Arion Bank

Condensed Consolidated Interim Financial Statements

1 January to 30 September 2022

Unaudited

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Arion Bank in brief

30.09.2022

14.8%
Return on equity

44.8%
Cost-to-income

19.3%
CET1 ratio

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

Rating from Moody's
Long term: Baa1
Outlook: Positive

UNEP FINANCE INITIATIVE | PRINCIPLES FOR RESPONSIBLE BANKING

The Banker – Bank of the Year 2021 – ICELAND

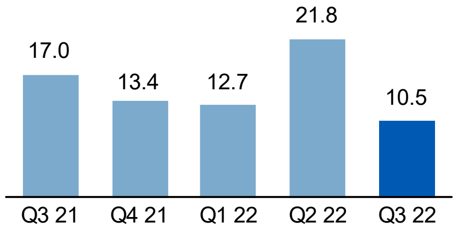
PRI Principles for Responsible Investment

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

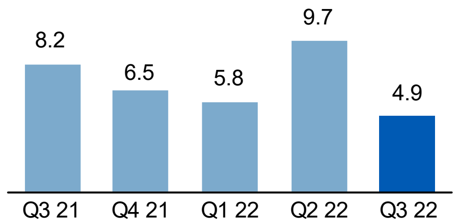
Key figures
(ISK m)

	9M 2022	9M 2021
Net earnings	20,393	22,093
ROE	14.8%	15.2%
Net interest margin	3.1%	2.7%
Cost to income ratio	44.8%	41.9%
Operating income / REA	6.5%	7.6%
	30.09.2022	**31.12.2021**
Total assets	1,427,886	1,313,864
Loans to customers	1,045,152	936,237
Deposits	739,969	655,476
Borrowings	376,540	356,637
Total equity	186,287	194,598
Stage 3 gross	1.4%	1.9%
Leverage ratio	12.0%	12.7%
Number of employees	777	751
EUR/ISK	141.32	147.60

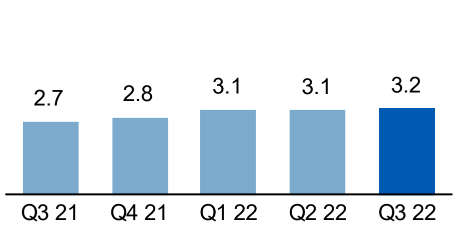
Return on equity (%)



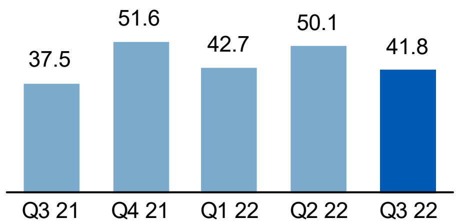
Net earnings (ISK billion)



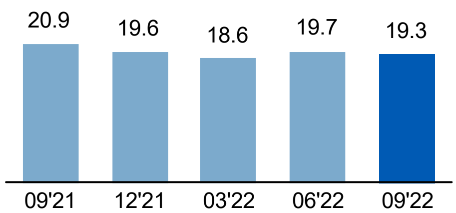
Net interest margin (%)



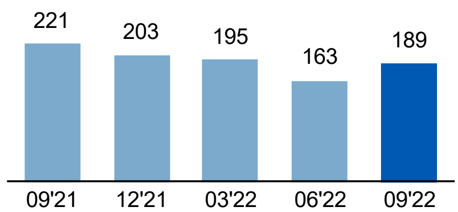
Cost-to-income ratio (%)



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 30 September 2022 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

Income Statement

Net earnings amounted to ISK 4.9 billion for the third quarter and ISK 20.4 billion for the first nine months of the year. Return on equity was 10.5% for the quarter and 14.8% for the first nine months. Core income, defined as net interest income, net commission income and net insurance income, increased by 19.2% in the quarter and by 19.6% for the first nine months, compared with the previous year. There was strong growth in net interest income in the quarter, compared with the previous year, mainly due to the increased base rate and 16.5% growth in the loan book from the third quarter 2021. Diversified fee generating operations support continued momentum in net fee and commission income. Net insurance income was affected by challenging conditions this year and an unusually high volume in claims. Challenging market conditions impacted financial income in the quarter.

On 1 July 2022 the sale of Valitor to Rapyd was settled. As all conditions were met at the end of June, the sale was fully accounted for in the second quarter results. The total consideration was ISK 14.6 billion (USD 112.5 million), resulting in a profit of ISK 5.6 billion, post cost of sale. The total capital impact of the sale was ISK 12.7 billion, which is a combination of the P&L gain and the REA release, but ISK 13.8 billion including the effect of capital released due to the reduced FX imbalance created in relation to the transaction. The REA release was effective from July. Transactions, mainly net fee and commission, between Valitor and Arion Bank are included in the results from the third quarter, while previously these have been lost in consolidation.

Balance Sheet

The Bank's balance sheet grew by 8.7% from year-end 2021. Loans to customers increased by 11.6% from year-end. The increase was 15.6% in corporate lending and 8.5% in loans to individuals. Deposits increased by 12.9%. Total equity amounted to ISK 186,287 million at the end of September. The Group's capital ratio was 23.1% and the CET1 ratio 19.3%. The ratios are determined on the basis of the unaudited net earnings in the quarter, and take into account the deduction of 50% of net earnings as foreseeable dividend in line with the Bank’s dividend policy, and ISK 2.8 billion of the outstanding buyback program. The Board of Directors decided to initiate 50% of the ISK 10 billion buyback of own shares authorized by the Financial Supervisory Authority of the Central Bank of Iceland (FSA) in the quarter, launched on 6 September. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 22.8% and the CET1 ratio was 19.0%. These ratios comfortably exceed the requirements made by the FSA and Icelandic law. The liquidity position was also strong at period end, with an LCR of 189%, which is well above the regulatory minimum.

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

	Actuals Q3 2022	Actuals 9M 2022	Arion Bank's medium-term financial targets
Return on equity	10.5%	14.8%	Exceed 13%
Operating income / REA	6.4%	6.5%	Exceed 7.3%
Insurance premium growth (YoY)	10.5%	10.3%	Premium growth (net of reinsurance) to exceed the growth of the domestic market by more than 3% (Premium growth in the domestic insurance market was 7.2% in 2021)
Loan growth	3.4%	11.6%	In line with nominal economic growth (Arion Bank forecasts economic growth of 12.5% in 2022)
Cost-to-income ratio	41.8%	44.8%	Below 45%
CET1 ratio	19.3%	19.3%	150-250 bps management buffer (~17.2 - 18.2% based on current capital requirements)
Dividend payout ratio	-	-	50%

Economic outlook

In many ways, the Icelandic economy is in an enviable position. According to preliminary figures from Statistics Iceland, GDP increased by 6.1% between years in Q2 2022, in line with expectations. Yet again growth was driven by record-breaking private consumption and increased growth in tourism, while regular business investment also lent a helping hand. Strong domestic economic activity has led to rapid import growth, resulting in a negative contribution of external trade to GDP growth and the largest current account deficit post the global financial crisis.

Despite the highly uncertain global economic outlook, there are signs that the Icelandic economy will experience continued strong growth. According to the IMF’s growth forecast, the Icelandic economy will grow by 2.9% in 2023, the third highest growth rate among advanced European countries. Domestic analysts share this view, with the consensus at 5.8% GDP growth in 2022, followed by 2.9% growth in 2023. Analysts expect that private consumption will continue to fuel growth, as unemployment is well below its natural rate, staffing shortages are at their highest levels since 2007, and wage negotiations are on the horizon. In this context it is important to keep in mind that despite 9.3% inflation (September), Icelandic households do not face the same cost-of-living crisis as their European counterparts, as nearly every household relies on domestically produced renewable energy sources for heating and electricity. In addition to strong private consumption, tourism has regained its former strength, with tourist arrivals in Q3 reaching 98% of Q3 2019. Even more importantly, each tourist is spending more than pre-covid, boosting the industry’s revenue growth. So far, bookings have remained strong, despite the deteriorating global economic outlook.

Endorsement and statement
by the Board of Directors and the CEO

Even though the outlook for Iceland remains bright, global economic uncertainty has grown which could negatively affect growth prospects in Iceland, e.g., through the exports sectors and financial conditions. Recent indicators from the labour market suggest that the output gap has peaked, as has inflation and housing prices. The Central Bank is finally seeing the results of its aggressive measures, and the bank raised its key interest rates (policy rates) by further 75 bps in Q3. Whether further rate hikes will prove necessary depends on the coming wage negotiations and public sector finances.

Outlook for the Bank

Arion Bank is in a strong position to navigate the current operating environment, with a robust, diversified, and profitable operating model combined with a strong capital, funding, and liquidity position. This is further supported by an operating environment in Iceland which can be considered relatively healthy in a global comparison, as further described in the Economic Outlook.

The pace and timeline of the policy rate shift and inflation contagion has been faster in Iceland than in most other jurisdictions. This was demonstrated when the Central Bank raised rates by 25bps in early October and at the same time indicated that the current 5.75% policy rate was close to terminal rates. This steep increase has stabilized the domestic housing market, which has been the key driver of domestic inflation. This trajectory allows for further clarity on the impact of these rate hikes on our business, most likely earlier than in most of our neighbouring countries. Currently, the credit quality of our borrowers remains robust, and we are not seeing the material impact of these rate hikes on credit quality.

Where we do see a direct impact from the global market backdrop is in our wholesale funding markets. As with the broader credit markets, the cost of funding has increased considerably over the past year. The Bank is again in a strong position to navigate these markets, with a strong liquidity position, broad funding options, robust growth in deposits which continued into Q3, and a light maturity profile over the coming year. It is, however, likely that should the current funding levels persist over the longer-term, this is likely to over time put pressure on our net interest margin, which has strengthened recently. Having a diversified business allows us flexibility when it comes to avenues of growth and uses of capital and funding.

Funding and liquidity

In terms of funding and liquidity management the Group’s liquidity position is strong. The Bank’s liquidity coverage ratio was well above the regulatory minimum of 100%, with a LCR of 189% at the end of September 2022.

Arion Bank continued to regularly issue green and covered bonds in the domestic market. The total issuance in the domestic market was ISK 18 billion during the first nine months of 2022, and the equivalent of ISK 81 billion in euros, Norwegian krone and Swedish krona, both in Senior Preferred and in Covered Bond formats.

Capital adequacy and dividends

Arion Bank’s dividend policy states that the Bank aims to pay 50% of net earnings in dividends and that additional dividend or share buybacks can be considered when the Bank’s capital levels exceed the minimum regulatory requirements together with the Bank’s management buffer. The Bank aims to maintain capital adequacy ratios 150-250bps above total regulatory requirements. The Bank has released equity through dividend payments and the purchase of own shares to meet this objective. In March 2022, the Bank paid dividends of ISK 22.5 billion, or ISK 15 per share, on the basis of the authority given by the Annual General Meeting. Following the completion of the sale of Valitor, the Bank received the approval of the FSA for a buyback program of up to ISK 10 billion. Based on this, the Bank initiated a process to purchase own shares for half the amount, or ISK 5 billion. At the reporting date, ISK 2.8 billion remained of this initiative and in accordance with CRR, this amount and the foreseeable dividends are deducted from CET1 capital.

On July 7, the FSA published the result of the Supervisory Review and Evaluation Process (SREP) for Arion Bank, based on financial information at year-end 2021. The additional capital requirement under Pillar 2 is set at 3.5% of total risk-weighted exposure amount (REA), which was an increase of 0.3% from the previous year. On 29 September 2022, the countercyclical buffer in Iceland rose from 0% to 2% based on a decision made by the Icelandic Financial Stability board a year earlier. In light of this, Arion Bank’s total capital requirement is 20.7% of REA and the CET1 capital requirement 15.7%.

The Group’s capital adequacy ratio on 30 September 2022 was 23.1% and the CET1 ratio 19.3%, when unaudited interim profits are included, and foreseeable dividends and buybacks are deducted.

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

The Bank’s REA decreased by ISK 3.4 billion in the third quarter of 2022. REA in the loan portfolio increased by ISK 15.2 billion, even though loans to customers rose by ISK 34.5 billion. This is due to a decrease in average risk weight and a reduction in off-balance sheet commitments. Other credit risk REA decreased by ISK 14.4 billion as of 30 June 2022. This line included a one-off item related to the settlement of the Valitor sale transaction. Market risk REA decreased by ISK 7.8 billion between quarters. Other changes to REA were smaller.

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

Endorsement and statement
by the Board of Directors and the CEO

Group ownership

At the end of September 2022 Gildi lífeyrissjódur was the largest shareholder in Arion Bank with a shareholding of 9.77%. Arion Bank owned 1.57% of its own shares at the end of September 2022. The number of shareholders has grown from around 11,300 at the beginning of the year to 12,350 at the end of September 2022. Further information on Arion Bank's shareholders can be found in Note 35. At the AGM in March 2022 a motion was passed to reduce the company's share capital by ISK 150 million at nominal value, by cancelling the company's own shares. The reduction took place on 4 April 2022.

Governance

At the Bank's AGM on 16 March 2022, five members were elected to serve on the Board of Directors until the next AGM, two women and three men. Additionally, two Alternate Directors (one woman and one man) were elected. The five Directors and two Alternates are independent of Arion Bank, its management and major shareholders.

Endorsement of the Board of Directors and the Chief Executive Officer

The Condensed Consolidated Interim Financial Statements of Arion Bank for the period ended 30 September 2022 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.

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 30 September 2022 and its financial position as at 30 September 2022. 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 30 September 2022 and confirm them by means of their signatures.

Reykjavík, 26 October 2022

Board of Directors

Brynjólfur Bjarnason, Chairman

Paul Richard Horner, Vice Chairman

Gunnar Sturluson

Liv Fiksdahl

Steinunn Kristín Thórdardóttir

Chief Executive Officer

Benedikt Gíslason

Consolidated Interim Income Statement

	Notes	2022 1.1.-30.9.	2021 1.1.-30.9.	2022 1.7.-30.9.	2021 1.7.-30.9.
Interest income		61,890	38,734	23,510	12,810
Interest expense		(32,137)	(15,439)	(13,089)	(4,873)
Net interest income	6	**29,753**	**23,295**	**10,421**	**7,937**
Fee and commission income		13,881	12,044	4,766	4,219
Fee and commission expense		(1,788)	(1,450)	(764)	(464)
Net fee and commission income	7	**12,093**	**10,594**	**4,002**	**3,755**
Net insurance income	8	1,781	2,577	690	992
Net financial income	9	(3,252)	5,069	(1,332)	1,366
Share of profit of associates	25	267	33	41	7
Other operating income	10	1,016	1,423	62	833
Other net operating income		**(188)**	**9,102**	**(539)**	**3,198**
Operating income		**41,658**	**42,991**	**13,884**	**14,890**
Salaries and related expenses	11	(10,483)	(9,745)	(3,100)	(2,899)
Other operating expenses	12	(8,177)	(8,263)	(2,710)	(2,689)
Operating expenses		**(18,660)**	**(18,008)**	**(5,810)**	**(5,588)**
Bank levy	13	(1,253)	(1,171)	(444)	(486)
Net impairment	14	(267)	2,610	42	718
Earnings before income tax		**21,478**	**26,422**	**7,672**	**9,534**
Income tax expense	15	(7,994)	(5,194)	(2,803)	(1,920)
Net earnings from continuing operations		**13,484**	**21,228**	**4,869**	**7,614**
Discontinued operations held for sale, net of income tax	16	6,909	865	(6)	624
Net earnings		**20,393**	**22,093**	**4,863**	**8,238**

Attributable to

Shareholders of Arion Bank hf.		20,386	22,076	4,869	8,228
Non-controlling interest		7	17	(6)	10
Net earnings		**20,393**	**22,093**	**4,863**	**8,238**

Earnings per share

	Notes				
Earnings per share	17				
Basic earnings per share attributable to the shareholders of Arion Bank (ISK)		13.60	13.68	3.26	5.23
Diluted earnings per share attributable to the shareholders of Arion Bank (ISK)		12.87	12.86	3.08	4.91

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	2022 1.1.-30.9.	2021 1.1.-30.9.	2022 1.7.-30.9.	2021 1.7.-30.9.
Net earnings		**20,393**	**22,093**	**4,863**	**8,238**
Net change in fair value of financial assets carried at fair value through OCI, net of tax		(1,230)	(1,491)	202	(419)
Net realized gain on financial assets carried at FV through OCI, net of tax, and reclassification from OCI equity reserve, transf. to the Income Statement	9	1,449	251	22	270
Changes to reserve for financial instruments at fair value through OCI		**219**	**(1,240)**	**224**	**(149)**
Exchange difference on translating foreign subsidiaries		(676)	18	-	52
Other comprehensive loss that is or may be reclassified subsequently to the Income Statement		**(458)**	**(1,222)**	**224**	**(97)**
Total comprehensive income		**19,936**	**20,871**	**5,087**	**8,141**

Attributable to

Shareholders of Arion Bank	19,929	20,854	5,093	8,131
Non-controlling interest	7	17	(6)	10
Total comprehensive income	**19,936**	**20,871**	**5,087**	**8,141**

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	30.9.2022	31.12.2021
Cash and balances with Central Bank	18	68,149	69,057
Loans to credit institutions	19	52,643	30,272
Loans to customers	20	1,045,152	936,237
Financial instruments	21-23	223,142	225,657
Investment property	23	6,617	6,560
Investments in associates	25	785	668
Intangible assets	26	8,816	9,463
Tax assets	27	2,886	2
Assets and disposal groups held for sale	28	2,152	16,047
Other assets	29	17,544	19,901
Total Assets		**1,427,886**	**1,313,864**

Liabilities			
Due to credit institutions and Central Bank	22	5,099	5,000
Deposits	22	739,969	655,476
Financial liabilities at fair value	22	21,800	5,877
Tax liabilities	27	15,596	7,102
Liabilities associated with disposal groups held for sale	28	-	16,935
Other liabilities	30	48,506	37,151
Borrowings	22,31	376,540	356,637
Subordinated liabilities	22,32	34,089	35,088
Total Liabilities		**1,241,599**	**1,119,266**

Equity	34		
Share capital and share premium		16,764	22,684
Other reserves		9,675	12,838
Retained earnings		159,168	158,403
Total Shareholders' Equity		**185,607**	**193,925**
Non-controlling interest		680	673
Total Equity		**186,287**	**194,598**
Total Liabilities and Equity		**1,427,886**	**1,313,864**

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								Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
			Share option	Warrants reserve	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Debt invest-ments at fair value thr. OCI, unrealized	Statutory reserve	Foreign currency trans-lation reserve				
Equity 1 January 2022	1,518	21,166	99	828	7,245	3,166	1,124	(1,937)	1,637	676	158,403	**193,925**	673	**194,598**
Net earnings											20,386	**20,386**	7	**20,393**
Net change in fair value								(1,230)				**(1,230)**		**(1,230)**
Net realized gain transf. to P/L and recl. from OCI equity reserve								1,449				**1,449**		**1,449**
Translation difference										(676)		**(676)**		**(676)**
Total comprehensive income	-	-	-	-	-	-	-	219	-	(676)	20,386	**19,929**	7	**19,936**
Transactions with owners														
Dividend paid											(22,489)	**(22,489)**		**(22,489)**
Purchase of treasury shares	(36)	(6,422)										**(6,458)**		**(6,458)**
Share option charge			201									**201**		**201**
Share option vested	3	349	(38)									**314**		**314**
Incentive scheme	1	184										**185**		**185**
Changes in reserves					(1,500)	(1,277)	(91)				2,868	**-**		**-**
Equity 30 September 2022	1,486	15,278	262	828	5,745	1,889	1,033	(1,719)	1,637	-	159,168	**185,607**	680	**186,287**

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								Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
			Share option	Warrants reserve	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Debt invest-ments at fair value thr. OCI, unrealized	Statutory reserve	Foreign currency trans-lation reserve				
Equity 1 January 2021	1,718	49,613	-	-	7,421	694	1,054	(141)	1,637	655	135,021	**197,672**	173	**197,845**
Net earnings											22,076	**22,076**	17	**22,093**
Net change in fair value								(1,491)				**(1,491)**		**(1,491)**
Net realized gain transferred to P/L ...								251				**251**		**251**
Translation difference										18		**18**		**18**
Total comprehensive income	-	-	-	-	-	-	-	(1,240)	-	18	22,076	**20,854**	17	**20,871**
Transactions with owners														
Dividend paid											(2,857)	**(2,857)**		**(2,857)**
Purchase of treasury shares	(168)	(22,500)										**(22,668)**		**(22,668)**
Share option charge			72									**72**		**72**
Warrants sold				828								**828**		**828**
Increase in non-controlling interests												**-**	490	**490**
Changes in reserves					(1,192)	2,118	99				(1,025)	**-**		**-**
Equity 30 September 2021	1,550	27,113	72	828	6,229	2,812	1,153	(1,381)	1,637	673	153,215	**193,901**	680	**194,581**

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

	2022	2021
Operating activities	1.1.-30.9.	1.1.-30.9.
Net earnings	20,393	22,093
Non-cash items included in net earnings	(21,919)	(23,061)
Changes in operating assets and liabilities		
Loans to credit institutions, excluding bank accounts	170	(2,059)
Loans to customers	(95,239)	(74,482)
Financial instruments and financial liabilities at fair value	3,313	(12,944)
Deposits	60,607	68,822
Borrowings	33,002	49,299
Other changes in operating assets and liabilities	1,675	(2,147)
Interest received	48,219	37,510
Interest paid	(13,798)	(9,832)
Dividend received	342	83
Income tax paid	(2,384)	(2,467)
Net cash from operating activities	**34,381**	**50,815**
Investing activities		
Proceeds from sale of subsidiary and associates	15,825	250
Acquisition of associates	(90)	(30)
Acquisition of intangible assets	(169)	(842)
Proceeds from sale of property and equipment	1,071	558
Acquisition of property and equipment	(240)	(409)
Net cash from (to) investing activities	**16,397**	**(473)**
Financing activities		
Proceeds from issued warrants	-	828
Proceeds from vested share options	352	-
Purchase of treasury stock	(6,458)	(22,668)
Dividend paid to shareholders of Arion Bank	(22,489)	(2,857)
Net cash used in financing activities	**(28,595)**	**(24,697)**
Net increase in cash and cash equivalents	22,183	25,645
Cash and cash equivalents at beginning of the year	90,678	58,284
Effect of exchange rate changes on cash and cash equivalents	(1,211)	2,261
Cash and cash equivalents	**111,650**	**86,190**
Cash and cash equivalents		
Cash and balances with Central Bank	68,149	70,136
Bank accounts	50,703	22,381
Mandatory reserve deposit with Central Bank	(7,202)	(6,327)
Cash and cash equivalents	**111,650**	**86,190**

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

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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 30 September 2022 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 26 October 2022.

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 Consolidated Financial Statements for the year ended 31 December 2021. The Annual Consolidated Financial Statements are available on Arion Bank's website www.arionbanki.is.

Statement of compliance

The Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union and additional requirements in the Icelandic Financial Statements Act, Financial Undertakings Act and rules on Accounting for Credit Institutions.

The same accounting policies, presentation and methods of computation are followed in these Condensed Consolidated Interim Financial Statements as were applied in the Consolidated Financial Statements for the year ended 31 December 2021.

Basis of measurement

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

- bonds and debt instruments, shares and equity instruments, short positions in listed bonds and equities and derivatives. For details on the accounting policy, see Note 56 in the Consolidated Financial Statements 2021;
- 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 144.47 and 141.32 for EUR (31.12.2021: USD 129.75 and EUR 147.60).

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 judgements 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.

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 three 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 2021.

Macroeconomic outlook

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

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 disposal groups. For further information on assets and disposal groups held for sale, see Note 28.

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 the Consolidated Income Statement. The recoverable amount of an asset is the greater of its value in use and its fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Revaluation of investment properties

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

4. The Group

			Equity interest	
Shares in the main subsidiaries in which Arion Bank holds a direct interest	Operating activity	Currency	30.09.2022	31.12.2021
Eignabjarg ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Leiguskjól ehf., Bjargargata 1, Reykjavík, Iceland	Rental guarantee	ISK	51.0%	51.0%
SRL slhf., Borgartún 19, Reykjavík, Iceland	Real estate	ISK	100.0%	100.0%
Stefnir hf., Borgartún 19, Reykjavík, Iceland	Asset management	ISK	100.0%	100.0%
Valitor hf., Dalshraun 3, Hafnarfjördur, Iceland	Payment solutions	ISK	-	100.0%
VISA Ísland ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Vördur tryggingar hf., Borgartún 19, Reykjavík, Iceland	Insurance	ISK	100.0%	100.0%

On 30 June 2022 Arion Bank sold its entire shareholding in the subsidiary Valitor hf. Valitor was classified as held for sale in accordance with IFRS. For further information, see Note 28.

Stakksberg ehf. and Sólbjarg ehf., the subsidiaries of the holding company Eignabjarg ehf., are classified as held for sale in accordance with IFRS 5, see Note 28 for further information.

SRL slhf. holds a 51% shareholding in its subsidiary Arnarland ehf. and recognizes minority interest accordingly.

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. The business units are segmented according to customers, products and services characteristics. Segment performance is evaluated based on earnings before tax.

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

5. Operating segments

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

Markets & Stefnir

Markets & Stefnir comprise Asset Management and Capital Markets. Asset Management manages financial assets on behalf of its customers according to a pre-determined investment strategy. Asset Management also administers pension funds. Asset management comprises Institutional Asset Management, 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. Arion Bank also offers comprehensive selection off funds from some of the leading international fund management companies. Capital Markets is a securities brokerage and brokers listed securities transactions for the Bank’s international and domestic clients on all the world’s major securities exchanges.

Corporate & Investment Banking (CIB)

Corporate & Investment Banking provides companies and investors with comprehensive financial services that meet the needs of each client, both in Iceland and internationally. The division is divided into Corporate Banking and Corporate Finance.

Corporate Banking's experienced account managers specialize in key economic sectors such as retail and services, seafood, energy and real estate. The division serves companies ranging from SMEs to large cap companies and provides a full range of lending and insurance products, including guarantees, deposit accounts, payment solutions, and, a variety of value-added digital solutions. The Corporate Banking portfolio includes several larger international transactions, partly in syndicates with other Icelandic or international banks.

Arion Bank‘s Corporate Finance works closely with Corporate Banking and provides the Bank’s clients with financial advisory services, with a key focus on M&A advisory, private placements of equity and IPOs and other offerings of securities.

Retail Banking

Retail Banking provides a diverse range of financial services in 15 branches and service points across Iceland and offers digital solutions both in the Arion app and online banking. These services include deposits and loans, savings, payment cards, pensions, insurance, securities and funds. In order to improve efficiency the branch network is split into four regions, and smaller branches can therefore benefit from the strength of larger units within each region. Retail Banking has more than 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.

Other subsidiaries

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

Supporting units

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

Notes to the Condensed Consolidated Interim Financial Statements

5. Operating segments, continued

1.1.-30.9.2022 *Income Statement*	Markets and Stefnir	CIB including insurance	Retail Banking including insurance	Treasury	Subsidi-aries excl. Stefnir and Vördur	Supporting units and elimi-nations	Total
Net interest income	2,295	14,439	14,241	(1,151)	(7)	(64)	29,753
Net fee and commission income	4,443	4,144	3,510	549	(547)	(6)	12,093
Net insurance income	-	(95)	1,943	-	(2)	(65)	1,781
Net financial income	(110)	(159)	(733)	(2,661)	478	(67)	(3,252)
Share of profit of associates	-	-	-	-	-	267	267
Other operating income	-	114	89	1	43	769	1,016
Operating income	6,628	18,443	19,050	(3,262)	(35)	834	41,658
Operating expenses	(1,490)	(1,785)	(3,717)	(494)	(198)	(10,976)	(18,660)
Allocated expenses	(1,417)	(2,651)	(5,346)	(884)	(31)	10,329	-
Bank levy	(50)	(396)	(584)	(223)	-	-	(1,253)
Net impairment	(1)	171	291	-	(39)	(689)	(267)
Earnings (loss) before income tax	3,670	13,782	9,694	(4,863)	(303)	(502)	21,478
Net seg. rev. from ext. customers	1,913	20,084	34,947	(16,945)	701	958	41,658
Net seg. rev. from other segments	4,715	(1,641)	(15,897)	13,683	(736)	(124)	-
Operating income	6,628	18,443	19,050	(3,262)	(35)	834	41,658
Balance Sheet							
Loans to customers	55	427,068	619,339	1	3	(1,314)	1,045,152
Financial instruments	42,349	7,843	19,233	153,301	3,268	(2,852)	223,142
Other external assets	5,726	4,550	9,216	103,063	10,396	26,641	159,592
Internal assets	39,855	-	-	277,866	18,756	(336,477)	-
Total assets	87,985	439,461	647,788	534,231	32,423	(314,002)	1,427,886
Deposits	75,728	263,545	321,702	80,785	-	(1,791)	739,969
Other external liabilities	3,310	12,405	19,734	420,022	21,893	24,266	501,630
Internal liabilities	-	88,687	247,790	-	-	(336,477)	-
Total liabilities	79,038	364,637	589,226	500,807	21,893	(314,002)	1,241,599
Allocated equity	8,947	74,824	58,562	33,424	10,530	-	186,287

Amounts are in ISK millions

5. Operating segments, continued

1.1.-30.9.2021 *Income Statement*	Markets and Stefnir	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other sub-sidiaries	Supporting units and elimi-nations	Total
Net interest income	594	8,753	11,424	2,569	67	(90)	(22)	23,295
Net fee and commission income	4,129	3,497	2,991	450	(143)	(530)	200	10,594
Net insurance income	-	-	-	-	2,634	-	(57)	2,577
Net financial income	272	1,075	-	2,352	1,569	(199)	-	5,069
Share of profit of associates	-	(8)	-	-	-	-	41	33
Other operating income	3	16	434	30	24	555	361	1,423
Operating income	4,998	13,333	14,849	5,401	4,151	(264)	523	42,991
Operating expenses	(1,302)	(1,072)	(3,692)	(394)	(1,788)	(167)	(9,593)	(18,008)
Allocated expenses	(1,424)	(1,952)	(4,995)	(743)	(13)	(3)	9,130	-
Bank levy	(52)	(338)	(559)	(222)	-	-	-	(1,171)
Net impairment	-	2,129	1,425	1	-	(601)	(344)	2,610
Earnings (loss) before income tax	2,220	12,100	7,028	4,043	2,350	(1,035)	(284)	26,422
Net seg. rev. from ext. customers	3,438	16,494	24,320	(6,049)	4,032	473	283	42,991
Net seg. rev. from other segments	1,560	(3,161)	(9,471)	11,450	119	(737)	240	-
Operating income	4,998	13,333	14,849	5,401	4,151	(264)	523	42,991
Balance Sheet								
Loans to customers	26	351,308	547,224	9	-	3	(1,630)	896,940
Financial instruments	58,346	351	-	165,614	25,343	2,726	(2,401)	249,979
Other external assets	5,445	8,894	2,837	130,763	8,448	36,875	5,911	199,173
Internal assets	26,977	-	-	277,695	-	-	(304,672)	-
Total assets	90,794	360,553	550,061	574,081	33,791	39,604	(302,792)	1,346,092
Deposits	77,832	214,634	291,385	69,613	-	-	(12,158)	641,306
Other external liabilities	5,229	5,007	1,513	451,325	21,205	11,889	14,038	510,206
Internal liabilities	-	83,681	211,131	-	971	8,889	(304,672)	-
Total liabilities	83,061	303,322	504,029	520,938	22,176	20,778	(302,792)	1,151,512
Allocated equity	7,733	57,231	46,032	53,143	11,615	18,826	-	194,580

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

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Consolidated Interim Income Statement

Quarterly statements

6. Operations by quarters, unaudited

2022	Q1	Q2	Q3	Total
Net interest income	9,528	9,804	10,421	29,753
Net fee and commission income	3,552	4,539	4,002	12,093
Net insurance income	5	1,086	690	1,781
Net financial income	991	(2,911)	(1,332)	(3,252)
Share of profit of associates	203	23	41	267
Other operating income	235	719	62	1,016
Operating income	14,514	13,260	13,884	41,658
Salaries and related expense	(3,540)	(3,843)	(3,100)	(10,483)
Other operating expense	(2,661)	(2,806)	(2,710)	(8,177)
Operating expenses	(6,201)	(6,649)	(5,810)	(18,660)
Bank levy	(393)	(416)	(444)	(1,253)
Net impairment	(495)	186	42	(267)
Earnings before income tax	7,425	6,381	7,672	21,478
Income tax expense	(1,703)	(3,488)	(2,803)	(7,994)
Net earnings from continuing operations	5,722	2,893	4,869	13,484
Discontinued operations, net of tax	96	6,819	(6)	6,909
Net earnings	5,818	9,712	4,863	20,393

2021	Q1	Q2	Q3	Total
Net interest income	7,342	8,016	7,937	23,295
Net fee and commission income	3,277	3,562	3,755	10,594
Net insurance income	671	914	992	2,577
Net financial income	1,500	2,203	1,366	5,069
Share of profit of associates	1	25	7	33
Other operating income	306	284	833	1,423
Operating income	13,097	15,004	14,890	42,991
Salaries and related expense	(3,271)	(3,575)	(2,899)	(9,745)
Other operating expense	(2,777)	(2,797)	(2,689)	(8,263)
Operating expenses	(6,048)	(6,372)	(5,588)	(18,008)
Bank levy	(330)	(355)	(486)	(1,171)
Net impairment	1,080	812	718	2,610
Earnings before income tax	7,799	9,089	9,534	26,422
Income tax expense	(1,866)	(1,408)	(1,920)	(5,194)
Net earnings from continuing operations	5,933	7,681	7,614	21,228
Discontinued operations, net of tax	106	135	624	865
Net earnings	6,039	7,816	8,238	22,093

Amounts are in ISK millions

6. Net interest income

1.1.-30.9.2022	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	2,106	-	-	2,106
Loans to credit institutions	64	53	-	117
Loans to customers	56,835	-	-	56,835
Securities	-	620	2,032	2,652
Other	180	-	-	180
Interest income	59,185	673	2,032	61,890
Interest expense				
Deposits	(15,886)	-	-	(15,886)
Borrowings	(14,398)	-	-	(14,398)
Subordinated liabilities	(1,724)	-	-	(1,724)
Other	(129)	-	-	(129)
Interest expense	(32,137)	-	-	(32,137)
Net interest income	27,048	673	2,032	29,753

1.1.-30.9.2021	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	385	-	-	385
Loans to credit institutions	65	35	-	100
Loans to customers	35,136	-	-	35,136
Securities	-	981	1,990	2,971
Other	142	-	-	142
Interest income	35,728	1,016	1,990	38,734
Interest expense				
Deposits	(4,497)	-	-	(4,497)
Borrowings	(9,461)	-	-	(9,461)
Subordinated liabilities	(1,393)	-	-	(1,393)
Other	(88)	-	-	(88)
Interest expense	(15,439)	-	-	(15,439)
Net interest income	20,289	1,016	1,990	23,295

Net interest income calculated using the effective interest rate method were ISK 61,710 million during the period (9M 2021: ISK 38,592 million).

Amounts are in ISK millions

6. Net interest income, cont.

1.7.-30.9.2022	Amortized	Fair value	Fair value	
Interest income	cost	thr. P/L	thr. OCI	Total
Cash and balances with Central Bank	993	-	-	993
Loans to credit institutions	48	21	-	69
Loans to customers	21,419	-	-	21,419
Securities	-	178	789	967
Other	62	-	-	62
Interest income	22,522	199	789	23,510
Interest expense				
Deposits	(7,158)	-	-	(7,158)
Borrowings	(5,269)	-	-	(5,269)
Subordinated liabilities	(624)	-	-	(624)
Other	(38)	-	-	(38)
Interest expense	(13,089)	-	-	(13,089)
Net interest income	9,433	199	789	10,421

1.7.-30.9.2021				
Interest income				
Cash and balances with Central Bank	176	-	-	176
Loans to credit institutions	29	14	-	43
Loans to customers	11,461	-	-	11,461
Securities	-	377	701	1,078
Other	52	-	-	52
Interest income	11,718	391	701	12,810
Interest expense				
Deposits	(1,386)	-	-	(1,386)
Borrowings	(3,003)	-	-	(3,003)
Subordinated liabilities	(455)	-	-	(455)
Other	(29)	-	-	(29)
Interest expense	(4,873)	-	-	(4,873)
Net interest income	6,845	391	701	7,937

Net interest income calculated using the effective interest rate method were ISK 23,448 million during the second quarte (Q3 2021: ISK 12,758 million).

	2022	2021	2022	2021
Interest spread	1.1.-30.9.	1.1.-30.9.	1.7.-30.9.	1.7.-30.9.
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	3.1%	2.7%	3.2%	2.7%

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

7. Net fee and commission income

	1.1.-30.9.2022			1.1.-30.9.2021		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	4,107	(436)	3,671	3,949	(373)	3,576
Capital markets and corporate finance	2,470	(34)	2,436	1,888	(24)	1,864
Lending and financial guarantees	3,381	-	3,381	3,348	-	3,348
Collection and payment services	1,144	(80)	1,064	1,045	(89)	956
Cards and payment solution	2,127	(711)	1,416	1,283	(372)	911
Other	652	(527)	125	531	(592)	(61)
Net fee and commission income	13,881	(1,788)	12,093	12,044	(1,450)	10,594

	1.7.-30.9.2022			1.7.-30.9.2021		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	1,390	(135)	1,255	1,596	(128)	1,468
Capital markets and corporate finance	571	(10)	561	503	(7)	496
Lending and financial guarantees	874	-	874	1,065	-	1,065
Collection and payment services	413	(27)	386	395	(22)	373
Cards and payment solution	1,231	(444)	787	494	(150)	344
Other	287	(148)	139	166	(157)	9
Net fee and commission income	4,766	(764)	4,002	4,219	(464)	3,755

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

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

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

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

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

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

8. Net insurance income

	2022 1.1.-30.9.	2021 1.1.-30.9.	2022 1.7.-30.9.	2021 1.7.-30.9.
Earned premiums, net of reinsurers' share				
Premiums written	12,128	11,056	3,436	3,169
Premiums written, reinsurers' shares	(425)	(368)	(142)	(109)
Change in provision for unearned premiums	(1,181)	(1,146)	372	259
Earned premiums, net of reinsurers' share	10,522	9,542	3,666	3,319
Claims incurred, net of reinsurers' share				
Claims paid	(7,134)	(6,007)	(2,240)	(1,729)
Claims paid, reinsurers' share	248	129	65	12
Change in provision for claims	(1,930)	(1,078)	(836)	(608)
Changes in provision for claims, reinsurers' share	75	(9)	35	(2)
Claims incurred, net of reinsurers' share	(8,741)	(6,965)	(2,976)	(2,327)
Net insurance income	1,781	2,577	690	992
Combined ratio				
Combined ratio	99.5%	91.7%	96.1%	85.5%

Amounts are in ISK millions

9. Net financial income

	2022 1.1.-30.9.	2021 1.1.-30.9.	2022 1.7.-30.9.	2021 1.7.-30.9.
Net (loss) gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	(1,081)	5,253	(1,219)	1,613
Gain on prepayments of borrowings	14	-	81	-
Net loss on fair value hedge of interest rate swap	(340)	(29)	(195)	(2)
Net realized loss on financial assets carried at fair value through OCI and reclassification from OCI equity reserve	(1,958)	(339)	(30)	(365)
Net foreign exchange gain	113	184	31	120
Net financial income	(3,252)	5,069	(1,332)	1,366

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

Equity instruments	(1,506)	3,982	(890)	1,331
Debt instruments	(519)	1,184	(455)	210
Derivatives	944	87	126	72
Net (loss) gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	(1,081)	5,253	(1,219)	1,613

Net loss on fair value hedge of interest rate swap

Fair value change of interest rate swaps designated as hedging instruments	(13,919)	(1,045)	(5,841)	(314)
Fair value change on bonds issued by the Group attributable to interest rate risk	13,579	1,016	5,646	312
Net loss on fair value hedge of interest rate swap	(340)	(29)	(195)	(2)

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

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

10. Other operating income

	2022 1.1.-30.9.	2021 1.1.-30.9.	2022 1.7.-30.9.	2021 1.7.-30.9.
Net gain on disposal of assets	722	280	8	-
Net gain on assets held for sale	130	188	23	(7)
Fair value changes on investment property	20	545	-	545
Other income	144	410	31	295
Other operating income	1,016	1,423	62	833

Net gain on assets held for sale

Income from real estates and other assets	137	216	23	4
Expense related to real estates and other assets	(7)	(28)	-	(11)
Net gain on assets held for sale	130	188	23	(7)

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

Amounts are in ISK millions

11. Personnel and salaries

	2022 1.1.-30.9.	2021 1.1.-30.9.	2022 1.7.-30.9.	2021 1.7.-30.9.
Number of employees				
Average number of full-time equivalent positions during the period	752	758	757	752
Full-time equivalent positions at the end of the period	777	763	777	763
Salaries and related expenses				
Salaries	7,916	7,614	2,332	2,209
Incentive scheme	19	-	10	-
Share-based payment expenses	201	72	77	27
Defined contribution pension plans	1,181	1,127	346	327
Salary-related expenses	1,166	1,093	335	336
Capitalization of salaries due to implementation of core systems	-	(161)	-	-
Salaries and related expenses	10,483	9,745	3,100	2,899

Incentive schemes

During the period the Group made a provision of ISK 25 million (2021: ISK 38 million) for the incentive scheme, including salary-related expenses. At the end of the period the Group's accrual for the incentive scheme payments amounted to ISK 419 million (31.12.2021: ISK 1,638 million).

Revised incentive scheme for Arion Bank hf. and Vördur came into effect in 2021. The scheme is in compliance with the FSA's rules on remuneration policy for financial institutions. The scheme is split into two parts. Firstly, employees can receive up to 10% of their fixed salary for each fiscal year in the form of a cash payment. Secondly, a limited group can receive up to 25% of their fixed salary as a payment in the form of shares in the Bank which will be subject to a three-year lock-up period. The key metric used to determine whether incentive scheme payments will be paid by the Bank, in part or in full, is whether the Bank's return on equity is higher than the weighted ROE of the Bank's main competitors. Other supporting metrics are for example ROE and cost-to-income ratio vs target, compliance, staff NPS etc. Corresponding metrics are for incentive scheme payment at Vördur, i.e. higher ROE than the Icelandic competitors and other internal measures. Stefnir hf. has a special incentive scheme where other criteria are used as a basis. No accrual was recognised in the Consolidated Interim Income Statement for the period. Given that all criterion will be met the maximum total expense is estimated to be ISK 1.6 billion, including salary related expenses, or ISK 0.7 billion due to the Group subject to the 10% of their fixed salary and ISK 0.9 billion due to the group subject to the 25% of their fixed salary.

Share-based payment expense

Arion Bank has in place a share option plan for all employees of the Bank, Vördur and Stefnir, approved at the Banks annual general meeting, under which employees may be granted options to purchase ordinary shares at an exercise price determined by the Bank's average share price 10 days prior to issue date. The employee must remain continuously employed with Arion Bank until the expiring date. The options carry neither rights to dividends nor voting rights and are valued using the Black-Scholes pricing model. A total expense of ISK 201 million was recognised in the Income Statement during the period (2021: ISK 45 million). Estimated remaining expenses due the share option contracts are ISK 461 million and will be expensed over the next four years. For further information on the share option program, see Note 34.

12. Other operating expenses

	2022 1.1.-30.9.	2021 1.1.-30.9.	2022 1.7.-30.9.	2021 1.7.-30.9.
IT expenses	3,272	3,555	1,110	1,099
Professional services	801	656	285	229
Housing expenses	519	541	175	180
Other administration expenses	2,172	1,792	724	560
Depositors' and Investors' Guarantee Fund	138	411	-	133
Depreciation of property and equipment	373	415	123	152
Depreciation of right of use asset	86	94	30	33
Amortization of intangible assets	816	799	263	303
Other operating expenses	8,177	8,263	2,710	2,689

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

13. Bank levy

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

14. Net impairment

Net impairment on financial instruments and value changes on loans	2022 1.1.-30.9.	2021 1.1.-30.9.	2022 1.7.-30.9.	2021 1.7.-30.9.
Net impairment on loans to customers and financial institutions	(505)	2,059	8	408
Net impairment on other financial instruments at FVOCI	2	1	1	(7)
Other value changes of loans - corporates	132	63	7	39
Other value changes of loans - individuals	104	487	26	278
Net impairment	(267)	2,610	42	718
Net impairment by customer type				
Individuals	267	63	(9)	(21)
Corporates	(534)	696	51	305
Financial institutions	-	1,851	-	434
Net impairment	(267)	2,610	42	718

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

15. Income tax expense

	2022 1.1.-30.9.	2021 1.1.-30.9.	2022 1.7.-30.9.	2021 1.7.-30.9.
Current tax expense	11,426	4,963	4,442	1,832
Deferred tax expense (income)	(3,432)	231	(1,639)	88
Income tax expense	7,994	5,194	2,803	1,920

Reconciliation of effective tax rate	2022 1.1.-30.9.		2021 1.1.-30.9.	
Earnings before income tax		21,478		26,422
Income tax using the Icelandic corporate tax rate	20.0%	4,296	20.0%	5,284
Additional 6% tax on Financial Undertakings	12.0%	2,577	3.6%	952
Non-deductible expenses	0.2%	42	0.1%	33
Tax exempt revenues / loss	2.1%	442	(4.8%)	(1,269)
Non-deductible taxes (Bank levy)	1.2%	251	0.9%	234
Tax incentives not recognized in the Income Statement	1.6%	337	(0.9%)	(234)
Other changes	0.2%	49	0.7%	194
Effective tax rate	37.2%	7,994	19.7%	5,194

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

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

Amounts are in ISK millions

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

	2022 1.1.-30.9.	2021 1.1.-30.9.	2022 1.7.-30.9.	2021 1.7.-30.9.
Net gain from discontinued operations held for sale	7,056	861	(12)	604
Income tax expense	(147)	4	6	20
Discontinued operations held for sale, net of income tax	6,909	865	(6)	624
Valitor hf.	6,656	470	(20)	184
Stakksberg ehf.	(275)	(55)	(11)	15
Sólbjarg ehf.	528	450	25	425
Discontinued operations held for sale, net of income tax	6,909	865	(6)	624

On 1 July 2022 the sale of Valitor was settled but as all conditions were met at the end of June, the sale was fully accounted for in the second quarter. The financial effects from the sale, less cost to sell, was ISK 5.6 billion and was recognized in the Income Statement. The net profit from Valitor's operation was ISK 627 million during the first six months of 2022 whereas Valitor's positive contribution to the Group, after taking into account the Group's eliminations, was ISK 1,106 million. For the first six months of 2022 operating income of Valitor was ISK 3,322 million, or ISK 3,822 million after taking into account the Group's eliminations.

Operating effects of Sólbjarg are mainly due to a purchase agreement of assets held by the company.

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

17. Earnings per share

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

	Continued operations		Discontinued operations		Net Earnings	
	2022	2021	2022	2021	2022	2021
1.1.-30.9.						
Net earnings attributable to the shareholders of Arion Bank	13,477	21,211	6,909	865	20,386	22,076
Weighted average number of outstanding shares (millions)	1,499	1,614	1,499	1,614	1,499	1,614
Weighted average number of outstanding shares including warrants and options (millions)	1,584	1,717	1,584	1,717	1,584	1,717
Basic earnings per share (ISK)	8.99	13.14	4.61	0.54	13.60	13.68
Diluted earnings per share (ISK)	8.51	12.35	4.36	0.50	12.87	12.86
1.7.-30.9.						
Net earnings attributable to the shareholders of Arion Bank	4,875	7,604	(6)	624	4,869	8,228
Weighted average number of outstanding shares (millions)	1,495	1,573	1,495	1,573	1,495	1,573
Weighted average number of outstanding shares including warrants and options (millions)	1,580	1,677	1,580	1,677	1,580	1,677
Basic earnings per share (ISK)	3.26	4.83	0.00	0.40	3.26	5.23
Diluted earnings per share (ISK)	3.09	4.53	0.00	0.37	3.08	4.91

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Consolidated Interim Statement of Financial Position

18. Cash and balances with Central Bank

	30.9.2022	31.12.2021
Cash on hand	3,941	3,556
Cash with Central Bank	57,006	58,966
Mandatory reserve deposit with Central Bank	7,202	6,535
Cash and balances with Central Bank	68,149	69,057

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

19. Loans to credit institutions

	30.9.2022	31.12.2021
Bank accounts	50,703	28,156
Other loans	1,940	2,116
Loans to credit institutions	52,643	30,272

20. Loans to customers

	Individuals		Corporates		Total	
30.9.2022	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
Overdrafts	15,008	14,521	28,933	28,282	43,941	42,803
Credit cards	14,605	14,453	1,835	1,791	16,440	16,244
Mortgage loans	502,537	502,148	60,573	60,469	563,110	562,617
Construction loans	-	-	23,415	23,297	23,415	23,297
Capital lease	4,612	4,595	3,936	3,904	8,548	8,499
Other loans	36,588	35,770	361,125	355,922	397,713	391,692
Loans to customers	573,350	571,487	479,817	473,665	1,053,167	1,045,152
31.12.2021						
Overdrafts	14,255	13,691	18,301	17,785	32,556	31,476
Credit cards	13,192	13,037	1,449	1,409	14,641	14,446
Mortgage loans	463,895	463,457	41,588	41,420	505,483	504,877
Construction loans	-	-	17,798	17,775	17,798	17,775
Capital lease	4,471	4,451	3,882	3,843	8,353	8,294
Other loans	32,573	31,862	332,433	327,507	365,006	359,369
Loans to customers	528,386	526,498	415,451	409,739	943,837	936,237

The total book value of pledged loans that were pledged against amounts borrowed was ISK 309 billion at the end of the period (31.12.2021: ISK 267 billion). Pledged loans comprised mortgage loans to individuals.

Further analysis of loans is provided in Risk management disclosures.

21. Financial instruments

	30.9.2022	31.12.2021
Bonds and debt instruments	157,465	151,852
Shares and equity instruments with variable income	20,290	25,063
Derivatives	8,203	2,905
Securities used for economic hedging	37,184	45,837
Financial instruments	223,142	225,657

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

22. Financial assets and financial liabilities

30.9.2022	Amortized cost	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	68,149	-	-	68,149
Loans to credit institutions	50,702	-	1,941	52,643
Loans to customers	1,045,152	-	-	1,045,152
Loans	1,164,003	-	1,941	1,165,944
Bonds and debt instruments				
Listed	-	134,250	22,578	156,828
Unlisted	-	-	637	637
Bonds and debt instruments	-	134,250	23,215	157,465
Shares and equity instruments with variable income				
Listed	-	-	8,729	8,729
Unlisted	-	-	9,193	9,193
Bond funds with variable income, unlisted	-	-	2,368	2,368
Shares and equity instruments with variable income	-	-	20,290	20,290
Derivatives				
OTC derivatives	-	-	8,203	8,203
Derivatives	-	-	8,203	8,203
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	7,449	7,449
Shares and equity instruments with variable income, listed	-	-	29,735	29,735
Securities used for economic hedging	-	-	37,184	37,184
Other financial assets				
Accounts receivable	5,699	-	-	5,699
Other financial assets	5,092	-	-	5,092
Other financial assets	10,791	-	-	10,791
Financial assets	1,174,794	134,250	90,833	1,399,877
Financial liabilities				
Due to credit institutions and Central Bank	5,099	-	-	5,099
Deposits	739,969	-	-	739,969
Borrowings *	376,540	-	-	376,540
Subordinated liabilities *	34,089	-	-	34,089
Derivatives	-	-	7,491	7,491
Derivatives used for hedge accounting	-	-	14,309	14,309
Other financial liabilities	18,211	-	-	18,211
Financial liabilities	1,173,908	-	21,800	1,195,708

* Including effect from hedge accounting derivatives.

Amounts are in ISK millions

22. Financial assets and financial liabilities, continued

31.12.2021	Amortized cost	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	69,057	-	-	69,057
Loans to credit institutions	28,156	-	2,116	30,272
Loans to customers	936,237	-	-	936,237
Loans	1,033,450	-	2,116	1,035,566
Bonds and debt instruments				
Listed	-	133,825	17,344	151,169
Unlisted	-	-	683	683
Bonds and debt instruments	-	133,825	18,027	151,852
Shares and equity instruments with variable income				
Listed	-	-	7,707	7,707
Unlisted	-	-	13,079	13,079
Bond funds with variable income, unlisted	-	-	4,277	4,277
Shares and equity instruments with variable income	-	-	25,063	25,063
Derivatives				
OTC derivatives	-	-	1,805	1,805
Derivatives used for hedge accounting	-	-	1,100	1,100
Derivatives	-	-	2,905	2,905
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	14,044	14,044
Shares and equity instruments with variable income, listed	-	-	31,793	31,793
Securities used for economic hedging	-	-	45,837	45,837
Other financial assets				
Accounts receivable	5,104	-	-	5,104
Other financial assets	7,617	-	-	7,617
Other financial assets	12,721	-	-	12,721
Financial assets	1,046,171	133,825	93,948	1,273,944
Financial liabilities				
Due to credit institutions and Central Bank	5,000	-	-	5,000
Deposits	655,476	-	-	655,476
Borrowings *	356,637	-	-	356,637
Subordinated liabilities *	35,088	-	-	35,088
Derivatives	-	-	4,974	4,974
Derivatives used for hedge accounting	-	-	903	903
Other financial liabilities	8,685	-	-	8,685
Financial liabilities	1,060,886	-	5,877	1,066,763

* Including effect from hedge accounting derivatives.

Amounts are in ISK millions

22. Financial assets and financial liabilities, continued

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

30.9.2022	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial and insurance activities	19,454	9,636	29,090
Public sector	114,796	11,119	125,915
Corporates	-	2,460	2,460
Bonds and debt instruments at fair value	134,250	23,215	157,465
31.12.2021			
Financial and insurance activities	21,001	7,561	28,562
Public sector	112,824	8,325	121,149
Corporates	-	2,141	2,141
Bonds and debt instruments at fair value	133,825	18,027	151,852

The total amount of pledged bonds was ISK 8.7 billion at the end of the period (31.12.2021: ISK 8.6 billion). Pledged bonds comprised Icelandic Government Bonds and Financial Institutions Bonds that were pledged against funding received and included in Due to credit institutions and Central Bank as well as short positions included in Financial liabilities at fair value.

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

30.9.2022

Assets at fair value	Level 1	Level 2	Level 3	Total
Loans to credit institutions	-	1,941	-	1,941
Bonds and debt instruments	155,041	2,326	98	157,465
Shares and equity instruments with variable income	6,109	12,190	1,991	20,290
Derivatives	-	8,203	-	8,203
Securities used for economic hedging	37,184	-	-	37,184
Investment property	-	-	6,617	6,617
Assets at fair value	198,334	24,660	8,706	231,700
Liabilities at fair value				
Derivatives	-	7,491	-	7,491
Derivatives used for hedge accounting	-	14,309	-	14,309
Liabilities at fair value	-	21,800	-	21,800

Amounts are in ISK millions

23. Fair value hierarchy, continued

31.12.2021

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

Transfers from Level 1 to Level 2 amounted to ISK 1,129 million during the period (2021: Transfers from Level 1 to Level 2 ISK 172 million and transfers from Level 2 to Level 1 ISK 122 million).

Fair value of assets and liabilities

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

Methods for establishing fair value

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

In some cases, the carrying value of an asset in Note 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		
30.9.2022	property	Bonds	Shares	Total
Balance at the beginning of the year	6,560	97	3,808	10,465
Net fair value changes	20	3	46	69
Additions	44	-	4	48
Disposals	(7)	(2)	(1,734)	(1,743)
Transfers out of Level 3	-	-	(133)	(133)
Balance at the end of the period	6,617	98	1,991	8,706
31.12.2021				
Balance at the beginning of the year	6,132	358	1,685	8,175
Net fair value changes	545	12	664	1,221
Additions	15	301	1,655	1,971
Disposal	(132)	(574)	(196)	(902)
Balance at the end of the period	6,560	97	3,808	10,465

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

1.1.-30.9.2022				
Net financial income	-	3	46	49
Other operating income	17	-	-	17
Effects recognized in the Income Statement	17	3	46	66
1.1.-30.9.2021				
Net financial income	-	11	643	654
Other operating income	573	-	-	573
Effects recognized in the Income Statement	573	11	643	1,227

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

30.9.2022 *Financial assets not carried at fair value*	Carrying value	Fair value	Unrealized gain (loss)
Cash and balances with Central Bank	68,149	68,149	-
Loans to credit institutions	52,643	52,643	-
Loans to customers	1,045,152	1,021,323	(23,829)
Other financial assets	10,791	10,791	-
Financial assets not carried at fair value	1,176,735	1,152,906	(23,829)
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	5,099	5,099	-
Deposits	739,969	739,969	-
Borrowings	376,540	371,614	4,926
Subordinated liabilities	34,089	30,524	3,565
Other financial liabilities	18,211	18,211	-
Financial liabilities not carried at fair value	1,173,908	1,165,417	8,491
31.12.2021			
Financial assets not carried at fair value			
Cash and balances with Central Bank	69,057	69,057	-
Loans to credit institutions	30,272	30,272	-
Loans to customers	936,237	937,179	942
Other financial assets	12,721	12,721	-
Financial assets not carried at fair value	1,048,287	1,049,229	942
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	5,000	5,000	-
Deposits	655,476	655,476	-
Borrowings	356,637	367,470	(10,833)
Subordinated liabilities	35,088	35,590	(502)
Other financial liabilities	8,685	8,685	-
Financial liabilities not carried at fair value	1,060,886	1,072,221	(11,335)

Loans to customers largely bear variable interest rates. Those loans, including corporate loans, are presented at book value as they generally have a short duration and very limited interest rate risk. Loans with fixed interest rates, mainly 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.

Derivatives

	Notional value	Fair value	
30.9.2022		Assets	Liabilities
Forward exchange rate agreements	104,318	2,409	1,700
Fair value hedge of interest rate swap	231,581	-	14,309
Interest rate and exchange rate agreements	81,594	869	4,164
Bond swap agreements	12,304	485	32
Share swap agreements	43,786	4,076	1,595
Options - purchased agreements, unlisted	-	364	-
Derivatives	473,583	8,203	21,800
31.12.2021			
Forward exchange rate agreements	59,089	229	444
Fair value hedge of interest rate swap	190,095	1,100	903
Interest rate and exchange rate agreements	51,426	692	874
Bond swap agreements	10,947	359	20
Share swap agreements	31,029	348	3,530
Options - purchased agreements, unlisted	22	177	106
Options - purchased agreements, listed	16	-	-
Derivatives	342,624	2,905	5,877

Amounts are in ISK millions

23. Fair value hierarchy, continued

Fair value hedge of interest rate swap

The Group applies fair value hedge accounting only with respect to interest rate swaps, whereby the Group pays floating rate interest and receives fixed rate interest, with identical cash flows to the borrowings. The interest rate swaps are hedging the exposure of changes in the fair value of certain fixed-rate EUR bonds, see Note 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 2021.

30.9.2022	Notional	Maturity date	Fair value Assets	Fair value Liabilities	Gain (loss) on FV changes
Interest rates swaps - EUR	19,290	3-6 mth	-	121	(799)
Interest rates swaps - EUR	42,395	1-5 years	-	2,142	(1,886)
Interest rates swaps - USD	14,447	1-5 years	-	1,140	(1,108)
Interest rates swaps - EUR	70,659	1-5 years	-	6,869	(6,550)
Interest rates swaps - EUR	42,395	1-5 years	-	3,636	(3,165)
Interest rates swaps - EUR	42,395	1-5 years	-	401	(411)
			-	14,309	(13,919)
31.12.2021					
Interest rates swaps - EUR	-	-	-	-	(122)
Interest rates swaps - EUR	44,280	1-5 years	802	-	(463)
Interest rates swaps - EUR	44,280	1-5 years	-	151	(301)
Interest rates swaps - USD	12,975	1-5 years	298	-	(526)
Interest rates swaps - EUR	44,280	1-5 years	-	350	(388)
Interest rates swaps - EUR	44,280	1-5 years	-	402	(462)
			1,100	903	(2,140)

Hedged borrowings and subordinated liabilities

30.9.2022	Book value	Accumulated fair value Assets	Accumulated fair value Liabilities	Gain (loss) on FV changes
EUR 300 million - issued 2018 - 5 years	18,954	407	-	288
EUR 300 million - issued 2020 - 4 years	40,251	2,150	-	1,869
USD 100 million - issued 2020 - Perpetual	13,297	1,135	-	1,136
EUR 500 million - issued 2021 - 5 years	61,903	7,036	-	6,674
EUR 300 million - issued 2021 - 4 years	38,631	3,637	-	3,203
EUR 300 million - issued 2022 - 2 years	41,865	410	-	410
Hedged borrowings and subordinated liabilities	214,901	14,775	-	13,579
31.12.2021				
EUR 500 million - issued 2017/18 - 5 years	-	-	-	(106)
EUR 300 million - issued 2018 - 5 years	41,491	119	-	461
EUR 300 million - issued 2020 - 4 years	44,021	293	-	306
USD 100 million - issued 2020 - Perpetual	13,224	-	82	526
EUR 300 million - issued 2021 - 5 years	43,624	382	-	391
EUR 300 million - issued 2021 - 4 years	43,681	455	-	468
Hedged borrowings and subordinated liabilities	186,041	1,249	82	2,046

The effectiveness of each hedge is measured regularly with linear regression. The relationship between fair value changes of an interest rate swap on the one hand and a borrowing on the other hand is examined. In all cases the effectiveness is within limits, or between 93-109%.

Amounts are in ISK millions

24. Offsetting financial assets and financial liabilities

Financial assets subject to enforceable master netting arrangements and similar arrangements

30.9.2022	Assets subject to netting arrangements: Gross assets before nettings	Assets subject to netting arrangements: Nettings with gross liabilities	Assets subject to netting arrangements: Assets recognized on Balance Sheet, net	Netting potential not recognized in the Balance Sheet: Financial liabilities	Netting potential not recognized in the Balance Sheet: 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	23,858	(11,048)	12,810	11,048	-	23,858	-	12,810
Derivatives	716	-	716	(288)	-	428	7,487	8,203
Total assets	24,574	(11,048)	13,526	10,760	-	24,286	7,487	21,013
31.12.2021								
Reverse repurchase agreements	8,560	(720)	7,840	720	-	8,560	-	7,840
Derivatives	1,689	-	1,689	(830)	-	859	1,216	2,905
Total assets	10,249	(720)	9,529	(110)	-	9,419	1,216	10,745

Financial liabilities subject to enforceable master netting arrangements and similar arrangements

30.9.2022	Liabilities subject to netting arrangements: Gross liabilities before nettings	Liabilities subject to netting arrangements: Nettings with gross assets	Liabilities subject to netting arrangements: Liabilities recognized on Balance Sheet, net	Netting potential not recognized in the Balance Sheet: Financial assets	Netting potential not recognized in the Balance Sheet: Collateral pledged	Liabilities after consideration of netting potential	Liabilities not subject to enforceable netting arr-angements	Total liabilities recognized on balance sheet
Repurchase agreements	-	(11,048)	(11,048)	11,048	-	-	-	(11,048)
Derivatives	19,514	-	19,514	(288)	-	19,226	2,286	21,800
Total liabilities	19,514	(11,048)	8,466	10,760	-	19,226	2,286	10,752
31.12.2021								
Repurchase agreements	-	(720)	(720)	720	-	-	-	(720)
Derivatives	2,000	-	2,000	(830)	-	1,170	3,877	5,877
Total liabilities	2,000	(720)	1,280	(110)	-	1,170	3,877	5,157

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

25. Investments in associates

	30.9.2022	31.12.2021
Carrying amount at the beginning of the year	668	891
Acquisitions / increased share capital	90	111
Disposals	(240)	(356)
Share of profit of associates and profit from sale	267	22
Investment in associates	785	668

The Group's interest in its principal associates

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

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

In 2022 the subsidiary Eignabjarg ehf. invested in the associated company Háblær ehf. and holds a 49% shareholding at period end.

Amounts are in ISK millions

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

30.9.2022	Goodwill	Infra-structure	Customer relationship and related agreements	Software	Total
Balance at the beginning of the year	669	2,383	607	5,804	9,463
Additions	-	-	-	169	169
Amortization	-	-	(45)	(771)	(816)
Intangible assets	669	2,383	562	5,202	8,816

31.12.2021	Goodwill	Infra-structure	Customer relationship and related agreements	Software	Total
Balance at the beginning of the year	669	2,383	667	5,970	9,689
Additions	-	-	-	844	844
Additions, capitalized salaries	-	-	-	161	161
Amortization	-	-	(60)	(1,171)	(1,231)
Intangible assets	669	2,383	607	5,804	9,463

Goodwill related to the insurance operation is recognized among assets in the operating segments Corporate & Investment Banking and Retail Banking, see Note 5 (2021: recognized in the operating segment Vördur).

27. Tax assets and tax liabilities

	30.9.2022		31.12.2021	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	15,585	-	6,543
Deferred tax	2,886	11	2	559
Tax assets and tax liabilities	2,886	15,596	2	7,102

Amounts are in ISK millions

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

Assets and disposal groups held for sale	30.9.2022	31.12.2021
Valitor hf.	-	12,294
Stakksberg ehf.	1,385	1,548
Sólbjarg ehf.	701	1,671
Disposal groups held for sale	2,086	15,513
Real estate	66	500
Other assets	-	34
Assets and disposal groups held for sale	2,152	16,047

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

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

Valitor hf.

Arion Bank's shareholding in the subsidiary Valitor hf. was 100%. In accordance with IFRS 5 Non-current assets and disposal groups held for sale, Valitor was classified as asset held for sale in these Consolidated Interim Financial Statements. On 1 July 2022 the sale of the entire shareholding in Valitor was settled. As all conditions were met at the end of June, the sale was fully accounted for in June 2022.

Sólbjarg ehf., a subsidiary of Eignabjarg ehf.

Sólbjarg ehf. is a holding company of the former TravelCo hf. tour operator group which included Terra Nova Sól ehf., Heimsferdir ehf. and TravelCo Nordic/Bravo Tours.

In the first quarter of 2020 Sólbjarg completed the sale of Terra Nova Sól ehf., in the fourth quarter the sale of its 59.4% share in the Danish operator Bravo Tours 1998 A/S and in the second quarter of 2022 the sale of all operations, brand, and domain of Heimsferdir ehf. Sólbjarg is a 27.5% shareholder in Ferdaskrifstofa Íslands ehf.

Stakksberg ehf., a subsidiary of Eignabjarg ehf.

In January 2018 United Silicon was declared bankrupt following severe technical issues at the plant which ended with the temporary suspension of operations. Following the bankruptcy of United Silicon in 2018, an agreement was reached between the liquidator of the estate and Arion Bank, under which the Bank acquired all the company's main assets. The assets of the silicon plant are currently under the supervision of Stakksberg ehf., which is owned by the Bank, via the subsidiary Eignabjarg ehf. After the assets of United Silicon were transferred to Stakksberg, the company has sought to reduce uncertainty over the recommissioning of the plant, by taking measures such as transferring the operating license to the company, obtaining a new power agreement for the company and undertaking engineering designs for the necessary improvements at the plant before it can be reopened.

Stakksberg submitted a new EIA for the plant during the year, and the Environment Agency of Iceland and the National Planning Agency have both submitted their opinions which support the continued consideration of the project. The Bank's objective is to investigate the possibility of selling Stakkberg's infrastructure on the basis of work which has been carried out for this purpose and also to consider the sale of infrastructure for other uses. The fundamental aim is to maximize the utilization of this infrastructure and also to find a buyer which sees opportunities and has the experience and expertise to continue to use this infrastructure in harmony with the local community. Therefore the Bank's holding in Stakksberg ehf. has been classified as a disposal group held for sale under IFRS 5.

Discussions are ongoing with potential buyers and are expected to be concluded in the coming months.

29. Other assets

	30.9.2022	31.12.2021
Property and equipment	3,816	4,298
Right of use asset	758	823
Accounts receivable	5,699	5,104
Unsettled securities trading	2,538	5,113
Investment for life assurance policyholders where risk is held by policyholder	1,010	1,281
Sundry assets	3,723	3,282
Other assets	17,544	19,901

Amounts are in ISK millions

30. Other liabilities

	30.9.2022	31.12.2021
Accounts payable	743	818
Unsettled securities trading	8,959	1,259
Depositors' and Investors' Guarantee Fund	-	138
Technical provision	21,277	18,170
Technical provision for life assurance policyholders were investment risk is held by policyholder	1,010	1,281
Withholding tax	351	810
Bank levy	1,884	1,516
Accrued expenses	3,221	4,200
Prepaid income	1,564	1,476
Impairment of off-balance items	1,072	711
Lease liability	989	878
Sundry liabilities	7,436	5,894
Other liabilities	48,506	37,151

Technical provision	Technical provision	Reinsurers' share	Total 30.9.2022	Technical provision	Reinsurers' share	Total 31.12.2021
Claims reported and loss adjustment expenses	10,498	(182)	10,316	9,473	(110)	9,363
Claims incurred but not reported	2,926	(68)	2,858	2,021	(64)	1,957
Claims outstanding	13,424	(250)	13,174	11,494	(174)	11,320
Provision for unearned premiums	7,853	(17)	7,836	6,676	(12)	6,664
Own technical provision	21,277	(267)	21,010	18,170	(186)	17,984

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

31. Borrowings

Currency, original nominal value	First issued	Maturity	Maturity type	Terms of interest	30.9.2022	31.12.2021
ARION CB 22, ISK 31,720 million	2015	2022	At maturity	Fixed, 6.50%	-	31,508
ARION CB 24 ISK 28,900 million	2019	2024	At maturity	Fixed, 6.00%	26,117	26,004
ARION CBI 25, ISK 37,940 million	2017	2025	At maturity	Fixed, CPI linked, 3.00%	47,053	43,341
ARION CBI 26 ISK 17,080 million	2019	2026	At maturity	Fixed, CPI linked, 2.00%	19,133	17,747
ARION CBI 29, ISK 27,200 million	2014	2029	At maturity	Fixed, CPI linked, 3.50%	35,568	29,902
ARION CBI 48, ISK 11,680 million	2018	2048	Amortizing	Fixed, CPI linked, 2.50%	11,556	11,017
ARION CB EUR 500 million *	2021	2026	At maturity	Fixed, EUR 0.05%	61,901	43,624
ARION CB 27, ISK 6,820 million	2022	2027	At maturity	Fixed, 5.50%	6,803	-
Statutory covered bonds					208,131	203,143
NOK 750 million	2019	2022	At maturity	Floating, NIBOR +1.82%	-	11,096
SEK 150 million	2019	2022	At maturity	Floating, 3 month STIBOR +1.33%	-	2,159
NOK 250 million	2017	2023	At maturity	Fixed, 3.02%	3,361	3,757
EUR 300 million *	2018	2023	At maturity	Fixed, 1.00%	18,954	41,491
EUR 300 million *	2020	2024	At maturity	Fixed, 0.625 %	40,251	44,021
NOK 250 million	2017	2027	At maturity	Fixed, 3.40%	3,367	3,766
EUR 300 million Green *	2021	2025	At maturity	Fixed, 0.375%	38,631	43,680
ARION 26 1222 Green (ISK 5,760m)	2021	2026	At maturity	Fixed, 4.70%	5,601	3,524
ARION 24 1020 Green (ISK 6,020m)	2022	2024	At maturity	Floating, REIBOR 3M +0.70%	6,054	-
EUR 300 million Green *	2022	2024	At maturity	Fixed, 4.875%	41,867	-
NOK 550 million	2022	2025	At maturity	Floating, OIBOR 3M +2.35%	7,326	-
SEK 230 million	2022	2025	At maturity	Floating, STIBOR 3M +2.35%	2,998	-
Senior unsecured bonds					168,409	153,494
Borrowings					376,540	356,637

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

The book value of listed bonds was ISK 377 billion at the end of the period (31.12.2021: ISK 357 billion). The market value of those bonds was ISK 323 billion (31.12.2021: ISK 367 billion). The Group repurchased own debts amounting to ISK 28 billion during the period with a net gain of ISK 14 million recognized in the Income Statement (2021: nil).

Amounts are in ISK millions

32. Subordinated liabilities

Currency, original nominal value	Issued	Maturity	First call date	Terms of interest	30.9.2022	31.12.2021
SEK 500 million	2018	2028	22 Nov '23	Floating, 3 month STIBOR +3.10%	6,504	7,174
NOK 300 million	2019	2029	9 Jul '24	Floating, NIBOR +3.65%	4,031	4,461
SEK 225 million	2019	2029	20 Dec '24	Floating, 3 month STIBOR +3.70%	2,926	3,232
ARION T2I 30 ISK 4,800 million	2019	2030	4 Jan '25	Fixed, CPI linked, 3.875%	5,724	5,337
ARION T2 30 ISK 880 million	2019	2030	4 Jan '25	Fixed, 6.75%	893	907
EUR 5 million	2019	2031	6 Mar '26	Fixed, 3.24%	714	752
Tier 2 subordinated liabilities					20,792	21,863
ARION AT1 USD 100 million *	2020	Perpetual	26 Mar '26	Fixed, 6.25%	13,297	13,225
Additional Tier 1 subordinated liabilities					13,297	13,225
Subordinated liabilities					34,089	35,088

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

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

33. Pledged assets

Pledged assets against liabilities	30.9.2022	31.12.2021
Assets, pledged as collateral against borrowings	335,701	287,449
Assets, pledged as collateral against loans from the Central Bank, credit institutions and short positions	12,809	8,560
Pledged assets against liabilities	348,510	296,009
Thereof pledged assets against issued covered bonds held by the Bank	(67,955)	(43,182)
Assets against repoed issued bonds	18,221	864
Pledged assets against liabilities on balance	298,776	253,691

The Group has pledged assets against borrowings, both issued covered bonds and other issued bonds and loan agreements. Pledged loans comprised mortgage loans to individuals. The book value of the borrowings was ISK 208 billion at period end (31.12.2021: ISK 203 billion).

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

The Group has issued covered bonds amounting to ISK 41 billion that can be used for repo borrowings at the Central Bank of Iceland, the European Central Bank or sold if market conditions are favorable (31.12.2021: ISK 35 billion). Pledged assets against those covered bonds are ISK 50 billion (31.12.2021: ISK 42 billion).

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

34. Equity

Share capital and share premium

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

	Share capital	Own shares	Share premium	Total 30.9.2022	Share capital	Own shares	Share premium	Total 31.12.2021
Balance at the beginning of the year ...	1,660	(142)	21,166	22,684	1,730	(11)	49,612	51,331
Share capital reduction	(150)	150	-	-	(70)	70	-	-
Purchase of treasury shares	-	(36)	(6,422)	(6,458)	-	(201)	(28,446)	(28,647)
Share option vested	-	3	349	353	-	-	-	-
Incentive scheme	-	1	184	185	-	-	-	-
Balance at the end of the period	1,510	(24)	15,278	16,764	1,660	(142)	21,166	22,684
Own shares / issued share capital		1.57%				8.54%		

Based on a share buyback program authorized by the Financial Supervisory Authority of the Central Bank of Iceland (FSA) on 5 September 2022, Arion Bank bought back own shares for ISK 2,189 million during the third quarter. The buyback program amounts up to a total of 57.3 million shares or up to ISK 10 billion. Arion Bank management has decided to launch 50% of the buyback authorized by the FSA and approved by the Board of Directors. The Program will end no later than 15 March 2023. Based on a share buyback program authorized by the FSA and which was launched in October 2021, Arion Bank bought back own shares for ISK 4,269 million during the first quarter of 2022. In March 2022 the programme was concluded. Buybacks in 2021 were based on authorisation from the FSA from 2020 and 2021.

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

Share options

The following share option contracts are in existence at period end.	Number of shares (in ths.)	Exercise year	Exercise price (ISK)
Issued in 2021 (ISK 600,000) - employees of Arion Bank	13,520	2023-2026	95.5
Issued in 2022 (ISK 900,000) - employees of Arion Bank	10,620	2023-2026	181.7
Issued in 2022 (ISK 1,500,000) - employees of Arion Bank	4,425	2023-2026	181.7
Issued in 2022 (ISK 1,500,000) - employees of subsidiaries	2,317	2023-2026	170.9
	30,882		

Movements in share options during the period.	30.9.2022		31.12.2021	
	Number of shares (in ths.)	Weighted average contract rate	Number of shares (in ths.)	Weighted average contract rate
Outstanding at the beginning of the year	19,728	95.5	-	-
Granted during the period	17,362	180.3	19,728	95.5
Forfeited during the period	(2,916)	95.5	-	-
Exercised during the period - average share price of ISK 187.6 at date of exercise	(3,292)	95.5	-	-
Outstanding at the end of the period	30,882	143.2	19,728	95.5

No share options are exercisable at period end. Next exercise period is in February 2023.

Warrants

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Other information

35. Shareholders of Arion Bank

	30.9.2022	31.12.2021
Gildi lífeyrissjódur	9.77%	8.83%
Lífeyrissjódur starfsmanna ríkisins	9.60%	9.10%
Lífeyrissjódur verzlunarmanna	9.57%	8.81%
Stodir hf.	5.20%	4.73%
Stefnir funds	3.86%	2.88%
Birta lífeyrissjódur	3.47%	3.16%
Brú lífeyrissjóður	3.27%	2.35%
Frjálsi lífeyrissjódurinn	3.17%	2.88%
Stapi lífeyrissjódur	2.97%	2.71%
Íslandsbanki hf.	2.63%	2.22%
Hvalur hf.	2.44%	2.22%
Kvika banki hf.	2.16%	2.20%
Festa lífeyrissjódur	1.89%	1.23%
Arion banki hf.	1.57%	8.54%
Almenni lífeyrissjódur	1.47%	1.33%
Landsbréf hf.	1.42%	0.97%
Akta sjóðir	1.39%	0.91%
Landsbankinn hf.	1.31%	0.70%
Lífsverk Pension fund	1.09%	1.07%
Vanguard	0.99%	0.00%
Kvika eignastýring	0.53%	1.31%
MainFirst Bank AG	0.00%	1.19%
Bóksal ehf.	0.00%	1.26%
Other shareholders with less than 1% shareholding	30.25%	29.40%
	100.0%	100.0%

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

	30.09.2022		31.12.2021	
	Warrants / options	Number of shares	Warrants	Number of shares
Steinunn Kristín Thórdardóttir, Director	-	12,000	-	12,000
Alternate directors of the Board	-	13,000	-	13,000
Benedikt Gíslason, CEO	1,006,482	2,306,283	992,953	2,300,000
Eight members of the Executive Committee (31.12.2021: eight)	4,945,258	722,751	4,482,724	1,633,076

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

Amounts are in ISK millions

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 year, the Group had several unresolved legal claims.

Contingent liabilities

Legal proceedings regarding damages

In a lawsuit brought in June 2013, Kortaþjónustan hf. claimed damages from Arion Bank hf., Íslandsbanki hf., Landsbankinn hf., Borgun hf. and Valitor hf. in the amount of ISK 1.2 billion plus interest. The lawsuit is a result of damage Kortaþjónustan hf. contended the five parties caused the company due to violations of the Competition Act. In June 2017 the Supreme Court dismissed the case on procedural grounds. Since then, Kortaþjónustan hf. and subsequently its largest shareholder EC-Clear have tried to initiate five lawsuits against the same defendants which have all been dismissed, the last one in March 2021. In September 2021 EC-Clear has once again brought the same matter of dispute, claiming damages in the amount of ISK 922 million plus interest, against the same defendants. In September 2022 the District Court dismissed the claims. EC-Clear has appealed the dismissal. Should the defendants be found liable for damages, they would be jointly responsible. Therefore, the Bank has not made any provision.

Consumer Association's class-action lawsuit

The Consumer Association of Iceland sent a letter to Arion Bank, Íslandsbanki and Landsbankinn in April 2020 urging the banks to review its contractual terms on variable rate mortgages to individuals. The letter called for revised terms and compensation to borrowers who, according to the Association, have suffered damage. The Association's argument is that standard contractual terms lack proper legal grounds, as parameters for interest rate decisions lack transparency and predictability, thus causing a contractual imbalance to the detriment of the consumer.

Arion Bank undertook a review of its contractual terms and processes for interest rate decisions in light of the letter, concluding that no changes were required and that the Association's arguments are unfounded. A reasoned response was sent to the Consumer Association in September 2020. According to information published on the Consumer Association's website, all three banks have rejected the Association's arguments.

The Consumer Association in May 2021 published an article on its website calling for participants in a class action lawsuit. The intention is to commence court proceedings against Icelandic credit institutions to provide court precedents for loans with variable rates. Arion Bank has received information requests from a legal firm representing approximately 1200 individuals and one case has been filed against the Bank. The Bank has commissioned an outside opinion on its legal position and believes it likely that it will be acquitted of the claims and has therefore not made any provision.

Administrative fine from Central Bank of Iceland

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

Other legal proceedings

Since 2008 Arion Bank has formally been a party to proceedings in Luxembourg, commenced against the Luxembourg company R Capital S.á r.l. and its beneficial owner, Mr. Umberto Ronsisvalle, for the collection of EUR 6 million plus interest. During this time, Kaupthing ehf. has been the beneficial owner of the claim, with Arion Bank's involvement limited to being the formal party to the proceedings while enjoying indemnity from Kaupthing. The reason for the setup is a decision by the Icelandic Financial Supervisory Authority in 2009 during the split of Kaupthing to the "new" and "old" bank. In 2019, a counterclaim was made against Arion Bank in the proceedings, for the net sum of EUR 24 million plus interest, with the Bank continuing to enjoy full indemnity from Kaupthing. In September 2021, Kaupthing and Arion Bank agreed that all rights and liabilities in the Luxembourg proceedings would be transferred to Arion Bank. The Bank is still held harmless for any liabilities associated with the claims and has therefore not made any provision.

The estate of TravelCo Nordic has filed a case against TravelCo hf. and the Bank in Denmark claiming payment in solidum in the amount of DKK 58.1 million plus interest. The merits and arguments against the Bank are vague. The bankruptcy estate alleges that the Bank, as owner of Heimsferdir ehf. and Terra Nova Sól ehf., contrived the sale of the companies to its subsidiary, Sólbjarg ehf., without real payment. The transaction the bankruptcy estate is referring to is in fact the legal and lawful enforcement of security (i.e. share pledges) by the Bank over the shares in Heimsferdir hf. and Terra Nova Sól ehf. following a default on a facilities agreement to TravelCo hf. as borrower. Following the enforcement, the Bank moved the companies to its holding company, Sólbjarg ehf., and the Bank remained the beneficial owner of the companies. The Bank believes it likely that it will be acquitted of the estate's claim and has therefore not made any provision.

37. Events after the reporting period

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

Off balance sheet information

38. Commitments

Financial guarantees, unused credit facilities and undrawn loan commitments	30.9.2022	31.12.2021
Financial guarantees	21,381	15,858
Unused overdrafts	59,002	63,108
Undrawn loan commitments	105,532	108,691
Financial guarantees, unused credit facilities and undrawn loan commitments	185,915	187,657

39. Assets under management and under custody

Assets under management	1,276,981	1,351,573
Assets under custody	1,102,402	1,148,203

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

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

Related party

40. Related party

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

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

30.9.2022	Assets	Liabilities	Net balance
Board of Directors and key Management personnel	87	(1,280)	(1,193)
Associates and other related parties	1	(208)	(207)
Balances with related parties	88	(1,488)	(1,400)
31.12.2021			
Board of Directors and key Management personnel	139	(284)	(145)
Associates and other related parties	530	(311)	219
Balances with related parties	669	(595)	74

Amounts are in ISK millions

Risk management disclosures

The Group faces various risks arising from its day to day operations. Managing risk is a core activity within the Group. The key to effective risk management is a process of on-going identification of significant 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 and this process enables the Group to ensure that the exposure to risk remains within acceptable levels.

Further information on risk management and capital adequacy is provided in the Annual Financial Statements for 2021, and in the Pillar 3 Risk Disclosures for 2021 and in the quarterly Additional Pillar 3 Risk Disclosures. These documents are available on the Bank's website, www.arionbank.com.

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 are the largest source of credit risk. Credit risk is also inherent in other types of assets, such as loans to credit institutions, bonds, derivatives and off-balance sheet items such as commitments and guarantees.

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

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

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

Exposure to credit risk

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

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

The value of collateral is based on estimated market value. The valuation of real estate is based on market price, official valuation by Registers Iceland, 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

		Collateral				
30.9.2022	Maximum exposure	Cash and securities	Real estate	Vessels	Other collateral	Total collateral
Cash and balances with Central Bank	68,149	-	-	-	-	-
Loans to credit institutions at amortized cost	50,702	-	-	-	-	-
Loans to customers at amortized cost	1,045,152	26,267	261,825	52,643	84,199	424,934
Individuals	*571,487*	-	-	-	-	-
Mortgages	*502,148*	-	*502,116*	-	*32*	*502,148*
Other	*69,339*	*879*	*18,638*	*18*	*18,219*	*37,754*
Corporates	*473,665*	*26,267*	*261,825*	*52,643*	*84,199*	*424,934*
Real estate activities	*104,487*	*746*	*99,051*	-	*576*	*100,373*
Construction	*47,149*	*491*	*40,866*	*49*	*2,658*	*44,064*
Fishing industry	*84,643*	*1,039*	*12,684*	*50,351*	*15,289*	*79,363*
Information and communication technology	*23,021*	*76*	*1,458*	-	*13,061*	*14,595*
Wholesale and retail trade	*73,517*	*279*	*51,106*	*24*	*16,245*	*67,654*
Financial and insurance activities	*44,642*	*23,204*	*7,266*	-	*12,269*	*42,739*
Industry, energy and manufacturing	*40,952*	*262*	*23,674*	-	*14,906*	*38,842*
Transportation	*15,070*	-	*2,488*	*1,031*	*3,409*	*6,928*
Services	*19,602*	*144*	*11,086*	*1,182*	*4,916*	*17,328*
Public sector	*8,542*	*26*	*2,153*	*6*	*159*	*2,344*
Agriculture and forestry	*12,040*	-	*9,993*	-	*711*	*10,704*
Other assets with credit risk	10,791	-	-	-	-	-
Financial guarantees	21,381	2,219	5,501	36	2,819	10,575
Undrawn loan commitments and unused overdrafts	164,534	-	-	-	-	-
Fair value through OCI	134,250	-	-	-	-	-
Government bonds	*114,796*	-	-	-	-	-
Bonds issued by financial institutions and corporates	*19,454*	-	-	-	-	-
Balance at the end of the period	1,494,959	28,486	267,326	52,679	87,018	435,509

31.12.2021	Maximum exposure	Cash and securities	Real estate	Vessels	Other collateral	Total collateral
Cash and balances with Central Bank	69,057	-	-	-	-	-
Loans to credit institutions at amortized cost	28,156	-	-	-	-	-
Loans to customers at amortized cost	936,237	29,159	704,442	42,797	85,030	861,428
Individuals	*526,498*	*712*	*481,088*	*15*	*15,139*	*496,954*
Mortgages	*463,458*	*22*	*463,402*	-	*34*	*463,458*
Other	*63,040*	*690*	*17,686*	*15*	*15,105*	*33,496*
Corporates	*409,739*	*28,447*	*223,354*	*42,782*	*69,891*	*364,474*
Real estate activities	*90,321*	*329*	*87,256*	-	*1,752*	*89,337*
Construction	*37,010*	*486*	*33,597*	*48*	*1,876*	*36,007*
Fishing industry	*78,094*	*1,967*	*12,850*	*40,999*	*21,056*	*76,872*
Information and communication technology	*16,736*	*939*	*1,219*	-	*1,684*	*3,842*
Wholesale and retail trade	*65,298*	*154*	*49,874*	*29*	*9,107*	*59,164*
Financial and insurance activities	*45,798*	*24,433*	*1,814*	-	*12,877*	*39,124*
Industry, energy and manufacturing	*27,919*	*7*	*15,206*	-	*11,040*	*26,253*
Transportation	*14,162*	-	*1,556*	*1,556*	*3,395*	*6,507*
Services	*17,269*	*119*	*8,559*	*143*	*6,235*	*15,056*
Public sector	*6,918*	*13*	*2,120*	*7*	*193*	*2,333*
Agriculture and forestry	*10,214*	-	*9,303*	-	*676*	*9,979*
Other assets with credit risk	12,721	-	-	-	-	-
Financial guarantees	15,858	1,184	5,618	41	3,888	10,731
Undrawn loan commitments and unused overdrafts	171,799	-	-	-	-	-
Fair value through OCI	133,825	-	-	-	-	-
Government bonds	*112,824*	-	-	-	-	-
Bonds issued by financial institutions and corporates	*21,001*	-	-	-	-	-
Balance at the end of the period	1,367,653	30,343	710,060	42,838	88,918	872,159

Amounts are in ISK millions

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 residential mortgage portfolio. LTV is calculated as the ratio of the gross carrying amount of the loan to the value of the collateral without adjusting for possible costs of obtaining and selling the collateral. As of 30.9.2022, the Bank has adopted a new real estate valuation model, which replaces the government tax value and is used when observed market value becomes older than 2 years. The new model gives an estimate of current value on a monthly basis.

	30.9.2022		31.12.2021	
	Gross carrying amount	Thereof credit impaired	Gross carrying amount	Thereof credit impaired
Less than 50%	232,255	2,232	137,392	1,194
50-70%	196,917	988	233,904	1,975
70-90%	70,774	629	88,276	1,112
90-100%	1,198	148	1,821	209
100-110%	413	72	753	50
More than 110%	980	67	1,716	-
Not classified	-	-	33	-
Balance at the end of the period	502,537	4,136	463,895	4,540

Collateral for financial assets in stage 3

At the end of the period, the gross carrying amount of assets in stage 3 was ISK 14,639 million (31.12.2021: ISK 17,703 million) with ISK 11,050 million in collateral (31.12.2021: ISK 14,421 million), thereof ISK 9,712 million in real estate (31.12.2021: 12,875 million).

Collateral repossessed

During the period, the Group took possession of assets due to foreclosures. The total value of real estate the Group took possession of during the period and still holds at the end of the period is nil (31.12.2021: ISK 422 million) and nil in other assets (31.12.2021: ISK 34 million). The assets are held for sale, see Note 28.

Large exposures

A large exposure is defined as an exposure to a group of financially related borrowers which is equal to or exceeds 10% of the Group's Tier 1 capital according to the Financial Undertakings Act No. 161/2002 and Regulation No. 233/2017 on Prudential Requirements. The legal maximum for individual large exposures is 25% of Tier 1 capital, net of eligible credit risk mitigation.

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

	30.09.2022		31.12.2021	
No.	Gross	Net	Gross	Net
1	12.5%	12.5%	11.5%	11.4%
2	11.7%	11.7%	<10%	<10%
3	10.9%	10.8%	<10%	<10%
Sum of large exposure gross and net > 10%	35.1%	35.0%	11.5%	11.4%

Credit quality

The Group uses internal credit ratings and external credit ratings, if available, to monitor credit risk. The Group's internal credit rating system rates customers through application of statistical models based on a variety of information that has been determined to be predictive of default. This includes demographic, behavioral, financial and economic data, coupled with qualitative expert judgment for large corporate exposures. Six exposure type models rate individuals' exposures – mortgages, consumer loans, auto loans, guarantees, loans to individuals for work purposes and other loans. The models are validated annually and recalibrated and updated with current data with the aim of maintaining their predictive power. Year-on-year changes in risk classification of loans may in part be due to model refinement. External ratings are primarily used for marketable securities and loans to credit institutions. For further information on the rating scales used, see Note 56 of the Annual Financial Statements for 2021.

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 impairment stage. The gross carrying amount net of loss allowance is the book value of the underlying assets. For off-balance sheet exposures, the nominal amount is shown. FVOCI stands for fair value through other comprehensive income.

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

Amounts are in ISK millions

41. Credit risk, continued

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

30.9.2022	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	68,149	50,702	134,239
Non-investment grade	-	-	-
Gross carrying amount	68,149	50,702	134,239
Loss allowance	-	-	11
Book value	68,149	50,702	134,250

Loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 - (Grades AAA to A-)	363,180	3,755	-	44	366,979
Risk class 1 - (Grades BBB+ to BBB-)	311,508	4,814	-	91	316,413
Risk class 2 - (Grades BB+ to BB-)	187,830	39,215	-	8	227,053
Risk class 3 to 4 - (Grades B+ to CCC-)	77,639	41,707	-	59	119,405
Risk class 5 - (DD)	-	-	14,454	185	14,639
Unrated	4,764	3,914	-	-	8,678
Gross carrying amount	944,921	93,405	14,454	387	1,053,167
Loss allowance	(1,821)	(1,769)	(4,425)	-	(8,015)
Book value	943,100	91,636	10,029	387	1,045,152
Loans to customers - Individuals					
Risk class 0 - (Grades AAA to A-)	282,885	1,886	-	44	284,815
Risk class 1 - (Grades BBB+ to BBB-)	200,707	3,312	-	91	204,110
Risk class 2 - (Grades BB+ to BB-)	40,308	15,161	-	8	55,477
Risk class 3 to 4 - (Grades B+ to CCC-)	11,479	11,037	-	59	22,575
Risk class 5 - (DD)	-	-	6,030	185	6,215
Unrated	157	1	-	-	158
Gross carrying amount	535,536	31,397	6,030	387	573,350
Loss allowance	(359)	(323)	(1,181)	-	(1,863)
Book value	535,177	31,074	4,849	387	571,487
Loans to customers - Corporates					
Risk class 0 - (Grades AAA to A-)	80,295	1,869	-	-	82,164
Risk class 1 - (Grades BBB+ to BBB-)	110,801	1,502	-	-	112,303
Risk class 2 - (Grades BB+ to BB-)	147,522	24,054	-	-	171,576
Risk class 3 to 4 - (Grades B+ to CCC-)	66,160	30,670	-	-	96,830
Risk class 5 - (DD)	-	-	8,424	-	8,424
Unrated	4,607	3,913	-	-	8,520
Gross carrying amount	409,385	62,008	8,424	-	479,817
Loss allowance	(1,462)	(1,446)	(3,244)	-	(6,152)
Book value	407,923	60,562	5,180	-	473,665
Loan commitments, guarantees and unused credit facilities					
Risk class 0 to 1 (Grades AAA to BBB-)	111,024	1,904	-	-	112,928
Risk class 2 to 4 (Grades BB+ to CCC-)	49,582	14,564	1,527	-	65,673
Unrated	7,196	118	-	-	7,314
Nominal	167,802	16,586	1,527	-	185,915
Loss allowance	(256)	(234)	(583)	-	(1,073)
Nominal less loss allowance	167,546	16,352	944	-	184,842

Amounts are in ISK millions

41. Credit risk, continued

31.12.2021	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	69,057	28,125	137,667
Non-investment grade	-	31	-
Gross carrying amount	69,057	28,156	137,667
Loss allowance	-	-	(13)
Book value	69,057	28,156	137,654

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

Amounts are in ISK millions

41. Credit risk, continued

Sector split, gross carrying value and loss allowance for financial instruments subject to IFRS 9 impairment requirements

	Stage 1		Stage 2		Stage 3		
30.09.2022	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Book value
Loans to credit instit., securities & cash	253,090	11	-	-	-	-	253,101
Loans to individuals	535,536	(359)	31,598	(323)	6,216	(1,181)	571,487
Mortgage	*471,566*	*(67)*	*26,835*	*(145)*	*4,136*	*(177)*	*502,148*
Other	*63,970*	*(292)*	*4,763*	*(178)*	*2,080*	*(1,004)*	*69,339*
Loans to corporates	409,385	(1,462)	62,008	(1,446)	8,424	(3,244)	473,665
Real estate activities	*92,279*	*(215)*	*10,780*	*(128)*	*2,128*	*(357)*	*104,487*
Construction	*42,609*	*(187)*	*4,297*	*(34)*	*472*	*(8)*	*47,149*
Fishing industry	*72,358*	*(128)*	*12,394*	*(290)*	*399*	*(90)*	*84,643*
Information and communication technology	*20,200*	*(93)*	*2,895*	*(48)*	*96*	*(29)*	*23,021*
Wholesale and retail trade	*56,359*	*(228)*	*16,754*	*(576)*	*2,130*	*(922)*	*73,517*
Financial and insurance activities	*37,410*	*(197)*	*7,321*	*(158)*	*758*	*(492)*	*44,642*
Industry, energy and manufacturing	*37,520*	*(80)*	*3,545*	*(71)*	*59*	*(21)*	*40,952*
Transportation	*14,736*	*(68)*	*171*	*(4)*	*974*	*(739)*	*15,070*
Services	*16,330*	*(114)*	*2,798*	*(125)*	*1,274*	*(561)*	*19,602*
Public Sector	*8,181*	*(32)*	*403*	*(10)*	*-*	*-*	*8,542*
Agriculture and forestry	*11,403*	*(120)*	*650*	*(2)*	*134*	*(25)*	*12,040*
Balance at the end of the period	1,198,011	(1,810)	93,606	(1,769)	14,640	(4,425)	1,298,253

31.12.2021	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Book value
Loans to credit instit., securities & cash	231,051	(13)	-	-	-	-	231,038
Loans to individuals	508,428	(490)	13,777	(246)	6,181	(1,152)	526,498
Mortgage	*450,305*	*(127)*	*9,055*	*(84)*	*4,536*	*(228)*	*463,457*
Other	*58,123*	*(363)*	*4,722*	*(162)*	*1,645*	*(924)*	*63,041*
Loans to corporates	352,500	(823)	51,429	(1,560)	11,522	(3,329)	409,739
Real estate activities	*80,318*	*(160)*	*7,092*	*(45)*	*3,472*	*(356)*	*90,321*
Construction	*34,382*	*(49)*	*2,411*	*(24)*	*317*	*(27)*	*37,010*
Fishing industry	*69,632*	*(58)*	*8,193*	*(199)*	*653*	*(127)*	*78,094*
Information and communication technology	*15,949*	*(58)*	*792*	*(39)*	*128*	*(36)*	*16,736*
Wholesale and retail trade	*46,824*	*(162)*	*17,362*	*(1,032)*	*3,420*	*(1,114)*	*65,298*
Financial and insurance activities	*37,275*	*(135)*	*8,411*	*(45)*	*733*	*(441)*	*45,798*
Industry, energy and manufacturing	*25,937*	*(49)*	*1,900*	*(10)*	*170*	*(29)*	*27,919*
Transportation	*12,474*	*(32)*	*1,065*	*(2)*	*1,649*	*(992)*	*14,162*
Services	*14,125*	*(70)*	*2,796*	*(153)*	*721*	*(150)*	*17,269*
Public Sector	*6,499*	*(29)*	*343*	*(4)*	*110*	*(1)*	*6,918*
Agriculture and forestry	*9,085*	*(21)*	*1,064*	*(7)*	*149*	*(56)*	*10,214*
Balance at the end of the period	1,091,979	(1,326)	65,206	(1,806)	17,703	(4,481)	1,167,275

Amounts are in ISK millions

41. Credit risk, continued

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

Transfers of financial assets between impairment stages

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

Net remeasurement of loss allowance

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

New financial assets, originated or purchased

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

Derecognitions and maturities

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

Write-offs

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

30.9.2022

*Impairment loss allowance **	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(1,606)	(1,897)	(4,824)	(1)	(8,328)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(798)	566	232	-	-
Transfers to Stage 2 (lifetime ECL)	239	(304)	65	-	-
Transfers to Stage 3 (credit impaired financial assets)	24	113	(137)	-	-
Net remeasurement of loss allowance **	995	(612)	(788)	1	(404)
New financial assets, originated or purchased	(1,535)	(202)	(1,013)	-	(2,750)
Derecognitions and maturities	603	326	1,320	(166)	2,083
Write-offs ***	1	7	137	166	311
Impairment loss allowance ****	(2,077)	(2,003)	(5,008)	-	(9,088)
Impairment loss allowances for assets only carrying 12-month ECL	11	-	-	-	11
Total impairment loss allowance	(2,066)	(2,003)	(5,008)	-	(9,077)

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

** During the period the loss allowance balance for stage 3 loans was raised by ISK 406 million due to unwinding of interest income.

*** During the period an amount of ISK 540 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	(1,313)	(1,806)	(4,480)	(1)	(7,600)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(747)	515	232	-	-
Transfers to Stage 2 (lifetime ECL)	221	(286)	65	-	-
Transfers to Stage 3 (credit impaired financial assets)	24	112	(136)	-	-
Net remeasurement of loss allowance	856	(446)	(499)	1	(88)
New financial assets, originated or purchased	(1,169)	(136)	(1,013)	-	(2,318)
Derecognitions and maturities	306	271	1,269	(166)	1,680
Write-offs	1	7	137	166	311
Total loss allowance for loans to customers	(1,821)	(1,769)	(4,425)	-	(8,015)

Impairment loss allowance for loans to customers - Individuals	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(492)	(246)	(1,151)	(1)	(1,890)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(414)	243	171	-	-
Transfers to Stage 2 (lifetime ECL)	77	(112)	35	-	-
Transfers to Stage 3 (credit impaired financial assets)	14	99	(113)	-	-
Net remeasurement of loss allowance	539	(320)	(345)	1	(125)
New financial assets, originated or purchased	(178)	(56)	(40)	-	(274)
Derecognitions and maturities	94	62	107	-	263
Write-offs	1	7	155	-	163
Total loss allowance for loans to individuals	(359)	(323)	(1,181)	-	(1,863)

Impairment loss allowance for loans to customers - Corporates	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(821)	(1,560)	(3,329)	-	(5,710)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(333)	272	61	-	-
Transfers to Stage 2 (lifetime ECL)	144	(174)	30	-	-
Transfers to Stage 3 (credit impaired financial assets)	10	13	(23)	-	-
Net remeasurement of loss allowance	317	(126)	(154)	-	37
New financial assets, originated or purchased	(991)	(80)	(973)	-	(2,044)
Derecognitions and maturities	212	209	1,162	(166)	1,417
Write-offs	-	-	(18)	166	148
Total loss allowance for loans to corporates	(1,462)	(1,446)	(3,244)	-	(6,152)

Impairment loss allowance for loan commitments, guarantees and unused credit facilities	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(293)	(91)	(344)	-	(728)
Transfers					
Transfers to 12-month ECL	(51)	51	-	-	-
Transfers to lifetime ECL	18	(18)	-	-	-
Transfers to credit impaired	-	1	(1)	-	-
Net remeasurement of loss allowance	139	(166)	(289)	-	(316)
New financial commitments originated	(366)	(66)	-	-	(432)
Derecognitions and maturities	297	55	51	-	403
Total loss allowance for loan commit., guarantees, unused facilities	(256)	(234)	(583)	-	(1,073)

Amounts are in ISK millions

41. Credit risk, continued

31.12.2021

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

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

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

*** During the period an amount of ISK 2,101 million was written off but is still subject to enforcement activities subject to Icelandic law.

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

Impairment loss allowance for loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(1,844)	(3,305)	(6,824)	(84)	(12,057)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(1,585)	1,309	276	-	-
Transfers to Stage 2 (lifetime ECL)	190	(281)	92	(1)	-
Transfers to Stage 3 (credit impaired financial assets)	58	377	(435)	-	-
Net remeasurement of loss allowance	2,774	21	(1,164)	-	1,631
New financial assets, originated or purchased	(1,481)	(267)	(327)	-	(2,075)
Derecognitions and maturities	569	330	1,523	(289)	2,133
Write-offs	6	10	2,379	373	2,768
Total loss allowance for loans to customers	(1,313)	(1,806)	(4,480)	(1)	(7,600)
Impairment loss allowance for loans to customers - Individuals					
Balance at the beginning of the year	(807)	(395)	(1,189)	(84)	(2,475)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(614)	454	160	-	-
Transfers to Stage 2 (lifetime ECL)	112	(162)	51	(1)	-
Transfers to Stage 3 (credit impaired financial assets)	43	157	(200)	-	-
Net remeasurement of loss allowance	921	(333)	(472)	-	116
New financial assets, originated or purchased	(341)	(67)	(107)	-	(515)
Derecognitions and maturities	190	90	284	(289)	275
Write-offs	6	10	322	373	711
Total loss allowance for loans to individuals	(490)	(246)	(1,151)	(1)	(1,888)

Amounts are in ISK millions

41. Credit risk, continued

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

Impairment loss allowance for loan commitments, guarantees and unused credit facilities	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(239)	(577)	(171)	-	(987)
Transfers					
Transfers to 12-month ECL	(156)	156	-	-	-
Transfers to lifetime ECL	12	(12)	-	-	-
Transfers to credit impaired	2	5	(7)	-	-
Net remeasurement of loss allowance	363	222	(168)	-	417
New financial commitments originated	(488)	(107)	-	-	(595)
Derecognitions and maturities	213	222	2	-	437
Total loss allowance for loan commit., guarantees, unused facilities	(293)	(91)	(344)	-	(728)

Macroeconomic forecast

The calculation of expected credit losses under IFRS 9 uses forward-looking information in the form of scenarios where the development of macro-economic variables is predicted. The expected credit loss is a probability-weighted average of the estimated forecasts over three scenarios: base case 60%, pessimistic 30% and optimistic 10% (31.12.2021: base case 60%, pessimistic 20% and optimistic 20%). The macroeconomic forecast and scenario probability weights is done by the Bank's Chief Economist and approved by the Bank's IFRS 9 committee. The following table shows values used for IFRS 9 impairment calculations.

	Base case		
	2022	2023	2024
Unemployment rate	3.9%	3.9%	3.8%
Housing prices	21.6%	7.1%	2.5%
Private consumption	7.2%	3.1%	3.0%
GDP	5.4%	2.8%	2.4%

	Optimistic			Pessimistic		
	2022	2023	2024	2022	2023	2024
Unemployment rate	3.2%	3.1%	3.0%	6.2%	7.1%	5.8%
Housing prices	22.9%	9.6%	3.1%	19.9%	2.0%	0.7%
Private consumption	8.5%	4.2%	3.3%	5.6%	-1.2%	3.5%
GDP	7.7%	5.1%	2.5%	3.5%	-0.4%	2.6%

Sensitivity analysis

Regarding macroeconomic outlook, see Note 3, Significant accounting estimates and judgements. The Group calculates loss for three different scenarios, optimistic, neutral and pessimistic and the loss allowance is the weighted average of the results. As a sensitivity analysis, it can be noted that the loss allowance in stage 1 and 2 for each of these scenarios separately is ISK 1.7 billion, ISK 3.0 billion and ISK 6.9 billion for the optimistic, base case and pessimistic scenarios, respectively. At year end 2021 the corresponding calcualated loss allowance was ISK 1.8 billion, ISK 3.3 billion and ISK 5.9 billion, respectively.

Amounts are in ISK millions

41. Credit risk, continued

Forbearance

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

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

	Stage 1		Stage 2		Stage 3		Total	
30.09.2022	Gross carrying amount	Loss allowance	Gross carrying carrying	Loss allowance	Gross carrying carrying	Loss allowance	Gross carrying carrying	Loss allowance
Individuals	-	-	9,131	(38)	2,734	(438)	11,865	(476)
Companies	-	-	21,468	(832)	5,256	(2,505)	26,724	(3,337)
Tourism	-	-	16,538	(638)	4,011	(2,262)	20,549	(2,900)
Other than tourism	-	-	4,930	(194)	1,245	(243)	6,175	(437)
Total	-	-	30,599	(870)	7,990	(2,943)	38,589	(3,813)
31.12.2021								
Individuals	10,972	(20)	1,962	(28)	2,695	(445)	15,629	(493)
Companies	10,912	(54)	17,440	(1,353)	7,104	(2,526)	35,456	(3,933)
Tourism	5,495	(40)	15,710	(1,148)	5,155	(2,055)	26,360	(3,243)
Other than tourism	5,417	(14)	1,730	(205)	1,949	(471)	9,096	(690)
Total	21,884	(74)	19,402	(1,381)	9,799	(2,971)	51,085	(4,426)

Groups with special focus due to the Covid-19 pandemic

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

30.09.2022	Tourism dependent	Covid-19 related payment moratoria	Recipient governmen sponsored loans	All focus groups	Thereof secured by real estate
Individuals	4,259	-	141	4,398	4,009
Real estate and construction	11,854	-	1,135	12,431	12,250
Services	5,307	-	2,963	5,745	2,341
Transportation	7,407	-	79	7,413	533
Industry, energy and manufacturing	168	-	377	418	128
Wholesale and retail trades	44,327	-	16,369	45,106	36,267
Other sectors	1,223	-	1,011	2,223	1,144
Gross carrying amount	74,545	-	22,075	77,734	56,672
Loss allowance	(3,317)	-	(1,366)	(3,369)	
Book value	71,228	-	20,709	74,365	
31.12.2021					
Individuals	4,212	612	161	4,917	4,535
Real estate and construction	10,545	2,627	1,176	11,058	10,870
Services	5,838	33	2,315	6,353	2,251
Transportation	8,679	-	867	8,685	358
Industry, energy and manufacturing	152	550	536	1,119	826
Wholesale and retail trades	43,766	12,588	18,336	44,527	39,681
Other sectors	1,347	-	1,065	2,409	1,282
Gross carrying amount	74,539	16,410	24,456	79,068	59,803
Loss allowance	(3,614)	(955)	(1,675)	(3,683)	
Book value	70,925	15,455	22,781	75,385	

Book value of Covid-19 impacted loans was ISK 74,365 million or 7.1% of loans to customers (31.12.2021: ISK 75,385 million and 8.1%).

Amounts are in ISK millions

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 Group's operations of meeting customers' investment and risk management needs. Market risk in the banking book arises from various mismatches in assets and liabilities in e.g. currencies, maturities and interest rates. Market risk in the trading book and in the banking book is managed separately.

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

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

Interest rate risk

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

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

At the beginning of the Covid-19 pandemic, the Icelandic Central Bank lowered interest rates to historic lows which resulted in sharp increase in demand for non-indexed mortgages with floating rates in 2020 and first half of 2021. Inflation in Iceland, currently at 9.3% and decreasing, has exceeded the Central Bank’s target of 2.5% since June 2020 and is expected to remain over the target throughout 2023. The Central Bank has responded by increasing interest rates by 500bps since its lowest value of 75bps at the start of 2021. From the second half of 2021 to the start of 2022, this resulted in a sharp increase in demand for non-indexed fixed rate mortgages with corresponding increase in interest rate risk. The risk exposure has been receding in 2022 as the duration of those loans is shortening.

Interest rate risk

The following table shows the Group's interest-bearing assets and liabilities by interest fixing periods, thus showing the banks exposure to interest rate risk. 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 Consolidated Financial Statements. The fair value reflects the likelihood of prepayment. Defaulted loans are presented at book value, which is based on the value of the underlying collateral, and are therefore assumed to be independent of interest adjustment periods and placed in the 'Up to 3 months' category.

30.09.2022	Up to 3	3-12	1-5	5-10	Over 10	
Assets	months	months	years	years	years	Total
Balances with Central Bank	68,149	-	-	-	-	68,149
Loans to credit institutions	52,643	-	-	-	-	52,643
Loans to customers	638,370	82,853	276,553	11,172	12,375	1,021,323
Financial instruments	62,261	60,586	25,989	6,197	2,431	157,464
Assets	821,423	143,439	302,542	17,369	14,806	1,299,579
Liabilities						
Due to credit institutions and Central Bank	5,099	-	-	-	-	5,099
Deposits	703,151	13,502	19,992	1,902	1,422	739,969
Borrowings	-	22,175	293,857	43,667	11,915	371,614
Subordinated liabilities	-	-	32,165	-	-	32,165
Liabilities	708,250	35,677	346,014	45,569	13,337	1,148,847
Derivatives and other off-balance sheet items (net position)	(187,286)	17,417	153,296	-	-	(16,573)
Net interest gap	(74,113)	125,179	109,824	(28,200)	1,469	134,159

Amounts are in ISK millions

42. Market risk, continued

31.12.2021 *Assets*	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	65,501	-	-	-	-	65,501
Loans to credit institutions	30,272	-	-	-	-	30,272
Loans to customers	578,253	107,607	235,275	4,920	11,124	937,179
Financial instruments	42,731	64,162	39,278	5,431	249	151,851
Assets	716,757	171,769	274,553	10,351	11,373	1,184,803
Liabilities						
Due to credit institutions and Central Bank	5,000	-	-	-	-	5,000
Deposits	655,476	-	-	-	-	655,476
Borrowings	11,308	34,217	275,315	34,665	11,965	367,470
Subordinated liabilities	-	-	35,860	-	-	35,860
Liabilities	671,784	34,217	311,175	34,665	11,965	1,063,806
Derivatives and other off-balance sheet items (net position)	(196,457)	(5)	193,205	3,766	-	509
Net interest gap	(151,484)	137,547	156,583	(20,548)	(592)	121,506

Sensitivity analysis of interest rate risk

The following table shows the sensitivity of the Group's net present value (NPV) of interest-bearing assets and liabilities and variation of annual net interest income (NII), due to changes in interest rates by currencies. The variation is calculated on the basis of simultaneous parallel shifts upwards or downwards of yield curves. The choice of shifts is not an estimate of risk likelihood. Behavioral maturities are taken into account in the NPV calculations, including prepayment likelihood and expected behavior of non-maturing deposits. The change to NII is however primarily based on contractual interest rate adjustments where it is simplistically assumed that all rates are equally sensitive to the presumed change in market rates. Behavioral maturity assumptions are however applied for non-maturing deposits and a zero percentage floor is applied to deposit interest rates. Changes were made to the NII calculations in Q3 2022, for the reference date. The interest rate shifts in both directions take account of the floor on interest rates so that when the floor has an effect then the shifts are restricted.

	30.09.2022		31.12.2021	
NPV change in the banking book	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	(1,585)	2,326	(2,250)	2,418
ISK, Non index-linked	1,454	(1,518)	2,308	(2,322)
Foreign currencies	(1,251)	1,165	338	(461)
NPV change in the trading book				
ISK, CPI index-linked	207	(187)	93	(85)
ISK, Non index-linked	3	1	(41)	43
Foreign currencies	86	(85)	74	(74)
NII change				
ISK, CPI index-linked	(1,090)	1,090	(1,044)	143
ISK, Non index-linked	(1,411)	194	(2,688)	1,332
Foreign currencies	(580)	228	(101)	101

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

30.09.2022	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	8,519	39,097	197,356	244,972
Financial instruments	6,582	3,258	9,824	19,664
Off-balance sheet position	-	-	-	-
Assets, CPI index-linked	15,101	42,355	207,180	264,636
Liabilities, CPI index-linked				
Deposits	85,395	19,866	3,324	108,585
Borrowings	329	67,586	45,395	113,310
Subordinated liabilities	-	-	5,724	5,724
Other	1,205	243	1,327	2,775
Off-balance sheet position	1,324	2,100	-	3,424
Liabilities, CPI index-linked	88,253	89,795	55,770	233,818
Net on-balance sheet position	(71,828)	(45,340)	151,410	34,242
Net off-balance sheet position	(1,324)	(2,100)	-	(3,424)
CPI Balance	(73,152)	(47,440)	151,410	30,818
CPI Balance for prudential consolidation, excluding insurance operations *	(71,978)	(50,456)	141,946	19,512

31.12.2021	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	7,500	41,730	172,662	221,892
Financial instruments	5,753	2,541	7,549	15,843
Off-balance sheet position	-	-	-	-
Assets, CPI index-linked	13,253	44,271	180,211	237,735
Liabilities, CPI index-linked				
Deposits	84,902	9,296	3,036	97,234
Borrowings	297	62,355	39,355	102,007
Subordinated liabilities	-	-	5,337	5,337
Other	1,134	222	1,316	2,672
Off-balance sheet position	1,221	3,246	-	4,467
Liabilities, CPI indexed linked	87,554	75,119	49,044	211,717
Net on-balance sheet position	(73,080)	(27,602)	131,167	30,485
Net off-balance sheet position	(1,221)	(3,246)	-	(4,467)
CPI Balance	(74,301)	(30,848)	131,167	26,018
CPI Balance for prudential consolidation, excluding insurance operations *	(73,444)	(33,167)	124,030	17,419

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

Amounts are in ISK millions

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. Net exposures per currency are monitored centrally in the Bank.

Breakdown of assets and liabilities by currency

30.09.2022

Financial assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	66,667	469	416	178	106	42	271	68,149
Loans to credit institutions	1,347	25,127	19,170	2,751	1,011	1,210	2,027	52,643
Loans to customers	861,760	100,477	53,016	471	27,347	136	1,945	1,045,152
Financial instruments	152,757	45,044	13,465	66	345	11,408	57	223,142
Other financial assets	9,745	737	291	11	4	3	-	10,791
Financial assets	1,092,276	171,854	86,358	3,477	28,813	12,799	4,300	1,399,877
Financial liabilities								
Due to credit inst. and Central Bank	4,380	270	326	8	46	-	69	5,099
Deposits	655,391	34,705	36,942	2,862	4,509	3,419	2,141	739,969
Financial liabilities at fair value	3,167	13,523	4,741	65	1	266	37	21,800
Other financial liabilities	8,412	5,475	3,174	169	463	218	300	18,211
Borrowings	157,886	201,602	-	-	-	14,054	2,998	376,540
Subordinated liabilities	6,617	714	13,297	-	-	4,031	9,430	34,089
Financial liabilities	835,853	256,289	58,480	3,104	5,019	21,988	14,975	1,195,708
Net on-balance sheet position	256,423	(84,435)	27,878	373	23,794	(9,189)	(10,675)	
Net off-balance sheet position	(51,322)	85,156	(27,852)	(320)	(24,505)	8,793	10,050	
Net position	205,101	721	26	53	(711)	(396)	(625)	
Non-financial assets								
Investment property	6,617	-	-	-	-	-	-	6,617
Investments in associates	785	-	-	-	-	-	-	785
Intangible assets	8,816	-	-	-	-	-	-	8,816
Tax assets	2,886	-	-	-	-	-	-	2,886
Assets and disposal groups held for sale	2,152	-	-	-	-	-	-	2,152
Other non financial assets	6,456	194	65	24	(1)	13	2	6,753
Non-financial assets	27,712	194	65	24	(1)	13	2	28,009
Non-financial liabilities and equity								
Tax liabilities	15,596	-	-	-	-	-	-	15,596
Liabilities associated with disposal groups held for sale	-	-	-	-	-	-	-	-
Other non-financial liabilities	30,227	60	6	-	3	-	(1)	30,295
Shareholders' equity	185,607	-	-	-	-	-	-	185,607
Non-controlling interest	680	-	-	-	-	-	-	680
Non-financial liabilities and equity	232,110	60	6	-	3	-	(1)	232,178
Management reporting of currency risk *	703	855	85	77	(715)	(383)	(622)	

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

Amounts are in ISK millions

42. Market risk, continued

31.12.2021

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

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

Amounts are in ISK millions

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 year. The analysis calculates the effect of a reasonably possible movement of the currency rate against the ISK, with all other variables held constant, on the Consolidated Income Statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). A negative amount in the table reflects a potential net reduction in the Consolidated 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).

	30.09.2022		31.12.2021	
Currency	-10%	+10%	-10%	+10%
EUR	(86)	86	(111)	111
USD	(9)	9	426	(426)
GBP	(8)	8	(33)	33
DKK	72	(72)	(109)	109
NOK	38	(38)	5	(5)
Other	62	(62)	28	(28)

Equity risk

Equity risk is the risk that the fair value of equities decreases. For information on assets seized and held for sale and equity exposures, see Notes 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 Consolidated Financial Statements. A negative amount in the table reflects a potential net reduction in the Consolidated Income Statement or equity, while a positive amount reflects a potential net increase. Investments in associates are excluded. The result of value-at-risk calculations for the trading book are shown in the Group's Pillar 3 Risk Disclosures.

	30.09.2022		31.12.2021	
Equity	-10%	+10%	-10%	+10%
Trading book - listed	(313)	313	(266)	266
Banking book - listed	(555)	555	(414)	414
Banking book - unlisted	(435)	435	(662)	662

Derivatives

Derivatives are a part of the Group's customer product offering. The types of derivatives currently offered are forward contracts, swaps and options. Eligible underlying market factors are interest rates, foreign exchange rates, equities and commodities. Exposure limits, hedging requirements and collateral requirements are determined in accordance with the Group's risk appetite and monitored by Risk Management on a daily basis. The Group also uses derivatives to hedge market risk on its balance sheet. Note 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 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 74% 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 or pledged to the Central Bank of Iceland and thus converted into cash at very short notice.

Contractual cash flow of assets and liabilities

30.09.2022	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	9,698	51,249	7,310	-	-	-	68,257	68,149
Loans to credit institutions	29,207	21,439	2,049	-	-	-	52,695	52,643
Loans to customers	5,397	130,170	132,399	434,454	1,028,490	-	1,730,910	1,045,152
Financial instruments	13,098	64,189	55,357	32,447	16,537	50,026	231,654	223,142
Derivatives - assets leg	-	*73,696*	*13,090*	*33,524*	*88*	-	*120,398*	*111,542*
Derivatives - liabilities leg	-	*(67,128)*	*(12,829)*	*(29,104)*	*(87)*	-	*(109,148)*	*(103,339)*
Other financial instruments	*13,098*	*57,621*	*55,096*	*28,027*	*16,536*	*50,026*	*220,404*	*214,939*
Other financial assets	488	4,948	3,621	1,734	-	-	10,791	10,791
Financial assets	57,888	271,995	200,736	468,635	1,045,027	50,026	2,094,307	1,399,877
Financial liabilities								
Due to credit inst. and Central Bank	2,605	2,512	-	-	-	-	5,117	5,099
Deposits	545,763	158,323	13,406	20,078	3,454	-	741,024	739,969
Financial liabilities at fair value	-	3,244	1,499	18,909	-	-	23,652	21,800
Derivatives - assets leg	-	*(62,320)*	*(12,716)*	*(30,924)*	-	-	*(105,960)*	*(105,528)*
Derivatives - liabilities leg	-	*65,564*	*14,215*	*49,833*	-	-	*129,612*	*127,328*
Short position in bonds	-	-	-	-	-	-	-	-
Other financial liabilities	71	14,988	756	2,396	-	-	18,211	18,211
Borrowings	-	5,888	27,158	320,671	57,677	-	411,394	376,540
Subordinated liabilities	-	250	1,939	19,266	22,734	-	44,189	34,089
Financial liabilities	548,439	185,205	44,758	381,320	83,865	-	1,243,587	1,195,708
Net position for assets and liab.	(490,551)	86,790	155,978	87,315	961,162	50,026	850,720	204,169
Off-balance sheet items								
Financial guarantees	-	1,260	10,018	2,446	7,657	-	21,381	21,381
Unused overdraft	-	59,002	-	-	-	-	59,002	59,002
Undrawn loan commitments	-	51,869	23,305	26,221	4,137	-	105,532	105,532
Off-balance sheet items	-	112,131	33,323	28,667	11,794	-	185,915	185,915
Net contractual cash flow	(490,551)	(25,341)	122,655	58,648	949,368	50,026	664,805	18,254

Amounts are in ISK millions

43. Liquidity and Funding risk, continued

31.12.2021 *Financial assets*	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity	Total	Book value
Cash and balances with CB	25,975	36,547	6,633	-	-	-	69,155	69,057
Loans to credit institutions	25,663	2,509	51	2,123	-	-	30,346	30,272
Loans to customers	3,033	100,588	137,323	345,777	790,442	-	1,377,163	936,237
Financial instruments	16,091	39,164	60,412	46,502	14,898	56,857	233,924	225,657
Derivatives - assets leg	-	*33,562*	*10,841*	*35,105*	*1,100*	-	*80,608*	*74,952*
Derivatives - liabilities leg	-	*(32,614)*	*(10,779)*	*(31,674)*	*(985)*	-	*(76,052)*	*(72,047)*
Other financial instruments	*16,091*	*38,216*	*60,350*	*43,071*	*14,783*	*56,857*	*229,368*	*222,752*
Other financial assets	679	6,720	3,734	1,588	-	-	12,721	12,721
Financial assets	71,441	185,528	208,153	395,990	805,340	56,857	1,723,309	1,273,944
Financial liabilities								
Due to credit inst. and Central Bank	3,230	1,811	-	-	-	-	5,041	5,000
Deposits	499,362	63,407	80,999	9,557	3,152	-	656,477	655,476
Financial liabilities at fair value	-	3,943	537	2,644	4	-	7,128	5,877
Derivatives - assets leg	-	*(53,896)*	*(3,855)*	*(5,590)*	*(519)*	-	*(63,860)*	*(63,483)*
Derivatives - liabilities leg	-	*57,839*	*4,392*	*8,234*	*523*	-	*70,988*	*69,360*
Other financial liabilities	74	6,010	725	1,033	843	-	8,685	8,685
Borrowings	-	13,996	40,498	258,049	73,001	-	385,544	356,637
Subordinated liabilities	-	1,192	946	42,763	1	-	44,902	35,088
Financial liabilities	502,666	90,359	123,705	314,046	77,001	-	1,107,777	1,066,763
Net position for assets and liab.	(431,225)	95,169	84,448	81,944	728,339	56,857	615,532	207,181
Off-balance sheet items								
Financial guarantees	-	974	5,501	1,942	7,441	-	15,858	15,858
Unused overdraft	-	63,108	-	-	-	-	63,108	63,108
Undrawn loan commitments	-	62,529	23,636	22,410	116	-	108,691	108,691
Off-balance sheet items	-	126,611	29,137	24,352	7,557	-	187,657	187,657
Net contractual cash flow	(431,225)	(31,442)	55,311	57,592	720,782	56,857	427,875	19,524

Net Stable Funding Ratio

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

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

	30.9.2022	31.12.2021
Available stable funding	1,079,981	1,001,543
Required stable funding	917,977	827,953
Net stable funding ratio	118%	121%

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. For LCR in ISK, the requirement is 40% in 2022 and 50% as of 2023.

The following table shows the breakdown for the Group's LCR calculations. The ratio is based on consolidated figures for the Bank.

30.09.2022	ISK	Foreign currency	Total
Liquid assets level 1 *	122,327	55,401	177,728
Liquid assets level 2	24,290	-	24,290
Liquid assets	146,617	55,401	202,018
Deposits	128,625	30,666	159,291
Borrowings	2,333	89	2,422
Other cash outflows	8,696	6,914	13,517
Cash outflows	139,654	37,669	175,230
Short-term deposits with other banks **	-	23,935	23,935
Other cash inflows	35,573	8,996	44,569
Cash inflows	35,573	32,931	68,504
Liquidity coverage ratio (LCR) ***	141%	588%	189%

31.12.2021	ISK	Foreign currency	Total
Liquid assets level 1 *	96,563	83,777	180,340
Liquid assets level 2	16,406	-	16,406
Liquid assets	112,969	83,777	196,746
Deposits	107,698	34,682	142,380
Borrowings	433	55	488
Other cash outflows	10,157	6,882	17,039
Cash outflows	118,288	41,619	159,907
Short-term deposits with other banks **	2,287	25,246	27,533
Other cash inflows	32,799	2,575	35,374
Cash inflows	35,086	27,821	62,907
Liquidity coverage ratio (LCR) ***	136%	607%	203%

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

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

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

Amounts are in ISK millions

43. Liquidity and Funding risk, continued

Composition of liquid assets

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

30.09.2022	ISK	USD	EUR	Other	Total
Cash and balances with Central Bank	66,667	416	469	597	68,149
Short-term deposits with financial institutions	-	7,389	11,669	4,877	23,935
Domestic bonds eligible as collateral with Central Bank	79,357	-	-	-	79,357
Foreign government bonds	-	7,935	36,767	9,213	53,915
Liquidity reserve	146,024	15,740	48,905	14,687	225,356
31.12.2021					
Cash and balances with Central Bank	67,690	280	608	479	69,057
Short-term deposits with financial institutions	2,287	7,170	6,176	11,900	27,533
Domestic bonds eligible as collateral with Central Bank	48,178	-	-	-	48,178
Foreign government bonds	-	14,272	49,016	19,117	82,405
Liquidity reserve	118,155	21,722	55,800	31,496	227,173

LCR deposit categorization

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

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

LCR categorization - amounts and LCR outflow weights	Deposits maturing within 30 days					
30.09.2022	Less stable	Weight %	Stable	Weight %	Term deposits*	Total deposits
Individuals	98,484	11%	118,577	5%	102,907	319,968
Small and medium enterprises	102,015	11%	20,091	5%	15,152	137,258
Operational relationship	15,270	25%	-	5%	-	15,270
Corporations	70,109	40%	3,170	20%	15,710	88,989
Sovereigns, central banks and PSE	34,490	40%	28	-	21,641	56,159
Pension funds	48,278	100%	-	-	14,468	62,746
Domestic financial entities	57,764	100%	-	-	5,813	63,577
Foreign financial entities	1,101	100%	-	-	-	1,101
Total	427,511		141,866		175,691	745,068
31.12.2021						
Individuals	89,425	11%	125,515	5%	91,170	306,110
Small and medium enterprises	84,557	11%	18,210	5%	9,122	111,889
Corporations	73,261	40%	2,797	20%	16,213	92,271
Sovereigns, central banks and PSE	31,041	40%	-	-	786	31,827
Pension funds	42,334	100%	-	-	13,448	55,782
Domestic financial entities	45,662	100%	-	-	15,641	61,303
Foreign financial entities	1,294	100%	-	-	-	1,294
Total	367,574		146,522		146,380	660,476

* 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 regulatory requirements, including the Pillar 2 and combined capital buffer requirements.

The Group's capital ratios are calculated in accordance with the Icelandic Financial Undertakings Act No. 161/2002 and Regulation No. 233/2017 on prudential requirements with later changes, through which CRD V / CRR II have been adopted. The Group applies the standardized approach to calculate capital requirements for credit risk, including counterparty credit risk, credit valuation adjustment, market risk and operational risk.

The Group's consolidated situation as stipulated in CRR is the Group's accounting consolidation excluding insurance subsidiaries, in particular Vördur.

Own funds	30.09.2022	31.12.2021
Total equity	186,287	194,598
Unaudited interim net earnings	(4,869)	-
Non-controlling interest not eligible for inclusion in CET1 capital	(680)	(673)
Common Equity Tier 1 capital before regulatory adjustments	180,738	193,925
Intangible assets	(6,055)	(8,435)
Additional value adjustments	(254)	(240)
Foreseeable dividend and buyback *	(10,570)	(26,773)
Adjustment under IFRS 9 transitional arrangements as amended	1,018	920
Common equity Tier 1 capital	164,877	159,397
Non-controlling interest eligible for inclusion in T1 capital	87	133
Additional Tier 1 capital	13,297	13,225
Tier 1 capital	178,261	172,755
Tier 2 instruments	20,792	21,863
Tier 2 instruments of financial sector entities (significant investments)	(1,154)	(1,056)
Tier 2 capital	19,638	20,807
Total own funds	197,899	193,562
Risk-weighted exposure amount (REA)		
Credit risk, loans and off-balance sheet items	693,037	623,395
Credit risk, securities and other	64,164	69,553
Counterparty credit risk	11,946	7,761
Market risk due to currency imbalance	1,778	4,691
Market risk due to trading book positions	10,315	8,958
Credit valuation adjustment	2,830	2,379
Operational risk	84,670	96,085
Total risk-weighted exposure amount	868,740	812,822
Capital ratios		
CET1 ratio	19.0%	19.6%
Tier 1 ratio	20.5%	21.2%
Capital adequacy ratio	22.8%	23.8%
Total own funds, including interim profit not eligible for inclusion	200,334	193,562
CET1 ratio, including interim profit not eligible for inclusion	19.3%	19.6%
Tier 1 ratio, including interim profit not eligible for inclusion	20.8%	21.2%
Capital adequacy ratio, including interim profit not eligible for inclusion	23.1%	23.8%

* On 30 September 2022, the foreseeable dividend corresponds to 50% of profits as per the Bank's dividend policy. There is also a buyback program ongoing following the sale of Valitor, the remainder of that program is included in the deduction. On 31 December 2021, the foreseeable dividend and buyback was the aggregation of an expected dividend of ISK 22.5 billion and the remainder of the buyback program amounting to ISK 4.3 billion based on permission from the FSA from 7 October 2021.

Amounts are in ISK millions

44. Capital management, continued

The Bank has opted to make use of the transitional arrangements for IFRS 9 and Covid-19 in its capital adequacy calculations and this is reflected in the Group's capital ratios. The transitional arrangements increase the capital adequacy ratio by 0.1 percentage points.

Capital ratios of the parent company	30.09.2022	31.12.2021
CET1 ratio	19.0%	20.2%
Tier 1 ratio	20.5%	21.9%
Capital adequacy ratio	22.8%	24.4%

The following table outlines the implementation of the capital buffer requirements in accordance with the Icelandic Financial Undertakings Act No. 161/2002, as prescribed by the Financial Stability Council (FSC) and approved by the FSA. The FSC has announced that the countercyclical capital buffer will increase to 2% on 29 September 2022.

Capital buffer requirement, % of REA	30.09.2022	31.12.2021
Capital conservation buffer	2.5%	2.5%
Capital buffer for systematically important institutions	2.0%	2.0%
Systemic risk buffer *	3.0%	3.0%
Countercyclical capital buffer *	2.0%	-
Combined capital buffer requirement	9.5%	7.5%

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

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

Capital requirement, % of REA	CET1	Tier 1	Total
Pillar 1 capital requirement	4.5%	6.0%	8.0%
Pillar 2R capital requirement **	2.0%	2.6%	3.5%
Combined buffer requirement *	9.2%	9.2%	9.2%
Regulatory capital requirement	15.7%	17.8%	20.7%
Available capital	19.0%	20.5%	22.8%

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

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

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.

	30.09.2022	31.12.2021
On-balance sheet exposures	1,380,093	1,256,916
Derivative exposures	25,837	4,796
Securities financing transaction exposures	10,943	720
Off-balance sheet exposures	63,019	102,016
Total exposure	1,479,892	1,364,448
Tier 1 capital	178,261	172,755
Leverage ratio	12.0%	12.7%

Amounts are in ISK millions

44. Capital management, continued

MREL

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

Minimum requirement for own funds and eligible liabilities	30.09.2022	31.12.2021
Own funds	197,899	193,365
Eligible liabilities	146,094	140,239
Own funds and eligible liabilities	343,993	333,604
Combined buffer requirement (CBR)	79,924	58,523
Own funds and eligible liabilities not used for CBR	264,069	275,081
Risk-weighted exposure amount (REA)	868,739	812,822
Own funds and eligible liabilities not used for CBR (% REA)	30.4%	33.8%
MREL requirement (% REA)	23.0%	-
Total liabilities and own funds (TLOF)	1,405,409	1,277,543
Own funds and eligible liabilities not used for CBR (% TLOF)	18.8%	21.5%
MREL requirement (% TLOF)	14.7%	-

Solvency II

Excess of assets over liabilities in accordance with Solvency II	9,374	9,090
Subordinated liabilities	1,143	1,069
Foreseeable dividends	-	-
Own funds	10,517	10,159
Solvency capital requirements (SCR)	6,842	6,902
SCR ratio	153.7%	147.2%

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

45. Operational risk

Operational risk is the risk of direct or indirect loss, or damage to the Group's reputation resulting from inadequate or failed internal processes or systems, from human error or external events that affect the Group's image and operational earnings.

Each business unit within the Group is primarily responsible for taking and managing their own operational risk. Risk management is responsible for developing and maintaining tools for identifying, measuring, monitoring and reporting the Group's operational risk.

The Group uses the standardized approach for the calculation of capital requirements for operational risk.

Amounts are in ISK millions

46. Sustainability risk

Sustainability risk is defined as the risk that certain activities or practices compromise the Bank's assets or reputation or the ability of future generations or segments of society to meet their own needs. This can be due to negative effects on the environment, natural or cultural resources or social conditions. The Bank's Sustainability Committee is responsible for reviewing the Bank's performance in relation to its commitments and policies in relation to environmental, social and governance (ESG) factors and aligning the Bank's strategy and risk appetite with them.

The Green Financing Framework

The Bank's Green Financing Framework was published in 2021. Undir this framework the Bank can issue Green Financing Instruments, including covered bonds, bonds, loans, commercial paper, repurchase agreements and deposits. The use of proceeds from these instruments is restricted to the financing of eligible assets as defined in the Framework. Eligible assets are divided into several eligible categories with inclusion and exclusion criteria. The Framework furthermore details the processes for identifying eligible assets, for reporting on use of the framework and for external review. Before the introduction of this framework the Bank had a framework for green deposits but these frameworks have been merged.

Green Financing Instruments	30.09.2022	31.12.2021
Deposits	23,630	8,209
Borrowings	92,152	47,148
Book value	115,782	55,357

Identified eligible green assets by category		
Sustainable fishery and aquaculture	46,437	42,245
Clean transportation	3,737	2,255
Green buildings	62,409	55,881
Energy efficiency	5,823	-
Pollution prevention and control and wastewater management	6,130	5,591
Book value	124,536	105,972

Amounts are in ISK millions

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