loss (see Note 66.4).

Accrued interest on interest rate swaps, which are designated and accounted for as hedging instruments in fair value hedges of the interest rate risk arising from certain fixed-rate euro denominated bonds issued by the Group (see Note 66.7), is recognised in profit or loss as an adjustment to the interest expense recognised for the bonds.

66.17 Net fee and commission income

Fees and commissions are recognised to reflect the transfer of services to customers at an amount that reflects the consideration that is expected to be received for such services. Fee and commission income and expenses that are integral to the effective interest rate on a financial asset or financial liability are included in the measurement of the effective interest rate.

Fees for loan commitments that are likely to be utilised are recognised as an adjustment to the effective interest rate of the loan. When a loan commitment is not expected to be utilised, fees are recognised in profit or loss on a straight-line basis over the commitment period.

Loan syndication fees are recognised as revenue in profit or loss when the syndication has been completed and the Group has retained no part of the loan package for itself or has retained a part at the same effective interest rate as the other participants.

66.17 Cont'd

Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as the arrangement of the acquisition of shares or other securities, or the purchase or sale of businesses, are recognised on completion of the underlying transaction.

Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportioned basis.

Asset management fees related to investment funds are recognised rateably over the period in which the service is provided. The same principle is applied for wealth management, financial planning, and custody services that are continuously provided over an extended period of time. Performance-linked fees or fee components are recognised when the performance criteria are fulfilled.

Where it is assessed that the Group is acting as an agent, the consideration is presented on a net basis.

66.18 Net financial income (expense)

Net financial income (expense) consists of net gain (loss) on financial assets and financial liabilities mandatorily at fair value through profit or loss, net gain (loss) on financial liabilities designated as at fair value through profit or loss and net gain (loss) on fair value hedges.

Net gain (loss) on financial assets and financial liabilities mandatorily at fair value through profit or loss
Net gain (loss) on financial assets and financial liabilities mandatorily at fair value through profit or loss includes all realised and unrealised fair value changes of financial assets and financial liabilities classified by the Group as mandatorily at fair value through profit or loss, except for interest income and interest expense, which are included in the line item "Net interest income", and foreign exchange gains and losses, which are included in the line item "Net foreign exchange gain (loss)". Dividend income from financial assets is recognised in the income statement when the Group's right to receive payment is established.

Net gain (loss) on financial liabilities designated as at fair value through profit or loss
Net gain (loss) on financial liabilities designated as at fair value through profit or loss includes all realised and unrealised fair value changes of financial liabilities designated by the Group as at fair value through profit or loss, except for changes in fair value attributable to changes in credit risk which is recognised in other comprehensive income, interests incurred which are included in the line item "Net interest income", and foreign exchange gains and losses which are included in the line item "Net foreign exchange gain (loss)".

Net gain (loss) on fair value hedges
Net gain (loss) on fair value hedges includes the changes in the clean fair value of interest rate swaps which are accounted for as hedging instruments in fair value hedges and the changes in the fair value of certain bonds, which are attributable to the interest rate risk of the bonds, and are accounted for as the hedged items in fair value hedges (see Note 66.7).

66.19 Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets, other than deferred tax assets and non-current assets and disposal groups held for sale, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the Group estimates the recoverable amount of the asset. If the carrying amount of an asset exceeds its estimated recoverable amount an impairment loss is recognised in profit or loss.

An impairment loss for non-financial assets is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

66.20 Taxes

Income tax expense

Income tax expense comprises special financial activities tax, current tax and deferred tax and is disclosed as a separate line item in the income statement. Income tax expense from discontinued operations is included in the income statement in the line item "Discontinued operations held for sale, net of income tax" (see Note 66.21). Income tax is recognised in profit or loss, except to the extent that it relates to items recognised directly in equity, consistent with the recognition of the underlying item to which it relates.

Bank tax

Bank tax is calculated as 0.145% (2020: 0.145%) of total liabilities at year-end as determined for tax purposes, in excess of ISK 50,000 million, excluding tax liabilities. The Bank tax is considered a non-deductible expense for the calculation of income tax. The Bank tax is shown in a separate line in the income statement and is included in the statement of financial position in the line item "Tax liabilities".

Special financial activities tax

Special financial activities tax is calculated as 6% of taxable profit exceeding ISK 1,000 million. Special financial activities tax is included in the statement of financial position in the line item "Tax liabilities".

Current tax

Current tax is the expected tax payable on the taxable income for the year using tax rates enacted at the reporting date. Current tax also includes any adjustment to tax payable in respect of previous years. Current tax assets and current tax liabilities are offset in the statement of financial position if the Group has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously. Current tax is included in the statement of financial position in the line item "Tax liabilities".

Deferred tax

Deferred tax is recognised based on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts. However, deferred taxes are not recognised if it arises from the initial recognition of an asset or liability, in a transaction other than a business combination, that at the time of the transaction affects neither the taxable profit nor the accounting profit. In addition, deferred taxes are not recognised if the temporary difference arises from the initial recognition of goodwill.

Deferred tax is measured using tax rates enacted at the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised. The deferred tax asset is reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax liabilities are included in the statement of financial position in the line item "Tax liabilities" and deferred tax assets are included in the statement of financial position in the line item "Other assets". Deferred taxes that are part of discontinued operations (see Note 66.11) are included in the line items "Non-current assets and disposal groups held for sale" and " Non-current liabilities and disposal groups held for sale ", respectively, in the statement of financial position.

66.21 Discontinued operations held for sale, net of income tax

Discontinued operations held for sale, net of income tax, are disclosed as a separate line item in the income statement and consist of (i) profit or loss from foreclosed assets and disposal groups held for sale, (ii) gain or loss recognised on the measurement to fair value less costs to sell in excess of book value of foreclosed assets, (iii) profit or loss from sales of foreclosed assets and disposal groups held for sale, and (iv) income tax expense from discontinued operations.

66.22 Offsetting

Financial assets and financial liabilities are set off and the net amount reported in the statement of financial position when, and only when, the Group has a legal right to offset the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

The Group presents income and expenses on a net basis in the income statement only when required or permitted by the accounting standards.

66.23 Earnings per share

The Group presents basic and diluted earnings per share for its ordinary shares. Basic earnings per share are calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share are determined by adjusting the profit or loss attributable to ordinary shareholders of the Bank and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, if any.

Íslandsbanki's Corporate Governance Statement 2021
Unaudited

The regulatory framework for corporate governance practices within Íslandsbanki consists of the law applicable to entities subject to the supervision of the Financial Supervisory Authority of the Central Bank (CB) as well as other applicable law and regulations, including those imposed by the CB and Nasdaq Iceland, available at their respective websites, www.cb.is and www.nasdaqomxnordic.com. The applicable law includes, inter alia, the Act on Financial Undertakings no. 161/2002, the Act on Recovery and Resolution of Credit Institutions and Investment Firms no. 70/2020, the Act on Markets for Financial Instruments no. 115/2021, the Act on Payment Services no. 120/2011, the Act on Measures against Money Laundering and the Financing of Terrorist Activities no. 140/2018, the Act on Mortgage Credit to Consumers no. 118/2016, the Act on Consumer Credit no. 33/2013, the Act on Competition no. 44/2005 and the Act on Public Limited Companies no. 2/1995, which along with the Íslandsbanki's Articles of Association lay the foundation for the Bank's existence and activities. The relevant law is available on the Icelandic legislature's website, www.althingi.is.

The Board of Directors of Íslandsbanki is committed to excellence in corporate governance complying with the applicable regulatory standards and best international practices in the field of corporate governance.

The Bank's compliance with Corporate Governance Guidelines issued by the Iceland Chamber of Commerce, Nasdaq Iceland and SA-Business Iceland (hereinafter the Guidelines) is reviewed annually. The Board of Directors follows the Guidelines in accordance with paragraph 7 of article 54 of the Act on Financial Undertakings no. 161/2002. The Guidelines are available on www.corporategovernance.is.

In the year 2021, 35% of the Bank's shares were admitted to trading on the Nasdaq Main Market in Iceland. The Bank also regularly issues bonds on the regulated securities market in both Iceland and Ireland. The Bank is therefore subject to the disclosure obligation of issuers pursuant to the Act on the Disclosure and Information requirements of Issuers of Securities and Notifications on Major Holdings no. 20/2021 and the rules of the relevant stock exchange.

The Icelandic State Financial Investments (ISFI), on behalf of the Icelandic Government, is the largest shareholder of the Bank and holds 65% of the Bank's shares, in accordance with the Act on Icelandic State Financial Investments no. 88/2009 and the Icelandic State Ownership Policy for financial undertakings. The Icelandic State's objective as owner is that its management of the Bank's assets and operations promote confidence in, and credibility of, the financial market, to promote competition in the financial market, and maximise long-term value for the Icelandic state Treasury, considering risk.

Main aspects of Risk Management and Internal Control

Internal Control

The risk management and internal control framework of the Bank is based on the three-lines-of-defense model, as referred to in the European Banking Authority's Guidelines on Internal Governance and aims for informed decision-making and strong risk awareness throughout the Bank. The framework is intended to ensure efficient operations, adequate control of risks, prudent conduct of business, reliability of financial and non-financial information reported internally and externally, and compliance with the applicable laws, regulations, supervisory requirements and the Bank's internal rules.

The first line of defense consists of the Bank's business and support units; the second line of defense is comprised of the Bank's internal control units, Risk Management and Compliance; and the third line of defense is Group Internal Audit which keeps the Board informed of the quality of corporate governance, risk management and internal controls, including by performing independent and objective audits.

Risk Management

The Board of Directors approves the risk policy, risk appetite statement and procedure for risk management and ensures that internal procedures for risk management are revised at least annually.

The All Risk Committee, a Senior Management Committee, is comprised of the CEO, all the managing directors of the Bank and other members of management appointed by the CEO. The committee takes major decisions on implementation of the Bank's risk management and internal audit frameworks and conducts oversight to ensure that the Bank's risk profile is within the limits defined in the Board's risk appetite statement. The All Risk Committee issues guidelines for risk assessment and individual risk thresholds or limits.

Further information on the Bank's risk management structure and internal control can be found in the Bank's unaudited Pillar 3 Report which is available on the Bank's website.

Audit and accounting

The CEO ensures that Directors of the Board are provided with accurate information on the Bank's finances, development and operations on a regular basis and the Board Audit Committee assists the Board in fulfilling its oversight responsibilities concerning the financial reporting process and the system of internal control.

The Bank's Finance division is responsible for the preparation of the Group's consolidated financial statements in line with the International Financial Reporting Standards (IFRS) 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 Board's Audit Committee reviews annual and interim consolidated financial statements before their submission for Board approval and endorsement. The Board's Audit Committee regularly discusses the Group's financial statements and evaluates its internal control processes. Management reporting is generally presented to the Board 10 times a year. The external auditors review the half year consolidated financial statements and audit the consolidated financial statements.

The consolidated financial statements are published on an annual and quarterly basis.

The Annual General Meeting (AGM) elects an external audit firm in accordance with the Bank's Articles of Association. The Board's proposal to the AGM is based on the Audit Committee's recommendation on the selection of an audit firm. While the Icelandic State holds at least half of the Bank's shares, the audit of the annual accounts is within the remit of the Auditor General, who may, in consultation with the Audit Committee, appoint an audit firm to carry out these tasks. Ernst & Young ehf. has carried out the external audit of the Bank in recent years.

Group Internal Audit

The Chief Audit Executive is appointed by the Board, reports directly to the Board and directs Group Internal Audit with a mandate from the Board. Group Internal Audit operates independently from other departments in accordance with article 16 of the Act on Financial Undertakings no. 161/2002. The department provides the Board with independent and objective assurance over the effectiveness of risk management, control and governance processes. The responsibilities and authorisations of the Chief Audit Executive and Group Internal Audit are further outlined in the Group Internal Audit Charter.

Compliance

The Bank's Compliance Officer is hired by the CEO, subject to Board confirmation. The Compliance Officer operates under the terms of a mandate letter approved by the Board. The Compliance Officer maintains an independent position within the Bank's organisation and is responsible for monitoring and assessing regularly whether the Bank's operations, regarding securities transactions, are in compliance with applicable law. Furthermore, the Compliance Officer is responsible for assessing and monitoring the Bank's compliance with Act on Measures against Money Laundering and Terrorist Financing no. 140/2018 and the Bank's responsible officer under the US Foreign Account Tax Compliance Act (FATCA) and the OECD Common Reporting Standard (CRS).

Íslandsbanki Values, Sustainability and Code of Conduct

The Bank's purpose is moving Iceland forward by empowering its customers to succeed. Íslandsbanki's values are the pillars of the Bank's corporate culture, shaping the conduct and attitudes of its employees. The values of Íslandsbanki are passion, professionalism, and collaboration.

The Board approves a Code of Conduct for the Bank's employees. The aim of the code is to promote good operational practices. The document is available on the Bank's website.

The Bank has in place a Sustainability Policy which is focused on making its operations exemplary in the Icelandic business environment based on established international ESG criteria. The Bank aspires to be a leader in sustainable development and to move Iceland forward by empowering its customers to succeed.

The Bank has decided to focus particularly on four of the UN Sustainable Development Goals in its course of business: quality education; gender equality; industry, innovation and infrastructure; and climate action. Annually the Bank publishes an Annual and Sustainability Report in accordance with the Nasdaq ESG guidelines, the applicable Global Reporting Initiative (GRI) metrics, the UN Global Compact, and the SDGs. For the last years Íslandsbanki has been a signatory to the UN Global Compact on social responsibility.

Board of Directors

The Board of Directors comprises seven non-executive directors, and two alternate members, elected at each AGM for a term of one year. The Chairman of the Board is elected by the shareholders' meeting. There are no limitations on duration of Board membership.

The Board undertakes the Bank's affairs in between shareholders' meetings unless otherwise provided by law or the Bank's Articles of Association. The Board is responsible for setting the Bank's general strategy and instructs the CEO on its further implementation and execution. The Board has a supervisory role in that it oversees that the Bank's organisation and activities are at all times in accordance with the relevant law, regulations and good business practices. The CEO and Chief Audit Executive are hired by the Board.

The Rules of Procedure of the Board are adopted in accordance with article 70 of the Act on Public

Limited Companies no. 2/1995 and article 54 of the Act on Financial Undertakings no. 161/2002. The Board's current Rules of Procedure are available on the Bank's website. According to its Rules of Procedure, at meetings of the Board the presence of at least five members of the Board is required to constitute a quorum. The Board met 20 times in 2021, each time constituting a quorum.

The Articles of Association of the Bank provide that the ratio of each gender on the Board of Directors shall not be lower than 40%, currently the Board is comprised of three women and four men. The Board has approved a policy on the suitability of the Board of Directors, the Executive Committee and key function holders. The policy states, among other things, that the composition of the Board shall at any time be diverse, with regard to educational and professional background, gender and age.

The Board subcommittees

The Board subcommittees are three in total and they operate under the terms of a mandate letter from the Board as well as the Rules of Procedure of the Board. The mandate letters of the Board subcommittees are available on the Bank's website. The Board appoints the members of the subcommittees as well as their Chairman. When appointing the subcommittees, the Board shall take into account the expertise, skills and experience needed of a member to be appointed to the relevant subcommittee. All of the subcommittees are constituted of members of the Board.

The Board Audit Committee, comprising three Board members, assists the Board in fulfilling its oversight responsibilities concerning the financial reporting process, the system of internal control, the audit process and the Bank's process for monitoring compliance with the relevant laws and regulations and its Code of Conduct. The committee met six times in 2021, each time constituting a quorum.

The Board Risk Management Committee, comprising three Board members, assists the Board in providing oversight of senior management activities in managing risk relevant to the Bank's operations. The committee's responsibilities include the parent company, its subsidiaries, and the whole Group. The committee met nine times in 2021, each time constituting a quorum.

The Board Corporate Governance and Human Resource Committee, comprising three Board members, assists the Board in overseeing the development and the regular assessment of the Bank's approach to corporate governance issues and Board effectiveness. Furthermore, the committee assists the Board in fulfilling its oversight responsibilities concerning the Bank's Compensation Policy, implementation of the Bank's Sustainability Policy and issues concerning human resources. The committee met seven times in 2021, each time constituting a quorum.

The structure and composition of Board sub-committees is illustrated below.

Members of the Board

Hallgrímur Snorrason, Chairman of the Board, (b. 1947) has been Chairman since March 2020 but first joined the Board in April 2016. He is an independent consultant in official statistics at international level. He was Director-General of Statistics Iceland in 1985-2007 and Deputy Managing Director of the National Economic Institute of Iceland in 1980-1984. Hallgrímur has been a member of the board of several companies, including Útvegsbanki Íslands hf., Skýrr and Auður Capital. He has also chaired or served on a number of governmental committees, both domestically and in connection with Nordic cooperation, EFTA, EU and the OECD.

Hallgrímur holds a M.Sc. in Economics from the University of Lund in Sweden and a B.Sc. in Economics from the University of Edinburgh, UK.

Hallgrímur holds no shares in Íslandsbanki and is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank.

Sub-Committees: Member of the Board Audit Committee.

Anna Þórðardóttir (b. 1960) joined the Board in April 2016. She has been a board member of a number of companies and organisations, including KPMG and the Institute of State Authorised Public Accountants in Iceland. She is currently a member of the board of The Icelandic Center for Future Studies (Framtíðarsetur Íslands) and is chairman of the Board Audit Committee of Hagar. Anna was an employee of KPMG in 1988-2015, where she became partner in 1999. While at KPMG, she was responsible for the audit of the following companies: Reitir, Hagar, 365, Baugur Group, Vodafone, Landfestar, Landey, 10-11 and Félagsbústaðir.

Anna holds a cand. oecon. in Business Administration from the University of Iceland and is a Chartered Accountant. She has also studied towards a cand. merc in Financial studies from Handelhøjskolen in Aarhus, Denmark.

Anna holds no shares in Íslandsbanki and is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank.

Sub-Committees: Chairman of the Board Audit Committee.

Árni Stefánsson (b. 1966) joined the Board in April 2016. He has extensive management experience in power-intensive industry in Iceland and is currently manager and member of the executive board at the Rio Tinto primary aluminium plant. Previously, he was a manager of the Century Aluminium plant Norðurál in Grundartangi; manager and on the executive board of Landsnet, the electric transmission grid company of Iceland; and manager at Landsvirkjun, the National Power Company of Iceland.

Árni holds an M.Sc. in Electrical Engineering.

Árni holds 0.00036% of the Bank's shares and is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank.

Sub-Committees: Chairman of the Board Risk Management Committee.

Frosti Ólafsson (b. 1982) joined the Board in March 2020. He is the CEO of Olíuverzlun Íslands hf. Before joining the Board, he operated i.a. as an independent consultant and is the former CEO of ORF Genetics, the former Managing Director of Iceland Chamber of Commerce and worked as a strategic consultant for McKinsey & Company. In his past roles, he has supported leading domestic and international companies on a wide range of topics, including strategy, operations and governance. Frosti is currently a Board member at Controlant, Óson and entities owned by Olíuverzlun Íslands, i.e. Mjöll-Frigg and Garður.

Frosti holds an MBA from London Business School and a B.Sc. in Economics from University of Iceland and Macquire University in Sydney, Australia.

Frosti holds 0.00063% of the Bank's shares and is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank.

Sub-Committees: Member of the Board Corporate Governance and Human Resource Committee and the Board Audit Committee.

Guðrún Þorgeirsdóttir (b. 1979) joined the Board in March 2020. She is the Chief Business Development Officer of PayAnalytics. Previously, Guðrún was the Chief Financial Officer of Skeljungur. Guðrún has prior experience as a Chief Risk Officer and as an investment manager. She is an experienced board member and has served on the board of directors of insurance companies, financial companies and retail and service companies, including VÍS, Lífís, Lyfja and Lýsing. Guðrún is an alternate member on the board of Pavonis ehf. and the CEO of Tharsis ehf.

Guðrún holds an MBA from HEC School of Management in France, has a B.Sc. in Industrial Engineering from the University of Iceland, and is a securities broker licensed by the Icelandic Ministry of Finance and Economic Affairs.

Guðrún holds no shares in Íslandsbanki and is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank.

Sub-Committees: Member of the Board Corporate Governance and Human Resource Committee and the Board Risk Management Committee.

Heiðrún Jónsdóttir (b. 1969) joined the Board in April 2016 and has been the Vice-Chairman of the Board since March 2020. She is an attorney at law with Múli Legal Services and serves as a member of the board of Reginn, real estate company, Royal Arctic Line, Svarmi and Múli lögmannsstofa. Previously, she was Managing Director at Eimskipafélag Íslands, Lex Legal Services, and Legal and Human Resources at KEA. She has been chairman of the board at Norðlenska, Íslensk Verðbréf and Gildi pension fund and has been a member of the board of Síminn, Icelandair Group, Olíuverzlun Íslands, the Icelandic Banks' Data Centre (RB), Ístak, the securities depository Arion Verðbréfavarsla, Þekking, and the Icelandic Pension Funds Association. Heiðrún served as a board member of the board of the Icelandic Bar Association in 2016-2019 and was the deputy chairman of the board in 2018-2019.

Heiðrún holds a cand. jur from the University of Iceland and is a securities broker licensed by the Icelandic Ministry of Finance and Economic Affairs. She completed an Advanced Management Program (AMP) at IESE Business School in Barcelona, Spain.

Heiðrún holds 0.00063% of the Bank's shares and is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank.

Sub-Committees: Chairman of the Board Corporate Governance and Human Resource Committee.

Jökull H. Úlfsson (b.1963) joined the Board in March 2021. Jökull heads the Personnel Policy Department of the Icelandic Government. Jökull has worked in the financial market for the past 25 years where he has acquired comprehensive knowledge of financial institutions' operations. Jökull has spent most of his career with Arion Bank hf. and its predecessors as a manager in asset management, business development, and human resources. He was a member of the board of directors of Stefnir from 2013-2019 and was Managing Director of Stefnir from 2019-2020. Jökull is a board member of Vitaskuld ehf.

Jökull holds a cand. oecon. in Business Administration from the University of Iceland and is securities broker licensed by the Icelandic Ministry of Finance and Economic Affairs.

Jökull holds 0.00063% of the Bank's shares and is considered independent of the Bank. Jökull works for the Icelandic Government and is therefore considered dependent on the Bank's major shareholder. No interest ties with main customers or competitors of the Bank.

Sub-Committees: Member of the Board Risk Management Committee.

The alternate members of the Board are Herdís Gunnarsdóttir, since April 2016, and Óskar Jósefsson, since March 2020.

Structure and composition of Board subcommittees

	Board Audit Committee	Board Risk Management Committee	Board Corporate Governance and HR Committee
Anna Þórðardóttir	Chair		
Árni Stefánsson		Chair	
Frosti Ólafsson	Member		Member
Guðrún Þorgeirsdóttir		Member	Member
Hallgrímur Snorrason	Member		
Heiðrún Jónsdóttir			Chair
Jökull Úlfsson		Member	

Chair Member

Íslandsbanki's Nomination Committee and the ISFI Selection Committee

In accordance with the Bank's Articles of Association the Bank operates a Nomination Committee whose role is to nominate individuals to the Bank's Board of Directors at the AGM, or as the case may be at a shareholders' meeting where Board elections are on the agenda. The members of the Nomination Committee shall be three, elected for one year at a time by the Board of Directors. The committee shall be independent in its work and the majority of the committee's members shall be independent of the Bank and its senior management.

The Nomination Committee consists of:

- Helga Valfells, Chairman
- Hallgrímur Snorrason, Chairman of the Board of Íslandsbanki
- Tómas Már Sigurðsson

ISFI operates a special three-member Selection Committee which, on behalf of the State, nominates candidates for the supervisory boards or boards of directors of banks or undertakings that are managed by ISFI. According to the Relationship Agreement between the Bank and the ISFI the Bank's Nomination Committee and the ISFI Selection Committee shall ensure that when the Board of Directors is elected, the candidates for election to the Board of Directors meet the requirements on composition according to law, both as concerns breadth of experience as well as gender representation. The Rules of Procedure of the Bank's Nomination Committee are published on the Bank's website.

Board Performance and Suitability Assessment

At least once a year, as provided for in the Board's Rules of Procedure, the Board assesses its work, procedures and practices as well as each of its members. This performance assessment is intended to improve working methods and increase the efficiency of the Board. The assessment entails an evaluation of the strengths and weaknesses of the Board's work and practices. This is inter alia based of the necessary number of board directors, the board structure in relation to knowledge and experience, board procedure and practices. This assessment was last performed by the Board in December 2021.

Furthermore, the Board annually assesses the collective suitability of the Board and individual Board members in accordance with the Board's Rules of Procedure and the Bank's policy on the assessment of the suitability of the Board of Directors, the CEO and key function holders.

The Chief Executive Officer

The Chief Executive Officer (CEO) is responsible for the day-to-day operations of the Bank and that the Bank's business is, at all times, in accordance with the Bank's Articles of Association, policies of the Board and the relevant law. The CEO engages the Bank's Compliance Officer and appoints members of the Executive Committee and other Senior Management Committees.

Birna Einarsdóttir (b. 1961) is the CEO of Íslandsbanki. She holds an MBA from the University of Edinburgh, UK and a cand.oecon. in Business Administration from the University of Iceland. Birna first started working with Íslandsbanki's predecessors in 1987 and has been CEO since 15 October 2008. Previous to that she was a Senior Product Manager at the Royal Bank of Scotland and Marketing Manager for the Icelandic Broadcasting Company Stöð 2 (Channel 2) and Íslensk getspá.

The CEO owns 0.0022% of the Bank's shares and is considered independent of the Bank and major shareholders. No interest ties with main customers or competitors of the Bank. No call-option agreements exist between the CEO and the Bank.

The Executive Committee

The Executive Committee consists of seven people, including the CEO: Birna Einarsdóttir, CEO since October 2008, Jón Guðni Ómarsson, Chief Financial Officer since October 2011, Sigríður Hrefna Hrafnkelsdóttir, Managing Director of Personal Banking since May 2017, Riaan Dreyer, Director of Information Technology since September 2019, Guðmundur Kristinn Birgisson, Chief Risk Officer since October 2018, Una Steinsdóttir, Managing Director of Business Banking since May 2017, and Ásmundur Tryggvason Managing Director of Corporate & Investment Banking since January 2019.

Senior Management Committees

Senior Management Committees are advisory committees appointed by the CEO. Senior Management Committees are divided into Policy-Setting Committees, which implement Board policies, and Business Committees, which take a position on specific business matters. The committees are appointed by the CEO, who also approves their letter of mandate.

The Executive Committee and the **All Risk Committee** are considered Policy-Setting Committees and they take major decisions on the implementation of the policies set by the Board. Committee members include all of the Bank's Managing Directors, as well as other members of senior management appointed by the CEO.

- **The Executive Committee,** oversees and coordinates key aspects of the Bank's activities and has decision-making authority in matters assigned to it by the CEO, in accordance with policies, goals, and risk appetite as defined by the Board.

- **The All Risk Committee** takes major decisions on implementation of the Bank's risk management and internal audit frameworks and conducts oversight to ensure that the Bank's risk profile is within the limits defined in the Board's risk appetite statement.

The Business Committees decide on individual business and operational matters in accordance with the rules and procedures issued by the Board, the Executive Committee and the All Risk Committee. The Bank's Business Committees are:

- **The Senior Credit Committee** decides on proposals on lending and is the formal venue for discussion and review of individual loan proposals.
- **The Asset and Liability Committee** decides on proposals regarding market risk, liquidity risk, funding, capital, and internal and external pricing.
- **The Investment Committee** decides on proposals regarding the purchase, sale and valuation of equity stakes and other investments of the Bank.
- **The Operational and Security Committee** decides on proposals regarding new products and services, continuous operation and material changes in systems and procedures.
- **The Sustainability Committee** is a formal forum for reviewing and discussing issues related to sustainability risk, sustainable procurement, and business opportunities.

Arrangement of communications between shareholders and the Board

The Board communicates with shareholders in accordance with the relevant laws, the Bank's Articles of Association, and the Board's Rules of Procedure.

Shareholders' meetings, the supreme authority of the Bank, are the general forum for informing and communicating with shareholders. All information that is defined as sensitive market information is disclosed to the market through the relevant regulated market's announcement system in accordance with the Bank's Disclosure and Communication Policy. The Bank also organises quarterly meetings for market participants where the CEO, CFO and representatives of investor relations present the Bank's interim financial statements.

The Bank's Disclosure Committee assesses the Bank's event-specific disclosure obligations and decides on disclosure in accordance with the Bank's Rules on insider trading and management transactions. The Disclosure Committee consists of the CFO, the General Counsel, Executive Director of Treasury, and the Compliance Officer (without a vote).

Information on infringements of laws and regulations that the appropriate supervisory or ruling body has determined

In the year 2021 no remarks were received from an appropriate supervisory or ruling body concerning violations of laws or regulations. Information on legal cases relating to Íslandsbanki can be found in the notes to the consolidated financial statements.

This Corporate Governance Statement was approved by Íslandsbanki's Board of Directors on 10 February 2022.