Arion Bank

Condensed Consolidated Interim Financial Statements

1 January - 31 March 2021

Contents

Arion Bank in brief

Q1 2021

12.5%
Return on equity

46.2%
Cost-to-income

26.9%
Capital adequacy ratio

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

UNEP FINANCE INITIATIVE | PRINCIPLES FOR RESPONSIBLE BANKING

Equal Pay Certification

PRI Principles for Responsible Investment

Arion Bank

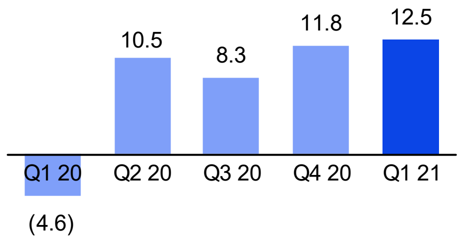
- Arion Bank and subsidiaries form a group which focuses on developing long-term relationships with its clients and is a market leader as a provider of cutting-edge and modern banking services
- The Bank's strategy is to excel by offering smart and reliable financial solutions which create future value for our customers, shareholders and society as a whole
- 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's structure has been simplified and the branch network and business premises have been streamlined
- Arion Bank has significant excess capital and aims to pay approximately ISK 50 billion in dividends and/or share buy-backs over the next years

Key figures (ISK million)

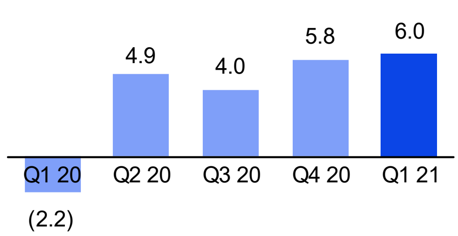
	Q1 2021	Q1 2020
Net earnings	6,039	(2,171)
ROE	12.5%	(4.6%)
ROE continuing operations	12.3%	(2.7%)
Net interest margin	2.7%	2.8%
Cost to income ratio	46.2%	69.2%
Operating income / REA	7.0%	5.0%

	31.03.2021	31.12.2020
Total assets	1,181,093	1,172,706
Loans to customers	837,162	822,941
Deposits	592,540	568,424
Borrowings	293,747	298,947
Stage 3 gross	2.9%	2.6%
Leverage ratio	14.7%	15.1%
Number of employees	772	776
EUR/ISK	148.70	156.09

Return on equity (%)

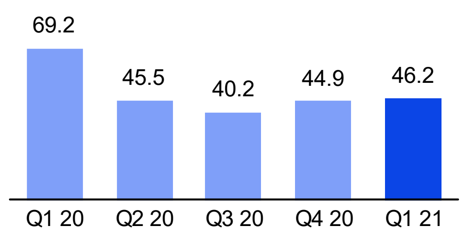


Net earnings (ISK billion)

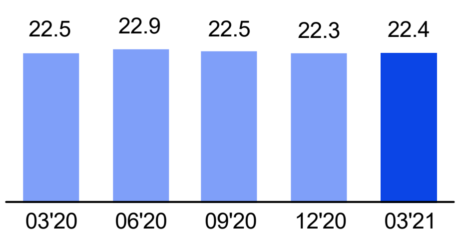


Net interest margin (%)

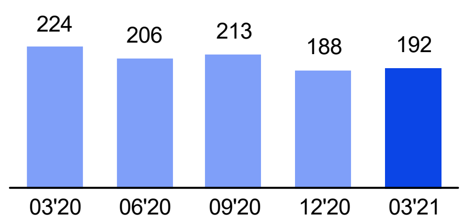
Cost-to-income ratio (%)



CET 1 ratio (%)



LCR ratio (%)



Endorsement and statement
by the Board of Directors and the CEO

The Condensed Consolidated Interim Financial Statements of Arion Bank for the period from 1 January to 31 March 2021 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

Net earnings amounted to ISK 6,039 million in the first quarter and return on equity was 12.5%. The cost-to-income ratio was 46.2% for the quarter.

Operating income for the quarter was ISK 13.1 billion, of which core income (net interest income, net commission income and net insurance income) was ISK 11.3 billion, representing a 4.2% increase from the first quarter last year. Net interest income increased slightly between years. Operating expenses for the quarter were ISK 6.0 billion, decreasing by 2.6% from the first quarter 2020.

The Bank's balance sheet increased by 0.7% during the first quarter of 2021. Loans to customers increased by 1.7%, primarily mortgage lending, but there was a slight decrease in liquid assets partly due to share buy-backs and dividend payments during the quarter. On the liability side deposits increased by 4.2%. Total equity amounted to ISK 189,419 million at the end of the period. Total equity increased due to the reported net earnings but decreased by ISK 2.9 billion due to dividend paid and ISK 11.9 billion due to share buy-backs under a buy-back program. The Group's capital ratio was 26.9% and the CET1 ratio 22.4%. The ratios are determined based on the unaudited net earnings in the quarter, with a deduction of 50% of net earnings as foreseeable dividend in line with the Bank’s dividend policy. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 26.5% and the CET1 ratio was 22.0%. The Bank’s capital ratios comfortably exceed the total regulatory requirements. The Bank’s liquidity position was also very strong at period end, reflected in an LCR ratio of 192%.

Economic outlook

According to the latest figures from Statistics Iceland, GDP contracted by 6.6% in 2020, which is an improvement on initial forecasts. In 2020 forecasts issued by both Arion Bank Research and the Central Bank of Iceland estimated a decrease in GDP of 7.1%-8.5%.

It was fully expected that the economic downturn would be significant in an international context, given the importance of the travel sector to the economy. Despite the relaxation of public health measures over the summer, the tourist high season was just a shadow of itself, with general unemployment continuing to rise. Household demand, however, remained buoyant. Card turnover in Iceland has been increasing since May last year and indicates that Icelandic households are for the most part in a reasonably strong position and that private consumption will be far more resilient than generally expected.

According to the official vaccination calendar of the Ministry of Health, the vaccination of all inhabitants of Iceland older than 16 years will be finished by the end of June. Currently most individuals older than 60 years old have had at least one jab. The government has also issued rules for tourists who want to visit Iceland, specifying what conditions they must meet, depending on their airport of origin. This is positive for the tourism sector which is already seeing increased demand.

Domestic analysts forecast 3% GDP growth on average this year and stronger growth in 2022. Unemployment is currently at a historic high of 9.8%. It is believed to have already peaked and has been decreasing slightly over the last few months. The outlook is for a further reduction in unemployment going into 2022.

Inflation has risen sharply to 4.3% on the back of a weakening ISK, but the inflation spike is expected to be short-lived. Low inflation expectations have been securely anchored and they have enabled the Central Bank’s monetary policy committee to wield its interest rate tool properly to support the economy with low interest rates. Although the economy has yet to rebound in a material way, it is helped by the fact that its foundations are robust, and extensive countermeasures by the government and the Central Bank have alleviated the impact.

Outlook for the Bank

Uncertainty surrounding the global Covid-19 pandemic has been reduced with the roll-out of successful vaccination programmes in the US, UK and, to a lesser degree, in Europe. Iceland is firmly on track in this respect with the economy being expected to bounce back in the second half of 2021.

Arion Bank has a clear strategy and vision for the future and is well equipped to work with its retail and corporate customers as economic activities resume. The Bank is highly capitalized, has strong liquidity in both Icelandic krona and foreign currencies and is well prepared to meet the diverse needs of its customers. Mortgage lending is expected to continue to grow, whereas corporate lending growth is projected to be slower, as the Bank’s objective is to work with customers and find solutions which meet their needs, whether through borrowing or different types of market funding. This is in line with the Bank’s objective of making effective use of risk-weighted assets, while at the same time growing the business. Rationalization measures are still expected across business sectors in the medium term following the pandemic. The Bank will take an active part in working on mergers and acquisitions and other streamlining measures, deploying its capabilities to tackle complex corporate projects. The Bank also intends to strengthen its position in asset management and capital markets.

Increased efficiency is a goal shared by all European banks, and Arion Bank is no exception. The Bank will continue to seek ways to rationalize its business through technology and digital channels.

Funding is and will be an important component of the Bank’s activities. Growing deposits and wholesale funding on the domestic and international markets remain key tasks and a greater focus will be placed on ESG related funding efforts. The Bank has completed the optimization of its capital structure composition with the issuance of Tier 2 and additional Tier 1 bonds in line with strategy and aims to distribute capital to shareholders in accordance with its stated objectives, in addition to paid out dividends and the recently completed share buy-back program.

Employees

The Group had 772 full-time equivalent positions at the end of the period, compared with 776 at the end of 2020. A total of 641 of these positions were at Arion Bank, compared with 648 at the end of 2020.

Funding and liquidity

The Bank's liquidity position is strong, with a liquidity coverage ratio of 192% at the end of March 2021, well above the regulatory minimum of 100%. At the end of 2020 the Bank had refinanced €300 million of the €500 million issue maturing in December 2021, thereby ensuring that its medium-term refinancing needs remain moderate and liquidity risk is minimized. The comfortable liquidity position and low foreseeable refinancing wholesale debt mean that the Bank has limited need to access the international wholesale funding markets in the near future.

Arion Bank issued covered bonds denominated in Icelandic króna, maturing in 2022, for a nominal value of ISK 18 billion in January on top of ISK 20 billion issued in December 2020 maturing in 2024. The Bank holds these covered bonds which can be used in financing operations with the Central Bank of Iceland or sold to investors.

Group ownership

At the end of March 2021 Gildi pension fund was the largest shareholder in Arion Bank with a shareholding of 9.13%. Arion Bank owned 6.36% of its own shares at the end of March 2021. The AGM on 16 March 2021 approved the cancellation of 70 million of the Bank's own shares, totalling ISK 70 million at nominal value. The reduction took place in April. The float of the Bank’s shares has been substantial over the last few months and Icelandic pension funds, insurance and fund management companies along with numerous private investors have added to their shareholdings, whilst large international investors have lowered their stakes. The number of shareholders has grown from 7,400 at year-end to 8,250 at the end of the quarter, and it is encouraging for the Bank to see the increased interest from retail investors. Further information on Arion Bank's shareholders can be found in Note 35.

Capital, risk weighted assets and dividends

Arion Bank’s dividend policy states that the Bank shall pay 50% of net earnings in dividends and that additional dividends or share buybacks can be considered when the Bank’s capital levels exceed the minimum regulatory requirements in addition to the Bank’s management buffer. Considering its strong capital position, Arion Bank expects to pay a dividend or buy back own shares in the amount of approximately ISK 50 billion over the next years.

Following the 2021 AGM, the Board of Directors proposed a dividend distribution of ISK 2,990 million, which was in line with guidance given by the Financial Supervision Committee of the Central Bank from 13 January in relation to economic conditions and uncertainties due to the Covid-19 pandemic. On 8 February 2021 the Financial Supervisory Authority authorized the Bank to buy back own shares for up to ISK 15 billion. At the end of the first quarter, the Bank had purchased own shares for ISK 11,944 million and paid dividend of ISK 2,857 million.

The Group's capital adequacy ratio on 31 March 2021 was 26.9% and the CET1 ratio 22.4%. The ratios account for the unaudited net earnings of the first quarter and a deduction is made for foreseeable dividend that represents 50% of net earnings according to the dividend policy, and the remaining ISK 3.1 billion of the ongoing buyback program.

The Board of Directors has broad authority to make a proposal on dividend payments or other release of capital. Given the Bank’s singularly strong capital position, the Board may seek further approval from the Central Bank to buy back shares or call an extraordinary shareholders’ meeting to decide on extraordinary dividends later in the year. Such action would depend on economic developments and the Bank’s risk profile and it must be ensured that such a proposal would not affect the Bank’s ability to support its customers and the Icelandic economy.

Risk-weighted exposure amounts (REA) increased by ISK 8.6 billion in the first quarter of 2021, which is primarily due to growth in loans to customers by ISK 14.2 billion.

As part of the government’s economic measures in response to Covid-19, the Financial Stability Committee decided to abolish the 2% countercyclical capital buffer, thereby reducing the Group’s total requirement from 20.3% to 18.4%. This measure had a limited impact on Arion Bank, however, given its strong capital position from the outset of the pandemic. At the end of the first quarter 2021 the Bank’s own funds were ISK 64 billion higher than the total capital requirement, factoring in foreseeable dividend. Excess capital, based on the Bank’s objective of maintaining 17% CET 1, is ISK 41 billion in addition to the foreseeable dividend.

Arion Bank issued 54 million warrants on 9 March 2021. The warrants were sold to investors in a private placement in February 2021. The purchase price of the warrants amounted to ISK 15.6 per warrant, resulting in a total sale price of ISK 842,400,000. The purchase price of the warrants was determined using market standard methodology. Approximately 48.5% of the total issue was sold to around 150 employees of the Group and 51.5% to professional investors. Should the owners of the warrants exercise their warrants, the Bank is obliged to issue new shares and sell to the warrant owners at a predefined price (strike price). If all the warrants were exercised, the Bank's share capital would increase to ISK 1,714 million, and the newly issued shares would represent approximately 3.1% of the Bank's total issued capital, post dilution. The exercise period runs from Q4 2023 to Q3 2024.

Governance

At the AGM on 16 March 2021, five members were elected to serve on the Board of Directors until the next AGM, three men and two women. In addition, two Alternate Directors (one man and one woman) were elected, and they attend meetings of the Board of Directors if a Director resigns or is unable to attend. The five Directors and two Alternates are independent of the Arion Bank, its management and major shareholders.

Endorsement and statement
by the Board of Directors and the CEO

Endorsement of the Board of Directors and the Chief Executive Officer

The Condensed Consolidated Interim Financial Statements of Arion Bank for the period ended 31 March 2021 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union and additional requirements in the Icelandic Financial Statements Act, Financial Undertakings Act and Rules on Accounting for Credit Institutions.

It is our opinion that the Condensed Consolidated Interim Financial Statements give a true and fair view of the financial performance and cash flow of the Group for the period ended 31 March 2021 and its financial position as at 31 March 2021.

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

The Board of Directors and the CEO have today discussed the Condensed Consolidated Interim Financial Statements of Arion Bank for the period ended 31 March 2021 and confirm them by means of their signatures.

Reykjavík, 5 May 2021

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	2021 1.1.-31.3.	2020 1.1.-31.3.
Interest income		11,779	12,044
Interest expense		(4,437)	(4,791)
Net interest income	6	**7,342**	**7,253**
Fee and commission income		3,726	3,481
Fee and commission expense		(449)	(405)
Net fee and commission income	7	**3,277**	**3,076**
Net insurance income	8	671	501
Net financial income	9	1,500	(2,000)
Share of profit of associates	25	1	(24)
Other operating income	10	306	170
Other net operating income		**2,478**	**(1,353)**
Operating income		**13,097**	**8,976**
Salaries and related expenses	11	(3,271)	(3,130)
Other operating expenses	12	(2,777)	(3,077)
Operating expenses		**(6,048)**	**(6,207)**
Bank levy	13	(330)	(331)
Net impairment	14	1,080	(2,860)
Earnings before income tax		**7,799**	**(422)**
Income tax expense	15	(1,866)	(860)
Net earnings from continuing operations		**5,933**	**(1,282)**
Discontinued operations held for sale, net of income tax	16	106	(889)
Net earnings		**6,039**	**(2,171)**

Attributable to

Shareholders of Arion Bank hf.		6,038	(2,167)
Non-controlling interest		1	(4)
Net earnings		**6,039**	**(2,171)**

Earnings per share

Earnings per share	17		
Basic earnings per share attributable to the shareholders of Arion Bank (ISK)		3.61	(1.25)
Diluted earnings per share attributable to the shareholders of Arion Bank (ISK)		3.46	(1.25)

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	2021 1.1.-31.3.	2020 1.1.-31.3.
Net earnings		**6,039**	**(2,171)**
Net (loss) gain on financial assets carried at fair value through OCI, net of tax		(481)	420
Realized net (loss) gain on financial assets carried at fair value through OCI, net of tax, transferred to the Income Statement	9	(35)	4
Changes to reserve for financial instruments at fair value through OCI		**(516)**	**424**
Exchange difference on translating foreign subsidiaries		6	183
Other comprehensive income that is or may be reclassified subsequently to the Income Statement		**(510)**	**607**
Total comprehensive income		**5,529**	**(1,564)**

Attributable to

Shareholders of Arion Bank		5,528	(1,560)
Non-controlling interest		1	(4)
Total comprehensive income		**5,529**	**(1,564)**

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

Amounts are in ISK millions

Consolidated Interim Statement of Financial Position

Assets	Notes	31.3.2021	31.12.2020
Cash and balances with Central Bank	18	60,479	42,136
Loans to credit institutions	19	29,251	28,235
Loans to customers	20	837,162	822,941
Financial instruments	21-23	197,216	227,251
Investment property	23	6,110	6,132
Investments in associates	25	892	891
Intangible assets	26	9,892	9,689
Tax assets	27	2	2
Assets and disposal groups held for sale	28	16,271	16,811
Other assets	29	23,818	18,618
Total Assets		**1,181,093**	**1,172,706**
Liabilities			
Due to credit institutions and Central Bank	22	9,525	13,031
Deposits	22	592,540	568,424
Financial liabilities at fair value	22	6,297	5,240
Tax liabilities	27	5,443	4,262
Liabilities associated with disposal groups held for sale	28	8,407	16,183
Other liabilities	30	41,083	32,714
Borrowings	22,31	293,747	298,947
Subordinated liabilities	22,32	34,632	36,060
Total Liabilities		**991,674**	**974,861**
Equity	34		
Share capital and share premium		39,387	51,331
Other reserves		12,757	11,320
Retained earnings		137,101	135,021
Total Shareholders' Equity		**189,245**	**197,672**
Non-controlling interest		174	173
Total Equity		**189,419**	**197,845**
Total Liabilities and Equity		**1,181,093**	**1,172,706**

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

Amounts are in ISK millions

Consolidated Interim Statement of Changes in Equity

			Restricted reserves											
	Share capital	Share premium	Share option	Warrants reserve	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Financial assets at fair value thr. OCI, unrealized	Statutory reserve	Foreign currency trans-lation reserve	Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
Equity 1 January 2021	1,718	49,613	-	-	7,421	694	1,054	(141)	1,637	655	135,021	**197,672**	173	**197,845**
Net earnings											6,038	**6,038**	1	**6,039**
Net fair value loss								(481)				**(481)**		**(481)**
Realized net loss transferred to P/L ...								(35)				**(35)**		**(35)**
Translation difference										6		**6**		**6**
Total comprehensive income	-	-	-	-	-	-	-	(516)	-	6	6,038	**5,528**	1	**5,529**
Dividend paid											(2,857)	**(2,857)**		**(2,857)**
Purchase of treasury stock	(98)	(11,846)										**(11,944)**		**(11,944)**
Share option charge for the period			18									**18**		**18**
Warrants sold				828								**828**		**828**
Changes in reserves					398	571	132				(1,101)	**-**		**-**
Equity 31 March 2021	1,620	37,767	18	828	7,819	1,265	1,186	(657)	1,637	661	137,101	**189,245**	174	**189,419**

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

Amounts are in ISK millions

Consolidated Interim Statement of Changes in Equity

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

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

	2021 1.1.-31.3.	2020 1.1.-31.3.
Operating activities		
Net earnings (loss)	6,039	(2,171)
Non-cash items included in net earnings	1,506	(1,795)
Changes in operating assets and liabilities		
Loans to credit institutions, excluding bank accounts	(1,410)	(677)
Loans to customers	(19,170)	14,492
Financial instruments and financial liabilities at fair value	22,071	(68,194)
Deposits	21,560	32,858
Borrowings	422	28,276
Other changes in operating assets and liabilities	(5,067)	16,737
Interest received	11,501	13,809
Interest paid	(3,913)	(4,184)
Dividend received	42	17
Income tax paid	(685)	(1,069)
Net cash from operating activities	**32,896**	**28,099**
Investing activities		
Acquisition of intangible assets	(396)	(654)
Proceeds from sale of property and equipment	67	2
Acquisition of property and equipment	(171)	(102)
Net cash to investing activities	**(500)**	**(754)**
Financing activities		
Issued subordinated liabilities	-	13,171
Proceeds from issued warrants	828	-
Purchase of treasury stock	(11,944)	(4,381)
Dividend paid to shareholders of Arion Bank	(2,857)	-
Net cash (to) from in financing activities	**(13,973)**	**8,790**
Net increase in cash and cash equivalents	18,423	36,135
Cash and cash equivalents at beginning of the year	58,284	102,186
Effect of exchange rate changes on cash and cash equivalents	(115)	4,791
Cash and cash equivalents	**76,592**	**143,112**
Cash and cash equivalents		
Cash and balances with Central Bank	60,479	118,174
Bank accounts	21,997	29,990
Mandatory reserve deposit with Central Bank	(5,884)	(5,052)
Cash and cash equivalents	**76,592**	**143,112**

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

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 Financial Statements for the period ended 31 March 2021 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 5 May 2021.

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

Statement of compliance

The Condensed Consolidated Interim Financial Statements have been prepared in accordance with International Financial Reporting Standard, IAS 34 Interim Financial Reporting, as adopted by the European Union and additional requirements in the Icelandic Financial Statements Act, Financial Undertakings Act and Rules on Accounting for Credit Institutions. The Condensed Consolidated Interim Financial Statements do not include all the information and disclosures required in the Annual Financial Statements, and should be read in conjunction with Arion Bank's Annual Consolidated Financial Statements for the year ended 31 December 2020. The Annual Consolidated Financial Statements are available on Arion Bank's website www.arionbanki.is.

The same accounting policies, presentation and methods of computation are followed in these Consolidated Financial Statements as were applied in the Consolidated Financial Statements for the year ended 31 December 2020.

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 Annual Financial Statements 2020;

- 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 126.60 and 148.70 for EUR (31.12.2020: USD 127.64 and EUR 156.09).

2. Going concern assumption

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

3. Significant accounting estimates and judgments in applying accounting policies

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

Estimates and assumptions

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

Notes to the Condensed Consolidated Interim Financial Statements

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

Impairment of financial assets

The book value of financial assets which fall under the impairment requirements of IFRS 9 are presented net of expected credit losses in the statement of financial position. On a monthly basis expected credit losses are recalculated for each asset, the calculations being derived from PD, LGD and EAD models. In addition to the model outcomes, the assessment of expected credit losses is based on three key factors: management's assumptions regarding the development of macroeconomic factors over the next 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 2020.

Macroeconomic outlook

Due to the unprecedented circumstances caused by the Covid-19 pandemic, Arion Bank has made changes to its macroeconomic outlook used for IFRS 9 provision calculations from the ones used in calculations for the 2019 impairment provisions (non pandemic comparison) Arion Bank has followed the guidelines of the European supervisors and the Central Bank of Iceland and used moderation in the application of impairment calculations considering the level of economic uncertainty. In doing so, the Bank has estimated the effects of the governmental stimulus programs, general and specific payment moratoria and other actions on expected default rates. The unemployment rate is the key macro factor that drives the forward-looking expectation of defaults. It is assumed that there will be a sharp increase in unemployment which will recover, and the speed of the recovery varies between scenarios, as quarantine restrictions and travel bans are eased.

Unemployment levels and scenarios have been updated from the ones used for Q3 2020 and are more in line with current economic projections. Expected unemployment levels have changed significantly from the ones used before the pandemic, they remain unchanged from the ones used in Q4 2020. The unemployment forecast is now higher and expected to normalize over a longer time period than estimated in 2019. Furthermore, the likelihood of the pessimistic scenario has been increased following the pandemic. Among the steps taken to address the uncertainty and information that is available but not addressed by the models are (1) shortening of the forecasting period, (2) application of expert judgment in cases where economic forecasts are outside the range of the Bank’s macro models, (3) assessment of mitigating effects on default rates in the near-term, (4) adjustment of collateral haircuts to more accurately reflect the realized economic development due to Covid-19, and (5) a management overlay over credit rating scores for specific groups of assets which have been most affected. The scenarios and the weights assigned to them will continue to be reexamined in the coming quarters as uncertainty over the local and global impact of Covid-19 is reduced and vaccines are rolled out. For further information about macroeconomic forecast, see Note 42.

Arion Bank has concluded that credit risk relating to the tourism sector and to counterparties in payment moratoria has significantly increased. The increase has been taken into account since Q1 2020 for tourism and Q3 for payment moratoria, which means that all such exposures are in Stage 2 as of year-end 2020, excluding financial assets to entities owned by the government. Furthermore, the credit rating of affected counterparties has been lowered in line with the increase of expected credit losses. The extent of the related impact on other industries and supporting businesses is unclear, Arion Bank has taken steps to approximate the effects as mentioned above. Companies that receive the court-determined status of temporary financial restructuring as per Act No. 57/2020 are transferred to Stage 3. The Bank continues to monitor developments closely and will adjust its provisions accordingly.

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.

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.

Notes to the Condensed Consolidated Interim Financial Statements

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

Impairment of intangible assets

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

Revaluation of investment properties

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

4. The Group

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

			Equity interest	
	Operating activity	Currency	31.3.2021	31.12.2020
Eignabjarg ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Leiguskjól ehf., Lágmúli 6, 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%	100.0%
VISA Ísland ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Vördur tryggingar hf., Borgartún 25, Reykjavík, Iceland	Insurance	ISK	100.0%	100.0%

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Operating segment reporting

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

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

5. Operating segments

Markets

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

Corporate & Investment Banking services large and medium-sized corporate clients and investors, 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 provides a full range of lending products such as guarantees, deposit accounts, payment solutions and a variety of value-added digital solutions to meet the needs of the Bank's larger corporate clients. The Corporate Banking portfolio includes several larger international transactions, partly in syndicates with other Icelandic banks and international banks.

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

Retail Banking

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

Treasury

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

Vördur

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

Subsidiaries

Subsidiaries include the subsidiaries 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 Valitor, 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) and IT. The information presented relating to the supporting units does not represent an operating segment. A significant proportion of expenses from support functions is allocated to operating segments in a separate line in the operating segment overview.

Notes to the Condensed Consolidated Interim Financial Statements

5. Operating segments, continued

1.1.-31.3.2021	Markets and Stefnir	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other sub-sidiaries	Supporting units and elimi-nations	Total
Net interest income	139	2,585	3,932	709	26	(41)	(8)	7,342
Net fee and commission income	1,191	1,107	940	165	(72)	(140)	86	3,277
Net insurance income	-	-	-	-	717	-	(46)	671
Net financial income	65	216	-	1,019	316	(116)	-	1,500
Share of profit of associates	-	-	-	-	-	-	1	1
Other operating income	-	1	211	(2)	8	(15)	103	306
Operating income	1,395	3,909	5,083	1,891	995	(312)	136	13,097
Operating expenses	(439)	(325)	(1,311)	(143)	(630)	(85)	(3,115)	(6,048)
Allocated expenses	(467)	(642)	(1,629)	(236)	(8)	(1)	2,983	-
Bank levy	(13)	(94)	(155)	(68)	-	-	-	(330)
Net impairment	-	841	414	2	-	(85)	(92)	1,080
Earnings (loss) before income tax	476	3,689	2,402	1,446	357	(483)	(88)	7,799
Net seg. rev. from ext. customers	1,033	4,988	7,779	(1,606)	915	(105)	93	13,097
Net seg. rev. from other segments	362	(1,079)	(2,696)	3,497	80	(207)	43	-
Operating income	1,395	3,909	5,083	1,891	995	(312)	136	13,097
Loans to customers	3	307,733	530,153	115	-	4	(846)	837,162
Financial instruments	48,175	1,267	-	123,608	23,538	2,804	(2,176)	197,216
Other external assets	5,154	8,023	4,179	74,057	8,463	31,635	15,204	146,715
Internal assets	24,595	-	-	248,093	-	-	(272,688)	-
Total assets	77,927	317,023	534,332	445,873	32,001	34,443	(260,506)	1,181,093
Deposits	64,525	107,254	361,077	63,671	-	-	(3,987)	592,540
Other external liabilities	5,285	1,775	5,436	337,375	21,205	11,889	16,169	399,134
Internal liabilities	-	148,674	124,014	-	-	-	(272,688)	-
Total liabilities	69,810	257,703	490,527	401,046	21,205	11,889	(260,506)	991,674
Allocated equity	8,117	59,320	43,805	44,827	10,796	22,554	-	189,419

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

5. Operating segments, continued

1.1.-31.3.2020	Markets and Stefnir	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other sub-sidiaries	Supporting units and elimi-nations	Total
Net interest income	197	2,522	3,831	848	47	(174)	(18)	7,253
Net fee and commission income	1,035	837	1,247	96	(41)	(211)	113	3,076
Net insurance income	-	-	-	-	523	-	(22)	501
Net financial income	(136)	-	-	(1,411)	130	(594)	11	(2,000)
Share of profit of associates	1	-	-	-	-	-	(25)	(24)
Other operating income	3	(2)	119	-	2	8	40	170
Operating income	1,100	3,357	5,197	(467)	661	(971)	99	8,976
Operating expenses	(474)	(385)	(1,493)	(185)	(636)	(75)	(2,959)	(6,207)
Allocated expenses	(468)	(618)	(1,473)	(211)	(12)	(1)	2,783	-
Bank levy	(8)	(107)	(158)	(58)	-	-	-	(331)
Net impairment	-	(1,645)	(1,903)	4	-	683	1	(2,860)
Earnings (loss) before income tax	150	602	170	(917)	13	(364)	(76)	(422)
Net seg. rev. from ext. customers	743	4,897	7,190	(3,895)	589	(575)	27	8,976
Net seg. rev. from other segments	357	(1,540)	(1,993)	3,428	72	(396)	72	-
Operating income	1,100	3,357	5,197	(467)	661	(971)	99	8,976

31.03.2020	Markets and Stefnir	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other sub-sidiaries	Supporting units and elimi-nations	Total
Loans to customers	10	316,959	470,211	15	-	5	(8,377)	778,823
Financial instruments	32,606	7,773	-	128,086	20,035	4,742	(1,186)	192,056
Other external assets	4,333	4,652	4,260	130,670	6,407	43,886	22,733	216,941
Internal assets	39,338	-	-	239,495	551	1,320	(280,704)	-
Total assets	76,287	329,384	474,471	498,266	26,993	49,953	(267,534)	1,187,820
Deposits	67,982	95,599	320,045	57,445	-	-	(1,759)	539,312
Other external liabilities	1,321	3,896	3,399	392,348	16,869	31,867	14,929	464,629
Internal liabilities	-	171,871	108,833	-	-	-	(280,704)	-
Total liabilities	69,303	271,366	432,277	449,793	16,869	31,867	(267,534)	1,003,941
Allocated equity	6,984	58,018	42,194	48,473	10,124	18,086	-	183,879

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Consolidated Interim Income Statement

6. Net interest income

1.1.-31.3.2021	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	88	-	-	88
Loans to credit institutions	25	7	-	32
Loans to customers	10,676	-	-	10,676
Securities	-	320	619	939
Other	44	-	-	44
Interest income	10,833	327	619	11,779
Interest expense				
Deposits	(1,181)	-	-	(1,181)
Borrowings	(2,774)	-	-	(2,774)
Subordinated liabilities	(453)	-	-	(453)
Other	(29)	-	-	(29)
Interest expense	(4,437)	-	-	(4,437)
Net interest income	6,396	327	619	7,342

1.1.-31.3.2020				
Interest income				
Cash and balances with Central Bank	774	-	-	774
Loans to credit institutions	78	-	-	78
Loans to customers	10,612	-	-	10,612
Securities	-	360	190	550
Other	30	-	-	30
Interest income	11,494	360	190	12,044
Interest expense				
Deposits	(2,011)	-	-	(2,011)
Borrowings	(2,443)	-	-	(2,443)
Subordinated liabilities	(313)	-	-	(313)
Other	(24)	-	-	(24)
Interest expense	(4,791)	-	-	(4,791)
Net interest income	6,703	360	190	7,253

Interest spread	2021 1.1.-31.3.	2020 1.1.-31.3.
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	2.7%	2.8%

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

7. Net fee and commission income

	1.1.-31.3.2021			1.1.-31.3.2020		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	1,139	(113)	1,026	1,015	(115)	900
Capital markets and corporate finance	584	(9)	575	413	(9)	404
Lending and financial guarantees	1,161	-	1,161	1,028	-	1,028
Collection and payment services	291	(34)	257	332	(28)	304
Cards and payment solution	414	(89)	325	536	(93)	443
Other	137	(204)	(67)	157	(160)	(3)
Net fee and commission income	3,726	(449)	3,277	3,481	(405)	3,076

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

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

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

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

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

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

8. Net insurance income

	2021 1.1.-31.3.	2020 1.1.-31.3.
Earned premiums, net of reinsurers' share		
Premiums written	4,330	4,003
Premiums written, reinsurers' shares	(115)	(108)
Change in provision for unearned premiums	(1,161)	(1,047)
Earned premiums, net of reinsurers' share	3,054	2,848
Claims incurred, net of reinsurers' share		
Claims paid	(2,074)	(2,005)
Claims paid, reinsurers' share	16	15
Change in provision for claims	(362)	(399)
Changes in provision for claims, reinsurers' share	37	42
Claims incurred, net of reinsurers' share	(2,383)	(2,347)
Net insurance income	671	501
Combined ratio		
Combined ratio	98.5%	103.5%

Amounts are in ISK millions

9. Net financial income

	2021 1.1.-31.3.	2020 1.1.-31.3.
Net gain (loss) on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	1,463	(1,673)
Net loss on fair value hedge of interest rate swap	(1)	(166)
Realized gain (loss) on financial assets carried at fair value through OCI	47	(5)
Net foreign exchange loss	(9)	(156)
Net financial income	1,500	(2,000)

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

Equity instruments	1,194	(2,406)
Debt instruments	366	472
Derivatives	(97)	261
Net gain (loss) on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	1,463	(1,673)

Net loss on fair value hedge of interest rate swap

Fair value change of interest rate swaps designated as hedging instruments	(523)	540
Fair value change on bonds issued by the Group attributable to interest rate risk	522	(706)
Net loss on fair value hedge of interest rate swap	(1)	(166)

10. Other operating income

Net gain on disposal of assets	49	-
Net gain on assets held for sale	109	116
Other income	148	54
Other operating income	306	170

Net gain on assets held for sale

Income from real estates and other assets	118	133
Expense related to real estates and other assets	(9)	(17)
Net gain on assets held for sale	109	116

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

11. Personnel and salaries

	2021 1.1.-31.3.	2020 1.1.-31.3.
Number of employees		
Average number of full-time equivalent positions during the year	768	809
Full-time equivalent positions at the end of the year	772	814
Number of employees at the parent company		
Average number of full-time equivalent positions during the year	637	681
Full-time equivalent positions at the end of the year	641	687
Salaries and related expenses		
Salaries	2,629	2,542
Share-based payment expenses	18	-
Defined contribution pension plans	389	376
Salary-related expenses	368	363
Capitalization of salaries due to implementation of core systems	(133)	(151)
Salaries and related expenses	3,271	3,130

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

11. Personnel and salaries, continued

Salaries and related expenses for the parent company	2021 1.1.-31.3.	2020 1.1.-31.3.
Salaries	2,181	2,105
Share-based payment expenses	18	-
Defined contribution pension plans	323	311
Salary-related expenses	308	303
Capitalization of salaries due to implementation of core systems	(133)	(151)
Salaries and related expenses for the parent company	2,697	2,568

Remuneration programs

During the period the Group made a provision of ISK 19 million (Q1 2020: ISK 17 million) for performance plan payments, including salary-related expenses, for which the Bank made no provision (2020: nil). Forty percent of the payment is deferred for three years in accordance with the FSA's rules on remuneration policies for financial undertakings. At the end of the period the Group's accrual for performance plan payments amounted to ISK 150 million (31.12.2020: ISK 232 million), of which the Bank's accrual amounted to ISK 42 million (31.12.2020: ISK 100 million).

The Board of Directors approved a revised bonus scheme which comes into effect in 2021. The scheme is in compliance with the FSA's rules on bonus payments to employees of financial institutions. The scheme is basically split into two parts. Firstly, employees can receive up to 10% of their fixed salary for 2021 in the form of a cash bonus payment. Secondly, a limited group can receive up to 25% of their fixed salary as a bonus in the form of shares in the Bank which will be subject to a three-year lock-up period. The criterion used to determine whether a bonus will be paid for 2021, in part or in full, is whether the Bank's return on equity in 2021 is higher than the weighted ROE of the Bank's main competitors. No accrual was recognised in the Consolidated Interim Income Statement for the period.

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

Share-based payment expense

In 2020 the Board of Directors approved a share option plan for all employees of the Bank. The share option plan is for five years and employees are entitled to buy shares for up to ISK 600,000 each year. The purchase price of ISK 95.5 per share was determined by the Bank's average share price 10 days before the share option agreement was signed, which was 3 February 2021. 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 of 628 employees entered into option agreements on up to 3,945,550 shares per year based on 100% exercise of share options.

A total expense of ISK 18 million is recognised in the Consolidated Interim Income Statement during the period (Q1 2020: nil). Estimated remaining expenses due the share option contracts are ISK 243 million and will be expensed over five years.

Equity-settled share-based payments to employees are measured at the fair value of the equity instruments at grant date. The grant date fair value of equity-settled share-based payment awards granted to employees is recognized as an employee expense, with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the awards. The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and non-market performance conditions are expected to be met, such that the amount ultimately recognized as an expense is based on the number of awards that meet the related service and non-market performance conditions at the vesting date.

12. Other operating expenses

	2021 1.1.-31.3.	2020 1.1.-31.3.
IT expenses	1,250	1,165
Professional services	232	302
Housing expenses	157	273
Other administration expenses	632	787
Depositors' and Investors' Guarantee Fund	143	191
Depreciation of property and equipment	137	130
Depreciation of right of use asset	33	34
Amortization of intangible assets	193	195
Other operating expenses	2,777	3,077

13. Bank levy

The Bank levy is 0.145% on total debts excluding tax liabilities, in excess of ISK 50 billion (2020: 0.145%). The tax is assessed on Financial Undertakings but non-financial subsidiaries are exempt from this tax.

Amounts are in ISK millions

14. Net impairment

Net impairment on financial instruments and value changes on loans	2021 1.1.-31.3.	2020 1.1.-31.3.
Net impairment on loans to customers and financial institutions	955	(3,041)
Net impairment on other financial instruments at FVOCI	1	(3)
Other value changes of loans - corporates	9	22
Other value changes of loans - individuals	115	162
Net impairment	1,080	(2,860)

Net impairment by customer type		
Financial institutions	(43)	(36)
Individuals	124	898
Corporates	999	(3,722)
Net impairment	1,080	(2,860)

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

15. Income tax expense

	2021 1.1.-31.3.	2020 1.1.-31.3.
Current tax expense	2,330	844
Deferred tax expense	(464)	16
Income tax expense	1,866	860

Reconciliation of effective tax rate	2021 1.1.-31.3.		2020 1.1.-31.3.	
Earnings before income tax		7,799		(422)
Income tax using the Icelandic corporate tax rate	20.0%	1,560	20.0%	(84)
Additional 6% tax on Financial Undertakings	6.6%	514	(38.9%)	164
Non-deductible expenses	0.0%	1	(0.2%)	1
Tax exempt revenues	(2.1%)	(166)	(143.6%)	606
Non-deductible taxes (bank levy)	0.8%	66	(15.6%)	66
Tax incentives not recognized in the Income Statement	(1.4%)	(111)	(25.1%)	106
Other changes	0.0%	2	(0.2%)	1
Effective tax rate	23.9%	1,866	(203.8%)	860

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

Tax exempt revenues consist mainly of profit from equity positions.

Bank levy of 0.145% on liabilities exceeding ISK 50 billion is non-deductible (2020: 0.145%).

Amounts are in ISK millions

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

	2021 1.1.-31.3.	2020 1.1.-31.3.
Net gain (loss) from discontinued operations held for sale	103	(892)
Income tax expense	3	3
Discontinued operations held for sale, net of income tax	106	(889)
Valitor hf.	120	(900)
Stakksberg ehf.	(34)	413
Sólbjarg ehf.	20	(402)
Discontinued operations held for sale, net of income tax	106	(889)

The net loss from Valitor's operation was ISK 10 million during the period whereas Valitor's positive contribution to the Group, after taking into account the Group's eliminations, was ISK 120 million. Operating income of Valitor was ISK 1,266 million, or ISK 1,396 million after taking into account the Group's eliminations.

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

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	
	2021 1.1.-31.3.	2020 1.1.-31.3.	2021 1.1.-31.3.	2020 1.1.-31.3.	2021 1.1.-31.3.	2020 1.1.-31.3.
Net earnings attributable to the shareholders of Arion Bank	5,932	(1,278)	106	(889)	6,038	(2,167)
Weighted average number of outstanding shares (millions)	1,673	1,735	1,673	1,735	1,673	1,735
Weighted average number of outstanding shares including warrants and options (millions)	1,747	1,735	1,747	1,735	1,747	1,735
Basic earnings per share (ISK)	3.55	(0.74)	0.06	(0.51)	3.61	(1.25)
Diluted earnings per share ISK)	3.40	(0.74)	0.06	(0.51)	3.46	(1.25)

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Consolidated Interim Statement of Financial Position

18. Cash and balances with Central Bank

	31.3.2021	31.12.2020
Cash on hand	3,228	3,342
Cash with Central Bank	51,367	32,588
Mandatory reserve deposit with Central Bank	5,884	6,206
Cash and balances with Central Bank	60,479	42,136

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

	31.3.2021	31.12.2020
Bank accounts	21,997	22,354
Other loans	7,398	5,982
Allowance for impairment	(144)	(101)
Loans to credit institutions	29,251	28,235

20. Loans to customers

	Individuals		Corporates		Total	
31.3.2021	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
Overdrafts	12,567	11,920	14,034	13,331	26,601	25,251
Credit cards	11,474	11,295	1,595	1,545	13,069	12,840
Mortgage loans	392,422	391,719	32,448	32,013	424,870	423,732
Other loans	32,901	32,062	351,201	343,277	384,102	375,339
Loans to customers	449,364	446,996	399,278	390,166	848,642	837,162
31.12.2020						
Overdrafts	12,875	12,176	15,471	14,208	28,346	26,384
Credit cards	12,260	12,062	1,086	1,019	13,346	13,081
Mortgage loans	378,554	377,873	32,175	31,768	410,729	409,641
Other loans	32,122	31,225	350,455	342,610	382,577	373,835
Loans to customers	435,811	433,336	399,187	389,605	834,998	822,941

The total book value of pledged loans that were pledged against amounts borrowed was ISK 241 billion at the end of the period (31.12.2020: ISK 219 billion). Pledged loans comprised mortgage loans to individuals.

Further analysis of loans is provided in Risk management disclosures.

21. Financial instruments

	31.3.2021	31.12.2020
Bonds and debt instruments	124,816	157,744
Shares and equity instruments with variable income	20,530	18,641
Derivatives	4,569	7,284
Securities used for economic hedging	47,301	43,582
Financial instruments	197,216	227,251

Amounts are in ISK millions

22. Financial assets and financial liabilities

31.3.2021	Amortized cost	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	60,479	-	-	60,479
Loans to credit institutions	27,146	-	2,105	29,251
Loans to customers	837,162	-	-	837,162
Loans	924,787	-	2,105	926,892
Bonds and debt instruments				
Listed	-	103,453	19,229	122,682
Unlisted	-	873	1,261	2,134
Bonds and debt instruments	-	104,326	20,490	124,816
Shares and equity instruments with variable income				
Listed	-	-	9,109	9,109
Unlisted	-	-	7,669	7,669
Bond funds with variable income, unlisted	-	-	3,752	3,752
Shares and equity instruments with variable income	-	-	20,530	20,530
Derivatives				
OTC derivatives	-	-	3,218	3,218
Derivatives used for hedge accounting	-	-	1,351	1,351
Derivatives	-	-	4,569	4,569
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	24,962	24,962
Shares and equity instruments with variable income, listed	-	-	22,224	16,335
Shares and equity instruments with variable income, unlisted	-	-	115	115
Securities used for economic hedging	-	-	47,301	47,301
Other financial assets				
Accounts receivable	6,027	-	-	6,027
Other financial assets	10,153	-	-	10,153
Other financial assets	16,180	-	-	16,180
Financial assets	940,967	104,326	94,995	1,140,288
Financial liabilities				
Due to credit institutions and Central Bank	9,525	-	-	9,525
Deposits	592,540	-	-	592,540
Borrowings	293,747	-	-	293,747
Subordinated liabilities	34,632	-	-	34,632
Short position in equity	-	-	10	10
Short position in bonds used for economic hedging	-	-	1,095	1,095
Derivatives	-	-	5,192	5,192
Other financial liabilities	15,571	-	-	15,571
Financial liabilities	946,015	-	6,297	952,312

Amounts are in ISK millions

22. Financial assets and financial liabilities, continued

31.12.2020	Amortized cost	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	42,136	-	-	42,136
Loans to credit institutions	28,235	-	-	28,235
Loans to customers	822,941	-	-	822,941
Loans	893,312	-	-	893,312
Bonds and debt instruments				
Listed	-	136,145	19,075	155,220
Unlisted	-	1,510	1,014	2,524
Bonds and debt instruments	-	137,655	20,089	157,744
Shares and equity instruments with variable income				
Listed	-	-	8,816	8,816
Unlisted	-	-	6,393	6,393
Bond funds with variable income, unlisted	-	-	3,432	3,432
Shares and equity instruments with variable income	-	-	18,641	18,641
Derivatives				
OTC derivatives	-	-	5,002	5,002
Derivatives used for hedge accounting	-	-	2,282	2,282
Derivatives	-	-	7,284	7,284
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	27,215	27,215
Shares and equity instruments with variable income, listed	-	-	16,335	16,335
Shares and equity instruments with variable income, unlisted	-	-	32	32
Securities used for economic hedging	-	-	43,582	43,582
Other financial assets				
Accounts receivable	3,740	-	-	3,740
Other financial assets	5,927	-	-	5,927
Other financial assets	9,667	-	-	9,667
Financial assets	902,979	137,655	89,596	1,130,230
Financial liabilities				
Due to credit institutions and Central Bank	13,031	-	-	13,031
Deposits	568,424	-	-	568,424
Borrowings	298,947	-	-	298,947
Subordinated liabilities	36,060	-	-	36,060
Short position in bonds	-	-	40	40
Short position in equity	-	-	63	63
Short position in equity, used for economic hedging	-	-	666	666
Derivatives	-	-	4,471	4,471
Other financial liabilities	8,011	-	-	8,011
Financial liabilities	924,473	-	5,240	929,713

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

22. Financial assets and financial liabilities, continued

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

31.3.2021	FVOCI	Mandatorily FVPL	Total
Financial and insurance activities	13,877	8,464	22,341
Public sector	90,002	9,771	99,773
Corporates	447	2,255	2,702
Bonds and debt instruments at fair value	104,326	20,490	124,816

31.12.2020	FVOCI	Mandatorily FVPL	Total
Financial and insurance activities	13,840	7,298	21,138
Public sector	122,743	11,097	133,840
Corporates	1,072	1,694	2,766
Bonds and debt instruments at fair value	137,655	20,089	157,744

The total amount of pledged bonds was ISK 8.3 billion at the end of the period (31.12.2020: ISK 8.2 billion). Pledged bonds comprised Icelandic Government Bonds and Financial Institutions Bonds that were pledged against funding received and included in Due to credit institutions and Central Bank as well as short positions included in Financial liabilities at fair value.

23. Fair value hierarchy

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

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

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

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

31.3.2021

Assets at fair value	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	122,313	2,295	208	124,816
Shares and equity instruments with variable income	6,540	11,426	2,564	20,530
Derivatives	-	3,218	-	3,218
Derivatives used for hedge accounting	-	1,351	-	1,351
Securities used for economic hedging	47,254	47	-	47,301
Investment property	-	-	6,110	6,110
Assets at fair value	176,107	18,337	8,882	203,326
Liabilities at fair value				
Short position in bonds used for economic hedging	1,095	-	-	1,095
Short position in equity	10	-	-	10
Derivatives	-	5,192	-	5,192
Liabilities at fair value	1,105	5,192	-	6,297

Amounts are in ISK millions

23. Fair value hierarchy, continued

31.12.2020

Assets at fair value	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	155,061	2,325	358	157,744
Shares and equity instruments with variable income	6,097	10,859	1,685	18,641
Derivatives	-	5,002	-	5,002
Derivatives used for hedge accounting	-	2,282	-	2,282
Securities used for economic hedging	43,551	31	-	43,582
Investment property	-	-	6,132	6,132
Assets at fair value	204,709	20,499	8,175	233,383

Liabilities at fair value	Level 1	Level 2	Level 3	Total
Short position in bonds	40	-	-	40
Short position in bonds used for economic hedging	666	-	-	666
Short position in equity	63	-	-	63
Derivatives	-	4,471	-	4,471
Liabilities at fair value	769	4,471	-	5,240

There was no transfer between Level 1 and Level 2 during the period (2020: Transfers from Level 2 to Level 1 amounted to ISK 82 million).

Fair value of assets and liabilities

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

Methods for establishing fair value

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

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

Level 1: Fair value established from quoted market prices

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

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

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

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

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

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

Amounts are in ISK millions

23. Fair value hierarchy, continued

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

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

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

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

Movements in Level 3 assets measured at fair value

	Investment	Financial assets		
31.3.2021	property	Bonds	Shares	Total
Balance at the beginning of the year	6,132	358	1,685	8,175
Net fair value changes	-	4	365	369
Additions	1	-	658	659
Disposals	(23)	(154)	(144)	(321)
Balance at the end of the year	6,110	208	2,564	8,882
31.12.2020				
Balance at the beginning of the year	7,119	28	1,555	8,702
Net fair value changes	580	9	(59)	530
Additions	17	762	196	975
Disposal	(1,584)	(441)	(7)	(2,032)
Balance at the end of the year	6,132	358	1,685	8,175

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

1.1.-31.3.2021				
Net financial income	-	4	365	369
Other operating income	3	-	-	3
Effects recognized in the Income Statement	3	4	365	372
1.1.-31.3.2020				
Net financial income	-	20	62	82
Other operating income	912	-	-	912
Effects recognized in the Income Statement	912	20	62	994

Amounts are in ISK millions

23. Fair value hierarchy, continued

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

31.3.2021	Carrying value	Fair value	Unrealized gain (loss)
Financial assets not carried at fair value			
Cash and balances with Central Bank	60,479	60,479	-
Loans to credit institutions	29,251	29,251	-
Loans to customers	837,162	841,634	4,472
Other financial assets	16,180	16,180	-
Financial assets not carried at fair value	943,072	947,544	4,472
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	9,525	9,525	-
Deposits	592,540	592,540	-
Borrowings	293,747	309,871	(16,124)
Subordinated liabilities	34,632	35,168	(536)
Other financial liabilities	15,571	15,571	-
Financial liabilities not carried at fair value	946,015	962,675	(16,660)
31.12.2020			
Financial assets not carried at fair value			
Cash and balances with Central Bank	42,136	42,136	-
Loans to credit institutions	28,235	28,235	-
Loans to customers	822,941	827,252	4,311
Other financial assets	9,667	9,667	-
Financial assets not carried at fair value	902,979	907,290	4,311
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	13,031	13,031	-
Deposits	568,424	568,424	-
Borrowings	298,947	316,643	(17,696)
Subordinated liabilities	36,060	34,762	1,298
Other financial liabilities	8,011	8,011	-
Financial liabilities not carried at fair value	924,473	940,871	(16,398)

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	Fair value	
31.3.2021	value	Assets	Liabilities
Forward exchange rate agreements	77,277	278	788
Fair value hedge of interest rate swap	131,620	1,351	-
Interest rate and exchange rate agreements	54,632	2,356	1,131
Bond swap agreements	29,561	145	263
Share swap agreements	19,330	433	3,002
Options - purchased agreements, unlisted	21	-	8
Options - purchased agreements, listed	6	6	-
Derivatives	312,447	4,569	5,192
31.12.2020			
Forward exchange rate agreements	72,804	1,140	267
Fair value hedge of interest rate swap	137,636	2,282	-
Interest rate and exchange rate agreements	55,838	3,339	1,022
Bond swap agreements	28,617	100	275
Share swap agreements	13,445	400	2,885
Options - purchased agreements, unlisted	826	11	22
Options - purchased agreements, listed	16	12	-
Derivatives	309,182	7,284	4,471

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 euro bonds, see Note 31, arising from changes in interest rates. On 1 January 2018 the Group adopted IFRS 9, but has elected to continue to apply the hedge accounting principles under IAS 39. For further information about the Group's hedge accounting policy, see Note 57 in the Annual Financial Statements 2020.

31.3.2021	Notional	Maturity date	Fair value Assets	Fair value Liabilities	Gain (loss) on FV changes
Interest rates swaps - EUR	44,610	1-5 years	812	-	(121)
Interest rates swaps - EUR	29,740	6-12 months	220	-	(34)
Interest rates swaps - EUR	44,610	1-5 years	13	-	(59)
Interest rates swaps - USD	12,660	1-5 years	306	-	(310)
31.12.2020					
Interest rates swaps - EUR	93,654	1-5 years	1,327	-	(304)
Interest rates swaps - EUR	31,218	6-12 months	139	-	(47)
Interest rates swaps - EUR	-	-	-	-	(45)
Interest rates swaps - USD	12,764	1-5 years	815	-	618

Hedged borrowings and subordinated liabilities

31.3.2021	Book value	Accumulated fair value Assets	Accumulated fair value Liabilities	Gain (loss) on FV changes
EUR 500 million - issued 2017/18 - 5 years	29,706	141	-	33
EUR 300 million - issued 2018 - 3 years	41,769	-	220	120
EUR 300 million - issued 2020 - 4 years	44,473	57	-	61
USD 100 million - issued 2020 - Perpetual	12,891	-	289	307
Hedged borrowings and subordinated liabilities	128,839	198	509	522
31.12.2020				
EUR 500 million - issued 2016/18 - 5 years	31,071	113	-	48
EUR 300 million - issued 2017 - 3 years	-	-	-	(38)
EUR 300 million - issued 2018 - 3 years	44,276	-	352	264
EUR 300 million - issued 2020 - 4 years	46,655	-	-	-
USD 100 million - issued 2020 - Perpetual	13,498	-	601	(673)
Hedged borrowings and subordinated liabilities	135,500	113	953	(399)

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 82-117%.

Amounts are in ISK millions

24. Offsetting financial assets and financial liabilities

Financial assets subject to enforceable master netting arrangements and similar arrangements

	Assets subject to netting arrangements			Netting potential not recognized in the Balance Sheet				
31.3.2021	Gross assets before nettings	Nettings with gross liabilities	Assets recognized on Balance Sheet, net	Financial liabilities	Collateral received	Assets after consideration of netting potential	Assets not subject to enforceable netting arr-angements	Total assets recognized on Balance Sheet, net
Reverse repurchase agreements	8,509	(286)	8,223	(7,396)	-	827	-	8,223
Derivatives	3,688	-	3,688	(1,148)	-	2,540	881	4,569
Total assets	12,197	(286)	11,911	(8,544)	-	3,367	881	12,792
31.12.2020								
Reverse repurchase agreements	8,229	(433)	7,796	(7,074)	-	722	-	7,796
Derivatives	6,012	-	6,012	(1,167)	-	4,845	1,272	7,284
Total assets	14,241	(433)	13,808	(8,241)	-	5,567	1,272	15,080

Financial liabilities subject to enforceable master netting arrangements and similar arrangements

	Liabilities subject to netting arrangements			Netting potential not recognized in the Balance Sheet				
31.3.2021	Gross liabilities before nettings	Nettings with gross assets	Liabilities recognized on Balance Sheet, net	Financial assets	Collateral pledged	Liabilities after consideration of netting potential	Liabilities not subject to enforceable netting arr-angements	Total liabilities recognized on balance sheet
Repurchase agreements	7,682	(286)	7,396	(7,396)	-	-	-	7,396
Derivatives	1,224	-	1,224	(1,148)	-	76	3,968	5,192
Total liabilities	8,906	(286)	8,620	(8,544)	-	76	3,968	12,588
31.12.2020								
Repurchase agreements	7,507	(433)	7,074	(7,074)	-	-	-	7,074
Derivatives	1,167	-	1,167	(1,167)	-	-	3,304	4,471
Total liabilities	8,674	(433)	8,241	(8,241)	-	-	3,304	11,545

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

25. Investments in associates

	31.3.2021	31.12.2020
Carrying amount at the beginning of the year	891	852
Acquisitions	-	39
Share of profit of associates and profit from sale	1	-
Investment in associates	892	891

The Group's interest in its principal associates

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

26. Intangible assets

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

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

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

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

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

31.3.2021	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	-	-	-	263	263
Additions, capitalized salaries	-	-	-	133	133
Amortization	-	-	(15)	(178)	(193)
Intangible assets	669	2,383	652	6,188	9,892

31.12.2020	Goodwill	Infra-structure	Customer relationship and related agreements	Software	Total
Balance at the beginning of the year	669	2,383	727	4,588	8,367
Additions	-	-	-	1,570	1,570
Additions, capitalized salaries	-	-	-	594	594
Amortization	-	-	(60)	(782)	(842)
Intangible assets	669	2,383	667	5,970	9,689

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

27. Tax assets and tax liabilities

	31.3.2021		31.12.2020	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	5,523	-	3,799
Deferred tax	2	(80)	2	463
Tax assets and tax liabilities	2	5,443	2	4,262

Amounts are in ISK millions

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

Assets and disposal groups held for sale	31.3.2021	31.12.2020
Valitor hf.	11,427	11,885
Stakksberg ehf.	1,637	1,580
Sólbjarg ehf.	2,446	2,323
Disposal groups held for sale	15,510	15,788
Real estate	748	1,019
Other assets	13	4
Assets and disposal groups held for sale	16,271	16,811

Liabilities associated with disposal groups held for sale	31.3.2021	31.12.2020
Valitor hf.	6,757	14,533
Sólbjarg ehf.	1,650	1,650
Liabilities associated with disposal groups held for sale	8,407	16,183

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

	31.3.2021	31.12.2020
Loans to credit institutions	5,234	14,127
Loans to customers	1,844	1,878
Financial instruments	32	-
Investments in associates	70	70
Intangible assets	4,431	4,534
Tax assets	479	422
Other assets	2,969	2,104
Assets	15,059	23,135
Elimination within Arion Bank Group	(3,632)	(11,250)
Valitor's contribution to the Group	11,427	11,885
Tax liabilities	31	163
Other liabilities	6,726	14,369
Borrowings	-	96
Liabilities	6,757	14,628
Elimination within Arion Bank Group	-	(95)
Valitor's contribution to the Group	6,757	14,533
Book value of Valitor	8,302	8,507

Sólbjarg ehf., a subsidiary of Eignabjarg ehf.

On 20 June 2019 Arion Bank acquired all shares in TravelCo hf. and its subsidiaries (hereafter "TravelCo") following an enforcement of pledges. TravelCo was established following the collapse of Primera Air ehf. and Primera Travel Group hf. with the purpose of owning and operating tour operators in Scandinavia and Iceland. Sólbjarg ehf (hereafter “Sólbjarg”) is the holding company of the TravelCo group in the beneficial ownership of Arion Bank. Arion Bank completed the sale of Terra Nova Sól ehf., a subsidiary of Sólbjarg, in Q1 2020. The travel industry was hit hard by the Covid-19 pandemic and suffered a total loss of income. The Scandinavian operations entered therefore into financial restructuring late 2020 and then bankruptcy proceedings with undergoing assets sales. Bravo Tours 1998 A/S was established and is now in 59.4% ownership of Sólbjarg and 40.6% under Danish ownership. Heimsferdir ehf., an Icelandic travel agency, is now under the direct ownership of Sólbjarg 100%. A sales and purchase agreement was signed with Ferðaskrifstofa Íslands ehf. in December 2020 for the sale all operations of Heimsferðir ehf. The sale is subject to the approval of the Icelandic Competition Authorities. Sólbjarg will be a minority shareholder in Ferðaskrifstofa Íslands ehf. if the sale will materialize. Sólbjarg’s subsidiaries are classified as held for sale in accordance with IFRS 5.

Amounts are in ISK millions

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

Stakksberg ehf., a subsidiary of Eignabjarg ehf.

In January 2018 United Silicon was declared bankrupt following serious operational problems which resulted in its operating license being temporarily suspended. In February 2018 an agreement was reached between the administrator of the bankrupt estate of United Silicon and Arion Bank, whereby the Bank foreclosed against its collateral and acquired all the company's main assets. The assets of the silicon plant are currently managed by Stakksberg ehf., which is held by the Bank through the subsidiary Eignabjarg ehf. Stakksberg ehf. has, since the transfer of the assets from United Silicon, worked to reduce uncertainties surrounding the recommissioning of the silicon plant, with measures including the securing of all necessary operating permits, power supply and undertaking further engineering design groundwork necessary for the carrying out of remedial work prior to the reopening of the plant. Stakksberg ehf. is currently engaged in the final stages of concluding a new environmental impact assessment for the plant. The Bank's objective is to divest Stakksberg ehf. based on this preparatory work. Stakksberg is therefore classified as held for sale in accordance with IFRS 5.

29. Other assets

	31.3.2021	31.12.2020
Property and equipment	4,810	4,792
Right of use asset	787	754
Accounts receivable	6,027	5,222
Unsettled securities trading	8,078	3,888
Investment for life assurance policyholders where risk is held by policyholder	1,147	1,141
Sundry assets	2,969	2,821
Other assets	23,818	18,618

30. Other liabilities

	31.3.2021	31.12.2020
Accounts payable	707	850
Unsettled securities trading	4,308	272
Depositors' and Investors' Guarantee Fund	138	131
Technical provision	17,671	16,152
Technical provision for life assurance policyholders were investment risk is held by policyholder	1,147	1,141
Withholding tax	342	790
Bank levy	1,121	1,301
Accrued expenses	2,765	2,888
Prepaid income	1,496	1,516
Impairment of off-balance items	1,012	1,062
Lease liability	831	787
Sundry liabilities	9,545	5,824
Other liabilities	41,083	32,714

Technical provision	Technical provision	Reinsurers' share	Total 31.3.2021	Technical provision	Reinsurers' share	Total 31.12.2020
Claims reported and loss adjustment expenses	8,710	(186)	8,524	8,428	(149)	8,279
Claims incurred but not reported	1,771	(82)	1,689	1,691	(82)	1,609
Claims outstanding	10,481	(268)	10,213	10,119	(231)	9,888
Provision for unearned premiums	7,190	(8)	7,182	6,033	(7)	6,026
Own technical provision	17,671	(276)	17,395	16,152	(238)	15,914

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

Amounts are in ISK millions

31. Borrowings

Currency, original nominal value	First issued	Maturity	Maturity type	Terms of interest	31.3.2021	31.12.2020
ARION CBI 21, ISK 10,220 million	2014	2021	At maturity	Fixed, CPI linked, 3.50%	10,751	10,576
ARION CB 22, ISK 46,720 million	2015	2022	At maturity	Fixed, 6.50%	27,972	28,443
ARION CB 24 ISK 40,180 million	2019	2024	At maturity	Fixed, 6.00%	17,070	16,857
ARION CBI 25, ISK 37,940 million	2017	2025	At maturity	Fixed, CPI linked, 3.00%	42,072	41,576
ARION CBI 26 ISK 15,460 million	2019	2026	At maturity	Fixed, CPI linked, 2.00%	17,331	17,030
ARION CBI 29, ISK 25,220 million	2014	2029	At maturity	Fixed, CPI linked, 3.50%	29,056	28,561
ARION CBI 48, ISK 11,680 million	2018	2048	Amortizing	Fixed, CPI linked, 2.50%	10,605	10,721
Statutory covered bonds					154,857	153,764
EUR 500 million *	2016	2021	At maturity	Fixed, 1.625%	29,706	31,071
EUR 13 million	2019	2021	At maturity	Floating, 3. EURIBOR +0.58%	1,933	2,030
NOK 750 million	2019	2022	At maturity	Floating, NIBOR +1.82%	11,178	11,207
SEK 150 million	2019	2022	At maturity	Floating, 3 month STIBOR +1.33%	2,186	2,338
NOK 250 million	2017	2023	At maturity	Fixed, 3.02%	3,816	3,798
EUR 300 million *	2018	2023	At maturity	Fixed, 1.00%	41,769	44,276
EUR 300 million *	2020	2024	At maturity	Fixed, 0.625 %	44,473	46,655
NOK 250 million	2017	2027	At maturity	Fixed, 3.40%	3,829	3,808
Senior unsecured bonds					138,890	145,183
Borrowings					293,747	298,947

* 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 294 billion at the end of the period (31.12.2020: ISK 299 billion). The market value of those bonds was ISK 310 billion (31.12.2020: ISK 317 billion). The Group repurchased no own debts during the period.

32. Subordinated liabilities

Currency, original nominal value	Issued	Maturity	First call date	Terms of interest	31.3.2021	31.12.2020
SEK 500 million	2018	2028	22 Nov '23	Floating, 3 month STIBOR +3.10% .	7,261	7,765
NOK 300 million	2019	2029	9 Jul '24	Floating, NIBOR +3.65%	4,495	4,508
SEK 225 million	2019	2029	20 Dec '24	Floating, 3 month STIBOR +3.70% .	3,273	3,500
ARION T2I 30 ISK 4.800 million	2019	2030	4 Jan '25	Fixed, CPI linked, 3.875%	5,081	5,088
ARION T2 30 ISK 880 million	2019	2030	4 Jan '25	Fixed, 6.75%	892	907
EUR 5 million	2019	2031	6 Mar '26	Fixed, 3.24%	739	794
Tier 2 subordinated liabilities					21,741	22,562
ARION AT1 USD 100 million *	2020	Perpetual	26 Feb '25	Fixed, 6.25%	12,891	13,498
Additional Tier 1 subordinated liabilities					12,891	13,498
Subordinated liabilities					34,632	36,060

* 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	31.3.2021	31.12.2020
Assets, pledged as collateral against borrowings	249,715	228,358
Assets, pledged as collateral against loans from credit institutions and short positions	8,285	8,150
Pledged assets against liabilities	258,000	236,508

The Group has pledged assets against borrowings, both issued covered bonds and other issued bonds and loan agreements. The total value of those pledged assets was ISK 250 billion at the end of the year (31.12.2020: ISK 228 billion). Pledged loans comprised mortgage loans to individuals. The book value of those borrowings was ISK 155 billion at the end of the year (31.12.2020: ISK 154 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 49 billion that can be used for repo borrowings at the Central Bank of Iceland or sold if market conditions are favorable (31.12.2020: ISK 30 billion). Pledged loans are thus higher than the covered bonds stated in the Consolidated Statement of Financial Position.

Amounts are in ISK millions

34. Equity

Share capital and share premium

According to the Bank's Articles of Association, total share capital amounts to ISK 1,730 million, with par value of ISK 1 per share. The holders of ordinary shares are entitled to receive dividends as approved by the general meeting and are entitled to one vote per share at shareholders' meetings.

	Share capital	Own shares	Share premium	Total 31.3.2021	Share capital	Own shares	Share premium	Total 31.12.2020
Balance at the beginning of the year ...	1,730	(11)	49,612	51,331	1,814	(41)	53,942	55,715
Share capital reduction	-	-	-	-	(84)	84	-	-
Purchase of treasury stock	-	(98)	(11,846)	(11,944)	-	(54)	(4,326)	(4,380)
Employees stock grant	-	-	-	-	-	-	(4)	(4)
Balance at the end of the period	1,730	(109)	37,766	39,387	1,730	(11)	49,612	51,331
Own shares / issued share capital	6.36%				0.69%			

In February 2021 the Board of Directors authorized the Bank to launch a share buy-back program in Iceland and Sweden (the Program) to purchase own shares (including in the form of SDRs). The purpose of the Program is to reduce the Bank's share capital (in line with the Bank's dividend policy). The Program was launched on 16 February 2021. The Bank may purchase up to ISK 15 billion at market value. The Program will end no later than 31 December 2021. According to the Program the Bank had purchased ISK 11.9 billion at market value of its own shares at the end of March.

In 2019 the Board of Directors authorized the Bank to initiate a share buy-back program in Iceland and Sweden. When the Program was initiated on 31 October 2019, the Bank was authorized to purchase up to 59 million own shares in total under the Program, corresponding to 3.25% of the issued share capital, or for up to ISK 4.5 billion at market value. In January 2020 the FSA approved the buy-back of an additional 41 million own shares, or for up to ISK 3.5 billion at market value, bringing the total amount of the share Program to 100 million shares or ISK 8.0 billion at market value. The Program continued until the AGM in March 2020.

At the AGM in March 2020 a motion was passed to reduce the company's share capital by ISK 84 million at nominal value, by cancelling the company's own shares. The reduction took place in May 2020. The company's share capital was reduced from ISK 1,814 million to ISK 1,730 million at nominal value, divided into an equal number of shares and with one vote attached to each share.

According to a decision made by the Board of Directors, own shares were allocated to employees in connection with the Bank's IPO and listing in 2018. In total, approximately 4 million shares were allocated to employees at ISK 75 per share, a total of ISK 295 million. In accordance with the employees' stock grant programme, an employee who resigned within the vesting period of two years returned the shares to the Bank. The vesting period ended in June 2020.

Warrants

The warrants reserve represents the consideration received for outstanding warrants.

Arion Bank issued 54 million warrants on 9 March 2021. The warrants were sold to investors in a private placement in February 2021. The purchase price of the warrants amounted to ISK 15.6 per warrant, resulting in a total sale price of ISK 842,400,000. The purchase price of the warrants was determined using market standard methodology. Approximately 48.5% of the total issue was sold to around 150 employees of the Group and 51.5% to professional investors. Should the owners of the warrants exercise their warrants, the Bank is obliged to issue new shares and sell to the warrant owners at a predefined price (strike price). If all the warrants were exercised, the Bank's share capital would increase to ISK 1,714 million, and the newly issued shares would represent approximately 3.1% of the Bank's total issued capital, post dilution. 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	27.4.2021	31.3.2021	31.12.2020
Gildi lífeyrissjódur	9.51%	9.13%	9.92%
Lífeyrissjódur verzlunarmanna	9.23%	8.45%	7.46%
Lífeyrissjódur starfsmanna ríkisins	8.80%	7.86%	6.03%
Arion banki hf.	3.88%	6.36%	0.69%
Stodir hf.	4.99%	4.99%	4.99%
Birta lífeyrissjódur	3.29%	3.10%	2.83%
Stapi Lífeyrissjódur	2.84%	2.73%	2.92%
Frjálsi lífeyrissjódurinn	2.82%	2.71%	2.73%
Stefnir rekstrarfélag hf.	3.29%	2.66%	2.13%
Kvika banki hf.	3.17%	2.51%	0.63%
Hvalur hf.	2.22%	2.13%	1.52%
Íslandsbanki hf.	3.83%	1.91%	0.38%
Kvika eignastýring	1.56%	1.54%	0.98%
Lífsverk Pension fund	1.49%	1.50%	1.37%
Brú Lífeyrissjódur	1.58%	1.40%	0.63%
Lífeyrissjódur Vestmannaeyja	1.51%	1.33%	1.13%
Akta sjódir	1.49%	0.78%	0.00%
Almenni lífeyrissjódur	1.38%	1.32%	0.67%
Eaton Vance funds	1.36%	1.30%	2.11%
Landsbréf hf.	1.30%	1.21%	0.66%
MainFirst Bank AG	1.19%	1.14%	1.14%
Íslandssjódir	1.29%	1.13%	0.69%
Landsbankinn hf.	2.41%	1.11%	0.98%
Sjóvá tryggingar	1.17%	1.09%	0.87%
Festa lífeyrissjódur	1.18%	1.02%	0.72%
Taconic Capital Advisors	-	-	23.22%
Sculptor Capital Management	-	-	6.12%
Lansdowne partners	-	-	1.12%
Other shareholders with less than 1% shareholding	23.21%	29.59%	15.37%
	100.0%	100.0%	100.0%

In the first quarter of 2021 the Bank's largest shareholder, Taconic Capital Advisors, sold its entire 23.22% shareholding in the Bank to a diverse group of investors, mainly Icelandic pension funds, fund managers and other domestic investors. As part of the sale was settled beginning of April information about changes in the shareholders group are also presented as of 27 April 2021.

At the AGM in March 2021 a motion was passed to reduce the company's share capital by ISK 70 million nominal value, totalling 70 million shares, by cancelling the company's own shares. The reduction was effective 20 April 2021. The company's share capital was reduced from ISK 1,730 million to ISK 1,660 million at nominal value. The shareholdings as of 27 April 2021, taking into account the share capital reduction, are reflected in the table above.

At the end of March the Bank's employees held a shareholding of 0.51% in Arion Bank (31.12.2020: 0.53%).

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

36. Legal matters

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

Contingent liabilities

Legal proceedings regarding damages

In a lawsuit brought in June 2013, Kortathjónustan hf. claimed damages from Arion Bank hf., Íslandsbanki hf., Landsbankinn hf., Borgun hf. and the Bank's subsidiary Valitor hf. in the amount of ISK 1.2 billion plus interest, as a result of damage Kortathjónustan hf. contended the five parties caused the company due to violations of the Competition Act. In June 2017 the Supreme Court dismissed the case on procedural grounds. Since then Kortatjónustan and subsequently its largest shareholder EC-Clear have tried to initiate four lawsuits against the same defendants which have all been dismissed, last one in December 2019. In April 2020 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 March 2021 the Landsrettur Appeal Court confirmed the District Courts dismissal of the case for the fifth time. Therefore, the Bank has not made any provision.

Administrative fine from Central Bank of Iceland

On 17 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 obligation to disclose insider information in a timely manner. The decision has been published on FSA´s website. Arion Bank paid the fine but filed a claim to the district court of Reykjavik in October 2020 demanding that FSA´s decision will be annulled. A statement by FSA was submitted in the case in November 2020. Principal proceedings in the case are on the District Court’s docket in autumn of 2021.

37. Events after the reporting period

At the AGM in March 2021 a motion was passed to reduce the company’s share capital by ISK 70 million nominal value, totalling 70 million shares, by cancelling the company’s own shares. This reduction was effective from 20 April 2021. The company’s share capital has therefore been reduced from ISK 1,730 million to ISK 1,660 million at nominal value, divided into an equal number of shares and with one vote attached to each share.

Off balance sheet information

38. Commitments

Financial guarantees, unused credit facilities and undrawn loan commitments	31.3.2021	31.12.2020
Financial guarantees	13,716	20,857
Unused overdrafts	51,047	49,164
Undrawn loan commitments	78,625	64,055
Financial guarantees, unused credit facilities and undrawn loan commitments	143,388	134,076

39. Assets under management and under custody

Assets under management	1,184,392	1,130,978
Assets under custody	966,268	934,967

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

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

Related party

40. Related party

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

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

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

Balances with related parties

31.3.2021	Assets	Liabilities	Net balance
Board of Directors and key Management personnel	178	(860)	(682)
Associates and other related parties	-	(98)	(98)
Balances with related parties	178	(958)	(780)

31.12.2020			
Board of Directors and key Management personnel	172	(575)	(403)
Associates and other related parties	-	(112)	(112)
Balances with related parties	172	(687)	(515)

Amounts are in ISK millions

Risk management disclosures

The Group faces various risks arising from its day to day operations and is currently facing a unique set of risks arising from the impact of the Covid-19 pandemic on the Group's operations and its customers. 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 2020 and in the Pillar 3 Risk Disclosures for 2020. The Pillar 3 Risk Disclosures 2020 are available on the Bank's website, www.arionbanki.is.

41. Credit risk

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

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

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

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

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

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

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

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

41. Credit risk, continued

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

		Collateral				
31.3.2021	Maximum exposure	Cash and securities	Real estate	Vessels	Other collateral	Total collateral
Cash and balances with Central Bank	60,479	-	-	-	-	-
Loans to credit institutions	27,146	-	-	-	-	-
Loans to customers at amortized cost	837,162	24,560	624,618	43,337	77,190	769,705
Individuals	*446,996*	*360*	*408,185*	*10*	*12,332*	*420,887*
Corporates	*390,166*	*24,200*	*216,433*	*43,327*	*64,858*	*348,818*
Real estate activities and construction	*128,219*	*229*	*121,562*	*65*	*2,512*	*124,368*
Fishing industry	*81,303*	*1,414*	*11,247*	*41,351*	*25,407*	*79,419*
Information and communication technology	*23,129*	*10*	*5,109*	*-*	*1,493*	*6,612*
Wholesale and retail trade	*52,953*	*186*	*39,942*	*26*	*10,785*	*50,939*
Financial and insurance activities	*35,534*	*22,190*	*2,935*	*-*	*8,655*	*33,780*
Industry, energy and manufacturing	*29,089*	*33*	*16,954*	*-*	*11,131*	*28,118*
Transportation	*12,015*	*2*	*892*	*1,745*	*1,927*	*4,566*
Services	*12,808*	*110*	*8,250*	*132*	*2,101*	*10,593*
Public sector	*6,589*	*24*	*2,007*	*8*	*226*	*2,265*
Agriculture and forestry	*8,527*	*2*	*7,535*	*-*	*621*	*8,158*
Other assets with credit risk	16,180	-	-	-	-	-
Financial guarantees	13,716	1,187	5,833	66	3,337	10,423
Undrawn loan commitments and unused overdrafts	129,672	-	-	-	-	-
Fair value through OCI	104,326	-	-	-	-	-
Government bonds	*90,002*	-	-	-	-	-
Corporate and finance bonds	*14,324*	-	-	-	-	-
Balance at the end of the period	1,188,681	25,747	630,451	43,403	80,527	780,128
31.12.2020						
Cash and balances with Central Bank	42,136	-	-	-	-	-
Loans to credit institutions	28,235	-	-	-	-	-
Loans to customers at amortized cost	822,941	19,233	599,938	43,338	82,881	745,390
Individuals	*433,336*	*52*	*393,680*	*8*	*12,335*	*406,075*
Corporates	*389,605*	*19,181*	*206,258*	*43,330*	*70,546*	*339,315*
Real estate activities and construction	*127,888*	*273*	*110,453*	*65*	*2,912*	*113,703*
Fishing industry	*81,582*	*244*	*13,655*	*41,206*	*25,665*	*80,770*
Information and communication technology	*20,810*	*44*	*5,184*	*-*	*4,693*	*9,921*
Wholesale and retail trade	*51,599*	*274*	*38,600*	*25*	*10,220*	*49,119*
Financial and insurance activities	*35,749*	*18,295*	*3,267*	*-*	*9,606*	*31,168*
Industry, energy and manufacturing	*31,193*	*14*	*16,214*	*-*	*12,520*	*28,748*
Transportation	*12,740*	*1*	*744*	*1,875*	*2,340*	*4,960*
Services	*13,175*	*33*	*8,615*	*152*	*1,998*	*10,798*
Public sector	*6,786*	*3*	*2,103*	*7*	*228*	*2,341*
Agriculture and forestry	*8,083*	*-*	*7,423*	*-*	*364*	*7,787*
Other assets with credit risk	9,667	-	-	-	-	-
Financial guarantees	20,857	6,200	6,255	35	2,374	14,864
Undrawn loan commitments and unused overdrafts	113,219	-	-	-	-	-
Fair value through OCI	137,655	-	-	-	-	-
Government bonds	*122,743*	-	-	-	-	-
Corporate and finance bonds	*14,912*	-	-	-	-	-
Balance at the end of the period	1,174,710	25,433	606,193	43,373	85,255	760,254

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 mortgage loan book. LTV is calculated as the ratio of the gross amount of the loan to the value of the collateral without adjusting for possible costs of obtaining and selling the collateral. The valuation is based on the official valuation of the Icelandic Property Registry.

	31.03.2021		31.12.2020	
	Gross carrying amount	Thereof credit impaired	Gross carrying amount	Thereof credit impaired
Less than 50%	119,137	1,435	119,846	1,154
50-70%	185,490	2,233	176,986	2,175
70-90%	91,029	1,198	87,941	989
90-100%	11,702	394	10,031	213
100-110%	3,497	55	2,981	44
More than 110%	13,835	1,002	12,922	731
Not classified	180	-	22	-
Balance at the end of the period	424,870	6,317	410,729	5,306

Collateral for financial assets in stage 3

At the end of the period the gross carrying amount of assets in stage 3 are ISK 24,013 million (31.12.2020: ISK 21,606 million) with ISK 18,125 million in collateral (31.12.2020: ISK 16.097 million), thereof ISK 16,564 million in real estates (31.12.2020: 14.790 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 ISK 23 million (31.12.2020: ISK 330 million) and ISK 9 million in other assets (31.12.2020: ISK 4 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 eligible capital according to Financial Undertakings Act No. 161/2002 and Regulation No. 233/2017 on prudential requirements. The legal maximum for individual large exposures is 25% of eligible capital, net of eligible credit risk mitigation.

The Group has one large exposure at the end of the period, totaling ISK 20.1 billion (10.1% of eligible capital) before taking into account eligible credit risk mitigation (31.12.2020: one large exposure, totaling ISK 20.9 billion). The total exposure is ISK 19.9 billion (10.0% of eligible capital) after taking into account eligible credit risk mitigation.

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 updated at least annually and recalibrated with current data with the aim of maintaining their predictive power. Year-on-year changes in risk classification of loans may in part be due to model refinement. External ratings are primarily used for marketable securities and loans to credit institutions. For further information on the rating scales used, see Note 56 in the Annual Financial Statements 2020.

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.

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

31.03.2021	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	60,479	19,996	104,337
Non-investment grade	-	7,294	-
Gross carrying amount	60,479	27,290	104,337
Loss allowance	-	(144)	(11)
Book value	60,479	27,146	104,326

Loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 to 1 (Grades AAA to BBB-)	440,944	2,704	-	44	443,692
Risk class 2 (Grades BB+ to BB-)	174,048	26,554	-	69	200,671
Risk class 3 (Grades B+ to B-)	79,522	57,572	-	56	137,150
Risk class 4 (Grades CCC+ to CCC-)	9,575	31,204	-	38	40,817
Risk class 5 (DD)	-	-	23,696	317	24,013
Unrated	2,294	5	-	-	2,299
Gross carrying amount	706,383	118,039	23,696	524	848,642
Loss allowance	(1,855)	(2,980)	(6,561)	(84)	(11,480)
Book value	704,528	115,059	17,135	440	837,162
Loans to customers - Individuals					
Risk class 0 to 1 (Grades AAA to BBB-)	330,418	1,608	-	44	332,070
Risk class 2 (Grades BB+ to BB-)	74,412	7,694	-	69	82,175
Risk class 3 (Grades B+ to B-)	15,821	3,902	-	56	19,779
Risk class 4 (Grades CCC+ to CCC-)	2,788	4,472	-	38	7,298
Risk class 5 (DD)	-	-	6,123	317	6,440
Unrated	1,597	5	-	-	1,602
Gross carrying amount	425,036	17,681	6,123	524	449,364
Loss allowance	(812)	(371)	(1,101)	(84)	(2,368)
Book value	424,224	17,310	5,022	440	446,996
Loans to customers - Companies and sovereign					
Risk class 0 to 1 (Grades AAA to BBB-)	110,526	1,096	-	-	111,622
Risk class 2 (Grades BB+ to BB-)	99,636	18,860	-	-	118,496
Risk class 3 (Grades B+ to B-)	63,701	53,670	-	-	117,371
Risk class 4 (Grades CCC+ to CCC-)	6,787	26,732	-	-	33,519
Risk class 5 (DD)	-	-	17,573	-	17,573
Unrated	697	-	-	-	697
Gross carrying amount	281,347	100,358	17,573	-	399,278
Loss allowance	(1,043)	(2,609)	(5,460)	-	(9,112)
Book value	280,304	97,749	12,113	-	390,166
Loan commitments, guarantees and unused credit facilities					
Risk class 0 to 1 (Grades AAA to BBB-)	66,420	585	-	-	67,005
Risk class 2 to 4 (Grades BB+ to CCC-)	46,177	14,773	1,474	-	62,424
Unrated	13,958	1	-	-	13,959
Gross carrying amount	126,555	15,359	1,474	-	143,388
Loss allowance	(272)	(513)	(170)	-	(955)
Book value	126,283	14,846	1,304	-	142,433

Amounts are in ISK millions

41. Credit risk, continued

31.12.2020	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	42,136	21,238	137,667
Non-investment grade	-	7,098	-
Gross carrying amount	42,136	28,336	137,667
Loss allowance	-	(101)	(12)
Book value	42,136	28,235	137,655

Loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 to 1 - (Grades AAA to BBB-)	422,053	2,300	-	40	424,393
Risk class 2 - (Grades BB+ to BB-)	174,857	28,364	-	54	203,275
Risk class 3 - (Grades B+ to B-)	72,459	57,330	-	55	129,844
Risk class 4 - (Grades CCC+ to CCC-)	11,243	41,289	-	98	52,630
Risk class 5 - (DD)	-	-	21,297	310	21,607
Unrated	2,641	608	-	-	3,249
Gross carrying amount	683,253	129,891	21,297	557	834,998
Loss allowance	(1,844)	(3,305)	(6,824)	(84)	(12,057)
Book value	681,409	126,586	14,473	473	822,941
Loans to customers - Individuals					
Risk class 0 to 1 (Grades AAA to BBB-)	317,898	1,499	-	40	319,437
Risk class 2 (Grades BB+ to BB-)	75,261	6,865	-	54	82,180
Risk class 3 (Grades B+ to B-)	16,611	4,206	-	55	20,872
Risk class 4 (Grades CCC+ to CCC-)	2,920	4,734	-	98	7,752
Risk class 5 (DD)	-	-	5,149	310	5,459
Unrated	109	2	-	-	111
Gross carrying amount	412,799	17,306	5,149	557	435,811
Loss allowance	(807)	(395)	(1,189)	(84)	(2,475)
Book value	411,992	16,911	3,960	473	433,336
Loans to customers - Companies and sovereign					
Risk class 0 to 1 (Grades AAA to BBB-)	104,155	801	-	-	104,956
Risk class 2 (Grades BB+ to BB-)	99,596	21,499	-	-	121,095
Risk class 3 (Grades B+ to B-)	55,848	53,124	-	-	108,972
Risk class 4 (Grades CCC+ to CCC-)	8,323	36,555	-	-	44,878
Risk class 5 (DD)	-	-	16,148	-	16,148
Unrated	2,532	606	-	-	3,138
Gross carrying amount	270,454	112,585	16,148	-	399,187
Loss allowance	(1,037)	(2,910)	(5,635)	-	(9,582)
Book value	269,417	109,675	10,513	-	389,605
Loan commitments, guarantees and unused credit facilities					
Risk class 0 to 1 - (Grades AAA to BBB-)	62,426	590	-	-	63,016
Risk class 2 to 4 - (Grades BB+ to CCC-)	43,550	17,530	1,435	-	62,515
Unrated	8,543	2	-	-	8,545
Gross carrying amount	114,519	18,122	1,435	-	134,076
Loss allowance	(239)	(577)	(171)	-	(987)
Book value	114,280	17,545	1,264	-	133,089

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			
31.03.2021	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Total Loss allowance	Book value
Loans to credit instit., securities & cash ...	192,106	(155)	-	-	-	-	(155)	191,951
Loans to individuals	425,036	(812)	17,888	(371)	6,440	(1,185)	(2,368)	446,996
Mortgage	*373,589*	*(386)*	*14,324*	*(129)*	*4,507*	*(186)*	*(701)*	*391,719*
Other	*51,447*	*(426)*	*3,564*	*(242)*	*1,933*	*(999)*	*(1,667)*	*55,277*
Loans to corporates and sovereign	281,347	(1,043)	100,358	(2,609)	17,573	(5,460)	(9,112)	390,166
Real estate activities and construction .	*82,695*	*(388)*	*44,474*	*(564)*	*2,572*	*(570)*	*(1,522)*	*128,219*
Fishing industry	*75,544*	*(198)*	*5,461*	*(8)*	*695*	*(191)*	*(397)*	*81,303*
Information and communication technolo	*22,584*	*(30)*	*539*	*(60)*	*164*	*(68)*	*(158)*	*23,129*
Wholesale and retail trade	*18,032*	*(56)*	*28,914*	*(1,289)*	*8,927*	*(1,575)*	*(2,920)*	*52,953*
Financial and insurance activities	*28,386*	*(146)*	*7,007*	*(48)*	*695*	*(360)*	*(554)*	*35,534*
Industry, energy and manufacturing	*24,256*	*(88)*	*4,503*	*(128)*	*1,217*	*(671)*	*(887)*	*29,089*
Transportation	*9,623*	*(43)*	*2,337*	*(144)*	*1,244*	*(1,002)*	*(1,189)*	*12,015*
Services	*6,861*	*(27)*	*5,695*	*(340)*	*1,420*	*(801)*	*(1,168)*	*12,808*
Public Sector	*5,785*	*(35)*	*755*	*(19)*	*162*	*(59)*	*(113)*	*6,589*
Agriculture and forestry	*7,581*	*(32)*	*673*	*(9)*	*477*	*(163)*	*(204)*	*8,527*
Balance at the end of the period	898,489	(2,010)	118,246	(2,980)	24,013	(6,645)	(11,635)	1,029,113

31.12.2020	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Total Loss allowance	Book value
Loans to credit instit., securities & cash ...	208,139	(113)	-	-	-	-	(113)	208,026
Loans to individuals	412,799	(807)	17,554	(395)	5,458	(1,273)	(2,475)	433,336
Mortgage	*360,964*	*(365)*	*13,833*	*(141)*	*3,756*	*(174)*	*(680)*	*377,873*
Other	*51,835*	*(442)*	*3,721*	*(254)*	*1,702*	*(1,099)*	*(1,795)*	*55,463*
Loans to corporates	270,454	(1,037)	112,585	(2,910)	16,148	(5,635)	(9,582)	389,605
Real estate activities and construction .	*78,573*	*(376)*	*49,366*	*(576)*	*1,500*	*(599)*	*(1,551)*	*127,888*
Fishing industry	*73,520*	*(232)*	*7,832*	*(9)*	*675*	*(204)*	*(445)*	*81,582*
Information and communication technolo	*20,131*	*(31)*	*680*	*(66)*	*170*	*(74)*	*(171)*	*20,810*
Wholesale and retail trade	*14,917*	*(54)*	*30,925*	*(1,459)*	*8,851*	*(1,581)*	*(3,094)*	*51,599*
Financial and insurance activities	*27,835*	*(132)*	*7,791*	*(102)*	*703*	*(346)*	*(580)*	*35,749*
Industry, energy and manufacturing	*25,653*	*(70)*	*5,253*	*(132)*	*1,214*	*(725)*	*(927)*	*31,193*
Transportation	*9,910*	*(40)*	*2,846*	*(155)*	*1,166*	*(987)*	*(1,182)*	*12,740*
Services	*6,357*	*(26)*	*6,775*	*(387)*	*1,284*	*(828)*	*(1,241)*	*13,175*
Public Sector	*6,429*	*(40)*	*282*	*(4)*	*164*	*(45)*	*(89)*	*6,786*
Agriculture and forestry	*7,129*	*(36)*	*835*	*(20)*	*421*	*(246)*	*(302)*	*8,083*
Balance at the end of the period	891,392	(1,957)	130,139	(3,305)	21,606	(6,908)	(12,170)	1,030,967

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 requirements

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

Net remeasurement of loss allowance

Comprise the impact of changes in model inputs or assumptions, including changes in forward-looking macroeconomic conditions, partial repayments and additional draws on existing facilities, inflation, changes in the measurement following a transfer between stages, 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 period.

Derecognitions and maturities

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

Write-offs

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

31.03.2021

*Impairment loss allowance **	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(2,085)	(3,882)	(6,995)	(84)	(13,046)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(275)	251	24	-	-
Transfers to Stage 2 (lifetime ECL)	42	(66)	24	-	-
Transfers to Stage 3 (credit impaired financial assets)	26	120	(146)	-	-
Net remeasurement of loss allowance **	373	122	(138)	(19)	338
New financial assets, originated or purchased	(399)	(132)	(28)	-	(559)
Derecognitions and maturities	190	93	299	-	582
Write-offs ***	1	1	229	19	250
Impairment loss allowance ****	(2,127)	(3,493)	(6,731)	(84)	(12,435)
Impairment loss allowances for assets only carrying 12-month ECL	(155)	-	-	-	(155)
Total impairment loss allowance	(2,282)	(3,493)	(6,731)	(84)	(12,590)

* 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 148 million due to unwinding of interest income.

*** During the period an amount of ISK 189 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	(1,846)	(3,305)	(6,824)	(84)	(12,059)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(267)	243	24	-	-
Transfers to Stage 2 (lifetime ECL)	40	(64)	24	-	-
Transfers to Stage 3 (credit impaired financial assets)	25	118	(143)	-	-
Net remeasurement of loss allowance	361	68	(141)	(19)	269
New financial assets, originated or purchased	(312)	(107)	(28)	-	(447)
Derecognitions and maturities	143	66	298	-	507
Write-offs	1	1	229	19	250
Total loss allowance for loans to customers	(1,855)	(2,980)	(6,561)	(84)	(11,480)
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)	(145)	126	19	-	-
Transfers to Stage 2 (lifetime ECL)	31	(55)	24	-	-
Transfers to Stage 3 (credit impaired financial assets)	20	69	(89)	-	-
Net remeasurement of loss allowance	133	(125)	(26)	(19)	(37)
New financial assets, originated or purchased	(87)	(15)	(10)	-	(112)
Derecognitions and maturities	42	23	102	-	167
Write-offs	1	1	68	19	89
Total loss allowance for individuals	(812)	(371)	(1,101)	(84)	(2,368)
Impairment loss allowance for loans to customers - Companies and sovereign					
Balance at the beginning of the year	(1,039)	(2,910)	(5,635)	-	(9,584)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(122)	117	5	-	-
Transfers to Stage 2 (lifetime ECL)	9	(9)	-	-	-
Transfers to Stage 3 (credit impaired financial assets)	5	49	(54)	-	-
Net remeasurement of loss allowance	228	193	(115)	-	306
New financial assets, originated or purchased	(225)	(92)	(18)	-	(335)
Derecognitions and maturities	101	43	196	-	340
Write-offs	-	-	161	-	161
Total loss allowance for companies and sovereign	(1,043)	(2,609)	(5,460)	-	(9,112)
Impairment loss allowance for loan commitments, guarantees and unused credit facilities					
Balance at the beginning of the year	(239)	(577)	(171)	-	(987)
Transfers					
Transfers to 12-month ECL	(8)	8	-	-	-
Transfers to lifetime ECL	2	(2)	-	-	-
Transfers to credit impaired	1	2	(3)	-	-
Net remeasurement of loss allowance	12	54	3	-	69
New financial commitments originated	(87)	(25)	-	-	(112)
Derecognitions and maturities	47	27	1	-	75
Total loss allowance for loan commit., guarantees, unused cr. facili	(272)	(513)	(170)	-	(955)

Amounts are in ISK millions

41. Credit risk, continued

31.12.2020

*Impairment loss allowance **	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(1,137)	(1,166)	(7,141)	(209)	(9,653)
Transfers of financial assets:	-	-	-	-	-
Transfers to Stage 1 (12-month ECL)	(3,394)	3,116	278	-	-
Transfers to Stage 2 (lifetime ECL)	1,052	(1,085)	33	-	-
Transfers to Stage 3 (credit impaired financial assets)	82	816	(898)	-	-
Net remeasurement of loss allowance **	2,282	(5,598)	(2,773)	(20)	(6,109)
New financial assets, originated or purchased	(1,713)	(428)	(1,067)	-	(3,208)
Derecognitions and maturities	756	496	1,882	-	3,134
Write-offs ***	-	2	2,977	149	3,128
Foreign exchange rate differences	(11)	(35)	(286)	(4)	(336)
Impairment loss allowance ****	**(2,083)**	**(3,882)**	**(6,995)**	**(84)**	**(13,044)**
Impairment loss allowances for assets only carrying 12-month ECL	(113)	-	-	-	(113)
Total impairment loss allowance	**(2,196)**	**(3,882)**	**(6,995)**	**(84)**	**(13,157)**

* 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 789 million due to unwinding of interest income.

*** During the period an amount of ISK 2,672 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	(974)	(921)	(7,067)	(209)	(9,171)
Transfers of financial assets:	-	-	-	-	
Transfers to Stage 1 (12-month ECL)	(3,109)	2,838	271	-	-
Transfers to Stage 2 (lifetime ECL)	994	(1,027)	33	-	-
Transfers to Stage 3 (credit impaired financial assets)	80	812	(892)	-	-
Net remeasurement of loss allowance	2,045	(5,141)	(2,626)	(20)	(5,742)
New financial assets, originated or purchased	(1,295)	(213)	(1,063)	-	(2,571)
Derecognitions and maturities	420	382	1,821	-	2,623
Write-offs	-	2	2,977	149	3,128
Foreign exchange rate differences	(5)	(37)	(278)	(4)	(324)
Total loss allowance for loans to customers	**(1,844)**	**(3,305)**	**(6,824)**	**(84)**	**(12,057)**

Impairment loss allowance for loans to customers - Individuals	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	(418)	(319)	(1,601)	(209)	(2,547)
Transfers of financial assets	-	-	-	-	
Transfers to Stage 1 (12-month ECL)	(1,594)	1,451	143	-	-
Transfers to Stage 2 (lifetime ECL)	520	(548)	28	-	-
Transfers to Stage 3 (credit impaired financial assets)	48	333	(381)	-	-
Net remeasurement of loss allowance	832	(1,393)	(721)	(20)	(1,302)
New financial assets, originated or purchased	(345)	(20)	(26)	-	(391)
Derecognitions and maturities	151	99	428	-	678
Write-offs	-	2	975	149	1,126
Foreign exchange rate differences	(1)	-	(34)	(4)	(39)
Total loss allowance for individuals	**(807)**	**(395)**	**(1,189)**	**(84)**	**(2,475)**

Amounts are in ISK millions

41. Credit risk, continued

	Stage 1	Stage 2	Stage 3	POCI	Total
Impairment loss allowance for loans to customers - Companies and sovereign					
Balance at the beginning of the year	(556)	(602)	(5,466)	-	(6,624)
Transfers of financial assets	-	-	-	-	
Transfers to Stage 1 (12-month ECL)	(1,515)	1,387	128	-	-
Transfers to Stage 2 (lifetime ECL)	474	(479)	5	-	-
Transfers to Stage 3 (credit impaired financial assets)	32	479	(511)	-	-
Net remeasurement of loss allowance	1,213	(3,748)	(1,905)	-	(4,440)
New financial assets, originated or purchased	(950)	(193)	(1,037)	-	(2,180)
Derecognitions and maturities	269	283	1,393	-	1,945
Write-offs	-	-	2,002	-	2,002
Foreign exchange rate differences	(4)	(37)	(244)	-	(285)
Total loss allowance for companies and sovereign	(1,037)	(2,910)	(5,635)	-	(9,582)

	Stage 1	Stage 2	Stage 3	POCI	Total
Impairment loss allowance for loan commitments, guarantees and unused credit facilities					
Balance at the beginning of the year	(163)	(245)	(74)	-	(482)
Transfers	-	-	-	-	
Transfers to 12-month ECL	(285)	278	7	-	-
Transfers to lifetime ECL	58	(58)	-	-	-
Transfers to credit impaired	2	4	(6)	-	-
Net remeasurement of loss allowance	237	(457)	(147)	-	(367)
New financial commitments originated	(418)	(215)	(4)	-	(637)
Derecognitions and maturities	336	114	61	-	511
Foreign exchange rate differences	(6)	2	(8)	-	(12)
Total loss allowance for loan commit., guarantees, unused cr. facili	(239)	(577)	(171)	-	(987)

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 are predicted. The expected credit loss is a probability-weighted average of the estimated forecasts over three scenarios: base case (65%), pessimistic (20%) and optimistic (15%). 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		
	2021	2022	2023
Unemployment rate	8.0%	6.3%	5.6%
Housing prices	6.0%	5.2%	4.9%
Private consumption	2.7%	3.8%	3.0%
GDP	2.8%	5.3%	4.6%

	Optimistic			Pessimistic		
	2021	2022	2023	2021	2022	2023
Unemployment rate	6.0%	5.4%	4.9%	10.3%	8.6%	6.8%
Housing prices	8.9%	6.7%	5.5%	2.3%	3.1%	5.7%
Private consumption	6.6%	3.5%	2.1%	-1.2%	5.4%	3.4%
GDP	4.6%	7.2%	5.0%	-0.4%	4.4%	3.4%

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 2.1 billion, ISK 4.5 billion and ISK 12.9 billion for the optimistic, base case and pessimistic scenarios, respectively. At year end 2020 the corresponding calcualated loss allowance was ISK 2.3 billion, ISK 4.9 billion and ISK 13.7 billion, respectively.

Amounts are in ISK millions

41. Credit risk, continued

Payment moratoria and groups with special focus due to the Covid-19 pandemic

Three groups of customers have been identified as a focus for the assessment of the impact of the Covid-19 pandemic on the Group; i) Tourism; where there is a high probability of impact due to public health restrictions; ii) Customers which have had active 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 crisis. The exposure to these groups is shown in the following table, broken down by industry sector. Also shown is the amount secured by real estate as this is the largest type of collateral for loans to customers. The same customer can be in more than one group.

31.03.2021	Tourism dependent	Payment moratoria in Q1 2021	Recipient governmen sponsored loans	All focus groups	Thereof secured by real estate
Individuals	3,916	12,313	166	16,182	15,462
Real estate and construction	27,023	9,192	1,556	30,707	29,651
Services	5,647	1,809	2,342	6,236	2,871
Transportation	8,582	949	872	8,590	256
Industry, energy and manufacturing	35	1,451	498	1,871	883
Wholesale and retail trades	32,139	20,342	17,627	32,815	29,953
Other sectors	949	1,657	1,000	3,038	2,003
Gross carrying amount	78,291	47,713	24,061	99,439	81,079
Loss allowance	(5,133)	(1,665)	(1,255)	(5,412)	
Book value	73,158	46,048	22,806	94,027	

Book value of Covid-19 impacted loans at year-end 2020 was ISK 102,035 million or 12% of loans to customers.

The following table shows loans to customers which have been granted moratoria during the period including those where the moratoria are no longer active. Also shown are loans to customers that have active moratoria at the end of the period.

	Individuals	Companies
Moratoria granted, including loans where the moratoria are no longer active	55,423	83,465
Active moratoria at period-end	7,518	23,039

The exposures to the focus groups were divided into four groups by impact assessment. The largest exposures in tourism were individually assessed into the four impact groups based on summer 2020 performance and outlook. In group 1 the assessed impact is minimal. In groups 2, 3 and 4 the impact is assessed to correspond to a worse rating by 1, 2 and 3 notches, respectively. The average assessed impact was group 3 (two notches) and other customers in the focus group were therefore given that assessment.

	Impact group 1	Impact group 2	Impact group 3	Impact group 4	In default	Total
Individuals	-	-	16,028	-	154	16,182
Real estate and construction	-	1,928	26,129	2,539	111	30,707
Services	226	-	4,550	383	1,077	6,236
Transportation	6,185	12	440	793	1,160	8,590
Industry, energy and manufacturing	-	-	1,871	-	-	1,871
Wholesale and retail trades	19	205	18,661	6,040	7,890	32,815
Other sectors	-	-	2,228	-	810	3,038
Gross carrying amount	6,430	2,145	69,907	9,755	11,202	99,439
Loss allowance	(20)	(23)	(1,624)	(443)	(3,302)	(5,412)
Book value	6,410	2,122	68,283	9,312	7,900	94,027

The following table shows the effect of the impact assessment on the distribution of exposure into risk classes

	Before impact assessment	After impact assessment
Risk class 0 to 1 (Grades AAA to BBB-)	19,824	10,955
Risk class 2 (Grades BB+ to BB-)	29,982	14,985
Risk class 3 (Grades B+ to B-)	24,206	42,053
Risk class 4 (Grades CCC+ to CCC-)	14,225	20,244
Risk class 5 (DD)	11,202	11,202
Unrated	-	-
Gross carrying amount	99,439	99,439

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.

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

Interest rate risk in the banking book

The following table shows the Group's interest-bearing assets and liabilities by interest fixing periods. The figures for loans to customers and borrowings are shown on a fair value basis, see Note 24, and are therefore different from the amounts shown in these Consolidated Financial Statements. The fair value reflects the likelihood of prepayment. Defaulted loans are presented at book value, which is based on the value of the underlying collateral, and are therefore assumed to be independent of interest adjustment periods and placed in the 'Up to 3 months' category. The assets and liabilities of Valitor hf. are not included in the figures as they are classified as held for sale.

31.03.2021	Up to 3	3-12	1-5	5-10	Over 10	
Assets	months	months	years	years	years	Total
Balances with Central Bank	57,251	-	-	-	-	57,251
Loans to credit institutions	29,251	-	-	-	-	29,251
Loans to customers	578,404	72,875	168,589	3,521	18,245	841,634
Financial instruments	20,757	40,618	37,836	4,833	643	104,687
Assets	685,663	113,493	206,425	8,354	18,888	1,032,823
Liabilities						
Due to credit institutions and Central Bank	9,525	-	-	-	-	9,525
Deposits	538,155	42,357	9,271	1,567	1,189	592,539
Borrowings	15,186	41,067	186,372	55,525	11,721	309,871
Subordinated liabilities	15,438	-	19,730	-	-	35,168
Liabilities	578,304	83,424	215,373	57,092	12,910	947,103
Derivatives and other off-balance sheet items (net position)	(113,514)	30,085	85,183	849	-	2,603
Net interest gap	(6,155)	60,154	76,235	(47,889)	5,978	88,323

Amounts are in ISK millions

42. Market risk, continued

31.12.2020 *Assets*	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	38,794	-	-	-	-	38,794
Loans to credit institutions	28,235	-	-	-	-	28,235
Loans to customers	568,875	63,622	172,247	4,838	17,670	827,252
Financial instruments	33,329	61,122	38,392	1,672	4,171	138,686
Assets	669,233	124,744	210,639	6,510	21,841	1,032,967
Liabilities						
Due to credit institutions and Central Bank	13,031	-	-	-	-	13,031
Deposits	540,730	15,367	9,610	1,542	1,175	568,424
Borrowings	15,410	42,351	191,650	55,533	11,699	316,643
Subordinated liabilities	15,831	-	17,957	975	-	34,763
Liabilities	585,002	57,718	219,217	58,050	12,874	932,861
Derivatives and other off-balance sheet items (net position)	(119,170)	31,260	91,774	861	-	4,725
Net interest gap	(34,939)	98,286	83,196	(50,679)	8,967	104,831

Sensitivity analysis of interest rate risk in the banking book

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

	31.03.2021		31.12.2020	
NPV change	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	(3,979)	3,436	(3,849)	3,511
ISK, Non index-linked	1,155	(841)	933	(1,002)
Foreign currencies	436	(450)	301	(327)
NII change				
ISK, CPI index-linked	(961)	218	(1,032)	309
ISK, Non index-linked	(3,638)	806	(3,414)	668
Foreign currencies	64	(64)	(27)	27

Sensitivity analysis of interest rate risk in the trading book

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

	31.03.2021		31.12.2020	
Currency	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	169	(154)	117	(105)
ISK, Non index-linked	50	(44)	185	(169)
Foreign currencies	54	(54)	34	(34)

Amounts are in ISK millions

42. Market risk, continued

Indexation risk

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

Book value and maturity profile of indexed assets and liabilities

31.03.2021	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	10,786	43,188	189,427	243,401
Financial instruments	16,219	-	-	16,219
Off-balance sheet position	-	(494)	-	(494)
Assets, CPI index-linked	27,005	42,694	189,427	259,126
Liabilities, CPI index-linked				
Deposits	80,309	12,877	2,786	95,972
Borrowings	11,030	43,260	55,524	109,814
Subordinated liabilities	-	-	5,081	5,081
Other	1,189	211	1,325	2,725
Off-balance sheet position	3,362	3,787	23	7,172
Liabilities, CPI index-linked	95,890	60,135	64,739	220,764
Net on-balance sheet position	(65,523)	(13,160)	124,711	46,028
Net off-balance sheet position	(3,362)	(4,281)	(23)	(7,666)
CPI Balance	(68,885)	(17,441)	124,688	38,362
CPI Balance for prudential consolidation, excluding insurance operations *	(69,620)	(20,129)	118,387	28,637

31.12.2020	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	12,366	49,754	195,666	257,786
Financial instruments	14,917	-	-	14,917
Off-balance sheet position				(487)
Assets, CPI index-linked	27,283	49,754	195,666	272,216
Liabilities, CPI index-linked				
Deposits	77,805	13,322	2,724	93,851
Borrowings	10,851	42,747	54,865	108,463
Subordinated liabilities	-	-	5,088	5,088
Other	1,091	208	1,318	2,617
Off-balance sheet position	3,334	3,739	45	7,118
Liabilities, CPI indexed linked	93,081	60,016	64,040	217,137
Net on-balance sheet position	(62,464)	(6,523)	131,671	62,684
Net off-balance sheet position	(3,334)	(4,226)	(45)	(7,605)
CPI Balance	(65,798)	(10,749)	131,626	55,079
CPI Balance for prudential consolidation, excluding insurance operations *	(65,668)	(13,386)	126,684	47,632

* 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

31.03.2021

Financial assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	59,209	488	260	148	85	46	243	60,479
Loans to credit institutions	5,501	6,673	9,355	3,202	797	1,359	2,364	29,251
Loans to customers	678,579	103,805	39,103	5,181	4,094	1,874	4,526	837,162
Financial instruments	146,726	19,264	18,275	101	1	12,845	4	197,216
Other financial assets	12,046	677	3,440	-	-	17	-	16,180
Financial assets	902,061	130,907	70,433	8,632	4,977	16,141	7,137	1,140,288
Financial liabilities								
Due to credit inst. and Central Bank	6,066	2,038	1,420	-	-	-	1	9,525
Deposits	520,269	27,161	32,019	1,696	3,010	5,576	2,809	592,540
Financial liabilities at fair value	5,754	238	169	75	-	48	13	6,297
Other financial liabilities	7,035	1,063	6,175	315	491	244	248	15,571
Borrowings	154,857	117,881	-	-	-	18,823	2,186	293,747
Subordinated liabilities	5,973	739	12,892	-	-	4,495	10,533	34,632
Financial liabilities	699,954	149,120	52,675	2,086	3,501	29,186	15,790	952,312
Net on-balance sheet position	202,107	(18,213)	17,758	6,546	1,476	(13,045)	(8,653)	
Net off-balance sheet position	(17,477)	20,448	(17,478)	(6,504)	(850)	13,163	8,698	
Net position	184,630	2,235	280	42	626	118	45	
Non-financial assets								
Investment property	6,110	-	-	-	-	-	-	6,110
Investments in associates	892	-	-	-	-	-	-	892
Intangible assets	9,892	-	-	-	-	-	-	9,892
Tax assets	2	-	-	-	-	-	-	2
Assets and disposal groups held for sale	13,117	681	26	2,408	6	5	28	16,271
Other non financial assets	7,418	118	22	53	-	22	5	7,638
Non-financial assets	37,431	799	48	2,461	6	27	33	40,805
Non-financial liabilities and equity								
Tax liabilities	5,443	-	-	-	-	-	-	5,443
Liabilities associated with disposal groups held for sale	8,013	-	289	88	13	-	4	8,407
Other non-financial liabilities	25,340	105	61	-	4	-	2	25,512
Shareholders' equity	189,245	-	-	-	-	-	-	189,245
Non-controlling interest	174	-	-	-	-	-	-	174
Non-financial liabilities and equity	228,215	105	350	88	17	-	6	228,781
Management reporting of currency risk *	(6,154)	2,929	(22)	2,415	615	145	72	

* 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

31.12.2020								
Financial assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	40,996	407	270	153	77	40	193	42,136
Loans to credit institutions	6,453	9,785	4,631	1,158	756	2,397	3,055	28,235
Loans to customers	665,640	105,764	34,653	6,257	4,189	833	5,605	822,941
Financial instruments	154,745	27,274	38,139	24	4	6,917	148	227,251
Other financial assets	7,458	208	3,460	1	-	22	(1,482)	9,667
Financial assets	875,292	143,438	81,153	7,593	5,026	10,209	7,519	1,130,230
Financial liabilities								
Due to credit inst. and Central Bank	7,433	3,235	2,348	14	-	-	1	13,031
Deposits	494,606	32,505	29,069	1,992	2,895	4,556	2,801	568,424
Financial liabilities at fair value	4,925	95	171	44	-	4	1	5,240
Other financial liabilities	4,444	857	2,103	150	275	53	128	8,010
Borrowings	153,764	124,032	-	-	-	18,813	2,338	298,947
Subordinated liabilities	5,995	794	13,498	-	-	4,508	11,265	36,060
Financial liabilities	671,167	161,518	47,189	2,200	3,170	27,934	16,534	929,712
Net on-balance sheet position	204,125	(18,080)	33,964	5,393	1,856	(17,725)	(9,015)	
Net off-balance sheet position	(9,148)	22,434	(31,586)	(5,184)	(1,932)	17,739	7,677	
Net position	194,977	4,354	2,378	209	(76)	14	(1,338)	
Non-financial assets								
Investment property	6,132	-	-	-	-	-	-	6,132
Investments in associates	891	-	-	-	-	-	-	891
Intangible assets	9,689	-	-	-	-	-	-	9,689
Tax assets	2	-	-	-	-	-	-	2
Assets and disposal groups								-
held for sale	13,709	955	132	920	947	10	138	16,811
Other non financial assets	7,228	121	20	71	-	26	1,485	8,951
Non-financial assets	37,651	1,076	152	991	947	36	1,623	42,476
Non-financial liabilities and equity								
Tax liabilities	4,262	-	-	-	-	-	-	4,262
Liabilities associated with disposal								
groups held for sale	13,184	268	66	467	1,765	224	209	16,183
Other non-financial liabilities	24,508	119	73	-	4	-	-	24,704
Shareholders' equity	197,672	-	-	-	-	-	-	197,672
Non-controlling interest	173	-	-	-	-	-	-	173
Non-financial liabilities and equity	239,799	387	139	467	1,769	224	209	242,994
Management reporting								
of currency risk *	(7,171)	5,043	2,391	733	(898)	(174)	76	

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

	31.03.2021		31.12.2020	
Currency	-10%	+10%	-10%	+10%
EUR	(293)	293	(504)	504
USD	2	(2)	(239)	239
GBP	(242)	242	(73)	73
DKK	(62)	62	90	(90)
NOK	(15)	15	17	(17)
Other	(7)	7	(8)	8

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.

	31.03.2021		31.12.2020	
Equity	-10%	+10%	-10%	+10%
Trading book - listed	(424)	424	(391)	391
Banking book - listed	(387)	387	(382)	382
Banking book - unlisted	(364)	364	(276)	276

Derivatives

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

Amounts are in ISK millions

43. Liquidity and Funding risk

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

A primary source of funding for the Group is from deposits from individuals, businesses and financial undertakings. The Group's liquidity risk stems from the fact that the maturity of loans exceeds the maturity of deposits, of which 73% 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

31.03.2021 *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	15,710	38,889	5,972	-	-	-	60,571	60,479
Loans to credit institutions	19,906	7,254	41	2,158	-	-	29,359	29,251
Loans to customers	5,232	102,272	121,146	295,640	628,426	-	1,152,716	837,162
Financial instruments	30,082	22,346	47,129	50,821	13,840	42,870	207,088	197,216
Derivatives - assets leg	*1*	*53,595*	*23,015*	*11,308*	*1,846*	-	*89,765*	*82,917*
Derivatives - liabilities leg	*(1)*	*(52,924)*	*(20,283)*	*(8,339)*	*(1,571)*	-	*(83,118)*	*(78,348)*
Other financial instruments	*30,082*	*21,675*	*44,397*	*47,852*	*13,565*	*42,870*	*200,441*	*192,647*
Other financial assets	3,926	8,241	3,170	843	-	-	16,180	16,180
Financial assets	74,856	179,002	177,458	349,462	642,266	42,870	1,465,914	1,140,288
Financial liabilities								
Due to credit inst. and Central Bank	6,511	3,074	-	-	-	-	9,585	9,525
Deposits	435,826	86,276	54,692	13,219	3,064	-	593,077	592,540
Financial liabilities at fair value	-	4,859	651	1,048	51	-	6,609	6,297
Derivatives - assets leg	-	*(79,571)*	*(9,516)*	*(4,008)*	*(1,025)*	-	*(94,120)*	*(93,736)*
Derivatives - liabilities leg	-	*83,325*	*10,167*	*5,056*	*1,076*	-	*99,624*	*98,928*
Short position in bonds	-	-	-	-	-	-	-	-
Short position in equity	-	*10*	-	-	-	-	*10*	*10*
Short position in bonds used for hedging	-	*1,095*	-	-	-	-	*1,095*	*1,095*
Other financial liabilities	106	13,213	135	1,110	1,008	-	15,572	15,571
Borrowings	-	6,281	57,140	195,460	65,926	-	324,807	293,747
Subordinated liabilities	-	198	1,609	18,829	24,474	-	45,110	34,632
Financial liabilities	442,443	113,901	114,227	229,666	94,523	-	994,760	952,312
Net position for assets and liab.	(367,587)	65,101	63,231	119,796	547,743	42,870	471,154	187,976
Off-balance sheet items								
Financial guarantees	-	644	2,874	3,276	6,922	-	13,716	13,716
Unused overdraft	-	51,047	-	-	-	-	51,047	51,047
Undrawn loan commitments	-	64,349	10,335	3,941	-	-	78,625	78,625
Off-balance sheet items	-	116,040	13,209	7,217	6,922	-	143,388	143,388
Net contractual cash flow	(367,587)	(50,939)	50,022	112,579	540,821	42,870	327,766	44,588

Amounts are in ISK millions

43. Liquidity and Funding risk, continued

31.12.2020 *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	5,723	30,210	6,299	-	-	-	42,232	42,136
Loans to credit institutions	20,170	8,065	-	-	-	-	28,235	28,235
Loans to customers	4,643	109,363	106,656	307,086	600,174	-	1,127,922	822,941
Financial instruments	32,665	35,485	67,721	52,118	13,778	35,007	236,774	227,251
Derivatives - assets leg	-	*63,147*	*35,669*	*8,328*	*1,116*	-	*108,260*	*105,362*
Derivatives - liabilities leg	-	*(61,599)*	*(32,638)*	*(4,628)*	*(776)*	-	*(99,641)*	*(98,078)*
Other financial instruments	*32,665*	*33,937*	*64,690*	*48,418*	*13,438*	*35,007*	*228,155*	*219,967*
Other financial assets	534	5,413	2,882	838	-	-	9,667	9,667
Financial assets	63,735	188,536	183,558	360,042	613,952	35,007	1,444,830	1,130,230
Financial liabilities								
Due to credit inst. and Central Bank	11,491	1,550	28	-	-	-	13,069	13,031
Deposits	414,052	106,071	32,169	13,717	3,007	-	569,016	568,424
Financial liabilities at fair value	-	4,123	1,116	1,349	44	-	6,632	5,240
Derivatives - assets leg	-	*(46,444)*	*(5,067)*	*(9,196)*	*(413)*	-	*(61,120)*	*(55,928)*
Derivatives - liabilities leg	-	*49,798*	*6,183*	*10,545*	*457*	-	*66,983*	*60,399*
Short position bonds and derivatives	-	*40*	-	-	-	-	*40*	*40*
Short position securities used	-	*63*	-	-	-	-	*63*	*63*
for economic hedging	-	*666*	-	-	-	-	*666*	*666*
Other financial liabilities	82	5,423	112	1,328	1,066	-	8,011	8,011
Borrowings	-	2,803	50,635	212,471	65,633	-	331,542	298,947
Subordinated liabilities	-	1,178	943	19,762	25,586	-	47,469	36,060
Financial liabilities	425,625	121,148	85,003	248,627	95,336	-	975,739	929,713
Net position for assets and liab.	(361,890)	67,388	98,555	111,415	518,616	35,007	469,091	200,517
Off-balance sheet items								
Financial guarantees	-	593	4,539	2,016	13,709	-	20,857	20,857
Unused overdraft	-	49,164	-	-	-	-	49,164	49,164
Undrawn loan commitments	-	51,231	8,910	3,914	-	-	64,055	64,055
Off-balance sheet items	-	100,988	13,449	5,930	13,709	-	134,076	134,076
Net contractual cash flow	(361,890)	(33,600)	85,106	105,485	504,907	35,007	335,015	66,441

Net Stable Funding Ratio

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

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

31.03.2021	ISK	Foreign currency	Total
Available stable funding	682,018	184,615	866,633
Required stable funding	653,588	124,204	777,792
Foreign currency balance		(3,529)	
Net stable funding ratio	104%	146%	111%

31.12.2020	ISK	Foreign currency	Total
Available stable funding	705,538	169,723	875,261
Required stable funding	618,456	126,594	745,050
Foreign currency balance		(150)	
Net stable funding ratio	114%	134%	117%

Amounts are in ISK millions

43. Liquidity and Funding risk, continued

Liquidity coverage ratio

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

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

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

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

31.03.2021	ISK	Foreign currency	Total
Liquid assets level 1 *	107,068	41,126	148,194
Liquid assets level 2	10,487	-	10,487
Liquid assets	117,555	41,126	158,681
Deposits	105,568	28,850	134,418
Borrowings	1,372	65	1,437
Other cash outflows	11,114	13,739	24,853
Cash outflows	118,054	42,654	160,708
Short-term deposits with other banks **	1,867	18,933	20,800
Other cash inflows	39,475	17,599	57,074
Cash inflows	41,342	36,532	77,874
Liquidity coverage ratio (LCR) * **	153%	386%	192%

31.12.2020			
Liquid assets level 1 *	103,138	61,282	164,420
Liquid assets level 2	10,515	-	10,515
Liquid assets	113,653	61,282	174,935
Deposits	99,885	27,592	127,477
Borrowings	287	64	351
Other cash outflows	10,427	11,678	22,105
Cash outflows	110,599	39,334	149,933
Short-term deposits with other banks **	3,178	19,501	22,679
Other cash inflows	28,251	6,194	34,445
Cash inflows	31,429	25,695	57,124
Liquidity coverage ratio (LCR) * **	144%	449%	188%

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

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

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

Amounts are in ISK millions

43. Liquidity and Funding risk, continued

Composition of liquid assets

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

31.03.2021	ISK	USD	EUR	Other	Total
Cash and balances with Central Bank	59,209	260	488	522	60,479
Short-term deposits in other banks	1,868	9,161	4,510	5,261	20,800
Domestic bonds eligible as collateral at the Central Bank	60,318	-	-	-	60,318
Foreign government bonds	-	14,559	13,416	11,877	39,852
Liquidity reserve	121,395	23,980	18,414	17,660	181,449

31.12.2020	ISK	USD	EUR	Other	Total
Cash and balances with Central Bank	40,996	270	407	463	42,136
Short-term deposits in other banks	3,179	4,467	7,765	7,268	22,679
Domestic bonds eligible as collateral at the Central Bank	74,637	-	-	-	74,637
Foreign government bonds	-	33,817	20,364	5,956	60,137
Liquidity reserve	118,812	38,554	28,536	13,687	199,589

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					
31.03.2021	Less stable	Weight %	Stable	Weight %	Term deposits*	Total deposits
Individuals	95,255	11%	123,684	5%	74,480	293,419
Small and medium enterprises	53,471	11%	16,665	5%	5,100	75,236
Corporations	68,026	40%	3,912	20%	7,525	79,463
Sovereigns, central banks and PSE	51,639	40%	-	-	11,985	63,624
Pension funds	40,459	100%	-	-	13,877	54,336
Domestic financial entities	20,973	100%	-	-	13,315	34,288
Foreign financial entities	1,699	100%	-	-	-	1,699
Total	331,522		144,261		126,282	602,065

31.12.2020	Less stable	Weight %	Stable	Weight %	Term deposits*	Total deposits
Individuals	89,950	11%	123,897	5%	73,321	287,168
Small and medium enterprises	52,527	11%	16,180	5%	5,572	74,279
Corporations	64,445	40%	3,854	20%	8,646	76,945
Sovereigns, central banks and PSE	43,379	40%	-	-	12,932	56,311
Pension funds	38,042	100%	-	-	14,325	52,367
Domestic financial entities	22,391	100%	-	-	9,907	32,298
Foreign financial entities	2,087	100%	-	-	-	2,087
Total	312,821		143,931		124,703	581,455

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

Amounts are in ISK millions

44. Capital management

Capital adequacy

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

The Group's capital ratios are calculated in accordance with the Icelandic Financial Undertakings Act No. 161/2002 and Regulation No. 233/2017 on prudential requirements. Iceland has adopted the EU Capital Requirements Directive and Regulation (CRD IV / CRR). The Group applies the standardized approach to calculate capital requirements for credit risk, credit valuation adjustment, market risk and operational risk.

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

Valitor hf. is classified as held for sale in these Consolidated Financial Statements. This does not affect the Group's capital adequacy calculations. For disclosure, assuming a cash sale of the subsidiary at book value, the Group's capital adequacy ratio would increase from 26.9% to 28.3%. The sale of Valitor would result in a reduction of the Group's regulatory own funds adjustments, with positive effect on capital adequacy.

Own funds	31.03.2021	31.12.2020
Total equity	189,419	197,845
Unaudited interim net earnings	(6,038)	-
Non-controlling interest not eligible for inclusion in CET1 capital	(174)	(173)
Common Equity Tier 1 capital before regulatory adjustments	183,207	197,672
Intangible assets	(13,915)	(13,092)
Cash flow hedges	(1,351)	(2,282)
Additional value adjustments	(210)	(238)
Foreseeable dividend and buyback *	(3,056)	(17,990)
Adjustment under IFRS 9 transitional arrangements	1,238	1,890
Common equity Tier 1 capital	165,913	165,960
Non-controlling interest not eligible for inclusion in CET1 capital	174	173
Additional Tier 1 capital	12,891	13,498
Tier 1 capital	178,978	179,631
Tier 2 instruments	21,741	22,562
Tier 2 instruments of financial sector entities (signif. invest.)	(1,026)	(1,007)
Tier 2 capital	20,715	21,555
Total own funds	199,693	201,186
Risk-weighted exposure amount (REA)		
Credit risk, loans	577,130	570,554
Credit risk, securities and other	61,812	60,813
Counterparty credit risk	4,831	3,462
Market risk due to currency imbalance	6,297	8,569
Market risk, other	15,255	13,063
Credit valuation adjustment	589	842
Operational risk	88,462	88,462
Total risk-weighted exposure amount	754,376	745,765
Capital ratios		
CET1 ratio	22.0%	22.3%
Tier 1 ratio	23.7%	24.1%
Capital adequacy ratio	26.5%	27.0%
Total own funds, including interim profit not eligible for inclusion	202,712	201,186
CET1 ratio, including interim profit not eligible for inclusion	22.4%	22.3%
Tier 1 ratio, including interim profit not eligible for inclusion	24.1%	24.1%
Capital adequacy ratio, including interim profit not eligible for inclusion	26.9%	27.0%

* On 31 December 2020, the foreseeable dividend and buyback is the aggregation of a dividend distribution of ISK 3 billion, which adheres to the guidance of the FSA, and planned buyback of own shares amounting to ISK 15 billion which has received permission from the FSA. On 31 March 2021, the foreseeable dividend and buyback is the amount remaining of the planned buyback.

Amounts are in ISK millions

44. Capital management, continued

On 4 May 2020 the Icelandic Ministry of Finance ratified Regulation (EU) 2017/2395 into Icelandic law. The regulation introduces transitional arrangements for IFRS 9 to allow the regulatory capital impact of expected credit loss to be phased in over time. These arrangements have been available to European banks since 2017. Institutions that elect to make use of these transitional arrangements can in 2020 add back CET1 equivalent to up to 70% of provisions incurred from the application of IFRS9 and 50% in 2021. The Bank has opted to make use of the transitional arrangements, thus reflected in the Group's capital ratios for 2020. The transitional arrangements increase the capital adequacy ratio by 0.2 percentage points.

Capital ratios of the parent company	31.03.2021	31.12.2020
CET1 ratio	22.6%	22.8%
Tier 1 ratio	24.3%	24.6%
Capital adequacy ratio	27.0%	27.5%

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

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

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

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

Capital requirement, % of REA

2020	CET1	Tier 1	Total
Pillar 1 capital requirement	4.5%	6.0%	8.0%
Pillar 2R capital requirement **	1.7%	2.3%	3.1%
Combined buffer requirement *	7.3%	7.3%	7.3%
Regulatory capital requirement	13.5%	15.6%	18.4%
Available capital	22.0%	23.7%	26.5%

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

** The SREP result based on the Group's Financial Statement at 31 December 2018. Due to the Covid-19 pandemic, the FSA decided that this result would be unchanged in 2020. The Pillar 2 requirement is 3.1% of risk-weighted exposure amount based on the Group's prudential consolidation under CRR, which excludes Vördur tryggingar hf.

Leverage ratio

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

	31.03.2021	31.12.2020
On-balance sheet exposures	1,139,032	1,114,450
Derivative exposures	6,409	9,124
Securities financing transaction exposures	514	512
Off-balance sheet exposures	74,587	65,425
Total exposure	1,220,542	1,189,511
Tier 1 capital	178,978	179,631
Leverage ratio	14.7%	15.1%

Amounts are in ISK millions

44. Capital management, continued

Solvency II	31.03.2021	31.12.2020
Excess of assets over liabilities in accordance with Solvency II	7,629	7,397
Subordinated liabilities	1,012	1,000
Foreseeable dividends	(800)	(800)
Own funds	7,841	7,597
Solvency capital requirements (SCR)	5,473	5,105
SCR ratio	143%	149%

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

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