Arion Bank

Condensed Consolidated **Interim Financial Statements** 1 January - 31 March 2020

Contents

Arion Bank in brief

3M 2020

(4.6%)
Return on equity

69.2%
Cost-to-income

27.5%
Capital adequacy ratio

Rating from S&P

Long term: BBB

Short term: A-2

Outlook: Stable

UNEP FINANCE INITIATIVE

Equal Pay Certification

THE ALLBRIGHT.

In 25th place out of 333 listed in Sweden in gender equality

Arion Bank

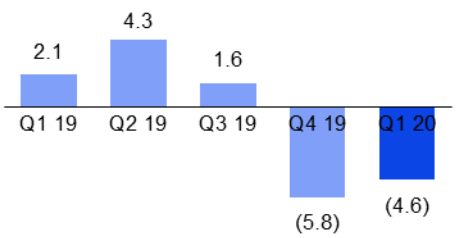
- Arion Bank is a leading universal relationship bank in Iceland which provides a full range of financial services.
- After a long period of strong economic growth the economy has come to an abrupt halt due to Covid-19. The Great Lockdown, as named by the IMF, will heavily impact the Icelandic economy due to its dependency on tourism. However, both fiscal and monitory policy have ammunition to support the economy.
- Arion Bank intends to maintain its leading position in digital banking, which has proven effective during the pandemic.
- The balance sheet is extraordinarily strong which is prudent at this time due to Covid-19 but not efficient, under normal circumstances.
- The Bank is very well positioned to meet the funding requirements of its customers in both ISK and FX and to provide customers with solutions through the Covid-19 pandemic.

Key figures

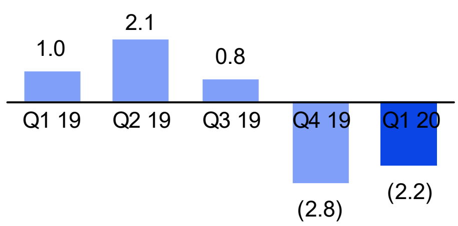
(ISK million)

	3M 2020	3M 2019
Net earnings (loss)	(2,171)	1,949
ROE	(4.6%)	3.6%
ROE continuing operations	(2.7%)	4.5%
Net interest margin	2.8%	2.7%
Cost to income ratio	69.2%	62.5%
Operating income / REA	5.0%	5.9%
	31.03.2020	**31.12.2019**
Total assets	1,187,820	1,081,855
Loans to customers	778,823	773,955
Deposits	539,312	492,916
Borrowings	322,470	304,745
Stage 3 gross	2.9%	2.7%
Leverage ratio	14.5%	14.1%
Number of employees	814	801
EUR/ISK	155.30	135.83

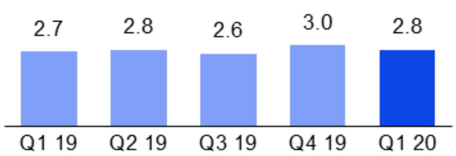
Return on equity (%)



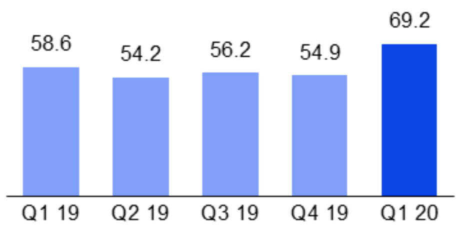
Net earnings (ISK billion)



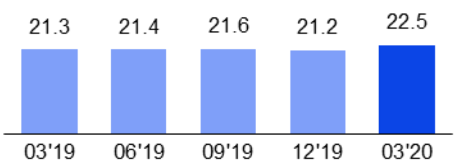
Net interest margin (%)



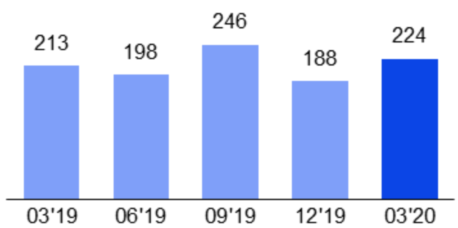
Cost-to-income ratio (%)



CET 1 ratio (%)



LCR ratio (%)



Endorsement and statement
by the Board of Directors and the CEO

The Condensed Consolidated Interim Financial Statements of Arion Bank for the period from 1 January to 31 March 2020 include the Condensed Consolidated Interim Financial Statements of Arion Bank ("the Bank") and its subsidiaries, together referred to as "the Group".

Operations during the period

Covid-19 had a substantial effect on the Icelandic economy and Arion Bank during the last month of the first quarter of 2020. Arion Bank reported a net loss of ISK 1,282 million from continuing operations and a net loss of ISK 2,171 million in the quarter. Return on equity was negative by 4.6% and 2.7% from continuing operations. There were three main factors that had a fundamental effect on the outcome: Net financial income was negative by ISK 2,000 million during the period, highly affected by fair value changes of equity holdings due to unfavorable market conditions; Net impairment was negative by ISK 2,860 million, mostly due to more pessimistic assumptions in the Bank's IFRS 9 models, especially as regards unemployment and the transfer of customers in tourism to Stage 2; and discontinued operations were negative by ISK 889 million, due to an operating loss at Valitor and value changes of Sólbjarg ehf. and Stakksberg ehf., all of which are classified as held for sale assets. Net commission income was strong during the period and increased by 39% compared with the same period in 2019, mainly due to increased activities in the loan book. Operating expenses are developing favorably and decreased by 10% compared with the same period in 2019, mainly due to the reduced number of FTEs. The bank levy has been lowered from 0.376% to 0.145%, as part of the government's response to the Covid-19 pandemic, which explains the 63% decrease compared with the same period last year.

The Bank's balance sheet increased by 9.8% during the first quarter of 2020. The increase was mainly in liquid assets, funded by deposit growth and proceeds from the Bank's issuance of AT1. However, the risk-weighted exposure amount (REA) decreased by ISK 7 billion in the quarter.

Total equity amounted to ISK 183,879 million at the end of the quarter and decreased by ISK 4.4 billion during the period due to share buy-backs under a buy-back program period and due to the loss reported for the first three months of 2020. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 27.5% and the CET1 ratio was 22.5%. This comfortably meets the requirements set by law and the Financial Supervisory Authority (FME). The Bank's liquidity position was also very strong at period end and well above the regulatory minimum.

In April 2020, Standard & Poor's downgraded Arion Bank's long-term credit rating from BBB+ to BBB, but revised the outlook from negative to stable. The Bank's short-term credit rating remains A-2.

As described above, Covid-19 has had a widespread effect on the Icelandic economy and Arion Bank. The Bank activated its business continuity plan on February 25. The process went relatively quickly from social distancing to approximately 80% of employees working from home. All branches have been closed since March 25 and customers have only been allowed to visit the Bank by appointment. Arion Bank has been able to conduct normal business despite these changed circumstances, partially thanks to its extensive digital offering. The Bank has been working with its customers, many of which have reduced revenue streams and cash flow challenges, and has offered payment holidays and other solutions. With the pandemic being on the decline in Iceland, the Bank will move towards normality in its operations. This experience, however, may have a lasting impact on the way the Bank and its customers do business.

Operational outlook

The Covid-19 pandemic has delayed Arion Bank's planned distribution of capital, as the Central Bank of Iceland has recommended that financial institutions reconsider their proposals on capital distributions in light of the economic uncertainty. Arion Bank is, however, committed to its strategy of focusing on the profitability of its REA and reducing the cost-to-income ratio. The Bank will, in the short term, focus on supporting its customers as far as reasonably possible and is very well equipped to do so with its high capital and liquidity. Regulators have acted swiftly and the banking sector now has better back-up when it comes to liquidity through new repo arrangements with the Central Bank. The Government has also been firm and is in the process of providing support to corporates and SME's as well as providing government guaranteed loan facilities to corporates, the details of which are still to be finalized.

Core revenues have been trending in the right direction but it is difficult to assess the impact of Covid-19 going forward. Operating expenses are decreasing and the emphasis will continue to be on reducing them further, as the Bank sees opportunities in streamlining the product offering and IT. Impairments are difficult to predict given the uncertainty that still exist. Whilst the Bank took drastic steps as regards impairments during this quarter, it is impossible to state at this time that further impairments will not be needed as the reality of the economic crisis becomes clearer.

Sales processes of HFS assets will continue but Covid-19 related factors are likely to delay the results somewhat.

Arion Bank expects the current turmoil to last at least over the coming two quarters and will focus on maintaining strong capital and liquidity during that period. However, the Bank does not rule out the possibility that the current economic environment, coupled with the Bank's very strong capital and liquidity position, might open up opportunities for the efficient use of these resources for either internal or external growth.

The Bank's objective is to resume its capital distribution when the Covid-19 pandemic is over.

Economic environment and outlook

According to preliminary figures GDP grew by 1.9% in 2019, surpassing all expectations. It was expected that 2020 would be a difficult year for the Icelandic economy, with the three largest export sectors still facing adversity following a turbulent 2019. Before the spread of coronavirus the economy was expected to be stagnant this year. The coronavirus outbreak and the restrictions imposed by governments around the world, including the Icelandic government, render previous forecasts obsolete. Few advanced economies are as dependent on tourism as Iceland, with tourism generating over 35% of export revenues and employing 15% of the labor force. It is impossible to quantify the effects of Covid-19 on tourism at this time, as it is unclear whether, and what, travel restrictions will remain in force throughout the year. For the time being, a 50% drop in tourist arrivals is a conservative scenario. Unemployment is expected to reach unprecedented heights, peaking in April and May at 17% according to the latest estimates. Despite the sharp depreciation of the ISK, inflation has remained below the Central Bank of Iceland's 2.5% inflation target and is expected to remain at similar levels throughout the year. Despite the mitigating actions taken by the government and the Central Bank of Iceland in response to the situation the economy is expected to contract sharply in 2020.

Endorsement and statement
by the Board of Directors and the CEO

Funding and liquidity

The Group's liquidity position is strong, with a liquidity coverage ratio of 224%, see Note 43, well above the regulatory minimum of 100%. The Bank's foreseeable refinancing risk is low as it does not have any material redemption of long-term funding until December 2021. The comfortable liquidity position and limited foreseeable refinancing needs mean that the Bank does not need to access the international wholesale funding markets in 2020.

Arion Bank continued to issue covered bonds which are secured under the Covered Bond Act No. 11/2008. During the first three months of 2020 the Bank issued covered bonds amounting to ISK 3,440 million.

Capital and REA

The Group's capital adequacy ratio at 31 March 2020 was 27.5% and the CET1 ratio 22.5%. The Group's own funds increased by ISK 23.3 billion from year-end 2019, primarily due to the very successful issuance of a USD 100 million Additional Tier 1 capital instrument in February 2020, and as a result of the Board of Directors' decision to propose that no dividends are paid in connection with operations in 2019 in light of the Covid-19 pandemic and the recommendation of the Central Bank of Iceland to that effect. This effectively reintroduces the foreseeable ISK 10 billion dividend at year-end 2019 as loss absorbing capital. This increase in own funds is, however, partly offset by negative earnings in the first quarter.

The Group's risk-weighted exposure amount (REA) decreased from ISK 720 billion to ISK 713 billion in the quarter. The introduction of the SME supporting factor into the Icelandic capital adequacy regime came into effect on 1 January 2020, reducing REA by ISK 13 billion, providing capital relief for exposures to SMEs below EUR 1.5 million. A continuing contraction of the corporate loan book and a reduced currency imbalance also contribute to lower REA. The aforementioned changes to REA are, however, largely offset by increased leverage as a result of the krona depreciating by 12% in the first quarter.

As part of the economic measures introduced by the Icelandic authorities, the 2% countercyclical capital buffer has been vacated entirely, which reduces the Group's total capital requirement from 20.3% to 18.4%. The Group's CET1 capital requirement is reduced from 15.5% to 13.6%. At 31 March 2020 the Group had ISK 63 billion of CET1 capital in excess of regulatory requirements and ISK 39 billion in excess of the Group's target CET1 ratio of 17%.

Group ownership

At the end of March 2020 Taconic Capital was the largest shareholder of Arion Bank, with a holding of 23.53%, and Sculptor Capital Management was the second largest with a holding of 9.53%. Following the launch of a share buy-back program at the end of October 2019, Arion Bank held 5.28% of its own shares at the end of March 2020. For further information on the shareholders of Arion Bank, see Note 35. The AGM on 17 March 2020 approved the cancellation of 84 million of the Bank's own shares, totalling ISK 84 million at nominal value.

Governance

At the AGM on 17 March 2020, seven members were elected to serve on the Board of Directors until the next AGM, four men and three women. Furthermore, three Alternate Directors (two men and one woman) were elected, and they attend meetings of the Board of Directors in the event that a Director resigns or is unable to attend.

On 26 March 2020 the Bank announced that Herdís Dröfn Fjeldsted, vice-chairman of the Board of Directors, would temporarily step aside as a board member while acting as the CEO of Valitor, a subsidiary of Arion Bank, on a temporary basis. In her absence one of the Alternate Directors will take a seat on the Board of Directors.

Endorsement and statement
by the Board of Directors and the CEO

Endorsement of the Board of Directors and the Chief Executive Officer

The Condensed Consolidated Interim Financial Statements of Arion Bank for the period ended 31 March 2020 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union and additional requirements in the Icelandic Financial Statements Act, Financial Undertakings Act and Rules on Accounting for Credit Institutions.

It is our opinion that the Condensed Consolidated Interim Financial Statements give a true and fair view of the financial performance and cash flow of the Group for the period ended 31 March 2020 and its financial position as at 31 March 2020.

Furthermore, in our opinion the Condensed Consolidated Interim Financial Statements and the Endorsement of the Board of Directors and the CEO give a fair view of the development and performance of the Group's operations and its position and describe the principal risks and uncertainties faced by the Group.

The Board of Directors and the CEO have today discussed the Condensed Consolidated Interim Financial Statements of Arion Bank for the period ended 31 March 2020 and confirm them by means of their signatures.

Reykjavík, 6 May 2020

Board of Directors

Brynjólfur Bjarnason, Chairman

Gunnar Sturluson

Liv Fiksdahl

Paul Richard Horner

Renier Lemmens

Sigurbjörg Ásta Jónsdóttir

Steinunn Kristín Thórdardóttir

Chief Executive Officer

Benedikt Gíslason

Consolidated Interim Income Statement

	Notes	2020 1.1.-31.3.	2019 1.1.-31.3.
Interest income		12,044	14,684
Interest expense		(4,791)	(7,250)
Net interest income	6	**7,253**	**7,434**
Fee and commission income		3,481	2,630
Fee and commission expense		(405)	(412)
Net fee and commission income	7	**3,076**	**2,218**
Net insurance income	8	501	253
Net financial (loss) income	9	(2,000)	766
Share of (loss) profit of associates	25	(24)	727
Other operating income	10	170	310
Other net operating income / loss		**(1,353)**	**2,056**
Operating income		**8,976**	**11,708**
Salaries and related expenses	11	(3,130)	(3,630)
Other operating expenses	12	(3,077)	(3,232)
Operating expenses		**(6,207)**	**(6,862)**
Bank levy	13	(331)	(906)
Net impairment	14	(2,860)	(1,081)
Earnings / loss before income tax		**(422)**	**2,859**
Income tax expense	15	(860)	(622)
Net earnings / loss from continuing operations		**(1,282)**	**2,237**
Discontinued operations held for sale, net of income tax	16	(889)	(1,219)
Net earnings / loss		**(2,171)**	**1,018**

Attributable to

Shareholders of Arion Bank hf.		(2,167)	1,018
Non-controlling interest		(4)	-
Net earnings / loss		**(2,171)**	**1,018**

Earnings per share

Basic and diluted earnings / loss per share attributable to the shareholders of Arion Bank (ISK)	17	(1.25)	0.56

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

Amounts are in ISK millions

Consolidated Interim Statement of Comprehensive Income

	Notes	2020 1.1.-31.3.	2019 1.1.-31.3.
Net earnings / loss		**(2,171)**	**1,018**
Net gain on financial assets carried at fair value through OCI, net of tax		420	99
Realized net gain on financial assets carried at fair value through OCI, net of tax, transferred to the Income Statement	9	4	(31)
Changes to reserve for financial instruments at fair value through OCI		**424**	**68**
Exchange difference on translating foreign subsidiaries		183	180
Other comprehensive income that is or may be reclassified subsequently to the Income Statement		**607**	**248**
Total comprehensive income / loss		**(1,564)**	**1,266**

Attributable to

Shareholders of Arion Bank		(1,560)	1,266
Non-controlling interest		(4)	-
Total comprehensive income / loss		**(1,564)**	**1,266**

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

Amounts are in ISK millions

Consolidated Interim Statement of Financial Position

Assets	Notes	31.3.2020	31.12.2019
Cash and balances with Central Bank	18	118,174	95,717
Loans to credit institutions	19	33,797	17,947
Loans to customers	20	778,823	773,955
Financial instruments	21-23	192,056	117,406
Investment property	23	7,129	7,119
Investments in associates	25	828	852
Intangible assets	26	8,826	8,367
Tax assets	27	2	2
Assets and disposal groups held for sale	28	28,038	43,626
Other assets	29	20,147	16,864
Total Assets		**1,187,820**	**1,081,855**

Liabilities			
Due to credit institutions and Central Bank	22	8,323	5,984
Deposits	22	539,312	492,916
Financial liabilities at fair value	22	4,687	2,570
Tax liabilities	27	4,195	4,404
Liabilities associated with disposal groups held for sale	28	22,857	28,631
Other liabilities	30	66,260	32,697
Borrowings	22,31	322,470	304,745
Subordinated liabilities	22,32	35,837	20,083
Total Liabilities		**1,003,941**	**892,030**

Equity			
Share capital and share premium	34	51,334	55,715
Other reserves		10,409	9,493
Retained earnings		121,959	124,436
Total Shareholders' Equity		**183,702**	**189,644**
Non-controlling interest		177	181
Total Equity		**183,879**	**189,825**
Total Liabilities and Equity		**1,187,820**	**1,081,855**

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

Amounts are in ISK millions

Consolidated Interim Statement of Changes in Equity

	Share capital	Share premium	Restricted reserves: Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Financial assets at fair value thr. OCI, unrealized	Statutory reserve	Foreign currency trans-lation reserve	Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
Equity 1 January 2020	1,773	53,942	6,127	692	459	135	1,637	443	124,436	**189,644**	181	**189,825**
Net earnings / loss									(2,167)	**(2,167)**	(4)	**(2,171)**
Net fair value gain						420				**420**		**420**
Realized net gain transferred to the Income Statement						4				**4**		**4**
Translation difference								183		**183**		**183**
Total comprehensive income	-	-	-	-	-	424	-	183	(2,167)	**(1,560)**	(4)	**(1,564)**
Purchase of treasury stock *	(55)	(4,325)								**(4,380)**		**(4,380)**
Changes in treasury stock **	-	(1)								**(1)**		**(1)**
Changes in reserves			157	1	151				(310)	**-**		**-**
Equity 31 March 2020	1,718	49,616	6,284	693	610	559	1,637	626	121,959	**183,702**	177	**183,879**

* Refers to the purchase of own shares after the Board of Directors authorized the Bank to initiate a share buy-back program in Iceland and Sweden (the Program) to purchase own shares, which is in line with the authorization granted by the AGM on 20 March 2019. The purpose of the Program is to reduce the Bank's share capital (in line with the Bank's dividend policy). When the Program was initiated on 31 October 2019, the Bank was authorized to purchase up to 59 million own shares in total under the Program, corresponding to 3.25% of the issued share capital, or for up to ISK 4.5 billion at market value. In January 2020 the FSA approved the buy-back of an additional 41 million own shares or for up to ISK 3.5 billion at market value, bringing the total amount of the share Program to 100 million shares or ISK 8.0 billion at market value. The Program continued until the AGM in March 2020. The AGM on 17 March 2020 approved the cancellation of 84 million of the Bank's own shares, totalling ISK 84 million at nominal value.

** In 2018 approximately 4 million shares were allocated to employees at ISK 75 per share, a total of ISK 295 million. In accordance with the employees stock grant program, an employee who resigns within the vesting period of two years, returns the shares to the Bank.

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

Amounts are in ISK millions

Consolidated Interim Statement of Changes in Equity

			Restricted reserves									
	Share capital	Share premium	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Financial assets at fair value thr. OCI unrealized	Statutory reserve	Foreign currency trans-lation reserve	Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
Equity 1 January 2019	1,814	57,196	12,373	417	-	87	1,637	308	126,897	**200,728**	130	**200,858**
Net earnings									1,018	**1,018**		**1,018**
Net fair value gain						99				**99**		**99**
Realized net gain transferred to the Income Statement						(31)				**(31)**		**(31)**
Translation difference								180		**180**		**180**
Total comprehensive income	-	-	-	-	-	68	-	180	1,018	**1,266**	-	**1,266**
Dividend paid									(9,069)	**(9,069)**		**(9,069)**
Changes in treasury stock *		(2)								**(2)**		**(2)**
Changes in reserves			194	175					(369)	**-**		**-**
Equity 31 March 2019	1,814	57,194	12,567	592	-	155	1,637	488	118,477	**192,924**	130	**193,054**

* In 2018 approximately 4 million shares were allocated to employees at ISK 75 per share, a total of ISK 295 million. In accordance with the employees stock grant program, an employee who resigns within the vesting period of two years, returns the shares to the Bank.

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

Amounts are in ISK millions

Consolidated Interim Statement of Cash flows

	2020 1.1.-31.3.	2019 1.1.-31.3.
Operating activities		
Net earnings / loss	(2,171)	1,018
Non-cash items included in net earnings	(1,795)	(3,185)
Changes in operating assets and liabilities:		
Loans to credit institutions, excluding bank accounts	(677)	(12,616)
Loans to customers	14,492	10,490
Financial instruments and financial liabilities at fair value	(68,194)	(11,695)
Deposits	32,858	18,467
Borrowings	28,276	20,593
Other changes in operating assets and liabilities	16,737	488
Interest received	13,809	14,096
Interest paid	(4,184)	(4,418)
Dividend received	17	81
Income tax paid	(1,069)	(844)
Net cash used in operating activities	**28,099**	**32,475**
Investing activities		
Proceeds from sale of associates	-	740
Acquisition of intangible assets	(654)	(856)
Proceeds from sale of property and equipment	2	251
Acquisition of property and equipment	(102)	(75)
Net cash used in investing activities	**(754)**	**60**
Financing activities		
Issued subordinated liabilities	13,171	677
Purchase of treasury stock	(4,381)	-
Dividend paid to shareholders of Arion Bank	-	(9,069)
Net cash from (used) in financing activities	**8,790**	**(8,392)**
Net decrease in cash and cash equivalents	36,135	24,143
Cash and cash equivalents at beginning of the year	102,186	110,589
Effect of exchange rate changes on cash and cash equivalents	4,791	2,081
Cash and cash equivalents	**143,112**	**136,813**
Cash and cash equivalents		
Cash and balances with Central Bank	118,174	94,124
Bank accounts	29,990	52,851
Mandatory reserve deposit with Central Bank	(5,052)	(10,162)
Cash and cash equivalents	**143,112**	**136,813**

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Contents

Notes to the Condensed Consolidated Interim Financial Statements

General information

Arion Bank hf., the Parent Company, was established on 18 October 2008 and is incorporated and domiciled in Iceland. The registered office of Arion Bank hf. is located at Borgartún 19, Reykjavík. The Condensed Consolidated Interim Financial Statements for the period ended 31 March 2020 comprise the Parent Company and its subsidiaries (together referred to as "the Group").

1. Basis of preparation

The Condensed Consolidated Interim Financial Statements were approved and authorized for publication by the Board of Directors of Arion Bank on 6 May 2020.

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

Statement of compliance

The Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Financial Reporting Standard, IAS 34 Interim Financial Reporting, as adopted by the European Union and additional requirements in the Icelandic Financial Statements Act, Financial Undertakings Act and Rules on Accounting for Credit Institutions. The Condensed Consolidated Interim Financial Statements do not include all the information and disclosures required in the Annual Financial Statements, and should be read in conjunction with Arion Bank's Annual Financial Statements for the year ended 31 December 2019. The Annual Financial Statements are available on Arion Bank's website www.arionbanki.is.

The same accounting policies, presentation and methods of computation are followed in these Condensed Consolidated Interim Financial Statements as were applied in the Consolidated Financial Statements for the year ended 31 December 2019.

Basis of measurement

The Condensed Consolidated Interim Financial Statements have been prepared on a historical cost basis except for the following:

- assets and liabilities measured under IFRS 9. For details on the accounting policy, see Note 56 in the Annual Financial Statements 2019;
- investment properties are measured at fair value and;
- non-current assets and disposal groups held for sale are stated at the lower of their carrying amounts and fair value, less cost to sell.

Functional and presentation currency

The Condensed Consolidated Interim Financial Statements are presented in Icelandic krona (ISK), which is the Parent Company's functional currency, rounded to the nearest million, unless otherwise stated. At the end of the period the exchange rate of the ISK against USD was 142.15 and 156.33 for EUR (31.12.2019: USD 121.04 and EUR 135.83).

2. Going concern assumption

The Group's management has made an assessment of the ability to continue as a going concern and is satisfied that the Group has the resources to continue. In making this assessment, management has taken into consideration the risk exposures facing the Group, which are further described in the Risk Management Disclosures. The Condensed Consolidated Interim Financial Statements are prepared on a going concern basis.

3. Significant accounting estimates and judgments in applying accounting policies

The preparation of the Condensed Consolidated Interim Financial Statements requires management to make judgments, estimates and assumptions that affect the reported amount of revenues, expenses, assets and liabilities, and the accompanying disclosures, as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

Estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. The Group based its assumptions and estimates on parameters available when the Condensed Consolidated Interim Financial Statement were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising that are beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

Notes to the Condensed Consolidated Interim Financial Statements

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

Impairment of financial assets

The book value of financial assets which fall under the impairment requirements of IFRS 9 are presented net of expected credit losses in the statement of financial position. On a monthly basis expected credit losses are recalculated for each asset, the calculations being derived from PD, LGD and EAD models. In addition to the model outcomes, the assessment of expected credit losses is based on three key factors: management's assumptions regarding the development of macroeconomic factors over the next five years, how those factors affect each model and how to estimate a significant increase in credit risk. The assumptions for macroeconomic development are incorporated into each model for three scenarios: a base case, an optimistic case and a pessimistic case. Management estimates the probability weight for each scenario used for calculations of the probability weighted expected credit losses. The amount of expected credit losses to be recognized is dependent on the Bank's definition of significant increase in credit risk, which controls the impairment stage each asset is allocated to. Management has estimated factors to measure significant increase in credit risk from origination, by comparison of changes in PD values, annualized lifetime PD values, days past due and watch list. For further information see Note 56 in the Annual Financial Statements 2019.

Assets and disposal groups held for sale

Legal entities acquired exclusively with a view to resale, and discontinued operations held for sale are measured at the lower of carrying amount and fair value, less cost to sell. For the most part, fair value at the date of classification of these legal entities and discontinued operations was calculated using valuation models based on discontinued future cash flows that incorporated significant non-market observable inputs and assumptions. The use of reasonably possible alternative inputs and assumptions to these models, in particular changes to the discount rate employed (representing the required rate of return on equity), could have an impact on the value of these

Real estates acquired exclusively with a view to resale are measured at the lower of carrying amount and fair value, less cost to sell. Fair value at the date of classification is based on independent property values or management valuation. As the fair value measurement of real estates is based on valuation techniques, there is some uncertainty about the actual fair value of assets.

Impairment of intangible assets

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

Revaluation of investment properties

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

4. The Group

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

			Equity interest	
	Operating activity	Currency	31.3.2020	31.3.2019
Arion Bank Mortgages Instit. Investor Fund, Borgartún 19, Reykjavík, Iceland .	Retail banking	ISK	-	100.0%
BG12 slhf., Katrínartún 2, Reykjavík, Iceland	Holding company	ISK	62.0%	62.0%
Eignarhaldsfélagid Landey ehf., Ögurhvarf 4a, Kópavogur, Iceland	Real estate	ISK	100.0%	100.0%
Eignabjarg ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Leiguskjól ehf., Lágmúli 6, Reykjavík, Iceland	Rental guarantee	ISK	51.0%	-
Stefnir hf., Borgartún 19, Reykjavík, Iceland	Asset management	ISK	100.0%	100.0%
Valitor Holding hf., Dalshraun 3, Hafnarfjördur, Iceland	Payment solutions	ISK	100.0%	100.0%
VISA Ísland ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Vördur tryggingar hf., Borgartún 25, Reykjavík, Iceland	Insurance	ISK	100.0%	100.0%

The subsidiaries Eignabjarg ehf. (holding company of Stakksberg ehf. and Sólbjarg ehf.) and Valitor Holding hf. are classified as held for sale in accordance with IFRS 5.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Operating segment reporting

Segment information is presented in respect of the Group's operating segments and is based on the Group's management and internal reporting structure. Segment performance is evaluated based on earnings before tax.

Inter segment pricing is determined on an arm's length basis. Operating segments pay and receive interest to and from Treasury on an arm's length basis to reflect the allocation of capital, funding cost and relevant risk premium.

5. Operating segments

Markets

Markets comprises Asset Management and Capital Markets. Asset Management manages financial assets on behalf of its customers according to a pre-determined investment strategy. Asset Management also administers pension funds. Asset management comprises Institutional Asset Management, Private Banking and Pension Fund Administration. The operation of Stefnir hf. is presented under the segment. Stefnir hf. is an independently operating financial company owned by Arion Bank and manages a broad range of mutual funds, investment funds and institutional investor funds. Capital Markets is a securities and provides clients with a diverse range of fixed income services and risk management products.

Corporate & Investment Banking

Corporate & Investment Banking services large and medium-sized corporate clients and investors, both in Iceland and abroad. The division is divided into Corporate Banking and Corporate Finance.

Corporate Banking's experienced account managers specialize in key economic sectors such as retail and services, seafood, energy and real estate. The division provides a full range of lending products such as guarantees, deposit accounts, payment solutions and a variety of value-added digital solutions to meet the needs of the Bank's larger corporate clients. The Corporate Banking portfolio includes several larger international transactions, partly in syndicates with other Icelandic banks and international banks.

Arion Bank's Corporate Finance works closely with Corporate Banking, providing customers with various financial advisory and capital raising services, including M&A and LBO services. Furthermore, Corporate Finance offers financial structuring advice, as well as various services on public offerings of securities.

Retail Banking

Retail Banking provides a comprehensive range of products and services, including mortgage loans, savings and current accounts, vehicle and equipment financing, factoring, payment cards, pension services, insurance and funds, to both individuals and SMEs. Retail Banking has a strong focus on digital banking solutions, using the online bank and the Arion Bank app as key channels. Retail Banking operates out of several branches across Iceland with over 100,000 customers.

Treasury

Treasury is responsible for the Bank's liquidity, currency and interest rate management. Treasury is a market maker in Iceland in domestic securities and FX. Treasury is responsible for funds' transfer pricing and hedging and pricing of financial products. FX brokerage is part of the Treasury unit. Treasury also handles all debt issuance both in the domestic and foreign markets and maintaining the Banks credit ratings.

Vördur

The subsidiary Vördur is the fourth largest insurance company in Iceland, providing non-life and life insurance.

Subsidiaries

Subsidiaries include the subsidiaries Eignarhaldsfélagid Landey ehf., which holds the main part of investment property of the Group and the holding companies VISA Ísland ehf., BG12 slhf. and other smaller entities of the Group. The subsidiaries Valitor Holding, Stakksberg and Sólbjarg are classified as disposal groups held for sale in accordance with IFRS 5.

Supporting units

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

Other information

At the beginning of 2020 the proportion of deposits from corporate customers divided between Corporate & Investment Banking and Retail Banking changed. Deposits amounting to approx. ISK 50 billion were transferred from Retail Banking to Corporate & Investment Banking. At the same time direct income and expense from those deposits were transferred between divisions. As a result of these changes the figures are not fully comparable with those from 2019, mainly reflected in net interest income.

Notes to the Condensed Consolidated Interim Financial Statements

5. Operating segments, continued

1.1.-31.3.2020	Markets and Stefnir	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other sub-sidiaries	Supporting units and elimi-nations	Total
Net interest income (expense)	197	2,522	3,831	848	47	(174)	(18)	7,253
Net fee and commission income (exp.) .	1,035	837	1,247	96	(41)	(211)	113	3,076
Net insurance income	-	-	-	-	523	-	(22)	501
Net financial (loss) income	(136)	-	-	(1,411)	130	(594)	11	(2,000)
Share of profit (loss) of associates	1	-	-	-	-	-	(25)	(24)
Other operating income (loss)	3	(2)	119	-	2	8	40	170
Operating income / loss	1,100	3,357	5,197	(467)	661	(971)	99	8,976
Operating expenses	(474)	(385)	(1,493)	(185)	(636)	(75)	(2,959)	(6,207)
Allocated expenses	(468)	(618)	(1,473)	(211)	(12)	(1)	2,783	-
Bank levy	(8)	(107)	(158)	(58)	-	-	-	(331)
Net impairment	-	(1,645)	(1,903)	4	-	683	1	(2,860)
Earnings / loss before income tax	150	602	170	(917)	13	(364)	(76)	(422)
Net seg. rev. from ext. customers	743	4,897	7,190	(3,895)	589	(575)	27	8,976
Net seg. rev. from other segments	357	(1,540)	(1,993)	3,428	72	(396)	72	-
Operating income / loss	1,100	3,357	5,197	(467)	661	(971)	99	8,976
Depreciation and amortization	-	1	47	-	53	-	258	359
Total assets	77,452	329,384	474,471	480,872	26,993	51,792	(253,144)	1,187,820
Total liabilities	69,303	253,964	416,769	470,028	16,869	31,867	(254,859)	1,003,941
Allocated equity	8,149	75,420	57,702	10,844	10,124	19,925	1,715	183,879

1.1.-31.3.2019	Markets and Stefnir	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other sub-sidiaries	Supporting units and elimi-nations	Total
Net interest income	256	2,156	4,562	583	44	3	(170)	7,434
Net fee and commission income (exp.) .	1,054	498	1,092	(125)	(25)	(235)	(41)	2,218
Net insurance income	-	-	-	-	276	-	(23)	253
Net financial income (loss)	139	(222)	(26)	(34)	551	807	(449)	766
Share of profit of associates and net impairment	-	-	-	-	-	-	727	727
Other operating income (loss)	2	(4)	124	-	9	8	171	310
Operating income	1,451	2,428	5,752	424	855	583	215	11,708
Operating expenses	(518)	(448)	(1,811)	(68)	(579)	(17)	(3,421)	(6,862)
Allocated expenses	(430)	(956)	(1,536)	(284)	(6)	(1)	3,213	-
Bank levy	(46)	(201)	(339)	(320)	-	-	-	(906)
Net impairment	(5)	(1,032)	(43)	(1)	-	-	-	(1,081)
Earnings / loss before income tax	452	(209)	2,023	(249)	270	565	7	2,859
Net seg. rev. from ext. customers	648	5,103	8,575	(4,307)	787	838	64	11,708
Net seg. rev. from other segments	803	(2,675)	(2,823)	4,731	68	(255)	151	-
Operating income	1,451	2,428	5,752	424	855	583	215	11,708
Depreciation and amortization	-	1	44	-	49	1	251	346
Total assets	80,573	335,209	551,654	580,470	25,655	61,984	(412,850)	1,222,695
Total liabilities	73,122	264,102	489,652	569,151	16,869	34,619	(417,874)	1,029,641
Allocated equity	7,451	71,107	62,002	11,319	8,786	27,365	5,024	193,054

Comparative amounts for the first quarter of 2019 have been restated based on the organizational structure changes made at the end of September 2019.

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Consolidated Interim Income Statement

6. Net interest income

1.1.-31.3.2020	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	774	-	-	774
Loans	10,690	-	-	10,690
Securities	-	360	190	550
Other	30	-	-	30
Interest income	11,494	360	190	12,044
Interest expense				
Deposits	(2,011)	-	-	(2,011)
Borrowings	(2,443)	-	-	(2,443)
Subordinated liabilities	(313)	-	-	(313)
Other	(24)	-	-	(24)
Interest expense	(4,791)	-	-	(4,791)
Net interest income	6,703	360	190	7,253

1.1.-31.3.2019				
Interest income				
Cash and balances with Central Bank	969	-	-	969
Loans	13,428	-	-	13,428
Securities	-	108	129	237
Other	50	-	-	50
Interest income	14,447	108	129	14,684
Interest expense				
Deposits	(3,252)	-	-	(3,252)
Borrowings	(3,927)	-	-	(3,927)
Subordinated liabilities	(47)	-	-	(47)
Other	(24)	-	-	(24)
Interest expense	(7,250)	-	-	(7,250)
Net interest income	7,197	108	129	7,434

Interest spread	2020 1.1.-31.3.	2019 1.1.-31.3.
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	2.8%	2.7%

7. Net fee and commission income

	1.1.-31.3.2020			1.1.-31.3.2019		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	1,015	(115)	900	893	(135)	758
Capital markets and corporate finance	413	(9)	404	354	(14)	340
Lending and financial guarantees	1,028	-	1,028	469	-	469
Collection and payment services	332	(28)	304	372	(27)	345
Cards and payment solution	536	(93)	443	378	(78)	300
Other	157	(160)	(3)	164	(158)	6
Net fee and commission income	3,481	(405)	3,076	2,630	(412)	2,218

Amounts are in ISK millions

7. Net fee and commission income, continued

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

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

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

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

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

Other fee and commission income is mainly fees relating to FX transactions at branches and in ATMs, custody and market making on the Icelandic stock exchange.

8. Net insurance income

	2020 1.1.-31.3.	2019 1.1.-31.3.
Earned premiums, net of reinsurers' share		
Premiums written	4,003	3,801
Premiums written, reinsurers' shares	(108)	(94)
Change in provision for unearned premiums	(1,047)	(1,066)
Earned premiums, net of reinsurers' share	2,848	2,641
Claims incurred, net of reinsurers' share		
Claims paid	(2,005)	(1,849)
Claims paid, reinsurers' share	15	31
Change in provision for claims	(399)	(530)
Changes in provision for claims, reinsurers' share	42	(40)
Claims incurred, net of reinsurers' share	(2,347)	(2,388)
Net insurance income	501	253

9. Net financial (loss) income

	2020	2019
Net (loss) gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	(1,673)	1,048
Net loss on fair value hedge of interest rate swap	(166)	(15)
Realized (loss) gain on financial assets carried at fair value through OCI	(5)	42
Net foreign exchange loss	(156)	(309)
Net financial (loss) income	(2,000)	766
Net (loss) gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss		
Equity instruments	(2,406)	906
Debt instruments	472	245
Derivatives	261	(39)
Loans	-	(64)
Net (loss) gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	(1,673)	1,048
Net loss on fair value hedge of interest rate swap		
Fair value change of interest rate swaps designated as hedging instruments	540	397
Fair value change on bonds issued by the Group attributable to interest rate risk	(706)	(412)
Net loss on fair value hedge of interest rate swap	(166)	(15)

Amounts are in ISK millions

10. Other operating income

	2020 1.1.-31.3.	2019 1.1.-31.3.
Net gain on assets held for sale	116	113
Other income	54	197
Other operating income	170	310

Net gain on assets held for sale

Income from real estates and other assets	133	137
Expense related to real estates and other assets	(17)	(24)
Net gain on assets held for sale	116	113

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

11. Personnel and salaries

Number of employees	2020 1.1.-31.3.	2019 1.1.-31.3.
Average number of full-time equivalent positions during the period	809	910
Full-time equivalent positions at the end of the period	814	917

Number of employees at the parent company

Average number of full-time equivalent positions during the period	681	803
Full-time equivalent positions at the end of the period	687	811

Salaries and related expenses

Salaries	2,542	2,881
Defined contribution pension plans	376	414
Salary-related expenses	363	414
Capitalization of salaries due to implementation of core systems	(151)	(79)
Salaries and related expenses	3,130	3,630

Salaries and related expenses for the parent company

Salaries	2,105	2,507
Defined contribution pension plans	311	360
Salary-related expenses	303	362
Capitalization of salaries due to implementation of core systems	(151)	(79)
Salaries and related expenses for the parent company	2,568	3,150

In June 2018 Arion Bank adopted a share-based remuneration programme, when a limited stock grant was offered to all employees of the parent company, excluding internal control units, in connection with the IPO and listing of the Bank. Remuneration was paid in the form of deferred shares with a vesting period of two years. The Bank recognizes expenses related to the programme as salaries and related expenses, a total of ISK 651 million, over the vesting period, or approximately ISK 27 million per month from June 2018 to May 2020.

During the period the Group made a provision of ISK 17 million (Q1 2019: ISK 16 million) for performance plan payments, including salary-related expenses, for which the Bank made no provision (Q1 2019: nil). Forty percent of the payment is deferred for three years in accordance with FSA rules on remuneration policies for financial undertakings. At the end of the period the Group's accrual for performance plan payments amounted to ISK 275 million (Q1 2019: ISK 521 million), of which the Bank's accrual amounts to ISK 146 million (Q1 2019: ISK 394 million).

12. Other operating expenses

	2020 1.1.-31.3.	2019 1.1.-31.3.
IT expenses	1,165	1,156
Professional services	302	293
Housing expenses	273	275
Other administration expenses	787	930
Depositors' and Investors' Guarantee Fund	191	232
Depreciation of property and equipment	130	142
Depreciation of right of use asset	34	32
Amortization of intangible assets	195	172
Other operating expenses	3,077	3,232

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

13. Bank levy

The Bank levy is 0.145% (2019: 0.376%) on total debts excluding tax liabilities, in excess of ISK 50 billion. The tax is assessed on Financial Undertakings but non-financial subsidiaries are exempt from this tax.

14. Net impairment

	2020	2019
Net impairment on financial instruments	1.1.-31.3.	1.1.-31.3.
Net change in impairment of loans to credit institutions	(36)	(4)
Net change in impairment of loans to corporates	(1,738)	186
Net change in impairment of loans to individuals	(765)	(27)
Write offs on loans and receivables to corporates	(266)	(395)
Write offs on loans and receivables to individuals	(124)	(363)
Payments on loans and receivables previously written off from corporates	2	-
Payments on loans and receivables previously written off from individuals	20	33
Net change in impairment of financial instruments at FVOCI	(3)	(1)
Net change in impairment of loan commitments, guarantees and unused credit facilities	(134)	(854)
Net impairment on financial instruments	(3,044)	(1,425)
Other value changes of loans		
Increase in book value of loans to corporates	22	46
Increase in book value of loans to individuals	162	298
Other value changes of loans	184	344
Net impairment	(2,860)	(1,081)

Increase in book value of loans to individuals and corporates is mainly due to release of discount from loans acquired with discount during the years 2008 to 2013, both due to impairments and other discount rate than reflected in the interest rates of the loans. The discount release was primarily related to loans that were paid up or sold during the period.

15. Income tax expense

	2020	2019
	1.1.-31.3.	1.1.-31.3.
Current tax expense	844	664
Deferred tax expense	16	(42)
Income tax expense	860	622

Reconciliation of effective tax rate	2020		2019	
	1.1.-31.3.		1.1.-31.3.	
Earnings before tax		(422)		2,859
Income tax using the Icelandic corporate tax rate	20.0%	(84)	20.0%	572
Additional 6% tax on Financial Undertakings	(38.9%)	164	5.0%	142
Non-deductible expenses	(0.2%)	1	0.0%	1
Tax exempt revenues (loss)	(143.6%)	606	(10.6%)	(304)
Non-deductible taxes	(15.6%)	66	6.3%	181
Tax incentives not recognized in the Income Statement	(25.1%)	106	0.7%	21
Other changes	(0.2%)	1	0.3%	9
Effective tax rate	(203.8%)	860	21.8%	622

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

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

Bank levy of 0.145% on liabilities exceeding ISK 50 billion is non-deductible.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

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

	2020 1.1.-31.3.	2019 1.1.-31.3.
Net loss from discontinued operations held for sale	(889)	(1,506)
Income tax expense	-	287
Discontinued operations held for sale, net of income tax	(889)	(1,219)
Valitor Holding hf.	(900)	(1,219)
Stakksberg ehf.	413	-
Sólbjarg ehf.	(402)	-
Discontinued operations held for sale, net of income tax	(889)	(1,219)

Valitor reported an operating loss of ISK 1,193 million for the first three months of 2020 whereas Valitor's negative contribution to the Group, after taking into account the Group's eliminations, was ISK 900 million. Operating income of Valitor was ISK 1,389 million for the first three months of 2020, or ISK 1,682 million, after taking into account the Group's eliminations. In the same period in 2019 the operation of Valitor was greatly affected by the ISK 1,200 million Valitor paid to Sunshine Press Production and Datacell in damages. When Arion Bank acquired a 38.62% shareholding in Valitor in 2014, the Bank signed an agreement with the seller (Landsbankinn) which stipulated that the seller would bear a part of the liability which Valitor might potentially be subject to in relation to the compensatory damages. Hence, Landsbankinn was liable to pay part of the damages. The total effect of the damages was ISK 595 million, net of tax. The operating loss of Valitor for the first three months of 2019 was ISK 1,799 million, whereas Valitor's negative contribution to the Group, after taking into account the Group's eliminations, was ISK 1,219 million.

Operating effects of Stakksberg and Sólbjarg are due to fair value changes of underlying assets.

For further information about Valitor Holding hf., Stakksberg ehf. and Sólbjarg ehf. see Note 28.

17. Earnings / loss per share

	Continued operations		Discontinued operations		Net Earnings	
	2020 1.1.-31.3.	2019 1.1.-31.3.	2020 1.1.-31.3.	2019 1.1.-31.3.	2020 1.1.-31.3.	2019 1.1.-31.3.
Net earnings/loss attributable to the shareholders of Arion Bank	(1,278)	2,237	(889)	(1,219)	(2,167)	1,018
Weighted average number of outstanding shares	1,735	1,814	1,735	1,814	1,735	1,814
Basic earnings / loss per share	(0.74)	1.23	(0.51)	(0.67)	(1.25)	0.56

There were no instruments at the end of the period that could potentially dilute basic earnings per share (2019: none).

Amounts are in ISK millions

Notes to the Consolidated Interim Statement of Financial Position

18. Cash and balances with Central Bank

	31.3.2020	31.12.2019
Cash on hand	4,374	4,206
Cash with Central Bank	108,748	81,543
Mandatory reserve deposit with Central Bank	5,052	9,968
Cash and balances with Central Bank	118,174	95,717

The mandatory reserve deposit with the Central Bank is not available for the Group to use in its daily operations. Minimum reserve requirements of the Central Bank falls into two categories: a fixed reserve requirement and an average maintenance requirement. The fixed reserve requirement is 1%. In March 2020 the Central Bank decided to lower the average reserve requirement from 1% to 0%.

19. Loans to credit institutions

	31.3.2020	31.12.2019
Bank accounts	29,990	16,437
Other loans	3,807	1,510
Loans to credit institutions	33,797	17,947

20. Loans to customers

	Individuals		Corporates		Total	
31.3.2020	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
Overdrafts	15,465	14,416	17,611	16,476	33,076	30,892
Credit cards	10,805	10,469	1,065	991	11,870	11,460
Mortgage loans	317,882	317,333	23,178	22,902	341,060	340,235
Other loans	33,412	31,787	371,639	364,449	405,051	396,236
Loans to customers	377,564	374,005	413,493	404,818	791,057	778,823
31.12.2019						
Overdrafts	14,421	13,720	18,709	17,780	33,130	31,500
Credit cards	13,028	12,786	1,373	1,281	14,401	14,067
Mortgage loans	310,562	310,195	23,475	23,211	334,037	333,406
Other loans	33,105	31,868	368,453	363,114	401,558	394,982
Loans to customers	371,116	368,569	412,010	405,386	783,126	773,955

The total book value of pledged loans that were pledged against amounts borrowed was ISK 175 billion at the end of the period (31.12.2019: ISK 182 billion). Pledged loans comprised mortgage loans to individuals.

Further analysis of loans is provided in Risk management disclosures.

21. Financial instruments

	31.3.2020	31.12.2019
Bonds and debt instruments	130,961	65,874
Shares and equity instruments with variable income	20,878	21,600
Derivatives	9,935	6,617
Securities used for economic hedging	30,282	23,315
Financial instruments	192,056	117,406

Amounts are in ISK millions

22. Financial assets and financial liabilities

31.3.2020	Amortized cost	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	118,174	-	-	118,174
Loans to credit institutions	33,797	-	-	33,797
Loans to customers	778,823	-	-	778,823
Loans	930,794	-	-	930,794
Bonds and debt instruments				
Listed	-	111,086	17,229	128,315
Unlisted	-	1,626	1,020	2,646
Bonds and debt instruments	-	112,712	18,249	130,961
Shares and equity instruments with variable income				
Listed	-	-	10,216	10,216
Unlisted	-	-	6,219	6,219
Bond funds with variable income, unlisted	-	-	4,443	4,443
Shares and equity instruments with variable income	-	-	20,878	20,878
Derivatives				
OTC derivatives	-	-	7,482	7,482
Derivatives used for hedge accounting	-	-	2,453	2,453
Derivatives	-	-	9,935	9,935
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	22,231	22,231
Shares and equity instruments with variable income, listed	-	-	8,051	8,051
Securities used for economic hedging	-	-	30,282	30,282
Other financial assets				
Accounts receivable	4,321	-	-	4,321
Other financial assets	7,711	-	-	7,711
Other financial assets	12,032	-	-	12,032
Financial assets	942,826	112,712	79,344	1,134,882
Financial liabilities				
Due to credit institutions and Central Bank	8,323	-	-	8,323
Deposits	539,312	-	-	539,312
Borrowings	322,470	-	-	322,470
Subordinated liabilities	35,837	-	-	35,837
Short position in bonds	-	-	960	960
Short position in equity	-	-	15	15
Derivatives	-	-	3,712	3,712
Other financial liabilities	39,949	-	-	39,949
Financial liabilities	945,891	-	4,687	950,578

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

22. Financial assets and financial liabilities, continued

31.12.2019	Amortized cost	Fair value through OCI	Mandatorily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	95,717	-	-	95,717
Loans to credit institutions	17,947	-	-	17,947
Loans to customers	773,955	-	-	773,955
Loans	887,619	-	-	887,619
Bonds and debt instruments				
Listed	-	47,698	16,479	64,177
Unlisted	-	1,196	501	1,697
Bonds and debt instruments	-	48,894	16,980	65,874
Shares and equity instruments with variable income				
Listed	-	-	9,632	9,632
Unlisted	-	-	7,417	7,417
Bond funds with variable income, unlisted	-	-	4,551	4,551
Shares and equity instruments with variable income	-	-	21,600	21,600
Derivatives				
OTC derivatives	-	-	5,001	5,001
Derivatives used for hedge accounting	-	-	1,616	1,616
Derivatives	-	-	6,617	6,617
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	10,852	10,852
Shares and equity instruments with variable income, listed	-	-	12,459	12,459
Shares and equity instruments with variable income, unlisted	-	-	4	4
Securities used for economic hedging	-	-	23,315	23,315
Other financial assets				
Accounts receivable	3,617	-	-	3,617
Other financial assets	5,058	-	-	5,058
Other financial assets	8,675	-	-	8,675
Financial assets	896,294	48,894	68,512	1,013,700
Financial liabilities				
Due to credit institutions and Central Bank	5,984	-	-	5,984
Deposits	492,916	-	-	492,916
Borrowings	304,745	-	-	304,745
Subordinated liabilities	20,083	-	-	20,083
Short position in bonds	-	-	385	385
Short position in equity, used for economic hedging	-	-	107	107
Short position in equity	-	-	24	24
Derivatives	-	-	2,054	2,054
Other financial liabilities	6,408	-	-	6,408
Financial liabilities	830,136	-	2,570	832,706

Amounts are in ISK millions

22. Financial assets and financial liabilities, continued

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

31.3.2020	FVOCI	Mandatorily FVPL	Total
Financial and insurance activities	433	6,244	6,677
Public sector	103,793	6,148	109,941
Corporates	8,486	5,857	14,343
Bonds and debt instruments at fair value	112,712	18,249	130,961
31.12.2019			
Financial and insurance activities	417	5,613	6,030
Public sector	41,417	7,259	48,676
Corporates	7,060	4,108	11,168
Bonds and debt instruments at fair value	48,894	16,980	65,874

The total amount of pledged bonds was ISK 6.3 billion at the end of the period (31.12.2019: ISK 6.0 billion). Pledged bonds comprised Icelandic Government Bonds and Financial Institutions Bonds that were pledged against funding received and included in Due to credit institutions and Central Bank as well as short positions included in Financial liabilities at fair value.

23. Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of assets and liabilities by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
Level 2: valuation techniques for which all significant inputs are market observable, either directly or indirectly; and
Level 3: valuation techniques which include significant inputs that are not based on observable market data.

For assets and liabilities that are recognized at fair value on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Assets and liabilities recorded at fair value by level of the fair value hierarchy

31.3.2020

Assets at fair value	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	120,630	9,749	582	130,961
Shares and equity instruments with variable income	5,740	13,581	1,557	20,878
Derivatives	-	7,482	-	7,482
Derivatives used for hedge accounting	-	2,453	-	2,453
Securities used for economic hedging	30,282	-	-	30,282
Investment property	-	-	7,129	7,129
Assets at fair value	156,652	33,265	9,268	199,185
Liabilities at fair value				
Short position in bonds	960	-	-	960
Short position in equity	15	-	-	15
Derivatives	-	3,712	-	3,712
Liabilities at fair value	975	3,712	-	4,687

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

23. Fair value hierarchy, continued

31.12.2019

Assets at fair value	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	57,196	8,650	28	65,874
Shares and equity instruments with variable income	5,169	14,876	1,555	21,600
Derivatives	-	5,001	-	5,001
Derivatives used for hedge accounting	-	1,616	-	1,616
Securities used for economic hedging	22,819	496	-	23,315
Investment property	-	-	7,120	7,120
Assets at fair value	85,184	30,639	8,703	124,526
Liabilities at fair value				
Short position in bonds	385	-	-	385
Short position in equity	24	-	-	24
Short position in equity, used for economic hedging	107	-	-	107
Derivatives	-	2,054	-	2,054
Liabilities at fair value	516	2,054	-	2,570

Transfers from Level 2 to Level 1 amounted to ISK 82 million at the end of the period (31.12.2019: Transfers from Level 1 to Level 2 amounted to ISK 20 million).

Fair value of assets and liabilities

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

Methods for establishing fair value

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

In some cases, the carrying value of an asset in Note 22 is used as an approximation for the fair value of the asset. This is straight forward for cash and cash equivalents but is also used for short term investments and borrowings to highly rated counterparties, such as credit institutions, on contracts that feature interest close to or equal to market rates and expose the Group to little or no credit risk.

Level 1: Fair value established from quoted market prices

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

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

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

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

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

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

Amounts are in ISK millions

23. Fair value hierarchy, continued

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

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

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

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

Movements in Level 3 assets measured at fair value

	Investment	Financial assets		
31.3.2020	property	Bonds	Shares	Total
Balance at the beginning of the year	7,119	28	1,555	8,702
Net fair value changes	-	3	(15)	(12)
Additions	10	551	17	578
Balance at the end of the period	7,129	582	1,557	9,268
31.12.2019				
Balance at the beginning of the year	7,092	42	1,329	8,463
Net fair value changes	-	20	62	82
Additions	30	5	281	316
Disposal	(3)	(27)	(117)	(147)
Transfers out of Level 3	-	(12)	-	(12)
Balance at the end of the period	7,119	28	1,555	8,702

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

	Financial assets		
1.1.-31.3.2020	Bonds	Shares	Total
Net financial income (loss)	3	(15)	(12)
Effects recognized in the Income Statement	3	(15)	(12)
1.1.-31.3.2019			
Net financial income (loss)	19	(55)	(36)
Effects recognized in the Income Statement	19	(55)	(36)

Amounts are in ISK millions

23. Fair value hierarchy, continued

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

31.3.2020 *Financial assets not carried at fair value*	Carrying value	Fair value	Unrealized gain (loss)
Cash and balances with Central Bank	118,174	118,174	-
Loans to credit institutions	33,797	33,797	-
Loans to customers	778,823	783,107	4,284
Other financial assets	12,032	12,032	-
Financial assets not carried at fair value	942,826	947,110	4,284
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	8,323	8,323	-
Deposits	539,312	539,312	-
Borrowings	322,470	331,441	(8,971)
Subordinated liabilities	35,837	31,562	4,275
Other financial liabilities	39,949	39,949	-
Financial liabilities not carried at fair value	945,891	950,587	(4,696)

31.12.2019 *Financial assets not carried at fair value*			
Cash and balances with Central Bank	95,717	95,717	-
Loans to credit institutions	17,947	17,947	-
Loans to customers	773,955	777,320	3,327
Other financial assets	8,675	8,675	-
Financial assets not carried at fair value	896,294	899,659	3,327
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	5,984	5,984	-
Deposits	492,916	492,916	-
Borrowings	304,745	316,589	(8,608)
Subordinated liabilities	20,083	20,177	78
Other financial liabilities	6,408	6,408	-
Financial liabilities not carried at fair value	830,136	842,074	(8,530)

Loans to customers largely bear variable interest rates. Those loans, including corporate loans, are presented at book value as they generally have a short duration and very limited interest rate risk. Loans with fixed interest rates, mainly long-term retail mortgages, are estimated by using the discount cash flow method with the interest rates offered on new loans, taking into account loan to value. Defaulted loans are presented at book value as no future cash flow is expected on them. Instead they are written down according to their estimated potential recovery value

Amounts are in ISK millions

23. Fair value hierarchy, continued

Derivatives

31.3.2020	Notional value	Fair value Assets	Liabilities
Forward exchange rate agreements	75,137	3,083	506
Fair value hedge of interest rate swap	145,807	2,453	-
Interest rate and exchange rate agreements	73,583	1,818	2,749
Bond swap agreements	21,404	36	337
Share swap agreements	10,699	2,544	114
Options - purchased agreements, unlisted	6	1	6
Derivatives	326,636	9,935	3,712
31.12.2019			
Forward exchange rate agreements	90,121	1,196	407
Fair value hedge of interest rate swap	114,337	1,616	-
Interest rate and exchange rate agreements	65,823	2,312	1,168
Bond swap agreements	9,936	46	48
Share swap agreements	12,710	1,447	431
Derivatives	292,927	6,617	2,054

Fair value hedge of interest rate swap

The Group applies fair value hedge accounting only with respect to interest rate swaps, whereby the Group pays floating rate interest and receives fixed rate interest, with identical cash flows to the borrowings. The interest rate swaps are hedging the exposure of changes in the fair value of certain fixed-rate euro bonds, see Note 31, arising from changes in interest rates. On 1 January 2018 the Group adopted IFRS 9, but has elected to continue to apply the hedge accounting principles under IAS 39. For further information about the Group's hedge accounting policy, see Note 57 in the Annual Financial Statements 2019.

31.3.2020	Notional	Maturity date	Fair value Assets	Liabilities	Gain (loss) on FV changes
Interest rates swaps - EUR	125,067	1-5 years	2,433	-	(65)
Interest rates swaps - EUR	6,526	0-3 months	20	-	(2)
Interest rates swaps - USD	14,215	>5 years	659	-	607
31.12.2019					
Interest rates swaps - EUR	108,667	1-5 years	1,608	-	457
Interest rates swaps - EUR	5,670	0-3 months	8	-	302

Hedged borrowings

31.3.2020	Book value	Accumulated fair value Assets	Liabilities	Gain (loss) on FV changes
EUR 500 million - issued 2016/18 - 5 years	78,329	118	-	(63)
EUR 300 million - issued 2017 - 3 years	6,515	37	-	(2)
EUR 300 million - issued 2018 - 3 years	47,521	-	843	27
USD 100 million - issued 2020 - Perpetual	14,783	-	668	(668)
Hedged borrowings	147,148	155	1,511	(706)
31.12.2019				
EUR 500 million - issued 2016/18 - 5 years	67,713	157	-	(410)
EUR 300 million - issued 2017 - 3 years	5,635	33	-	(199)
EUR 300 million - issued 2018 - 3 years	41,601	-	756	(295)
Hedged borrowings	114,949	190	756	(904)

The effectiveness of each hedge is measured regularly with linear regression. The relationship between fair value changes of an interest rate swap on the one hand and a borrowing on the other hand is examined. In all cases the effectiveness is within limits, or between 95-113%.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

24. Offsetting financial assets and financial liabilities

Financial assets subject to enforceable master netting arrangements and similar arrangements

	Assets subject to netting arrangements			Netting potential not recognized in the Balance Sheet				
31.3.2020	Gross assets before nettings	Nettings with gross liabilities	Assets recognized on Balance Sheet, net	Financial liabilities	Collateral received	Assets after consideration of netting potential	Assets not subject to enforceable netting arr-angements	Total assets recognized on Balance Sheet, net
Reverse repurchase agreements	7,647	(158)	7,489	(6,752)	-	737	-	7,489
Derivatives	4,965	-	4,965	(2,996)	-	1,969	4,970	9,935
Total assets	12,612	(158)	12,454	(9,748)	-	2,706	4,970	17,424
31.12.2019								
Reverse repurchase agreements	6,539	(44)	6,495	(5,921)	-	574	-	6,495
Derivatives	4,601	-	4,601	(713)	-	3,888	2,016	6,617
Total assets	11,140	(44)	11,096	(6,634)	-	4,462	2,016	13,112

Financial liabilities subject to enforceable master netting arrangements and similar arrangements

	Liabilities subject to netting arrangements			Netting potential not recognized in the Balance Sheet				
31.3.2020	Gross liabilities before nettings	Nettings with gross assets	Liabilities recognized on Balance Sheet, net	Financial assets	Collateral pledged	Liabilities after consideration of netting potential	Liabilities not subject to enforceable netting arr-angements	Total liabilities recognized on balance sheet
Repurchase agreements	6,910	(158)	6,752	(6,752)	-	-	-	6,752
Derivatives	3,185	-	3,185	(2,996)	-	189	527	3,712
Total liabilities	10,095	(158)	9,937	(9,748)	-	189	527	10,464
31.12.2019								
Repurchase agreements	5,965	(44)	5,921	(5,921)	-	-	-	5,921
Derivatives	761	-	761	(713)	-	48	1,293	2,054
Total liabilities	6,726	(44)	6,682	(6,634)	-	48	1,293	7,975

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

25. Investments in associates

	31.3.2020	31.12.2019
Carrying amount at the beginning of the year	852	818
Acquisitions	-	18
Disposals	-	(740)
Share of profit (loss) of associates and profit from sale	(24)	756
Investment in associates	828	852

The Group's interest in its principal associates

Audkenni hf., Borgartún 31, Reykjavík, Iceland	25.4%	25.4%
JCC ehf., Borgartún 19, Reykjavík, Iceland	33.3%	33.3%
Reiknistofa bankanna hf., Katrínartún 2, Reykjavík, Iceland	20.0%	20.0%
220 Fjördur ehf., Fjardargata 13-15, Hafnarfjördur, Iceland	37.4%	37.4%
SER eignarhaldsfélag ehf., Borgartún 19, Reykjavík	35.3%	35.3%

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

26. Intangible assets

Intangible assets comprise the following categories: Goodwill, which arises on business combinations; Infrastructure, Customer relationships and related agreements which are identified during the acquisition of subsidiaries and related to the activities of the businesses being acquired; and Software, which is acquired (i.e. software licenses) and expenses of implementation.

Infrastructure, which is capitalized as an intangible asset, is related to the asset management operation and branding of the insurance operation. The business activity is based on years of developing expertise and systems, during which a valuable platform has been created for future growth. An impairment test is performed annually.

Customer relationships and related agreements are connected to business relationships and agreements which the Bank acquired in subsidiaries. The asset is based on the assumption that business relationships and agreements generate regular payments and earnings to the relevant business segments. The lifetime of these agreements is based on the experience of the Group and the industry. As a result, these agreements are assessed as having an identified useful lifetime.

Acquired software and internally developed software is capitalized on the basis of the cost of acquiring and bringing the software into service. Expenditure on internally developed software is recognized as an asset when the Group is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits, and when it can reliably measure the costs to complete the development. The capitalized costs of internally developed software include external expenses directly attributable to developing the software and salary and salary related expenses of implementation of core systems. Capitalized costs of software are amortized over its useful life. Computer software licenses and internally developed software recognized as intangible assets are amortized over their useful life, which is estimated to be 3-10 years.

Policies applied to the Group's intangible assets	Goodwill and infrastructure	Customer relationship and related agreements	Software
Useful lives	Undefined	Finite 6-15 years and undefined	Finite 3-10 years
Amortization method	Impairment test	Straight-line basis over 6-15 years and impairment test	Straight-line basis over 3-10 years
Internally generated or acquired	Acquired	Acquired	Acquired and internally generated

31.3.2020	Goodwill	Infra-structure	Customer relationship and related agreements	Software	Total
Balance at the beginning of the year	669	2,383	727	4,588	8,367
Additions	-	-	-	503	503
Additions, capitalized salaries	-	-	-	151	151
Amortization	-	-	(15)	(180)	(195)
Intangible assets	669	2,383	712	5,062	8,826

31.12.2019	Goodwill	Infra-structure	Customer relationship and related agreements	Software	Total
Balance at the beginning of the year	669	2,383	787	2,558	6,397
Additions	-	-	-	2,291	2,291
Additions, capitalized salaries	-	-	-	459	459
Amortization	-	-	(60)	(720)	(780)
Intangible assets	669	2,383	727	4,588	8,367

Goodwill is recognized among assets in the operating segment Vördur, see Note 5.

27. Tax assets and tax liabilities

	31.3.2020		31.12.2019	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	3,130	-	3,461
Deferred tax	2	1,065	2	943
Tax assets and tax liabilities	2	4,195	2	4,404

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

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

Assets and disposal groups held for sale	31.3.2020	31.12.2019
Valitor Holding hf.	16,664	30,657
Stakksberg ehf.	3,161	2,711
Sólbjarg ehf.	6,942	8,676
Disposal groups held for sale	26,767	42,044
Real estate	1,233	1,553
Other assets	38	29
Assets and disposal groups held for sale	28,038	43,626

Liabilities associated with disposal groups held for sale		
Valitor Holding hf.	17,414	22,052
Sólbjarg ehf.	5,443	6,579
Liabilities associated with disposal groups held for sale	22,857	28,631

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

Valitor Holding hf.

Arion Bank's shareholding in the subsidiary Valitor Holding (Valitor) is 100%. The Bank is in the process of potentially divesting the Bank's shareholding in Valitor and appointed Citi as a sales advisor. The Bank is aiming for having completed the sale of Valitor within the next 12 months. In accordance with IFRS 5 Non-current assets and disposal groups held for sale, Valitor is classified as asset held for sale in these Consolidated Interim Financial Statements.

	31.3.2020	31.12.2019
Cash and balances with Central Bank	2	9,363
Loans to credit institutions	16,264	12,563
Loans to customers	1,981	2,061
Financial instruments	-	28
Investments in associates	66	66
Intangible assets	4,416	4,720
Tax assets	330	293
Other assets	3,102	2,986
Assets	26,161	32,080
Elimination within Arion Bank Group	(9,497)	(1,423)
Valitor's contribution to the Group	16,664	30,657
Due to credit institutions and Central Bank	3	2
Financial liabilities at fair value	-	26
Tax liabilities	58	321
Other liabilities	16,986	21,712
Borrowings	3,587	3,500
Liabilities	20,634	25,561
Elimination within Arion Bank Group	(3,220)	(3,509)
Valitor's contribution to the Group	17,414	22,052
Book value of Valitor	5,527	6,519

Sólbjarg ehf., a subsidiary of Eignabjarg ehf.

On 20 June 2019 Arion Bank acquired all shares in TravelCo hf. and its subsidiaries (hereafter "TravelCo") following an enforcement of pledges. Sólbjarg ehf is a holding company in the beneficial ownership of Arion Bank and is the holding company of the TravelCo group. TravelCo was established following the collapse of Primera Air ehf. and Primera Travel Group hf. for the purpose of owning and running tour operators in Scandinavia and Iceland. This enforcement primarily represented a change in ownership and does not affect the daily operations or services of the tour operators. Arion Bank's rationale for acquiring TravelCo was to safeguard continued operations as well as the Bank's interests. Arion Bank is in the process of divesting all of the Bank's shareholding in TravelCo and the company is therefore classified as held for sale in accordance with IFRS 5. In Q1 2020 Arion Bank completed the sale of Terra Nova Sól ehf., a subsidiary of Sólbjarg ehf., with other entities held for sale.

Amounts are in ISK millions

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

Stakksberg ehf., a subsidiary of Eignabjarg ehf.

On 22 January 2018 United Silicon was declared bankrupt following serious operational problems which resulted in its operating license being temporarily suspended, after a failed attempt at reaching a composition arrangement with its creditors. In February 2018 an agreement was reached between the administrator of the bankrupt estate of United Silicon and Arion Bank, whereby the Bank foreclosed against its collateral and acquired all the company's main assets. The assets of the silicon plant are currently managed by Stakksberg ehf., which is held by the Bank through the subsidiary Eignabjarg ehf. Stakksberg ehf. has, since the transfer of the assets from United Silicon, worked to reduce uncertainties surrounding the recommissioning of the silicon plant, with measures including the securing of all necessary operating permits, power supply and undertaking further engineering design groundwork necessary for the carrying out of remedial work prior to the reopening of the plant. Stakksberg ehf. is currently engaged in the final stages of concluding a new environmental impact assessment for the plant. The proposed remedial actions fully fit within the scope of the current local plan for Stakksberg's plot in Helguvík. Nevertheless Reykjanesbær will be required to amend the current local plan to reflect building licenses which have already been issued by Reykjanesbær. The Bank's objective is to divest Stakksberg ehf. on the basis of this preparatory work. Stakksberg is therefore classified as held for sale in accordance with IFRS 5.

29. Other assets

	31.3.2020	31.12.2019
Property and equipment	5,213	5,243
Right of use asset	863	902
Accounts receivable	4,321	3,617
Unsettled securities trading	5,464	3,178
Investment for life assurance policyholders where risk is held by policyholder	912	1,008
Sundry assets	3,374	2,916
Other assets	20,147	16,864

30. Other liabilities

	31.3.2020	31.12.2019
Accounts payable	647	654
Unsettled securities trading	32,969	365
Depositors' and Investors' Guarantee Fund	183	167
Technical provision	16,152	14,709
Technical provision for life assurance policyholders were investment risk is held by policyholder	912	1,008
Withholding tax	279	1,492
Bank levy	3,315	2,984
Accrued expenses	3,058	3,441
Prepaid income	1,534	1,573
Impairment of off-balance items	617	481
Lease liability	878	914
Sundry liabilities	5,716	4,909
Other liabilities	66,260	32,697

Technical provision	Technical provision	Reinsurers' share	Total 31.3.2020	Technical provision	Reinsurers' share	Total 31.12.2019
Claims reported and loss adjustment expenses	8,066	(264)	7,802	7,742	(221)	7,521
Claims incurred but not reported	1,501	(82)	1,419	1,426	(82)	1,344
Claims outstanding	9,567	(346)	9,221	9,168	(303)	8,865
Provision for unearned premiums	6,585	(5)	6,580	5,541	(4)	5,537
Own technical provision	16,152	(351)	15,801	14,709	(307)	14,402

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

Amounts are in ISK millions

31. Borrowings

Currency, original nominal value	First issued	Maturity	Maturity type	Terms of interest	31.3.2020	31.12.2019
ARION CBI 21, ISK 10,220 million	2014	2021	At maturity	Fixed, CPI linked, 3.50%	10,258	10,176
ARION CB 22, ISK 28,720 million	2015	2022	At maturity	Fixed, 6.50%	27,749	28,264
ARION CB 24 ISK 20,180 million	2019	2024	At maturity	Fixed, 6.00%	17,198	16,060
ARION CBI 25, ISK 37,940 million	2017	2025	At maturity	Fixed, CPI linked, 3.00%	40,632	40,213
ARION CBI 26 ISK 15,460 million	2019	2026	At maturity	Fixed, CPI linked, 2.00%	15,102	12,320
ARION CBI 29, ISK 25,220 million	2014	2029	At maturity	Fixed, CPI linked, 3.50%	27,990	27,689
ARION CBI 48, ISK 11,680 million	2018	2048	Amortizing	Fixed, CPI linked, 2.50%	10,478	10,647
Statutory covered bonds					149,407	145,369
NOK 800 million	2015	2020	At maturity	Floating, NIBOR +2.95%	11,037	11,143
NOK 320 million	2016	2020	At maturity	Floating, NIBOR +1.95%	4,396	4,439
EUR 300 million *	2017	2020	At maturity	Fixed, 0.75%	6,515	5,635
SEK 300 million	2017	2020	At maturity	Floating, 3 month STIBOR +1.35%	-	2,598
SEK 250 million	2017	2020	At maturity	Floating, 3 month STIBOR +0.75%	3,576	3,241
EUR 500 million *	2016	2021	At maturity	Fixed, 1.625%	78,329	67,713
EUR 13 million	2019	2021	At maturity	Floating, 3. EURIBOR +0.58%	2,033	1,765
NOK 750 million	2019	2022	At maturity	Floating, NIBOR +1.82%	10,285	10,382
SEK 150 million	2019	2022	At maturity	Floating, 3 month STIBOR +1.33%	2,152	1,949
NOK 250 million	2017	2023	At maturity	Fixed, 3.02%	3,505	3,512
EUR 300 million *	2018	2023	At maturity	Fixed, 1.00%	47,521	41,601
NOK 250 million	2017	2027	At maturity	Fixed, 3.40%	3,517	3,521
Senior unsecured bonds					172,866	157,499
Bills issued					-	1,680
Other borrowings					197	197
Other loans / bills					197	1,877
Borrowings					322,470	304,745

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

The book value of listed bonds was ISK 322 billion at the end of the period (31.12.2019: ISK 303 billion). The market value of those bonds was ISK 331 billion (31.12.2019: ISK 315 billion). The Group repurchased no own debts during the period (31.12.2019: ISK 39 billion).

32. Subordinated liabilities

Currency, original nominal value	Issued	Maturity	First Call date	Terms of interest	31.3.2020	31.12.2019
SEK 500 million	2018	2028	22 Nov '23	Floating, 3 month STIBOR +3.10% .	7,142	6,472
NOK 300 million	2019	2029	9 Jul '24	Floating, NIBOR +3.65%	4,143	4,183
SEK 225 million	2019	2029	20 Dec '24	Floating, 3 month STIBOR +3.70% .	3,221	2,918
ARION T2I 30 ISK 4.800 million	2019	2030	4 Jan '25	Fixed, CPI linked, 3.875%	4,880	4,913
ARION T2 30 ISK 880 million	2019	2030	4 Jan '25	Fixed, 6.75%	892	907
EUR 5 million	2019	2031	6 Mar '26	Fixed, 3.24%	776	690
Tier 2 subordinated liabilities					21,054	20,083
ARION AT1 USD 100 million	2020	Perpetual	26 Feb '25	Fixed, 6.250%	14,783	-
Additional Tier 1 subordinated liabilities					14,783	-
Subordinated liabilities					35,837	20,083

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

33. Pledged assets

Pledged assets against liabilities	31.3.2020	31.12.2019
Assets, pledged as collateral against borrowings	180,615	186,902
Assets, pledged as collateral against loans from credit institutions and short positions	6,301	6,023
Pledged assets against liabilities	186,916	192,925

The Group has pledged assets against borrowings, both issued covered bonds and other issued bonds and loan agreements. The total value of those pledged assets was ISK 181 billion at the end of the period (31.12.2019: ISK 187 billion). Pledged loans comprised mortgage loans to individuals. The book value of those borrowings was ISK 149 billion at the end of the period (31.12.2019: ISK 145 billion).

The Group has pledged bonds against short term lending from the Central Bank of Iceland and against short positions, related to swap agreements, to hedge market risk of those assets.

34. Equity

Share capital and share premium

According to the Bank's Articles of Association, total share capital amounts to ISK 1,814 million, with par value of ISK 1 per share. The holders of ordinary shares are entitled to receive dividends as approved by the general meeting and are entitled to one vote per share at shareholders' meetings.

	Share capital	Share premium	31.3.2020	Share capital	Share premium	31.12.2019 2018
Shares outstanding at the beginning of the year	1,773	53,942	55,715	1,814	57,196	59,010
Purchase of treasury stock	(54)	(4,326)	(4,380)	(41)	(3,242)	(3,283)
Employees stock grant	-	(1)	(1)	-	(12)	(12)
Shares outstanding at the end of the period	1,719	49,615	51,334	1,773	53,942	55,715
Own shares at period-end	96			41		
- as proportion of issued share capital	5.3%			2.3%		

In 2019 the Board of Directors authorized the Bank to initiate a share buy-back program in Iceland and Sweden (the Program) to purchase own shares, which is in line with the authorization granted by the AGM on 20 March 2019. The purpose of the Program is to reduce the Bank's share capital (in line with the Bank's dividend policy). When the Program was initiated on 31 October 2020, the Bank was authorized to purchase up to 59 million own shares in total under the Program, corresponding to 3.25% of the issued share capital, or for up to ISK 4.5 billion at market value. In January 2020 the FSA approved the buy-back of an additional 41 million own shares or for up to ISK 3.5 billion at market value, bringing the total amount of the share Program to 100 million shares or ISK 8.0 billion at market value. The Program continued until the AGM in March 2020. The AGM on 17 March 2020 approved the cancellation of 84 million of the Bank's own shares, totalling ISK 84 million at nominal value.

According to a decision made by the Board of Directors, own shares were allocated to employees in connection with the Bank's IPO and listing in 2018. In total approximately 4 million shares were allocated to employees at ISK 75 per share, a total of ISK 295 million. In accordance with the employees' stock grant programme, an employee who resigns within the vesting period of two years, returns the shares to the Bank.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Other information

35. Shareholders of Arion Bank

	31.3.2020	31.12.2019
Taconic Capital (through TCA New Sidecar s.á.r.l.)	23.53%	23.53%
Sculptor Capital Management	9.53%	9.53%
Gildi lífeyrissjódur	9.14%	8.79%
Arion banki hf.	5.28%	2.27%
Lífeyrissjódur verzlunarmanna	5.10%	3.67%
Lífeyrissjódur starfsmanna ríkisins	4.99%	3.47%
Stodir hf.	4.73%	4.96%
Goldman Sachs International	3.16%	3.72%
Eaton Vance funds	2.89%	3.23%
Frjálsi lífeyrissjódurinn	2.30%	2.18%
Stapi lífeyrissjódur	2.30%	1.89%
Lansdowne partners	2.02%	5.02%
Birta lífeyrissjódur	1.68%	1.32%
Stefnir rekstrarfélag hf.	1.56%	2.46%
Hvalur hf.	1.45%	1.45%
MainFirst Bank AG	1.09%	1.09%
Íslandsbanki hf.	0.84%	1.00%
Júpíter rekstrarfélag hf.	0.77%	1.10%
Artemis	0.00%	0.41%
Other shareholders with less than 1% shareholding	17.64%	18.92%
	100.0%	100.0%

36. Legal matters

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

Contingent liabilities

Legal proceedings regarding damages

The former chairman of the Board of BM Vallá hf., together with Lindarflöt ehf., has filed two cases against the Bank with a claim for damages in the amount of more than ISK 4 billion, plus interest. The plaintiffs maintain that the Bank caused them, as shareholders of BM Vallá hf. and Fasteignafélagid Ártún ehf., damage by not allowing the companies to be financially restructured and thereby forcing the companies into bankruptcy. In April 2018 the District Court of Reykjavík dismissed one of the cases. The plaintiffs appealed the judgment to the Court of Appeal. In June 2018 the Court of Appeal annulled the judgment of the District Court and ordered the District Court to hear the case again. The District Court acquitted the Bank of all claims with a judgment in September 2018. The plaintiffs appealed the judgment to the Court of Appeal. In December 2019 the Court of Appeal confirmed the District Court's judgment. An appeal to the Supreme Court has been rejected by the Court. The second case was on hold awaiting the result of this first case. The Bank believes the result will be the same in both cases and that it will be acquitted of the plaintiffs' claims, as in the first case. No provision has therefore been made.

In a lawsuit brought in June 2013, Kortathjónustan hf. claimed damages from Arion Bank hf., Íslandsbanki hf., Landsbankinn hf., Borgun hf. and the Bank's subsidiary Valitor hf. in the amount of ISK 1.2 billion plus interest, as a result of damage Kortathjónustan hf. contended the five parties caused the company due to violations of the Competition Act. In June 2017 the Supreme Court dismissed the case on procedural grounds. Kortathjónustan hf. brought a new lawsuit in September 2017 regarding the same matter of dispute, claiming damages in the amount of ISK 922 million plus interest from the same defendants. The Court of Appeal dismissed the case in May 2018. Kortathjónustan tried to appeal the dismissal to the Supreme Court but the court dismissed the case as there was no right of complaint. In November 2018 EC-Clear brought a new lawsuit against the same defendants regarding the same matter of dispute, demanding the acknowledgement of liability for damages. EC-Clear was the largest shareholder in Kortathjónustan and according to the writ EC-Clear is now the owner of alleged liability claims against the defendants. The District Court dismissed the case in February 2019. EC-Clear appealed the dismissal to the Court of Appeal, which dismissed the case with a ruling in April 2019. In October 2019 EC-Clear brought a new lawsuit against the same defendants regarding the same matter of dispute, claiming damages in the amount of ISK 922 million plus interest from the same defendants, and demanding the acknowledgement of liability for damages. In December 2019 the case was dismissed as EC-Clear did not provide any insurance for legal expenses. In April 2020 EC-Clear has once again brought the same matter of dispute against the same defendants to the District Court. Should the defendants be found liable for damages, they would be jointly responsible. Therefore the Bank has not made any provision.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

37. Events after the reporting period

On 4 May 2020 Valitor Group announced that it had signed an agreement to sell the operations of Valitor in Denmark, Valitor A/S. The Valitor Group is classified as an asset held for sale in these Consolidated Interim Financial Statements and thus the sale will have no effect on net earnings from continuing operations of the Arion Bank Group. The operation of Valitor A/S contributed a net loss for the years 2018 and 2019. The sale will have a minor effect on the total assets of the Group. The commercial terms of the sale are confidential but the Group is currently estimating the financial effects of the sale of the entity.

Off balance sheet information

38. Commitments

Financial guarantees, unused credit facilities and undrawn loan commitments	31.3.2020	31.12.2019
Financial guarantees	16,544	15,097
Unused overdrafts	47,418	44,923
Undrawn loan commitments	54,982	54,101
Financial guarantees, unused credit facilities and undrawn loan commitments	118,944	114,121

39. Assets under management and under custody

Assets under management	998,977	1,013,101
Assets under custody	1,444,998	1,370,946

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

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

Related party

40. Related party

The Group has a related party relationship with an entity with an influence over the Group as the largest shareholder of Arion Bank, which is at the end of the period Taconic Capital (23.53%).

The Board of Directors of Arion Bank, key management personnel of the Bank and the Group's associates are defined as related parties, as are close family members of the individuals referred to above and legal entities controlled by them.

Transactions with related parties have been conducted on an arm's length basis. There have been no further guarantees provided or received for related party receivables or payables.

Balances with related parties

31.3.2020	Assets	Liabilities	Net balance
Board of Directors and key Management personnel	125	(403)	(278)
Associates and other related parties	-	(171)	(171)
Balances with related parties	125	(574)	(449)

31.12.2019			
Board of Directors and key Management personnel	184	(252)	(68)
Associates and other related parties	-	(59)	(59)
Balances with related parties	184	(311)	(127)

Amounts are in ISK millions

Risk management disclosures

The Group faces unprecedented levels of risk arising from the impact of the Covid-19 pandemic on the operations the Group and its customers. Managing risk is therefore a core activity within the Group. The key to effective risk management is a process of on-going identification of significant risk, quantification of risk exposure, actions to limit risk and constant monitoring of risk. This process of risk management and the ability to evaluate, manage and correctly price the risk encountered is critical to the Group's continuing profitability as well as to be able to ensure that the Group's exposure to risk remains within acceptable levels.

Further information on risk management and capital adequacy is provided in the Annual Financial Statements for 2019 and in the Pillar 3 Risk Disclosures for 2019. The Pillar 3 Risk Disclosures 2019 are available on the Bank's website, www.arionbanki.is.

41. Credit risk

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

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

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

The Group grants credit based on well informed lending decisions and seeks business with strong parties with strong collaterals and good repayment capacity. The risk level of each credit is considered in the pricing.

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

Exposure to credit risk

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

- Retail loans to individuals: Mortgages on residential properties.
- Corporate loans: Real estate, fishing vessels and other fixed and current assets, including inventory and trade receivables, cash and securities.
- Derivative exposures: Cash, treasury notes and bills, asset backed bonds, listed equity and funds that consist of eligible securities.

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

Collateral value is monitored and additional collateral requested in accordance with the underlying agreement. Collateral value is reviewed in line with the adequacy of the allowance for impairment losses. Collateral values are capped by the related exposure amount.

41. Credit risk, continued

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

31.3.2020	Maximum exposure	Collateral: Cash and securities	Real estate	Fishing vessels	Other collateral	Total collateral
Cash and balances with Central Bank	118,174	-	-	-	-	-
Loans to credit institutions	33,797	-	-	-	-	-
Loans to customers at amortized cost	778,823	21,505	543,290	52,590	89,986	707,371
Individuals	*374,005*	*57*	*334,541*	*7*	*11,594*	*346,199*
Corporates	*404,818*	*21,448*	*208,749*	*52,583*	*78,392*	*361,172*
Real estate activities and construction	*127,820*	*1,521*	*114,068*	*55*	*8,727*	*124,371*
Fishing industry	*86,167*	*49*	*12,100*	*52,097*	*19,225*	*83,471*
Information and communication technology	*18,615*	*92*	*3,844*	*-*	*4,017*	*7,953*
Wholesale and retail trade	*60,006*	*90*	*34,065*	*8*	*20,159*	*54,322*
Financial and insurance activities	*37,125*	*19,624*	*7,992*	*-*	*8,535*	*36,151*
Industry, energy and manufacturing	*31,664*	*34*	*17,755*	*-*	*8,138*	*25,927*
Transportation	*12,126*	*-*	*885*	*314*	*3,620*	*4,819*
Services	*17,042*	*34*	*9,051*	*109*	*5,333*	*14,527*
Public sector	*6,583*	*4*	*2,167*	*-*	*223*	*2,394*
Agriculture and forestry	*7,670*	*-*	*6,822*	*-*	*415*	*7,237*
Other assets with credit risk	12,032	-	-	-	-	-
Financial guarantees	16,544	2,288	6,660	1,450	3,537	13,935
Undrawn loan commitments and unused overdrafts	102,400	-	-	-	-	-
Fair value through OCI	112,712	-	-	-	-	-
Government bonds	*103,793*	*-*	*-*	*-*	*-*	*-*
Corporate and finance bonds	*8,919*	*-*	*-*	*-*	*-*	*-*
Balance at the end of the period	1,174,482	23,793	549,950	54,040	93,523	721,306

31.12.2019	Maximum exposure	Collateral: Cash and securities	Real estate	Fishing vessels	Other collateral	Total collateral
Cash and balances with Central Bank	95,717	-	-	-	-	-
Loans to credit institutions	17,947	-	-	-	-	-
Loans to customers at amortized cost	773,955	20,792	544,723	54,601	73,091	693,207
Individuals	*368,569*	*198*	*328,243*	*13*	*10,996*	*339,450*
Corporates	*405,386*	*20,594*	*216,480*	*54,588*	*62,095*	*353,757*
Real estate activities and construction	*129,856*	*1,972*	*113,465*	*55*	*8,022*	*123,514*
Fishing industry	*82,941*	*17*	*12,365*	*54,121*	*9,946*	*76,449*
Information and communication technology	*19,102*	*375*	*3,529*	*-*	*4,308*	*8,212*
Wholesale and retail trade	*54,989*	*375*	*32,508*	*7*	*15,980*	*48,870*
Financial and insurance activities	*33,669*	*17,726*	*7,254*	*-*	*7,622*	*32,602*
Industry, energy and manufacturing	*39,909*	*60*	*28,183*	*-*	*6,711*	*34,954*
Transportation	*11,066*	*-*	*1,048*	*313*	*3,285*	*4,646*
Services	*17,580*	*61*	*9,137*	*92*	*5,669*	*14,959*
Public sector	*8,617*	*4*	*2,194*	*-*	*289*	*2,487*
Agriculture and forestry	*7,657*	*4*	*6,797*	*-*	*263*	*7,064*
Other assets with credit risk	8,675	-	-	-	-	-
Financial guarantees	15,097	2,232	6,322	1,403	2,262	12,219
Undrawn loan commitments and unused overdrafts	99,024	-	-	-	-	-
Fair value through OCI	48,894	-	-	-	-	-
Government bonds	*41,417*	*-*	*-*	*-*	*-*	*-*
Corporate and finance bonds	*7,477*	*-*	*-*	*-*	*-*	*-*
Balance at the end of the year	1,059,309	23,024	551,045	56,004	75,353	705,426

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

41. Credit risk, continued

LTV ratio for residential mortgage lending

The following table describes the loan to value (LTV) and impairment status of the Group's mortgage loan book. LTV is calculated as the ratio of the gross amount of the loan to the value of the collateral without adjusting for possible costs of obtaining and selling the collateral. The collateral value is based on the value at origination, the most recent appraisal or official property valuation from the Icelandic Property Registry. For credit impaired loans the value of collateral is based on the most recent appraisal.

	31.03.2020		31.12.2019	
	Gross carrying amount	Thereof credit impaired	Gross carrying amount	Thereof credit impaired
Less than 50%	117,722	1,472	119,734	1,283
50-70%	131,617	2,510	130,257	2,546
70-90%	71,407	1,233	63,099	1,131
90-100%	7,924	154	7,369	170
100-110%	2,743	20	2,658	60
More than 110%	9,604	759	10,873	698
Not classified	43	4	47	-
Balance at the end of the period	341,060	6,152	334,037	5,888

At the end of the period the gross carrying amount of assets in stage 3 are ISK 22,489 million (31.3.2019: ISK 20,155 million) with ISK 15,207 million in collateral (31.3.2019: ISK 13,618 million), there of ISK 13,243 million in real estates (31.3.2019: 11,719 million).

Collateral repossessed

During the period the Group took possession of assets due to foreclosures. The total amounts of real estates the Group took possession of during the period and still holds at the end of the period amount to ISK 8 million (31.3.2019: ISK 501 million) and in other assets ISK 12 million (31.3.2019: ISK 9 million). The assets are held for sale, see Note 28.

Credit quality

The Group uses internal credit ratings and external credit ratings if available to monitor credit risk. The Group's internal credit rating system rates customers through application of statistical models based on a variety of information that has been determined to be predictive of default. These include demographic, behavioral, financial and economic data, coupled with qualitative expert judgment for large corporate exposures. Six exposure type models rate individuals' exposures – mortgages, consumer loans, auto loans, guarantees, loans to individuals for work purposes and other loans. The models are updated at least annually and recalibrated with current data with the aim of maintaining their predictive power. Year-on-year changes in risk classification of loans may in part be due to model refinement. All internal models were updated during 2019 and new models and model structure first deployed at the end of 2019. External ratings are primarily used for marketable securities and loans to credit institutions. For further information on the rating scales used, see Note 56 in the Annual Financial Statements 2019.

The following tables show financial instruments subject to the impairment requirements of IFRS 9 broken down by rating scale, where risk class 5, DD denotes, the highest risk. Assets carried at fair value through profit and loss are not subject to the impairment requirements of IFRS 9. The tables below sum up the gross carrying amount of assets by rating class and current impairment stage. The gross carrying amount net of loss allowance shows the book value of the underlying assets.

Exposures that are 'Unrated' are typically due to newly formed entities, entities for which the Bank's rating models are not applicable or no external rating is available.

Amounts are in ISK millions

41. Credit risk, continued

Credit quality profile by rating class

31.3.2020	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	118,174	30,336	112,721
Non-investment grade	-	3,513	-
Gross carrying amount	118,174	33,849	112,721
Loss allowance	-	(52)	(9)
Book value	118,174	33,797	112,712

Loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 to 1 (Grades AAA to BBB-)	345,063	11,687	-	-	356,750
Risk class 2 (Grades BB+ to BB-)	171,169	68,536	-	40	239,745
Risk class 3 (Grades B+ to B-)	85,777	41,815	-	62	127,654
Risk class 4 (Grades CCC+ to CCC-)	8,708	19,588	322	150	28,768
Risk class 5 (DD)	1	-	22,162	491	22,654
Unrated	8,956	6,530	-	-	15,486
Gross carrying amount	619,674	148,156	22,484	743	791,057
Loss allowance	(1,821)	(2,295)	(7,892)	(226)	(12,234)
Book value	617,853	145,861	14,592	517	778,823
Loans to customers - Individuals					
Risk class 0 to 1 (Grades AAA to BBB-)	272,160	2,529	-	-	274,689
Risk class 2 (Grades BB+ to BB-)	61,679	3,377	-	40	65,096
Risk class 3 (Grades B+ to B-)	13,965	3,439	-	62	17,466
Risk class 4 (Grades CCC+ to CCC-)	4,237	7,771	322	150	12,480
Risk class 5 (DD)	-	-	7,198	491	7,689
Unrated	88	56	-	-	144
Gross carrying amount	352,129	17,172	7,520	743	377,564
Loss allowance	(970)	(518)	(1,845)	(226)	(3,559)
Book value	351,159	16,654	5,675	517	374,005
Loans to customers - Companies and sovereign					
Risk class 0 to 1 (Grades AAA to BBB-)	72,903	9,158	-	-	82,061
Risk class 2 (Grades BB+ to BB-)	109,490	65,159	-	-	174,649
Risk class 3 (Grades B+ to B-)	71,812	38,376	-	-	110,188
Risk class 4 (Grades CCC+ to CCC-)	4,471	11,817	-	-	16,288
Risk class 5 (DD)	1	-	14,964	-	14,965
Unrated	8,868	6,474	-	-	15,342
Gross carrying amount	267,545	130,984	14,964	-	413,493
Loss allowance	(851)	(1,777)	(6,047)	-	(8,675)
Book value	266,694	129,207	8,917	-	404,818

Loan commitments, guarantees and unused credit facilities	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 to 1 (Grades AAA to BBB-)	53,202	1,335	-	-	54,537
Risk class 2 to 4 (Grades BB+ to CCC-)	37,245	12,633	1,839	-	51,717
Unrated	8,298	4,392	-	-	12,690
Gross carrying amount	98,745	18,360	1,839	-	118,944
Loss allowance	(245)	(279)	(92)	-	(616)
Book value	98,500	18,081	1,747	-	118,328

Amounts are in ISK millions

41. Credit risk, continued

31.12.2019	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	95,717	16,099	48,900
Non-investment grade	-	1,864	-
Gross carrying amount	95,717	17,963	48,900
Loss allowance	-	(16)	(6)
Book value	95,717	17,947	48,894

Loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 to 1 - (Grades AAA to BBB-)	369,623	981	-	-	370,604
Risk class 2 - (Grades BB+ to BB-)	196,133	35,291	-	81	231,505
Risk class 3 - (Grades B+ to B-)	94,515	37,100	-	39	131,654
Risk class 4 - (Grades CCC+ to CCC-)	11,669	15,828	-	114	27,611
Risk class 5 - (DD)	2	-	20,158	503	20,663
Unrated	661	426	2	-	1,089
Gross carrying amount	672,603	89,626	20,160	737	783,126
Loss allowance	(974)	(921)	(7,067)	(209)	(9,171)
Book value	671,629	88,705	13,093	528	773,955
Loans to customers - Individuals					
Risk class 0 to 1 (Grades AAA to BBB-)	272,967	723	-	-	273,690
Risk class 2 (Grades BB+ to BB-)	60,165	2,257	-	81	62,503
Risk class 3 (Grades B+ to B-)	13,882	3,125	-	39	17,046
Risk class 4 (Grades CCC+ to CCC-)	4,156	6,573	-	114	10,843
Risk class 5 (DD)	-	-	6,450	503	6,953
Unrated	25	54	2	-	81
Gross carrying amount	351,195	12,732	6,452	737	371,116
Loss allowance	(418)	(319)	(1,601)	(209)	(2,547)
Book value	350,777	12,413	4,851	528	368,569
Loans to customers - Companies and sovereign					
Risk class 0 to 1 (Grades AAA to BBB-)	96,656	258	-	-	96,914
Risk class 2 (Grades BB+ to BB-)	135,968	33,034	-	-	169,002
Risk class 3 (Grades B+ to B-)	80,633	33,975	-	-	114,608
Risk class 4 (Grades CCC+ to CCC-)	7,513	9,255	-	-	16,768
Risk class 5 (DD)	2	-	13,708	-	13,710
Unrated	636	372	-	-	1,008
Gross carrying amount	321,408	76,894	13,708	-	412,010
Loss allowance	(556)	(602)	(5,466)	-	(6,624)
Book value	320,852	76,292	8,242	-	405,386
Loan commitments, guarantees and unused credit facilities					
Risk class 0 to 1 - (Grades AAA to BBB-)	53,650	1	-	-	53,651
Risk class 2 to 4 - (Grades BB+ to CCC-)	43,205	8,349	1,790	-	53,344
Unrated	5,688	1,438	-	-	7,126
Gross carrying amount	102,543	9,788	1,790	-	114,121
Loss allowance	(165)	(244)	(73)	-	(482)
Book value	102,378	9,544	1,717	-	113,639

Amounts are in ISK millions

41. Credit risk, continued

Sector split, Gross carrying value against loss allowance

31.3.2020	Stage 1 Gross Carrying amount	Stage 1 Loss allowance	Stage 2 Gross Carrying amount	Stage 2 Loss allowance	Stage 3 Gross Carrying amount	Stage 3 Loss allowance	Total Loss allowance	Book value
Loans to credit instit., securities & cash ...	264,744	(61)	-	-	-	-	(61)	264,683
Individuals ...	352,129	(970)	17,425	(522)	8,011	(2,068)	(3,560)	374,005
Mortgage ...	*300,224*	*(162)*	*12,949*	*(112)*	*4,709*	*(275)*	*(549)*	*317,333*
Other ...	*51,905*	*(808)*	*4,476*	*(410)*	*3,302*	*(1,793)*	*(3,011)*	*56,672*
Companies and sovereign ...	267,544	(851)	130,986	(1,778)	14,964	(6,047)	(8,676)	404,818
Real estate activities and construction .	*86,777*	*(198)*	*39,468*	*(351)*	*2,758*	*(634)*	*(1,183)*	*127,820*
Fishing industry ...	*55,321*	*(199)*	*30,770*	*(333)*	*1,098*	*(490)*	*(1,022)*	*86,167*
Information and communication technolo	*17,899*	*(39)*	*733*	*(54)*	*296*	*(220)*	*(313)*	*18,615*
Wholesale and retail trade ...	*28,571*	*(138)*	*29,145*	*(480)*	*4,323*	*(1,415)*	*(2,033)*	*60,006*
Financial and insurance activities ...	*26,392*	*(77)*	*10,658*	*(249)*	*545*	*(144)*	*(470)*	*37,125*
Industry, energy and manufacturing ...	*29,103*	*(61)*	*2,095*	*(21)*	*1,269*	*(721)*	*(803)*	*31,664*
Transportation ...	*2,107*	*(19)*	*9,392*	*(75)*	*1,334*	*(613)*	*(707)*	*12,126*
Services ...	*10,110*	*(35)*	*6,654*	*(122)*	*1,721*	*(1,286)*	*(1,443)*	*17,042*
Public Sector ...	*5,483*	*(73)*	*1,099*	*(70)*	*201*	*(57)*	*(200)*	*6,583*
Agriculture and forestry ...	*5,781*	*(12)*	*972*	*(23)*	*1,419*	*(467)*	*(502)*	*7,670*
Balance at the end of the period ...	884,417	(1,882)	148,411	(2,300)	22,975	(8,115)	(12,297)	1,043,506

31.12.2019	Stage 1 Gross Carrying amount	Stage 1 Loss allowance	Stage 2 Gross Carrying amount	Stage 2 Loss allowance	Stage 3 Gross Carrying amount	Stage 3 Loss allowance	Total Loss allowance	Book value
Loans to credit instit., securities & cash ...	162,580	(22)	-	-	-	-	(22)	162,558
Individuals ...	351,193	(418)	12,967	(319)	6,957	(1,811)	(2,548)	368,569
Mortgage ...	*296,826*	*(45)*	*9,095*	*(62)*	*4,641*	*(260)*	*(367)*	*310,195*
Other ...	*54,367*	*(373)*	*3,872*	*(257)*	*2,316*	*(1,551)*	*(2,181)*	*58,374*
Companies and sovereign ...	321,408	(554)	76,894	(602)	13,705	(5,464)	(6,620)	405,386
Real estate activities and construction .	*106,568*	*(152)*	*21,473*	*(58)*	*2,733*	*(708)*	*(918)*	*129,856*
Fishing industry ...	*54,934*	*(105)*	*27,846*	*(205)*	*1,105*	*(634)*	*(944)*	*82,941*
Information and communication technolo	*18,323*	*(35)*	*737*	*(10)*	*291*	*(204)*	*(249)*	*19,102*
Wholesale and retail trade ...	*43,397*	*(92)*	*9,171*	*(126)*	*3,710*	*(1,071)*	*(1,289)*	*54,989*
Financial and insurance activities ...	*24,792*	*(19)*	*8,867*	*(139)*	*277*	*(109)*	*(267)*	*33,669*
Industry, energy and manufacturing ...	*37,071*	*(23)*	*2,131*	*(19)*	*1,218*	*(469)*	*(511)*	*39,909*
Transportation ...	*9,259*	*(27)*	*1,252*	*(13)*	*1,162*	*(567)*	*(607)*	*11,066*
Services ...	*13,138*	*(35)*	*4,077*	*(20)*	*1,795*	*(1,375)*	*(1,430)*	*17,580*
Public Sector ...	*8,093*	*(58)*	*445*	*(4)*	*197*	*(56)*	*(118)*	*8,617*
Agriculture and forestry ...	*5,832*	*(8)*	*895*	*(8)*	*1,217*	*(271)*	*(287)*	*7,657*
Balance at the end of the period ...	835,181	(994)	89,861	(921)	20,662	(7,275)	(9,190)	936,513

Amounts are in ISK millions

41. Credit risk, continued

The following tables reconciles the opening and closing allowance balance for loans to customers and debt securities at amortized cost and FVOCI and loan commitments, guarantees and unused credit facilities by their impairment requirements.

The reconciliation includes:

Transfers of financial assets between impairment requirements

Include transfers to 12 month expected credit losses, to lifetime expected credit losses and credit impaired financial assets. All transfers are presumed to occur before any corresponding remeasurement of the loss allowance.

Net remeasurement of loss allowance

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

New financial assets

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

Derecognitions and maturities

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

Write-offs

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

Foreign exchange

The effects of foreign exchange on the loss allowance between years.

Due to the unprecedented circumstances caused by the Covid-19 pandemic, Arion Bank has made changes to its macroeconomic outlook used for IFRS 9 provision calculations. Arion Bank has followed the guidelines of the European supervisors and the Central Bank of Iceland and used moderation in the application of impairment calculations. In doing so, the Bank has estimated the effects of the governmental stimulus programs, public and private payment moratoria and other actions on its key macro factor, unemployment. It is assumed that there will be a sharp increase in unemployment which will quickly recover, to an extent, as quarantine restrictions and travel bans are eased. Unemployment levels previously associated with a pessimistic scenario now define the baseline scenario. A new pessimistic scenario has been defined. These scenarios and the weights assigned to them will be reexamined in the coming quarter as uncertainty over the local and global impact of Covid-19 is reduced.

Arion Bank has concluded that credit risk relating to the tourism exposure has significantly increased in credit risk and has taken this into consideration in the Q1 2020 provision calculations. The extent of the related impact on other industries and supporting businesses is unclear. The Bank continues to monitor developments closely and will adjust its provisions accordingly.

31.3.2020

*Impairment loss allowance **	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	1,182	1,166	7,141	209	9,698
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	426	(395)	(31)	-	-
Transfers to Stage 2 (lifetime ECL)	(192)	196	(4)	-	-
Transfers to Stage 3 (credit impaired financial assets)	(21)	(115)	136	-	-
Net remeasurement of loss allowance **	601	1,640	969	12	3,222
New financial assets, originated or purchased	193	44	104	-	341
Derecognitions and maturities	(103)	(27)	(321)	-	(451)
Write-offs ***	-	(1)	(353)	-	(354)
Foreign exchange difference	25	66	343	5	439
Impairment loss allowance ****	2,111	2,574	7,984	226	12,895
Impairment loss allowances for assets only carrying 12-month ECL	61	-	-	-	61
Total impairment loss allowance	2,172	2,574	7,984	226	12,956

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

** During the period the loss allowance balance for stage 3 loans was raised by ISK 132 million due to unwinding of interest income.

*** During the period an amount of ISK 336 million was written off but is still subject to enforcement activities subject to Icelandic law.

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

Amounts are in ISK millions

41. Credit risk, continued

Impairment loss allowance for loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	974	921	7,067	209	9,171
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	375	(345)	(30)	-	-
Transfers to Stage 2 (lifetime ECL)	(182)	186	(4)	-	-
Transfers to Stage 3 (credit impaired financial assets)	(20)	(115)	135	-	-
Net remeasurement of loss allowance	561	1,575	959	12	3,107
New financial assets, originated or purchased	143	34	104	-	281
Derecognitions and maturities	(49)	(24)	(320)	-	(393)
Write-offs	-	(1)	(353)	-	(354)
Foreign exchange differences	19	64	334	5	422
Total loss allowance for loans to customers	1,821	2,295	7,892	226	12,234

Impairment loss allowance for loans to customers - Individuals	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	418	319	1,601	209	2,547
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	266	(236)	(30)	-	-
Transfers to Stage 2 (lifetime ECL)	(76)	80	(4)	-	-
Transfers to Stage 3 (credit impaired financial assets)	(12)	(73)	85	-	-
Net remeasurement of loss allowance	336	442	306	12	1,096
New financial assets, originated or purchased	57	1	3	-	61
Derecognitions and maturities	(20)	(15)	(44)	-	(79)
Write-offs	-	(1)	(105)	-	(106)
Foreign exchange differences	1	-	34	5	40
Total loss allowance for individuals	970	517	1,846	226	3,559

Impairment loss allowance for loans to customers - Companies and sovereign	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	556	602	5,466	-	6,624
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	109	(109)	-	-	-
Transfers to Stage 2 (lifetime ECL)	(106)	106	-	-	-
Transfers to Stage 3 (credit impaired financial assets)	(8)	(42)	50	-	-
Net remeasurement of loss allowance	225	1,133	653	-	2,011
New financial assets, originated or purchased	86	33	101	-	220
Derecognitions and maturities	(29)	(9)	(276)	-	(314)
Write-offs	-	-	(248)	-	(248)
Foreign exchange differences	18	64	300	-	382
Total loss allowance for companies and sovereign	851	1,778	6,046	-	8,675

Impairment loss allowance for loan commitments, guarantees and unused credit facilities	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	163	245	74	-	482
Transfers					
Transfers to 12-month ECL	51	(50)	(1)	-	-
Transfers to lifetime ECL	(10)	10	-	-	-
Transfers to credit impaired	(1)	-	1	-	-
Net remeasurement of loss allowance	40	65	10	-	115
New financial commitments originated	50	10	-	-	60
Derecognitions and maturities	(54)	(3)	(1)	-	(58)
Foreign exchange differences	6	2	9	-	17
Total loss allowance for loan commit., guarantees, unused cr. facilitie	245	279	92	-	616

Large exposures

A large exposure is defined as an exposure to a group of financially related borrowers which is equal to or exceeds 10% of the Group's eligible capital according to Financial Undertakings Act No. 161/2002 and Regulation No. 233/2017 on prudential requirements. The legal maximum for individual large exposures is 25% of eligible capital, net of eligible credit risk mitigation.

The Group has one large exposure at the end of the period, totaling ISK 20.5 billion (10.4% of eligible capital) before taking into account eligible credit risk mitigation (31.12.2019: two large exposures, totaling ISK 36.8 billion). The total exposure is ISK 20.3 billion (10.4% of eligible capital) after taking into account eligible credit risk mitigation.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

42. Market risk

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

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

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

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

The Group aims to manage and limit market exposures and imbalances between assets and liabilities in accordance with its risk appetite and strategic goals for net profit.

Interest rate risk

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

The Group's interest rate risk for foreign currencies is limited as foreign denominated assets predominantly have short fixing periods and the Group generally applies cash flow hedging for its foreign denominated fixed rate borrowings. For domestic rates, longer fixing periods are more common. The sale of the Arion Bank Mortgage Institutional Fund mortgage portfolio, executed in October 2019, with resulting full prepayment of the remaining matched structural covered bonds issuance, significantly shortens the interest fixing profile of the Bank for indexed rates.

Due to favorable refinancing spreads, prepayments and/or refinancing of loans have been considerable over the past few years, resulting in reduced average duration of fixed rates for the Bank's assets. Prepayment risk is mitigated by prepayment fees and the Group's own prepayment options. The Group's prepayment of structured covered bonds is a reaction to mortgage prepayments and mortgage refinancing. Decreasing domestic interest rates furthermore put pressure on the Group's net interest income as a result of tighter margins for deposit funding.

Interest rate risk in the banking book

The following table shows the Group's interest-bearing assets and liabilities by interest fixing periods. The figures for loans to customers and borrowings are shown on a fair value basis, see Note 23, and are therefore different from the amounts shown in these Condensed Consolidated Interim Financial Statements. The fair value reflects the likelihood of prepayment. Defaulted loans are presented at book value, which is based on the value of the underlying collateral, and are therefore assumed to be independent of interest adjustment periods and placed in the 'Up to 3 months' category. The assets and liabilities of Valitor Holding hf. are not included in the figures as they are classified as held for sale.

31.3.2020 *Assets*	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	113,800	-	-	-	-	113,800
Loans to credit institutions	33,797	-	-	-	-	33,797
Loans to customers	506,666	82,655	157,437	9,295	27,054	783,107
Financial instruments	63,924	31,474	11,283	1,467	4,587	112,735
Assets	718,187	114,129	168,720	10,762	31,641	1,043,439
Liabilities						
Due to credit institutions and Central Bank	8,323	-	-	-	-	8,323
Deposits	481,581	45,620	9,491	1,487	1,133	539,312
Borrowings	37,403	-	188,305	94,291	11,442	331,441
Subordinated liabilities	9,235	-	3,625	9,465	9,238	31,563
Liabilities	536,542	45,620	201,421	105,243	21,813	910,639
Derivatives and other off-balance sheet items (net position)	(124,588)	-	120,471	5,716	-	1,599
Net interest gap	57,057	68,509	87,770	(88,765)	9,828	134,399

Amounts are in ISK millions

42. Market risk, continued

31.12.2019 *Assets*	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	91,511	-	-	-	-	91,511
Loans to credit institutions	17,947	-	-	-	-	17,947
Loans to customers	497,936	84,260	148,015	9,076	38,033	777,320
Financial instruments	24,470	9,625	9,743	1,150	3,925	48,913
Assets	631,864	93,885	157,758	10,226	41,958	935,691
Liabilities						
Due to credit institutions and Central Bank	5,984	-	-	-	-	5,984
Deposits	449,627	30,875	9,826	1,474	1,114	492,916
Borrowings	35,359	5,668	174,814	89,264	11,484	316,589
Subordinated liabilities	13,975	-	-	6,202	-	20,177
Liabilities	504,945	36,543	184,640	96,940	12,598	835,666
Derivatives and other off-balance sheet items (net position)	(102,295)	25	104,180	869	-	2,779
Net interest gap	24,624	57,367	77,298	(85,845)	29,360	102,804

Sensitivity analysis of interest rate risk in the banking book

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

	31.3.2020		31.12.2019	
NPV change	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	(3,319)	2,861	(3,198)	2,651
ISK, Non index-linked	(7)	90	(135)	210
Foreign currencies	545	(538)	365	(392)
NII change				
ISK, CPI index-linked	(1,057)	684	(751)	719
ISK, Non index-linked	(2,177)	791	(1,078)	434
Foreign currencies	249	(249)	200	(200)

Sensitivity analysis of interest rate risk in the trading book

The following table shows the interest sensitivity of the Group's net positions in the trading book by currencies. Sensitivity is quantified as the net change in value when assuming a simultaneous parallel shift upwards and downwards of all yield curves by 100 basis points. The sensitivity does not relate to variation of annual net interest income and is not an estimate of risk. The calculations are based on duration and convexity in this table.

	31.3.2020		31.12.2019	
Currency	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	60	(50)	83	(74)
ISK, Non index-linked	188	(177)	107	(100)
Foreign currencies	30	(30)	(77)	73

Amounts are in ISK millions

42. Market risk, continued

Indexation risk

A significant part of the Group's balance sheet is linked to the Icelandic Consumer Price Index (CPI). For index-linked instruments, principal and interest payments are adjusted proportionally to the CPI. The Group is exposed to indexation risk as indexed assets exceed indexed liabilities. Financial instruments held for liquidity or market making purposes are assumed to be on demand.

Book value and maturity profile of indexed assets and liabilities

31.3.2020	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	18,956	56,837	208,076	283,869
Financial instruments	12,087	-	-	12,087
Off-balance sheet position	(267)	(1,167)	-	(1,434)
Assets, CPI index-linked	30,776	55,670	208,076	294,522
Liabilities, CPI index-linked				
Deposits	78,177	13,163	2,633	93,973
Borrowings	271	11,421	92,965	104,657
Subordinated liabilities	-	-	4,880	4,880
Other	1,139	209	1,429	2,777
Off-balance sheet position	794	5,652	107	6,553
Liabilities, CPI index-linked	80,381	30,445	102,014	212,840
Net on-balance sheet position	(48,544)	32,044	106,169	89,669
Net off-balance sheet position	(1,061)	(6,819)	(107)	(7,987)
CPI Balance	(49,605)	25,225	106,062	81,682
CPI Balance for prudential consolidation, which excludes insurance operations *	(48,534)	21,551	102,418	75,436

31.12.2019	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	18,945	57,405	207,514	283,864
Financial instruments	13,647	-	-	13,647
Assets, CPI index-linked	32,592	57,405	207,514	297,511
Liabilities, CPI index-linked				
Deposits	75,944	13,381	2,582	91,907
Borrowings	269	11,329	89,644	101,242
Subordinated liabilities	-	-	4,913	4,913
Other	1,046	210	1,427	2,683
Off-balance sheet position	1,036	6,675	125	7,836
Liabilities, CPI indexed linked	78,295	31,595	98,691	208,581
Net on-balance sheet position	(44,667)	32,485	108,948	96,766
Net off-balance sheet position	(1,036)	(6,675)	(125)	(7,836)
CPI Balance	(45,703)	25,810	108,823	88,930
CPI Balance for prudential consolidation, which excludes insurance operations *	(52,586)	26,020	109,256	82,689

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

Amounts are in ISK millions

42. Market risk, continued

Currency risk

Currency risk is the risk of loss due to adverse movements in foreign exchange rates. The Group is exposed to currency risk through a currency mismatch between assets and liabilities. ISK denominated deposits are a primary source of funding for the Group whereas a substantial part of the Group's assets consists of foreign currency denominated loans to customers. Net exposures per currency are monitored centrally in the Bank.

Breakdown of assets and liabilities by currency

31.3.2020

Financial assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	115,728	1,140	505	356	107	62	276	118,174
Loans to credit institutions	4,289	14,728	7,889	1,560	1,356	527	3,448	33,797
Loans to customers	605,302	115,619	41,909	4,289	5,622	33	6,049	778,823
Financial instruments	111,183	18,394	49,056	13	29	13,272	109	192,056
Other financial assets	9,824	2,071	122	-	9	5	1	12,032
Financial assets	846,326	151,952	99,481	6,218	7,123	13,899	9,883	1,134,882
Financial liabilities								
Due to credit inst. and Central Bank	5,279	469	2,560	14	-	-	1	8,323
Deposits	450,068	35,722	42,239	2,338	3,441	3,214	2,290	539,312
Financial liabilities at fair value	2,069	1,388	1,129	39	-	-	62	4,687
Other financial liabilities	37,316	904	964	246	329	69	121	39,949
Borrowings	149,603	134,398	-	-	-	32,740	5,729	322,470
Subordinated liabilities	5,772	776	14,783	-	-	4,143	10,363	35,837
Financial liabilities	650,107	173,657	61,675	2,637	3,770	40,166	18,566	950,578
Net on-balance sheet position	196,219	(21,705)	37,806	3,581	3,353	(26,267)	(8,683)	
Net off-balance sheet position	(10,343)	20,789	(37,918)	(3,658)	(3,851)	26,219	8,762	
Net position	185,876	(916)	(112)	(77)	(498)	(48)	79	
Non-financial assets								
Investment property	7,129	-	-	-	-	-	-	7,129
Investments in associates	828	-	-	-	-	-	-	828
Intangible assets	8,826	-	-	-	-	-	-	8,826
Tax assets	2	-	-	-	-	-	-	2
Assets and disposal groups held for sale	15,489	9,315	218	2,739	260	11	6	28,038
Other non financial assets	7,947	77	20	49	-	19	3	8,115
Non-financial assets	40,221	9,392	238	2,788	260	30	9	52,938
Non-financial liabilities and equity								
Tax liabilities	4,195	-	-	-	-	-	-	4,195
Liabilities associated with disposal groups held for sale	11,356	7,903	135	2,579	-	398	486	22,857
Other non-financial liabilities	26,111	149	47	-	5	-	(1)	26,311
Shareholders' equity	183,702	-	-	-	-	-	-	183,702
Non-controlling interest	177	-	-	-	-	-	-	177
Non-financial liabilities and equity	225,541	8,052	182	2,579	5	398	485	237,242
Intangible assets of Valitor in foreign operation excluded *	1,534	-	-	(1,534)	-	-	-	
Management reporting of currency risk **	2,090	424	(56)	(1,402)	(243)	(416)	(397)	

* Based on an authorization from the Icelandic FSA to exclude Valitor's intangible assets in the currency balance.

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

Amounts are in ISK millions

42. Market risk, continued

31.12.2019 *Financial assets*	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	94,363	534	286	173	65	53	243	95,717
Loans to credit institutions	2,024	5,845	4,835	1,355	628	656	2,604	17,947
Loans to customers	608,144	116,793	35,113	3,956	4,578	2	5,369	773,955
Financial instruments	73,482	18,253	22,618	35	2	2,868	148	117,406
Other financial assets	5,354	160	3,096	-	22	4	39	8,675
Financial assets	783,367	141,585	65,948	5,519	5,295	3,583	8,403	1,013,700
Financial liabilities								
Due to credit inst. and Central Bank	2,548	1,748	1,675	13	-	-	-	5,984
Deposits	424,136	28,730	30,729	2,071	2,504	2,900	1,846	492,916
Financial liabilities at fair value	1,665	561	66	17	-	192	69	2,570
Other financial liabilities	4,178	335	967	201	371	53	303	6,408
Borrowings	147,245	116,712	-	-	-	32,999	7,789	304,745
Subordinated liabilities	5,820	690	-	-	-	4,183	9,390	20,083
Financial liabilities	585,592	148,776	33,437	2,302	2,875	40,327	19,397	832,706
Net on-balance sheet position	197,775	(7,191)	32,511	3,217	2,420	(36,744)	(10,994)	
Net off-balance sheet position	(2,575)	1,522	(36,242)	(4,825)	(4,694)	36,252	10,562	
Net position	195,200	(5,669)	(3,731)	(1,608)	(2,274)	(492)	(432)	
Non-financial assets								
Investment property	7,119	-	-	-	-	-	-	7,119
Investments in associates	852	-	-	-	-	-	-	852
Intangible assets	8,367	-	-	-	-	-	-	8,367
Tax assets	2	-	-	-	-	-	-	2
Assets and disposal groups								-
held for sale	20,632	13,080	1,302	5,637	1,206	307	1,462	43,626
Other non financial assets	7,963	119	27	56	1	18	5	8,189
Non-financial assets	44,935	13,199	1,329	5,693	1,207	325	1,467	68,155
Non-financial liabilities and equity								
Tax liabilities	4,404	-	-	-	-	-	-	4,404
Liabilities associated with disposal groups held for sale	11,442	8,667	71	2,849	2,597	496	2,509	28,631
Other non-financial liabilities	26,097	141	46	-	5	-	-	26,289
Shareholders' equity	189,644	-	-	-	-	-	-	189,644
Non-controlling interest	181	-	-	-	-	-	-	181
Non-financial liabilities and equity	231,768	8,808	117	2,849	2,602	496	2,509	249,149
Intangible assets of Valitor in foreign operation excluded *	1,534	-	-	(1,455)	(79)	-	-	
Management reporting of currency risk **	9,901	(1,278)	(2,519)	(219)	(3,748)	(663)	(1,474)	

* Based on an authorization from the Icelandic FSA to exclude Valitor's intangible assets in the currency balance.

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

Amounts are in ISK millions

42. Market risk, continued

Sensitivity analysis for currency risk

The table below indicates the currencies to which the Group had significant exposure at the end of the period. The analysis calculates the effect of a reasonably possible movement of the currency rate against the ISK, with all other variables held constant, on the Consolidated Interim Income Statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). A negative amount in the table reflects a potential net reduction in the Consolidated Interim Income Statement or equity, while a positive amount reflects a net potential increase. An equivalent decrease in each of the below currencies against the ISK would have resulted in an equivalent but opposite impact (+10% denotes a depreciation of the ISK).

	31.3.2020		31.12.2019	
Currency	-10%	+10%	-10%	+10%
EUR	(42)	42	128	(128)
USD	6	(6)	252	(252)
GBP	140	(140)	22	(22)
DKK	24	(24)	375	(375)
NOK	42	(42)	66	(66)
Other	40	(40)	147	(147)

Equity risk

Equity risk is the risk that the fair value of equities decreases as the result of changes in the level of equity indices and individual stocks. For information on assets seized and held for sale and equity exposures, see Notes 29 and 22 respectively.

Sensitivity analysis for equity risk

The analysis below calculates the effect of a reasonable possible movement in equity prices that affect the Condensed Consolidated Interim Financial Statements. A negative amount in the table reflects a potential net reduction in the Consolidated Income Statement or equity, while a positive amount reflects a potential net increase. Investments in associates are excluded. The result of value-at-risk calculations for the trading book are shown in the Group's Pillar 3 Disclosures.

	31.3.2020		31.12.2019	
Equity	-10%	+10%	-10%	+10%
Trading book - listed	(402)	402	(301)	301
Banking book - listed	(443)	443	(486)	486
Banking book - unlisted	(273)	273	(296)	296

Derivatives

Derivatives are a part of the Group's customer product offering. The types of derivatives currently offered are forward contracts, swaps and options. Eligible underlying market factors are interest rates, foreign exchange rates, equities and commodities. Exposure limits, hedging requirements and collateral requirements are determined in accordance with the Group's risk appetite and monitored by Risk Management on a daily basis. The Group also uses derivatives to hedge market risk on its balance sheet. Note 23 provides a breakdown of the Group's derivative positions by type.

Amounts are in ISK millions

43. Liquidity and Funding risk

Liquidity risk is defined as the risk that the Group, though solvent, either does not have sufficient financial resources available to meet its liabilities when they fall due, or can secure them only at excessive cost. Liquidity risk arises from the inability to manage unplanned decreases or changes in funding sources.

A primary source of funding for the Group is from deposits from individuals, businesses and financial undertakings. The Group's liquidity risk stems from the fact that the maturity of loans exceeds the maturity of deposits, of which 70% is on-demand.

Liquidity risk is one of the Group's most significant risk factors and a great deal of emphasis is placed on managing it. The Asset and Liability Committee (ALCO) is responsible for managing liquidity and funding risk within the risk appetite set by the Board of Directors. The Bank's Treasury manages liquidity positions on a day-to-day basis. Risk Management measures, monitors and reports the Bank's liquidity and funding risk on a daily basis.

The Group's strategy in relation to liquidity risk is to actively manage its liquidity positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions. The Group seeks to maintain a stable funding profile which supports its business strategy and liquidity profile, ensuring that the Group can withstand periods of market turbulence, without reliance on volatile funding or external support.

Maturity analysis of assets and liabilities

The maturity analysis is based on contractual cash flows. The amounts are not discounted and include future interest payments, but CPI-linked amounts do not include accrued indexation due to future inflation. The total amount for each item is higher than the corresponding amount on the Bank's balance sheet, since the amounts on the balance sheet are either at amortized cost and do not contain future interest payments, or at fair value where future cash flows have been discounted.

Contractual cash flows differ in many ways from expected cash flows. The difference is most significant for deposits on the liability side and bonds on the asset side. Deposits are always assumed to be withdrawn at the earliest possible date, despite the fact that a large part of the deposit base is considered to be stable funding where behavioral maturity considerably exceeds contractual maturity. Furthermore, although contractual cash flows are presented for bonds held by the Bank, a large portion of the bonds are a part of the Bank's liquidity buffer and are considered to be highly liquid and can be sold and/or pledged to the Central Bank of Iceland and thus converted into cash at very short notice.

Contractual cash flow of assets and liabilities

31.3.2020	On	Up to 3	3-12	1-5	Over 5	With no		Book
Financial assets	demand	months	months	years	years	maturity	Total	value
Cash and balances with CB	15,139	97,983	5,128	-	-	-	118,250	118,174
Loans to credit institutions	24,773	9,024	-	-	-	-	33,797	33,797
Loans to customers	11,015	117,435	112,396	288,811	548,795	-	1,078,452	778,823
Financial instruments	29,306	66,115	36,758	25,357	12,817	28,928	199,281	192,056
Derivatives - assets leg	-	*54,793*	*9,541*	*59,868*	*9,343*	-	*133,545*	*123,366*
Derivatives - liabilities leg	-	*(50,227)*	*(7,932)*	*(54,471)*	*(8,217)*	-	*(120,847)*	*(113,431)*
Other financial instruments	*29,306*	*61,549*	*35,149*	*19,960*	*11,691*	*28,928*	*186,583*	*182,121*
Other financial assets	1,603	6,562	3,050	817	-	-	12,032	12,032
Financial assets	81,836	297,119	157,332	314,985	561,612	28,928	1,441,812	1,134,882
Financial liabilities								
Due to credit inst. and Central Bank	8,393	-	-	-	-	-	8,393	8,323
Deposits	379,039	86,404	58,121	13,784	3,072	-	540,420	539,312
Financial liabilities at fair value	-	2,847	1,827	1,625	23	-	6,322	4,687
Derivatives - assets leg	-	*(49,827)*	*(6,274)*	*(6,287)*	*(472)*	-	*(62,860)*	*(61,601)*
Derivatives - liabilities leg	-	*51,699*	*8,101*	*7,912*	*495*	-	*68,207*	*65,313*
Short position bonds and derivatives	-	*975*	-	-	-	-	*975*	*975*
Other financial liabilities	307	37,109	106	692	1,735	-	39,949	39,949
Borrowings	-	10,921	25,913	219,688	104,505	-	361,027	322,470
Subordinated liabilities	-	229	1,739	6,936	39,899	-	48,803	35,837
Financial liabilities	387,739	137,510	87,706	242,725	149,234	-	1,004,914	950,578
Net position for assets and liab.	(305,903)	159,609	69,626	72,260	412,378	28,928	436,898	184,304
Off-balance sheet items								
Financial guarantees	-	1,146	4,105	3,569	7,724	-	16,544	16,544
Unused overdraft	-	47,418	-	-	-	-	47,418	47,418
Undrawn loan commitments	-	46,067	8,376	539	-	-	54,982	54,982
Off-balance sheet items	-	94,631	12,481	4,108	7,724	-	118,944	118,944
Net contractual cash flow	(305,903)	64,978	57,145	68,152	404,654	28,928	317,954	65,360

Amounts are in ISK millions

43. Liquidity and Funding risk, continued

31.12.2019 *Financial assets*	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity	Total	Book value
Cash and balances with CB	6,352	84,434	5,059	-	-	-	95,845	95,717
Loans to credit institutions	15,652	2,295	-	-	-	-	17,947	17,947
Loans to customers	6,191	124,040	105,974	299,695	578,647	-	1,114,547	773,955
Financial instruments	16,381	28,346	11,451	22,612	10,238	34,063	123,091	117,406
Derivatives - assets leg	-	*69,432*	*12,020*	*48,571*	*357*	-	*130,380*	*124,911*
Derivatives - liabilities leg	-	*(66,935)*	*(11,006)*	*(43,875)*	*(294)*	-	*(122,110)*	*(118,295)*
Other financial instruments	*16,381*	*25,849*	*10,437*	*17,916*	*10,175*	*34,063*	*114,821*	*110,790*
Other financial assets	577	4,618	2,656	824	-	-	8,675	8,675
Financial assets	45,153	243,733	125,140	323,131	588,885	34,063	1,360,105	1,013,700
Financial liabilities								
Due to credit inst. and Central Bank	5,997	-	26	-	-	-	6,023	5,984
Deposits	350,451	78,459	42,423	14,318	9,279	-	494,930	492,916
Financial liabilities at fair value	-	1,506	1,318	1,812	44	-	4,680	2,570
Derivatives - assets leg	-	*(48,335)*	*(6,983)*	*(8,218)*	*(1,360)*	-	*(64,896)*	*(63,456)*
Derivatives - liabilities leg	-	*49,326*	*8,301*	*10,030*	*1,404*	-	*69,061*	*65,510*
Short position bonds and derivatives	-	*408*	-	-	-	-	*408*	*409*
Short position securities used for economic hedging	-	*107*	-	-	-	-	*107*	*107*
Other financial liabilities	141	3,856	119	559	1,733	-	6,408	6,408
Borrowings	-	7,416	32,028	202,725	101,862	-	344,031	304,745
Subordinated liabilities	-	479	566	3,316	23,908	-	28,269	20,083
Financial liabilities	356,589	91,716	76,480	222,730	136,826	-	884,341	832,706
Net position for assets and liab.	(311,436)	152,017	48,660	100,401	452,059	34,063	475,764	180,994
Off-balance sheet items								
Financial guarantees	554	2,617	1,202	3,560	7,164	-	15,097	15,097
Unused overdraft	-	44,923	-	-	-	-	44,923	44,923
Undrawn loan commitments	-	43,406	9,455	1,240	-	-	54,101	54,101
Off-balance sheet items	554	90,946	10,657	4,800	7,164	-	114,121	114,121
Net contractual cash flow	(311,990)	61,071	38,003	95,601	444,895	34,063	361,643	66,873

Net Stable Funding Ratio

The Net Stable Funding Ratio (NSFR) measures the amount of available stable funding (ASF) at the Group against the required stable funding (RSF) as per the definition of the Central Bank of Iceland rules No. 1032/2014. In general, RSF is determined by applying different weights to different asset classes depending on the level of liquidity. ASF however is calculated by applying weights to the Group's liabilities depending on maturity and/or stickiness. The NSFR for foreign currency shall exceed 100%.

The NSFR calculations are based solely on figures for the parent company. The Bank's subsidiaries have a negligible impact on the funding ratio. When calculating the ratio for foreign currencies, a negative foreign currency balance is subtracted from the numerator and a positive balance is subtracted from the denominator. The foreign currency balance used is different from the one in this Consolidated Financial Statement due to the sub-consolidation applied.

31.3.2020	ISK	Foreign currency	Total
Available stable funding	657,758	197,353	855,111
Required stable funding	594,231	145,638	739,869
Foreign currency balance		(4,652)	
Net stable funding ratio	111%	132%	116%

31.12.2019			
Available stable funding	640,719	182,728	823,447
Required stable funding	566,797	141,533	708,330
Foreign currency balance		(4,122)	
Net stable funding ratio	113%	126%	116%

Amounts are in ISK millions

43. Liquidity and Funding risk, continued

Liquidity coverage ratio

The Liquidity Coverage Ratio (LCR) is one of the standards introduced in the Basel III Accord. The LCR is the result of a stress test that is designed to ensure that banks have the necessary assets on hand to withstand short-term liquidity disruptions. More precisely, LCR represents the balance between highly liquid assets and the expected net cash outflow of the Group in the next 30 days under stressed conditions.

To qualify as highly liquid assets under the LCR rules, assets must be non-pledged, liquid and easily priced on the market, traded on an active market and not issued by the Group or related entities.

The Bank complies with the Central Bank of Iceland's liquidity rules No. 266/2017, which effectively adopt the liquidity rules of the EU Capital Requirements Regulation (CRR). The Bank is required to maintain a 100% minimum LCR ratio for both the aggregate position in all foreign currencies and all currencies.

The following table shows the breakdown for the Group's LCR calculations. The ratio at 31 March 2020 is based on the parent company only, as Valitor hf. is no longer classified as a credit institution to which LCR rules apply. The ratio at 31 December 2019 is based on consolidated figures for the Bank and Valitor Holding hf.

31.3.2020	ISK	Foreign currency	Total
Liquid assets level 1 *	128,144	61,642	189,786
Liquid assets level 2	101	-	101
Liquid assets	128,245	61,642	189,887
Deposits	99,291	35,352	134,643
Borrowings	1,319	226	1,545
Other cash outflows	12,823	10,435	20,312
Cash outflows	113,433	46,013	156,500
Short-term deposits with other banks **	-	23,240	23,240
Other cash inflows	31,333	17,224	48,557
Cash inflows	31,333	40,464	71,797
Liquidity coverage ratio (LCR) * **	156%	536%	224%

31.12.2019	ISK	Foreign currency	Total
Liquid assets level 1 *	107,918	28,973	136,891
Liquid assets level 2	291	-	291
Liquid assets	108,209	28,973	137,182
Deposits	89,609	23,655	113,264
Borrowings	2,081	10	2,091
Other cash outflows	7,479	11,082	18,561
Cash outflows	99,169	34,747	133,916
Short-term deposits with other banks **	-	18,185	18,185
Other cash inflows	30,743	9,201	39,944
Cash inflows	30,743	27,386	58,129
Liquidity coverage ratio (LCR) * **	158%	334%	188%

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

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

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

Amounts are in ISK millions

43. Liquidity and Funding risk, continued

Composition of liquid assets

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

31.3.2020	ISK	USD	EUR	Other	Total
Cash and balances with Central Bank	115,728	505	1,140	801	118,174
Short-term deposits in other banks	-	7,426	9,315	6,499	23,240
Domestic bonds eligible as collateral at the Central Bank	13,778	-	-	-	13,778
Foreign government bonds	-	35,590	11,734	11,859	59,183
Liquidity reserve	129,506	43,521	22,189	19,159	214,375
31.12.2019					
Cash and balances with Central Bank	103,726	286	534	534	105,080
Short-term deposits in other banks	-	5,410	5,771	7,004	18,185
Domestic bonds eligible as collateral at the Central Bank	11,878	-	-	-	11,878
Foreign government bonds	-	13,930	12,234	1,373	27,537
Liquidity reserve	115,604	19,626	18,539	8,911	162,680

LCR deposit categorization

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

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

LCR categorization - amounts and LCR outflow weights	Deposits maturing within 30 days					
31.3.2020	Less Stable	Weight (%)	Stable	Weight (%)	Term deposits*	Total deposits
Individuals	132,349	11%	52,546	5%	75,771	260,666
Small and medium enterprises	53,370	11%	5,422	5%	6,745	65,537
Operational relationship	-	25%	-	5%	4	4
Corporations	72,668	40%	952	20%	8,115	81,735
Sovereigns, central banks and PSE	20,898	40%	-	-	5,962	26,860
Pension funds	45,209	100%	-	-	19,660	64,869
Domestic financial entities	23,623	100%	-	-	22,051	45,674
Foreign financial entities	2,290	100%	-	-	-	2,290
Total	350,407		58,920		138,308	547,635
31.12.2019						
Individuals	130,942	10%	52,735	5%	74,580	258,257
Small and medium enterprises	50,339	10%	4,998	5%	6,156	61,493
Corporations	56,694	40%	829	20%	7,170	64,693
Sovereigns, central banks and PSE	13,501	40%	-	-	716	14,217
Pension funds	34,024	100%	-	-	16,431	50,455
Domestic financial entities	20,857	100%	-	-	27,051	47,908
Foreign financial entities	1,877	100%	-	-	-	1,877
Total	308,234		58,562		132,104	498,900

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

Amounts are in ISK millions

44. Capital management

Capital adequacy

The focus of capital management at the Group is to normalize the capital structure in the medium term and consequently maintain the Group's capitalization comfortably above the regulatory requirement, including capital buffers and Pillar 2 requirements.

The Group's capital ratios are calculated in accordance with the Icelandic Financial Undertakings Act No. 161/2002 and Regulation No. 233/2017 on prudential requirements. Iceland has adopted the EU Capital Requirements Directive and Regulation (CRD IV / CRR). On 1 January 2020, CRR was incorporated into the EEA Agreement, effectively introducing the SME supporting factor for capital adequacy for Icelandic institutions, which was previously excluded. The Group applies the standardized approach to calculate capital requirements for credit risk, credit valuation adjustment, market risk and operational risk.

The Group's consolidated situation as stipulated in CRR is the Group's accounting consolidation excluding insurance subsidiaries. The capital position and solvency requirements of Vördur tryggingar hf. should be viewed independently from capital adequacy for the Group's consolidated situation.

The Group's capital ratios are fully loaded, i.e. without IFRS 9 transitional arrangements. On 16 April 2020 the Icelandic Ministry of Finance announced plans to ratify Regulation (EU) 2017/2395 into Icelandic law, effective 1 June 2020. The regulation introduces transitional arrangements for IFRS 9 to allow the regulatory capital impact of expected credit loss to be phased in over time. These arrangements have been available to European banks since 2017. Institutions that elect to make use of these transitional arrangements can in 2020 add back CET1 equivalent to up to 70% of provisions incurred from the application of IFRS9. The Bank has not decided whether it will elect to make use of the transitional arrangements.

Valitor Holding hf. is classified as held for sale in these Consolidated Interim Financial Statements. This does not affect the Group's capital adequacy calculations. For disclosure, assuming a cash sale of the subsidiary at book value, the Group's capital adequacy ratio would increase from 27.5% to 29.0%. The sale of Valitor would result in reduction in the Group's regulatory own funds adjustments, with positive effect on capital adequacy.

Own funds	31.3.2020	31.12.2019
Total equity	183,879	189,825
Deductions related to the consolidated situation	(10,088)	(10,159)
Non-controlling interest not eligible for inclusion in CET1 capital	(177)	(181)
Common Equity Tier 1 capital before regulatory adjustments	173,614	179,485
Intangible assets	(11,160)	(10,604)
Tax assets	(332)	(296)
Cash flow hedges	(1,794)	(1,616)
Additional value adjustments	(201)	(125)
Foreseeable dividend *	-	(14,153)
Common equity Tier 1 capital	160,127	152,691
Non-controlling interest not eligible for inclusion in CET1 capital	177	181
Additional Tier 1 capital	14,783	-
Tier 1 capital	175,087	152,872
Tier 2 capital	21,054	20,083
Total own funds	196,141	172,955
Risk-weighted exposure amount (REA)		
Credit risk, loans	557,415	561,602
Credit risk, securities and other	48,412	49,163
Counterparty credit risk	5,242	3,347
Market risk due to currency imbalance	2,676	10,070
Market risk, other	13,898	10,609
Credit valuation adjustment	1,934	1,477
Operational risk	83,487	83,487
Total risk-weighted exposure amount	713,064	719,755
Capital ratios		
CET1 ratio	22.5%	21.2%
Tier 1 ratio	24.6%	21.2%
Capital adequacy ratio	27.5%	24.0%

* On 31 December 2019, the foreseeable dividend was the aggregation of the Bank's planned equity reduction in Q1 2020 through dividend distribution and buy-back of own shares. Due to the Covid-19 crisis, the plan was halted and no dividend is to be paid for the fiscal year 2019 according to a proposal put forward to the extended annual general meeting on May 14 2020. As a result, the own funds deduction is rescinded on 31 March 2020.

Amounts are in ISK millions

44. Capital management, continued

Capital ratios of the parent company	31.3.2020	31.12.2019
CET1 ratio	24.5%	23.5%
Tier 1 ratio	26.5%	23.5%
Capital adequacy ratio	29.4%	26.2%

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

Capital buffer requirement, % of REA	1.2.2020	18.3.2020
Capital conservation buffer	2.50%	2.50%
Capital buffer for systematically important institutions	2.00%	2.00%
Systemic risk buffer *	3.00%	3.00%
Countercyclical capital buffer *	2.00%	-
Combined capital buffer requirement	9.50%	7.50%

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

The Bank's Pillar 2R capital add-on, which is the result of the ICAAP/SREP, may comprise 56.25% CET1 capital, 18.75% AT1 capital and 25% Tier 2 capital.

Capital requirement, % of REA

31.3.2020	CET1	Tier 1	Total
Pillar 1 capital requirement	4.5%	6.0%	8.0%
Pillar 2R capital requirement **	1.7%	2.3%	3.1%
Combined buffer requirement *	7.3%	7.3%	7.3%
Regulatory capital requirement	13.6%	15.6%	18.4%
Available capital	22.5%	24.6%	27.5%

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

** The SREP result based on the Group's Financial Statement at 31.12.2018. The Pillar 2 requirement is 3.1% of risk-weighted assets based on the Group's prudential consolidation under CRR, which excludes Vördur tryggingar hf.

Leverage ratio

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

	31.3.2020	31.12.2019
On-balance sheet exposures	1,136,168	1,022,521
Derivative exposures	13,176	10,217
Securities financing transaction exposures	1,557	577
Off-balance sheet exposures	56,222	52,299
Total exposure	1,207,123	1,085,614
Tier 1 capital	175,087	152,872
Leverage ratio	14.5%	14.1%

Amounts are in ISK millions

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