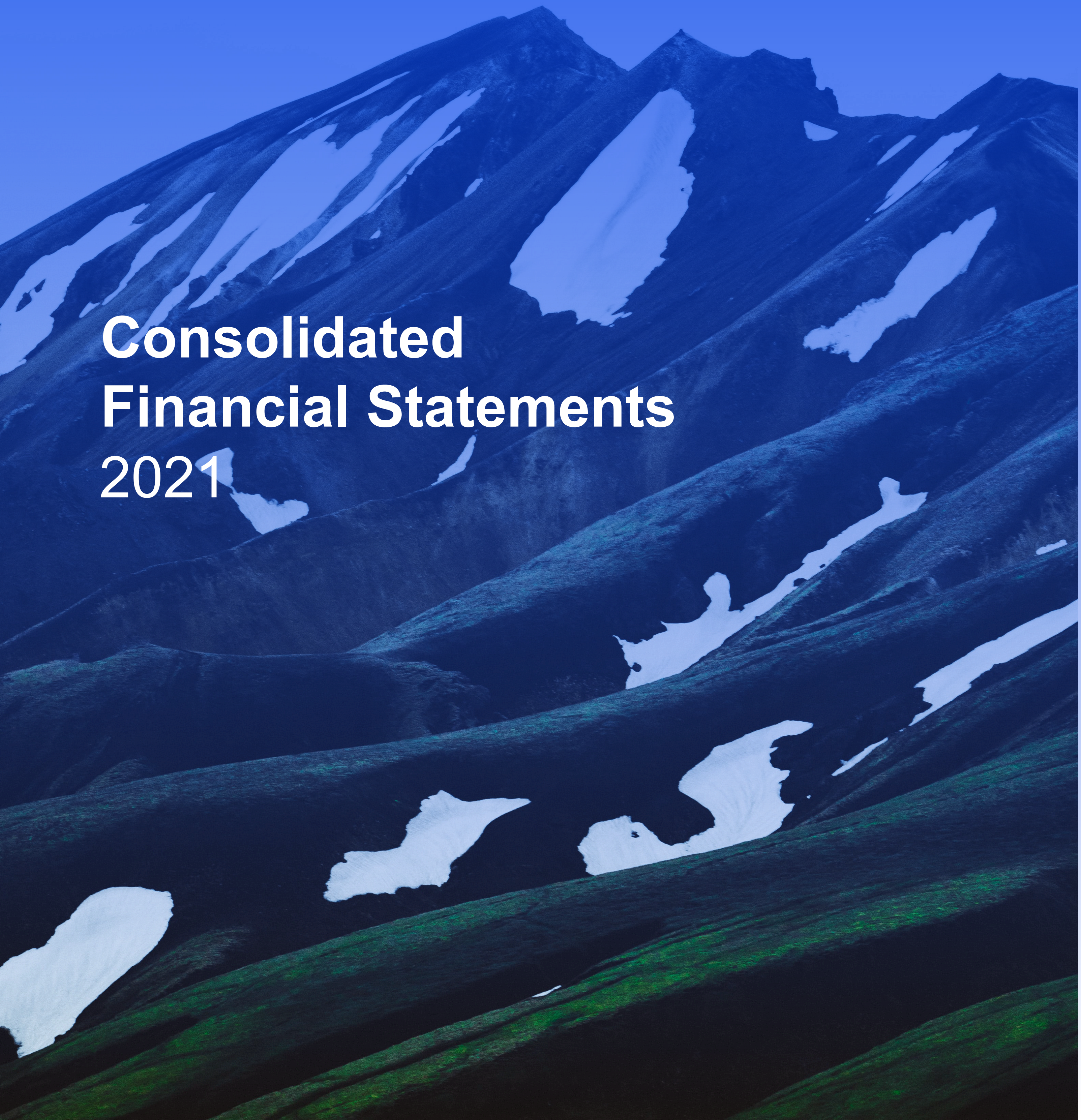
Arion Bank

Consolidated Financial Statements 2021



Contents

Arion Bank in brief

31.12.2021

14.7%
Return on equity

44.4%
Cost-to-income

19.6%
CET1 ratio

Rating from S&P

Long term: BBB

Short term: A-2

Outlook: Stable

The Banker
Bank of the Year 2021
ICELAND

UNEP FINANCE INITIATIVE
PRINCIPLES FOR RESPONSIBLE BANKING

Equal Pay Certification

PRI Principles for Responsible Investment

Arion Bank

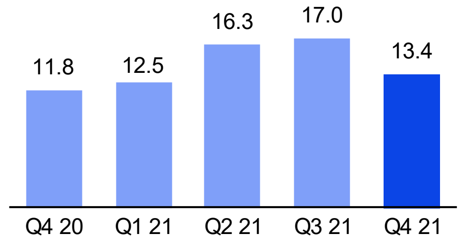
- Arion Bank provides services to households, corporates, institutions and investors. The Bank has three business segments: Retail Banking, Corporate & Investment Banking, and Markets. The service offering is further augmented by the subsidiaries Stefnir and Vördur. Stefnir is an Icelandic fund management company, and Vördur is an insurance company providing non-life and life insurance.
- Arion Bank plays an important role in the community through financing of progressive and sustainable initiatives in the community and sustainability is an integral part of the Bank's day-to-day activities, its decision-making and processes
- The diverse service offering at Arion Bank means that the revenue base is broad and the loan portfolio is well diversified between retail and corporate customers. The high percentage of mortgages and the healthy distribution of loans across different sectors reduces credit risk
- The Bank is a market leader in digital solutions and innovation. Numerous new digital solutions have been launched in the past few years, enhancing service to customers and making the Bank's operations more efficient, which in the long term reduces operating expenses across the Bank
- The Bank is emphazising customer experience in all aspects of the Bank
- At year-end 2021 Arion Bank has ISK 21bn in excess capital and expects to pay dividend and/or buy-back own shares in addittion to already foreseeable dividend and buy-back of ISK 26.7bn included in equity calculation to reach the 17% CET1 target

Key figures

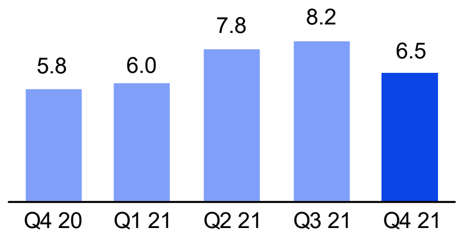
(ISK million)

	2021	2020
Net earnings	28,615	12,469
ROE	14.7%	6.5%
Net interest margin	2.8%	2.9%
Cost to income ratio	44.4%	48.1%
Operating income / REA	7.6%	7.0%
	31.12.2021	**31.12.2020**
Total assets	1,313,864	1,172,706
Loans to customers	936,237	822,941
Deposits	655,476	568,424
Borrowings	356,637	298,947
Stage 3 gross	1.9%	2.6%
Leverage ratio	12.6%	15.1%
Number of employees	751	776
EUR/ISK	147.60	156.10

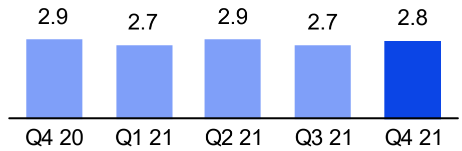
Return on equity (%)



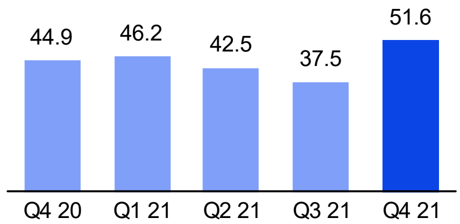
Net earnings (ISK billion)



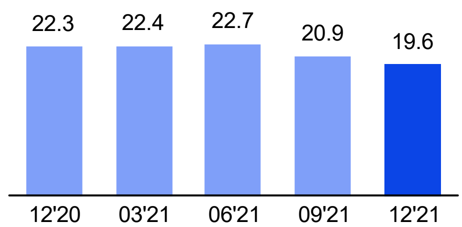
Net interest margin (%)



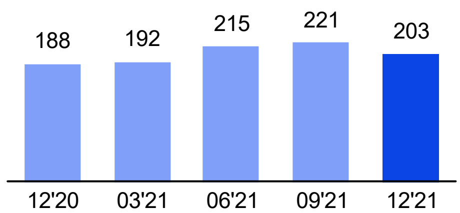
Cost-to-income ratio (%)



CET 1 ratio (%)



LCR ratio (%)



Endorsement and statement
by the Board of Directors and the CEO

The Consolidated Financial Statements of Arion Bank for the year ended 31 December 2021 include the Consolidated Financial Statements of Arion Bank ("the Bank") and its subsidiaries, together referred to as "the Group".

About Arion Bank

Arion Bank and its subsidiaries provide comprehensive financial services to the Icelandic society. 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. Arion Bank places great importance on developing long-term relationships with its clients and is a market leader as a provider of cutting-edge and modern banking services. In partnership with our customers the Bank stimulates shared growth and progress in Icelandic society.

Arion Bank provides services to households, corporates, institutes and investors in three business segments: Retail Banking, Corporate & Investment Banking, and Markets. The service offering is further augmented by the subsidiaries Stefnir and Vördur. Stefnir is one of the largest fund management companies in Iceland, and Vördur is the fastest growing insurance company in Iceland, providing non-life and life insurance. 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 mortgage loans and the healthy distribution of loans across different sectors reduces credit risk.

The Bank is a market leader in terms of 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 is a financially robust bank which places great importance on operating responsibly in harmony with society and the environment. The Bank places importance on paying competitive dividends to shareholders. The Bank is listed on the main lists of Nasdaq Iceland and Nasdaq Stockholm.

Arion Bank is an Icelandic bank which operates in Iceland and also provides services to companies in the seafood and seafood related sectors in Europe and North America.

Operations during the year

Income Statement

Net earnings amounted to ISK 28,615 million and return on equity was 14.7%. Earnings per share was ISK 17.96. Core revenues, defined as net interest income, net commission income and net insurance income, increased by 9.4% YoY, which indicates that the strategic changes introduced in the autumn of 2019 have largely proven successful despite the challenging conditions posed by the global pandemic over the last two years. The solid performance of the securities markets, the reversal of loan impairments on the back of a better performing economy and the positive impact of assets held for sale have helped to deliver strong and better than expected annual financial results. However, operating expenses have increased somewhat, particularly salary expenses, mainly due to the expected incentive scheme due to the strong financial results in 2021.

Balance Sheet

The Bank's balance sheet grew by 12.0% from year-end 2020. Loans to customers increased by 13.8%, primarily mortgage lending, whereas loans to corporates increased slightly. The majority of loans are now to individuals, 50% in the form of mortgages and 6% other loans. Liquid assets increased despite share buybacks and dividend payments during the year, a total of ISK 31.5 billion. On the liability side deposits increased by 13.6%, and deposits play an increasingly significant role in the Bank's funding mix, which is reflected by the fact that the ratio of loans to deposits has decreased from 145% to 143% between years. The Bank issued two international bonds for a total of €600 million during the year. The first issue was under the Green Financing Framework in July, and the second in September was a covered bond issue in euros, the first such transaction by an Icelandic issuer. Total equity amounted to ISK 194,598 billion at the end of the year. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 23.8% at year-end and the CET1 ratio was 19.6%, assuming ISK 22.5 billion dividend payment and ISK 4.3 billion buyback of own shares, which is the remainder of the current buyback program that had received permission from the Financial Supervisory Authority of the Central Bank of Iceland (FSA). These ratios comfortably exceed the requirements made by the FSA and Icelandic law. The liquidity position was also strong at year-end and well above the regulatory minimum.

Assets held for sale and discontinued operations

The operating results of the subsidiaries Valitor hf., Stakksberg ehf. and Sólbjarg ehf. are presented as discontinued operations as they are all classified as held for sale.

Valitor hf. is a market leader in Iceland in acquiring services and payment solutions and also operates in the United Kingdom. The operating results of Valitor had a positive effect of ISK 0.9 billion on the consolidated financial results of Arion Bank in 2021. At year-end the net book value of Valitor was ISK 8.6 billion.

On 1 July 2021 Arion Bank and Rapyd entered into a definitive agreement regarding the sale of Valitor hf. for a purchase price of USD 100 million. The transaction is subject to regulatory approval and the parties have agreed on a deadline for obtaining this approval of 1 May 2022. Should the sale not be finalized due to failure to obtain regulatory approval, the risk shall be borne by the buyer, valid for two years. The sale agreement for Valitor hf. does not affect the Consolidated Financial Statements for the period, in accordance with IFRS. Arion Bank expects to recognize a net profit of approximately ISK 3.5 billion from the sale when all conditions precedent have been met.

Stakksberg ehf. manages all the assets of the silicon plant in Helguvík. Stakksberg has been working to reduce uncertainty regarding the recommissioning of the plant, but the sale of the company has fallen behind the original schedule for a number of external reasons. In January 2022 a letter of intent was signed with a potential buyer for this asset, and due diligence is in progress which is expected to be completed by mid-year. The result of the due diligence is as yet unknown. Stakksberg had a negative impact of ISK 0.2 billion in 2021 due to the impairment of the silicon plant. At year-end the book value of Stakksberg was ISK 1.5 billion.

Endorsement and statement
by the Board of Directors and the CEO

Sólbjarg ehf. administered the Bank's shareholding in travel companies in Scandinavia and Iceland which previously belonged to TravelCo. The company sold Bravo Tours in Denmark during the year and the sale of Heimsferðir is awaiting the approval of the Icelandic Competition Authority. Sólbjarg had a positive impact of ISK 0.7 billion in 2021 and the main reason for this is the sale of the company's underlying assets. At year-end the net book value of Sólbjarg was ISK 0.3 billion.

Medium term targets

In December Arion Bank announced new financial targets following the updating of its 5-year business plan. The main changes were that the ROE target has been increased from 10% to 13% and the ratio of operating income to risk-weighted assets was increased from 6.7% to 7.3%. A new target was added which is that premiums earned will outgrow the growth rate on the Icelandic insurance market by 3 percentage points. The other targets remain largely unchanged.

	2021 FY	Previous target	New target
Return on equity	14.7%	Exceed 10%	Exceed 13%
Operating income / REA	7.6%	Exceed 6.7%	Exceed 7.3%
Insurance premium growth	12.4%	-	Premium growth (net of reinsurance) to exceed the growth of the domestic market by more than 3 percentage points
Loan growth	13.8%	The loan book will grow in line with economic growth, with growth in mortgage lending expected to outpace corporate lending	In line with nominal economic growth
Cost-to-income ratio	44.4%	Below 45%	Below 45%
CET1 ratio	19.6%	~17%	~17%
Dividend payout ratio	79%	50%	50%

Economic outlook

The Icelandic economy is quickly recovering from one of the biggest economic contractions in its history. After a difficult start to 2021, the economy turned over a new leaf and GDP grew by 6% YoY in the third quarter. Economic growth in 2021 is expected to be around 4%, a much stronger recovery than was forecast at the beginning of the year.

After the vaccination programme had been rolled out, all domestic public health measures were temporarily lifted and travel restrictions eased, measures that acted as a booster shot for the economy. Tourists began to flock to the country, leading to almost 700,000 tourists visiting the country in 2021. With tourism gaining momentum and the government establishing measures to support the labour market, e.g. employment subsidies, unemployment began to fall sharply and halved in just a few months. By the end of the third quarter, jobs had increased by more than 10,000 across all sectors, and unemployment had reached pre-pandemic levels. Unemployment is expected to continue to fall, reaching equilibrium unemployment much earlier than previously thought.

Better employment prospects, high consumer confidence and rapid asset growth in the housing market laid the foundations for strong private consumption, especially in the second half of the year. Thus, total payment card turnover in Iceland increased by 18% YoY in the fourth quarter, reaching record breaking heights in December. Due to soaring private consumption, as well as growing business investment, imports rapidly increased. Despite flourishing exports of goods and the recovery of tourism, the contribution of foreign trade to GDP was negative. Most analysts expect the opposite to hold true this year, thanks to a bright outlook for the country's main export sectors, especially tourism and the seafood industry.

Even though the economy is recovering, uncertainty remains. Covid-19 still has a strong hold over the global economy, inflation in Iceland and around the world remains well above inflation targets and productions chains are in disrepair. At the same time as social distancing measures are in place, negatively affecting public finances, central banks around the world are forced to raise interest rates and tighten their monetary policy. The Central Bank of Iceland has raised its key interest rates by 1.25 percentage points since May, with most expecting further rate hikes in the near future. Although the long-term economic outlook is bright, and Iceland in an ideal position to emerge successfully through this turbulent period, short-term economic uncertainty has increased.

Outlook for the Bank

The past year has been a successful milestone in the strategic journey of the Group. The operational results are a testament to this positive momentum and the Bank has exceeded all operational targets during the year.

This progress is firstly supported by the robust foundations of the Group, built over decades of experience of the Bank and its predecessors. This is characterized by a solid infrastructure, diverse and mature business units, best in class digital offering, and an excellent talent pool.

Building on this strong foundation, over the past couple of years, the Group's strategy has been renewed to reinforce this further and align the direction with the evolving operational environment and building on our core competitive strengths. A key project has been the realignment of our Corporate and Investment Bank (CIB), which is now an important contributor to the Group's earnings. Importantly, all key business areas of the Group are now delivering above target returns which supports strategic flexibility going forward. Another key initiative was the alignment of the employee incentive scheme with the operational performance and shareholder returns. The scheme was incorporated during the year where every employee of the Bank is incentivized with the same overall targets and for key employees' payments, which are capped at 25% of salaries, are in the form of shares which vest over three years. The overarching KPI is for the Group to deliver ROE in excess of key competitors. This was an important step to relieve pressure on fixed pay and to focus employees on enhancing longer term shareholder value.

The key aim for the new year is to utilize the strong operational position to strengthen the longer term competitive position of the Group. A revised business plan therefore aims to invest in two key strategic initiatives during 2022: IT infrastructure and customer experience. These investments will impact operating expenses during the year but strengthen efficiencies and sustainable returns over the medium-term. The Bank's ambitious business plan, supported by a positive view of the market outlook, is reflected in the updated operational targets of the Group presented in the fourth quarter.

Strengthened by these investments, the next phase of the Group's progression focuses on holistic customer journey optimization. With a broad offering of mature products and services combined with a competitive edge in our digital distribution channels, there are considerable strategic opportunities in this area. A key part of this vision is bringing Vördur insurance company closer to the Bank for a more focused bancassurance offering. Bringing together Arion Bank's digital distribution channels and infrastructure with Vördur's growth potential and earnings strength is a key opportunity for the Group. The Group also sees opportunities to utilize this strong position to actively participate in the emergence of the growth and importance of the Arctic in the global economy. This is a longer-term vision which will be a driver for medium-term strategic plans.

Capital optimization continues to be a focus for the Group and significant milestones are being achieved in this area. Shareholder distributions since the start of 2021 have amounted to ISK 31.5 billion through buybacks and dividend payment. The proposed dividend for the year 2021, which will be subject to the approval of the annual general meeting on 16 March, corresponds to ISK 15 per share or around ISK 22.5 billion, net of own shares. Additionally, it is anticipated that the approximate ISK 12 billion proceeds from the sale of Valitor, expected to be completed later in the year, will also be distributed as an extraordinary dividend. Share buy-backs will also continue to be explored later in the year. The medium-term target remains to bring CET1 ratio to the optimized 17% area.

Banks play a key part in the community through financing of progressive and sustainable initiatives. Arion Bank has reached key milestones this year through the establishment of a green financing framework, followed by successful green bond issues in EUR and ISK. In 2022, we will continue to focus on sustainability with our customers and will set a policy for sectors that have the most impact on our lending in terms of climate and environmental considerations. We will also start estimating the carbon footprint of the Bank's overall loan portfolio according to the methodology of the Partnership for Carbon Accounting Financials (PCAF). See further information about Arion Bank's sustainability journey in the chapter "Sustainability and non-financial reporting".

The current position of the Group is enviable, and while there continue to be some headwinds in the external environment, there is strong overall optimism. Operations have turned a corner and allowed for a focused investment plan which will strengthen the long-term position of the Group. The lending and advisory pipeline is robust and allows for profitable growth plans in the near term, supporting the recovery of the economy. A key focus for the year will be to manage these growth opportunities with the capital release plans to optimize shareholder returns.

Employees

The Group had 751 full-time equivalent positions at the end of the year, compared with 776 at the end of 2020. A total of 619 of these positions were at Arion Bank, compared with 648 at the end of 2020.

In December 2020 the Board of Directors of Arion Bank and Vördur approved a revised incentive scheme which came into effect in 2021 for employees of Arion Bank and Vördur. The scheme is in compliance with the FSA's rules on incentive schemes to employees of financial institutions. The scheme is split into two parts. Firstly, employees can receive up to 10% of their fixed salary for 2021 in the form of a cash payment. Secondly, a limited group can receive up to 25% of their fixed salary as a payment in the form of shares in the Bank which will be subject to three-year lock-up period. The criterion used to determine whether something 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. The Board of Directors of Arion Bank also approved a new share option plan for all employees of the Bank, which is important for aligning the interests of employees with the long-term interests 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 is determined by the Bank's average share price 10 days before the share option agreement was signed, which was 3 February 2021.

Funding and liquidity

In terms of funding and liquidity management the year was characterized by the Bank's strong liquidity position and strong deposit growth. The Bank's liquidity position was well above the regulatory minimum of 100% all year, with a liquidity coverage ratio of 203% at the end of 2021. The strong liquidity position is due to successful bond transactions and the growth of customer deposits, increasing 15% from ISK 568 billion to ISK 655 billion, while lending growth was similar to deposit growth.

The Bank did not have any significant bond or long-term funding maturities in 2021. The €500 million issue maturing in December 2021 had to a large extent been refinanced at year-end 2020.

In September 2021 Arion Bank became the first Icelandic financial institution to issue covered bonds in euros, issuing €300 million. The bonds were sold at rates corresponding to a 0.27% margin over interbank rates, which are the best rates which an Icelandic issuer, including the Icelandic government, has obtained on the international credit markets since Arion Bank was founded 13 years ago.

Arion Bank also held its inaugural green bond issues. In July the Bank issued its first green bond to international investors for a total of €300 million. The bonds were sold at rates corresponding to a 0.80% margin over interbank rates. In December 2021 Arion Bank held its inaugural green bond in ISK. The new series amounting to ISK 3.6 billion was Arion Bank's first unsecured issue in ISK. The bonds were issued under the Bank's Green Financing Framework. The Framework sets out clearly and transparently the conditions which the Bank's loans need to meet in order to be considered green.

Endorsement and statement
by the Board of Directors and the CEO

Group ownership

The main venue at which the Board and the Bank report information to the shareholders and propose decisions is at legally convened shareholders' meetings. The Bank provides an effective and accessible arrangement for communications between shareholders and the Board of Directors between those meetings. Any information sensitive to the market will be released through a MAR press release. Arion Bank also arranges quarterly meetings where the CEO, CFO and Investor Relations present the interim financial results. The Bank has also held its capital markets day on two occasions, in November 2019 and 2021, where the management team discussed the progress in the Banks operations and key focus areas going forward. The next capital markets day is scheduled to be held in 2023.

At the end of 2021 Lífeyrissjódur starfsmanna ríkisins was the largest shareholder in Arion Bank with a shareholding of 9.10%. Arion Bank owned 8.54% of its own shares at the end of 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 2021. The float of the Bank's shares has been substantial during 2021. Icelandic pension funds, insurance and fund management companies along with numerous private investors have added to their shareholdings, while at the same time international ownership has decreased. The number of shareholders has grown from around 7,400 at the beginning of the year to 11,300 at the end of the year, 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 36.

Capital adequacy 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 together with the Bank's management buffer. The Bank has the objective to maintain a 17% Common Equity Tier 1 ratio. The corresponding capital requirement is 13.5% of total risk-weighted exposure amount. The Bank has released equity through dividend payments and purchase of own shares to meet this objective. In March 2021, the Bank paid dividend of ISK 2.9 billion and in 2021 the Bank has purchased a total of ISK 28.6 billion of own shares.

The Board of Directors proposes that the Bank pay dividends of ISK 22.5 billion in 2022, net of own shares. This dividend calculates as ISK 15 per share. The Board of Directors has the authority to propose that the Bank pay dividends or other disbursement of equity and may convene a special shareholders' meeting later in the year to propose a payment.

The Group's capital adequacy ratio on 31 December 2021 was 23.8% and the CET1 ratio 19.6%. The ratios account for a deduction due to foreseeable dividend that represents an expected dividend payment of ISK 22.5 billion in the first quarter of 2022 and ISK 4.3 billion in share buyback due to the completion of the programme announced in October 2021. The capital position of Arion Bank will remain very strong and the planned equity release to shareholders will not impact the Bank's ability to support its customers and the Icelandic economy.

The Bank's total risk-weighted exposure amount (REA) increased by ISK 67 billion in 2021, primarily due to an increase to loans to customers of ISK 113 billion. In June 2021, changes to the European capital requirements (CRD V / CRR II) were adopted in Iceland which resulted in further capital relief for SME exposures, a lower threshold for large exposures and a new methodology for calculating capital requirements for counterparty credit risk.

As part of the Icelandic government's economic measures in response to Covid-19, the Financial Stability Committee decided to vacate the 2% countercyclical capital buffer in March 2020, thereby reducing the Group's total requirement from 20.3% to 18.4%. In September 2021, the Committee announced that the countercyclical capital buffer would again be set at 2% as of 29 September 2022. Both of these measures had a limited impact on Arion Bank, however, given its strong capital position throughout the pandemic.

Risk management

The Group faces various risks arising from its day-to-day operations as a financial institution. Managing risk is therefore a core activity within the Group. The key to effective risk management is a process of on-going identification of significant risk, quantification of risk exposure, actions to limit risk and constant monitoring of risk. This process of risk management and the ability to manage and price risk factors is critical to the Group's continuing profitability as well as ensuring that the Group's exposure to risk remains within acceptable levels. The Board of Directors is ultimately responsible for the Bank's risk management framework and ensuring that satisfactory risk policies and governance structure for controlling the Bank's risk exposure are in place. The Group's risk management, its structure and main risk factors are described in the notes and in the Bank's unaudited Pillar 3 Risk Disclosures.

Governance

At the Bank's AGM on 16 March 2021, five members were elected to serve on the Board of Directors until the next AGM, two women and three men. Additionally, two Alternate Directors (one woman and one man) were elected. The five Directors and two Alternates are independent of Arion Bank, its management and major shareholders. The Board's composition as regards gender representation complies with statutory requirements, which stipulate that companies employing more than 50 people must ensure that the gender ratio of the board of directors and alternate board is no less than 40%.

The Board of Directors of Arion Bank places great importance on good corporate governance and a corporate culture which fosters open and honest relations between the Bank, its shareholders, and other stakeholders. The Board of Directors is the supreme authority in the affairs of the Bank between shareholders' meetings and tends to those operations of the Bank which are not considered part of the day-to-day business, i.e., taking decisions on issues which are unusual or of a significant nature. The Board of Directors appoints a Chief Executive Officer who is responsible for the day-to-day operations in accordance with a strategy set out by the Board. The CEO hires the Executive Management.

There are four Board sub-committees: The Board Audit Committee, the Board Risk Committee, the Board Credit Committee and the Board Remuneration Committee. One of the committee members on the Board Audit Committee is not a Board member and is independent of the Bank and its shareholders. In late 2020 the Board set up a temporary sub-committee, the Board Tech Committee, to advise the Board and senior management on the Bank's near to medium-term development of the Bank's IT enterprise architecture.

The main roles of the Board, as further specified in the rules of procedure of the Board, include approving the Bank's strategy, supervising financial affairs and accounting, and ensuring that appropriate internal controls are in place. The Board ensures that the Bank has active Internal Audit, Compliance and Risk Management departments. The Internal Auditor is appointed by the Board of Directors and works independently of other departments of the Bank in accordance with a charter from the Board. The Internal Auditor provides independent and objective assurance and advice designed to add value and improve the Bank's operations. The Compliance Officer, who reports directly to the CEO, works independently within the Bank in accordance with a charter from the Board. The main role of Compliance is to ensure that the Bank has in place proactive measures to reduce the risk of rules being breached in the course of its activities. Compliance is also responsible for coordinating the Bank's measures against money laundering and terrorist financing. The duties of Compliance are carried out under a risk-based compliance plan approved by the Board of Directors, including a monitoring and training schedule for employees which addresses the laws and rules under which the Bank operates.

Corporate governance at Arion Bank is described in more detail in the Bank's Corporate Governance Statement which is contained in the unaudited appendix to the Financial Statement and on the website www.arionbanki.is. The Corporate Governance Statement is based on legislation, regulations, and recognised guidelines in force when the Bank's annual financial statements are adopted by Board of Directors, prepared in accordance with the Guidelines on Corporate Governance, 6th edition, issued by the Icelandic Chamber of Commerce, SA – Business Iceland and Nasdaq Iceland in February 2021. Corporate governance at Arion Bank complies with the guidelines with two exceptions, which are explained in more detail in the Corporate Governance Statement.

Sustainability and non-financial reporting

Arion Bank places great importance on environmental and social issues and good corporate governance in its operations. Arion Bank's sustainability policy bears the title Together we make good things happen and signifies that the Bank wants to act as a role model in responsible and profitable business practices, taking into account the environment, the economy and society. At Arion Bank we aim to ensure that sustainability is an integral part of the Bank's day-to-day activities, its decision-making and processes.

We refer to Arion Bank's values as cornerstones and they are designed to provide guidance when making decisions and in everything the employees do. The cornerstones address our role, mentality and conduct and they are: we make a difference, we get things done, we say what we mean, and we fin solutions. The Bank's code of conduct has been approved by the Board of Directors and is designed as a guideline for employees and to support responsible decision making. Arion Bank has selected six UN Sustainable Development Goals which the Bank which it intends to focus on: goal number 5 on gender equality; number 7 on affordable and clean energy; number 8 on decent work and economic growth; number 9 on industry, innovation and infrastructure; number 12 on responsible consumption and production; and number 13 on climate action.

Arion Bank is involved in extensive partnerships in the field of sustainability and social responsibility, both in Iceland and abroad, and is a signatory to numerous treaties and declarations, such as the UN Global Compact, the UN Principles for Responsible Investment, the UN Principles for Responsible Banking and UN Women.

In November 2021 Arion Bank became a signatory to Partnership for Carbon Accounting Financials (PCAF), a global partnership of financial institutions that work together to develop and implement a harmonized approach to assess and disclose the greenhouse gas (GHG) emissions associated with their loans and investments. Arion Bank will apply this methodology in 2022 to estimate the carbon footprint from its loan portfolio. In order to gain a better overview of the risk related to climate change the Bank has made use of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The section on sustainability risk in the Bank's 2021 Pillar 3 Risk Disclosures is partly based on these guidelines and it also contains an analysis of the Bank's loan portfolio from the point of view of climate risk. The Bank formally became a signatory to TCFD in February 2022.

At home the Bank is a member of Festa – Center for Sustainability and is one of the founding members of IcelandSIF, the Iceland Sustainable Investment Forum. The Bank is also one the founding members of Green by Iceland, a joint business and government forum on climate issues and green solutions. The Bank has also been a signatory to the City of Reykjavík and Festa's Declaration on Climate Change since 2015, and signed a declaration of intent on investment for a sustainable recovery devised by the Prime Minister's Office, Festa – Center for Sustainability, the Icelandic Financial Services Association (SFF) and the National Association of Pension Funds (LL) in 2020.

The Human Resources Policy at Arion Bank is designed to create a positive and motivational work environment and to support our employees in their work and private lives. There is a strong emphasis on attracting and retaining outstanding employees and helping them develop professionally and personally. The Bank has adopted a clear equality and human rights policy, which was reviewed in 2021, and a 3-year action plan. The objective of the policy and action plan is to create an environment where people of similar education, work experience and responsibility have equal opportunities and terms, irrespective of gender, gender identity, sexual orientation, origin, nationality, skin colour, age, disability or religion or other factor. The Bank's new action plan place greater emphasis on balancing gender ratios at the Bank, not just at management level but throughout different job families, committees and business units. Since 2015 the Bank has had an equal pay system and equal pay certification.

In 2018 became the first Icelandic bank to get the Ministry of Welfare's equal pay symbol, and a pay equity analysis indicated that the unexplained gender pay gap was 2.4%. In 2021 the Bank underwent an audit which indicated that the difference for total compensation was 0.1%, and the Bank's target is to be below 1%. The Bank's target is for median total compensation for men compared with the median total compensation for women to be reduced to below 1.3 over the next three years. This figure was 1.43 in 2021. The main opportunity to balance the median total compensation is to improve gender equality in different job families.

Arion Bank has adopted an environment and climate policy and targets connected to the policy. The policy spells out the importance of the Bank minimizing the negative environmental impact of its activities and greenhouse gas emissions. The policy also states that the Bank will turn its focus onto financing projects which relate to sustainable development and green infrastructure. The Bank issued its first comprehensive green financing framework during the year and held two green bond issues based on the framework. Green deposits continued to grow in 2021, and there was an increase in loans to buy vehicles which run on 100% renewables.

The Bank’s credit policy places special emphasis on sustainability and increasing the percentage of green loans and quantifiable targets have been set. The Bank’s credit rules also stipulate that environmental, social and governance factors must be considered when assessing loans. At the end of 2021, 11% of the Bank’s total loans came under the definition of the green financing framework, and the Bank aims to increase this figure to at least 20% by 2030. This target on the ratio of green loans will be reviewed annually, taking into consideration the opportunities over the next few years for green financing and introducing the EU taxonomy in Iceland. The Bank hopes that it might grow even more quickly.

Arion Bank will issue its first impact and allocation report for the Bank’s green financing framework for 2021 at the same time as the 2021 annual and sustainability report. The report specifies the allocation of funds which have been raised through green bond issues and green deposits in 2021, and there is also a section on the positive environment and climate impact of green loans from Arion Bank. Deloitte is providing confirmation with limited assurance of the allocation of funds to green projects which have been raised through green bond issues and green deposits. The Bank’s targets in environment and climate issues include reducing carbon emissions and other greenhouse gases from own activities by 55% by 2030, i.e. emissions from the Bank’s business premises and vehicles. At the end of 2021 the Bank had reduced these emissions by 37.6% compared with the reference year 2015. The Bank has entered into an agreement with the Iceland Carbon Fund on carbon fixation to offset emissions from the Bank’s activities and other emissions such as flights, taxi journeys, waste and employee journeys to and from work.

In 2021 a sustainability committee was set up and sustainability risk was defined as part of the Bank’s risk management system. The new committee replaced the Bank’s steering committee on social responsibility. The CEO is the chairman of the sustainability committee, whose role is to monitor the Bank’s performance in connection with the policy and commitments on sustainability and to ensure that ESG factors are considered in decisions and plans made by the Bank. A green financing committee and equality committee are sub-committees of this committee. In addition to the CEO, the sustainability committee comprises the managing director of Retail Banking, Corporate & Investment Banking, Markets, Customer Experience and Finance. The Chief Risk Officer and Sustainability Officer attend committee meetings but do not have the right to vote. The Bank’s new sustainability risk policy was approved by the board of directors during the year and will be reviewed annually. This policy states that the Bank seeks to ensure that its operations and services do not have a negative impact on people or the environment. It also states that the Bank supports Iceland’s climate action plan whose goal is to meet the obligations of the Paris Climate Agreement and to achieve the ambitious goal of carbon neutrality by 2040.

At the beginning of 2022 a special risk assessment was performed in connection with ESG factors at the Bank. The main social risks relate to employee equality and diversity, disclosure and relations with stakeholders. The main environmental risks were insufficient action in environmental and climate issues in connection with goods and services, employees’ compliance with the Bank’s environment and climate policy and the risk of greenwashing. The assessment also revealed that the main governance risks were anti-money laundering measures and know-your-customer, data protection and ESG reporting. The management of these risks at the Bank were rated as adequate or strong.

The Bank has introduced a policy on actions against financial crime, such as money laundering, terrorist financing, bribery and corruption or market abuse. On the basis of this policy the Bank places great importance on knowing all customers and understanding their business so that the Bank is able to identify any suspicious transactions. Suspicious transactions are immediately reported to the authorities. Employees are given regular training on measures against financial crime and how to respond if they have any suspicions. The Bank also re-evaluates its measures regularly to respond to the main threats at any given time. Further information on actions against financial crime are contained in the Bank’s 2021 Pillar 3 Risk Disclosures.

In recent years Arion Bank has been recognized as a company which has achieved excellence in corporate governance, following a formal assessment based on guidelines on corporate governance issued by the Icelandic Chamber of Commerce, the Confederation of Icelandic Employers, and Nasdaq Iceland. Further information on corporate governance can be found in the corporate governance statement.

Arion Bank’s activities are governed by the provisions of the Annual Accounts Act on non-financial reporting, Article 66 d. Information in the annual and sustainability report has been prepared and published in accordance with the Global Reporting Initiative standard, GRI Core, which helps companies and institutions share information on sustainability in a transparent and comparable way. When sharing information on non-financial factors of the business the ESG reporting guide for the Nasdaq Nordic exchange, the 10 Principles of the UN Global Compact, and UN Sustainable Development Goals are referred to. For the second time the progress made in implementing the UN Principles for Responsible Banking is reported on. Deloitte is providing an opinion with limited assurance on non-financial reporting by Arion Bank in 2021 which is presented in accordance with the Global Reporting Initiative (GRI Core) and the Nasdaq ESG Reporting Guide.

Further information on sustainability and non-financial information can be found in the Annual and Sustainability Report which will be available on the Bank’s website on 16 February 2022: arsskyrsla2021.arionbanki.is/english

Endorsement and statement
by the Board of Directors and the CEO

Endorsement of the Board of Directors and the Chief Executive Officer

The Consolidated Financial Statements of Arion Bank for the year ended 31 December 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 Consolidated Financial Statements give a true and fair view of the financial performance and cash flow of the Group for the year ended 31 December 2021 and its financial position as at 31 December 2021. Furthermore, in our opinion the Consolidated 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.

In our opinion, the Consolidated Financial Statements of Arion Bank hf. for the year 2021 with the file name RIL4VBPDB0M7Z3KXSF19-2021-12-31-en.zip is prepared, in all material respects, in compliance with the ESEF Regulation.

The Board of Directors and the CEO have today discussed the Consolidated Financial Statements of Arion Bank for the year ended 31 December 2021 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the Consolidated Financial Statements be approved at the Annual General Meeting of Arion Bank.

Reykjavík, 9 February 2022

Board of Directors

Brynjólfur Bjarnason, Chairman

Paul Richard Horner, Vice Chairman

Gunnar Sturluson

Liv Fiksdahl

Steinunn Kristín Thórdardóttir

Chief Executive Officer

Benedikt Gíslason

Independent Auditor's report

To the Board of Directors and shareholders of Arion Bank.

Opinion

We have audited the Consolidated Financial Statements of Arion Bank hf. for the year ended December 31 2021 which comprise the Consolidated Income Statement, Consolidated Statement of Comprehensive Income, Consolidated Statement of Financial Position, Consolidated Statement of Changes in Equity, Consolidated Statement of Cash Flows for the year then ended and the notes to the Consolidated Financial Statements, including a summary of significant accounting policies.

In our opinion, the accompanying Consolidated Financial Statements give a true and fair view of the consolidated financial position of Arion Bank hf. as at December 31, 2021, its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional requirements in the Icelandic Financial Statement Act.

Our opinion in this report on the consolidated financial statements is consistent with the content of the additional report that has been submitted to the parent company´s audit committee in accordance with the EU Audit Regulation 537/2014 Article 11.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of Arion Bank hf. in accordance with the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Iceland, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. This includes that, based on the best of our knowledge and belief, no prohibited services referred to in the EU Audit Regulation 537/2014 Article 5.1 has been provided to the audited company or, where applicable, its parent company or its controlled companies within the EU. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the Consolidated Financial Statements of the current period. These matters were addressed in the context of our audit of the Consolidated Financial Statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matters	***How the matter was addressed in the audit***
Impairment charges for loans and provisions for guarantees	
Loans for the Group amounted to ISK 943,837 million at 31 December 2021, and the total allowance account for the Group amounted to ISK 8,341 million (including off-balance positions) at 31 December 2021. The Group valuate it´s impairment on loans based of IFRS 9 resulting in impairment charges are recognised when losses are expected based on forecasting models. Management has provided further information about the accounting policies for expected credit losses in note 56 and about loan impairment charges and provisions for guarantees in notes 15 and 42. Measurement of loan impairment charges for loans and provisions for guarantees is deemed a key audit matter as the determination of assumptions for expected credit losses is subjective due to the level of judgement applied by Management. The most significant judgements are: • Assumptions used in the expected credit loss models to assess the credit risk related to the exposure and the expected future cash flows of the customer. • Timely identification of exposures with significant increase in credit risk and credit impaired exposures. • Valuation of collateral and assumptions used for manually assessed credit-impaired exposures.	Based on our risk assessment and industry knowledge, we have examined the impairment charges for loans and provisions for guarantees and evaluated the methodology applied as well as the assumptions made according to the description of the key audit matter. As part of our audit, we have examined the Group’s implementation of IFRS 9. As part of our review of the implementation we performed substantive procedures on the Group’s impairment models and reviewed the methodology implemented for expected credit loss calculations. We used risk modelling specialists as well as IFRS specialists as part of our audit. Our examination included the following elements: • Testing of key controls over key assumptions used in the expected credit loss models to assess the credit risk related to the exposure and the expected future cash flows of the customer. • Substantively testing evidence to support the assumptions used in the expected credit loss models applied in stage allocation, assumptions applied to derive lifetime possibility of default and methods applied to derive loss given default. • Testing of key controls and substantive testing of timely identification of exposures with significant increase in credit risk and timely identification of credit impaired exposures. • Testing of key controls over models and manual processes for valuation of collateral used in the expected credit loss calculations. • Substantively testing evidence to support appropriate determination of assumptions for loan impairment charges and provisions for guarantees including valuation of collateral and assumptions of future cash flows on manually assessed credit impaired exposures.

Independent Auditor's report

Key Audit Matters	*How the matter was addressed in the audit*
Revenue recognition	
Interest income is a key element to the core business of the Bank. This is the single largest item of the Consolidated Income Statement. Interest income is subject to contractual terms and highly reliant on IT controls and other controls within the Bank's control environment. Therefore, we consider the interest income as key audit matter. The basis for revenue recognition and accounting policies are presented in note 51 to the consolidated financial statements.	We reviewed the policies, processes and controls surrounding the revenue recognition. We have tested relevant controls related to accounting for interest income. We have tested the appropriateness of the interest calculation in accordance with IFRS. We tested interest income by select sample of loans and compare the underlying data to the loans system. In addition, we performed analytical procedures on interest income. The Banks applications controls for the IT systems were tested for interest calculation. Furthermore, we selected sample of loans to ensure that interest is being accrued correctly.

Other information

The Board of Directors and CEO are responsible for the other information. The other information comprises the unaudited appendix to the Financial Statements, 5-year overview, key figures, unaudited quarterly statements in note 6 and Endorsement and statements by the Board of Directors and the CEO.

Our opinion on the Consolidated Financial Statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon, except the confirmation regarding the Endorsement and the statement by the Board of Directors and the CEO as stated below.

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

In accordance with Paragraph 2 article 104 of the Icelandic Financial Statement Act no. 3/2006, we confirm to the best of our knowledge that the accompanying the Endorsement and statements by the Board of Directors and the CEO includes all information required by the Icelandic Financial Statement Act that is not disclosed elsewhere in the Consolidated Financial Statements.

Responsibilities of the Board of Directors and the CEO for the Consolidated Financial Statements

The Board of Directors and the CEO are responsible for the preparation and fair presentation of the Consolidated Financial Statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional requirements in the Icelandic Financial Statement Act, and for such internal control as the Board of Directors and the CEO determines is necessary to enable the preparation of Consolidated Financial Statements that are free from material misstatement, whether due to fraud or error.

In preparing the Consolidated Financial Statements, the Board of Directors and the CEO are responsible for assessing Arion Bank hf.'s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

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

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Indentify and assess the risks of material misstatement of the Consolidated Financial Statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Arion Bank hf.'s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

Independent Auditor's report

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the Consolidated Financial Statements, including the disclosures, and whether the Consolidated Financial Statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated and separate financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

In addition to our work as the auditors of Arion Bank hf., Deloitte has provided the Bank with permitted additional services such as review of interim financial statements and other assurance engagement,. Deloitte has in place internal procedures in order to ensure its independence before acceptance of additional services. Arion Bank hf. audit committee also has in place internal procedures to approve additional services before they commence. The audit committee also evaluates the independence of the company's auditors on yearly basis in order to ensure their independence and objectivity.

Report on other legal and regulatory requirements

Report on European single electronic format (ESEF Regulation)

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

Management is responsible for preparing the consolidated financial statements in compliance with laws no. 20/2021 disclosure obligation of issuers of securities and the obligation to flag. This responsibility includes preparing the consolidated financial statements in a XHTML format in accordance to EU regulation 2019/815 on the European single electronic format (ESEF regulation).

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

In our opinion, the Consolidated Financial Statements of Arion Bank hf. for the year 2021 with the file name RIL4VBPDB0M7Z3KXSF19-2021-12-31-en.zip is prepared, in all material respects, in compliance with the ESEF Regulation.

Deloitte was appointed auditor of Arion Bank hf. By the general meeting of shareholders on 16 March 2021. Deloitte have been elected as auditor of the Group since the general meeting 2015.

Kópavogur, 9 February 2022

Deloitte ehf.

Gunnar Thorvardarson
State Authorized Public Accountant

Consolidated Income Statement

	Notes	2021	2020
Interest income		53,958	51,730
Interest expense		(21,895)	(20,572)
Net interest income	7	**32,063**	**31,158**
Fee and commission income		16,706	13,225
Fee and commission expense		(2,033)	(1,583)
Net fee and commission income	8	**14,673**	**11,642**
Net insurance income	9	3,442	3,071
Net financial income	10	6,220	2,745
Share of profit of associates	26	22	-
Other operating income	11	1,805	2,148
Other net operating income		**11,489**	**7,964**
Operating income		**58,225**	**50,764**
Salaries and related expenses	12	(14,638)	(12,332)
Other operating expenses	13	(11,237)	(12,109)
Operating expenses		**(25,875)**	**(24,441)**
Bank levy	14	(1,516)	(1,301)
Net impairment	15	3,169	(5,044)
Earnings before income tax		**34,003**	**19,978**
Income tax expense	16	(6,782)	(3,231)
Net earnings from continuing operations		**27,221**	**16,747**
Discontinued operations held for sale, net of income tax	17	1,394	(4,278)
Net earnings		**28,615**	**12,469**

Attributable to

		2021	2020
Shareholders of Arion Bank hf.		28,605	12,476
Non-controlling interest		10	(7)
Net earnings		**28,615**	**12,469**

Earnings per share

	Notes	2021	2020
Earnings per share	18		
Basic earnings per share attributable to the shareholders of Arion Bank (ISK)		17.96	7.24
Diluted earnings per share attributable to the shareholders of Arion Bank (ISK)		16.93	7.24

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

Amounts are in ISK millions

Consolidated Statement of Comprehensive Income

	Notes	2021	2020
Net earnings		**28,615**	**12,469**
Net change in fair value of debt investments carried at fair value through OCI, net of tax		(2,131)	(164)
Realized net loss (gain) on debt investments carried at fair value through OCI, net of tax, transferred to the Income Statement	10	335	(112)
Changes to reserve for financial instruments at fair value through OCI		**(1,796)**	**(276)**
Exchange difference on translating foreign subsidiaries		21	212
Other comprehensive loss that is or may be reclassified subsequently to the Income Statement		**(1,775)**	**(64)**
Total comprehensive income		**26,840**	**12,405**

Attributable to

		2021	2020
Shareholders of Arion Bank		26,830	12,412
Non-controlling interest		10	(7)
Total comprehensive income		**26,840**	**12,405**

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

Amounts are in ISK millions

Consolidated Statement of Financial Position

Assets	Notes	2021	2020
Cash and balances with Central Bank	19	69,057	42,136
Loans to credit institutions	20	30,272	28,235
Loans to customers	21	936,237	822,941
Financial instruments	22-24	225,657	227,251
Investment property	24	6,560	6,132
Investments in associates	26	668	891
Intangible assets	27	9,463	9,689
Tax assets	28	2	2
Assets and disposal groups held for sale	29	16,047	16,811
Other assets	30	19,901	18,618
Total Assets		**1,313,864**	**1,172,706**

Liabilities	Notes	2021	2020
Due to credit institutions and Central Bank	23	5,000	13,031
Deposits	23	655,476	568,424
Financial liabilities at fair value	23	5,877	5,240
Tax liabilities	28	7,102	4,262
Liabilities associated with disposal groups held for sale	29	16,935	16,183
Other liabilities	31	37,151	32,714
Borrowings	23.32	356,637	298,947
Subordinated liabilities	23.33	35,088	36,060
Total Liabilities		**1,119,266**	**974,861**

Equity	35		
Share capital and share premium		22,684	51,331
Other reserves		12,838	11,320
Retained earnings		158,403	135,021
Total Shareholders' Equity		**193,925**	**197,672**
Non-controlling interest		673	173
Total Equity		**194,598**	**197,845**
Total Liabilities and Equity		**1,313,864**	**1,172,706**

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

Amounts are in ISK millions

Consolidated 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	Debt invest-ments 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											28,605	**28,605**	10	**28,615**
Net change in fair value								(2,131)				**(2,131)**		**(2,131)**
Realized net loss transferred to P/L ...								335				**335**		**335**
Translation difference										21		**21**		**21**
Total comprehensive income	-	-	-	-	-	-	-	(1,796)	-	21	28,605	**26,830**	10	**26,840**
Transactions with owners														
Dividend paid											(2,857)	**(2,857)**		**(2,857)**
Purchase of treasury stock	(200)	(28,447)										**(28,647)**		**(28,647)**
Share option charge for the year			99									**99**		**99**
Warrants sold				828								**828**		**828**
Increase in non-controlling interest ..												**-**	490	**490**
Changes in reserves					(176)	2,472	70				(2,365)	**1**		**1**
Equity 31 December 2021	1,518	21,166	99	828	7,245	3,166	1,124	(1,937)	1,637	676	158,403	**193,925**	673	**194,598**

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

Amounts are in ISK millions

Consolidated 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	Debt invest- ments 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											12,476	**12,476**	(7)	**12,469**
Net change in fair value								(164)				**(164)**		**(164)**
Realized net gain transferred to P/L ..								(112)				**(112)**		**(112)**
Translation difference										212		**212**		**212**
Total comprehensive income	-	-	-	-	-	-	-	(276)	-	212	12,476	**12,412**	(7)	**12,405**
Transactions with owners														
Purchase of treasury stock	(54)	(4,325)										**(4,379)**		**(4,379)**
Changes in treasury stock	-	(4)										**(4)**		**(4)**
Changes in reserves					1,294	2	595				(1,891)	**-**		**-**
Equity 31 December 2020	1,718	49,613	-	-	7,421	694	1,054	(141)	1,637	655	135,021	**197,672**	173	**197,845**

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

Amounts are in ISK millions

Consolidated Statement of Cash flows

Operating activities	2021	2020
Net earnings	28,615	12,469
Non-cash items included in net earnings	(32,006)	(11,888)
Changes in operating assets and liabilities		
Loans to credit institutions, excluding bank accounts	3,163	(3,843)
Loans to customers	(105,988)	(29,810)
Financial instruments and financial liabilities at fair value	4,783	(108,835)
Deposits	90,642	69,631
Borrowings	54,566	(26,036)
Other changes in operating assets and liabilities	(1,440)	20,000
Interest received	41,866	47,268
Interest paid	(15,883)	(20,271)
Dividend received	95	68
Income tax paid	(3,942)	(3,361)
Net cash from (to) operating activities	**64,471**	**(54,608)**
Investing activities		
Acquisition of associates	(111)	(39)
Proceeds from sale of associates	356	96
Acquisition of intangible assets	(1,005)	(2,164)
Proceeds from sale of property and equipment	1,045	1,442
Acquisition of property and equipment	(581)	(1,115)
Net cash to investing activities	**(296)**	**(1,780)**
Financing activities		
Issued subordinated liabilities	-	12,805
Proceeds from issued warrants	828	-
Purchase of treasury stock	(28,647)	(4,381)
Dividend paid to shareholders of Arion Bank	(2,857)	-
Net cash (to) from in financing activities	**(30,676)**	**8,424**
Net increase (decrease) in cash and cash equivalents	33,499	(47,964)
Cash and cash equivalents at beginning of the year	58,284	102,186
Effect of exchange rate changes on cash and cash equivalents	(1,105)	4,062
Cash and cash equivalents	**90,678**	**58,284**
Cash and cash equivalents		
Cash and balances with Central Bank	69,057	42,136
Bank accounts	28,156	22,354
Mandatory reserve deposit with Central Bank	(6,535)	(6,206)
Cash and cash equivalents	**90,678**	**58,284**

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

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

Amounts are in ISK millions

Notes to the Consolidated Financial Statements
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Notes to the Consolidated 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 Consolidated Financial Statements for the year ended 31 December 2021 comprise the Parent Company and its subsidiaries (together referred to as "the Group").

1. Basis of preparation

The Consolidated Financial Statements were approved and authorized for publication by the Board of Directors of Arion Bank on 9 February 2022.

In preparing the Consolidated Financial Statements, the Group 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 Consolidated Financial Statements.

Statement of compliance

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

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

Basis of measurement

The Consolidated 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;
- 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 Consolidated 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 year the exchange rate of the ISK against USD was 129.75 and 147.60 for EUR (31.12.2020: USD 127.64 and EUR 156.09).

2. Changes in accounting policies

The Bank has not early adopted any standards, interpretations or amendments that have been issued but are not effective.

3. Significant accounting estimates and judgments in applying accounting policies

The preparation of the Consolidated 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 Consolidated Financial Statement were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising that are beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

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

Impairment of financial assets

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

Macroeconomic outlook

The Covid-19 public health crisis has reached a new phase with the emergence of the omicron variant. Case numbers in Iceland have reached unprecedented levels and restrictions have been toughened to promote social distancing. However, there are several encouraging signs that the era of stringent public health measures which impact public life and the economy may soon be behind us. The uptake of the vaccination booster program in Iceland has been exceptionally good. While this may have a limited impact on case numbers, it significantly reduces the number of severe cases requiring hospital treatment. The Icelandic healthcare system has also mounted an effective response for treating patients with Covid-19 and new anti-viral medications are being introduced to the market. As regards the economy, the government has launched economic measures to counteract the effects of the public health measures.

The year 2021 was a year of recovery. For the reasons outlined above and despite the setback caused by the omicron variant, it can be expected that the recovery will continue strongly in 2022. The unemployment rate is the key macro factor that drives the forward-looking expectation of defaults. All scenarios forecast that the current unemployment rate will decrease but the speed of the recovery varies between them.

Assets and disposal groups held for sale

Legal entities acquired exclusively with a view to resale, and discontinued operations held for sale are measured at the lower of carrying amount and fair value, less cost to sell. For the most part, fair value at the date of classification of these legal entities and discontinued operations was calculated using valuation models based on discontinued future cash flows that incorporated significant non-market observable inputs and assumptions. The use of reasonably possible alternative inputs and assumptions to these models, in particular changes to the discount rate employed (representing the required rate of return on equity), could have an impact on the value of these disposal groups. For further information on assets and disposal groups held for sale, see Note 29.

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

Impairment of intangible assets

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

Revaluation of investment properties

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

4. The Group

Shares in the main subsidiaries in which Arion Bank holds a direct interest			Equity interest	
	Operating activity	Currency	2021	2020
Eignabjarg ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Leiguskjól ehf., Bjargargata 1, Reykjavík, Iceland	Rental guarantee	ISK	51.0%	51.0%
SRL slhf., Borgartún 19, Reykjavík, Iceland	Real estate	ISK	100.0%	100.0%
Stefnir hf., Borgartún 19, Reykjavík, Iceland	Asset management	ISK	100.0%	100.0%
Valitor hf., Dalshraun 3, Hafnarfjördur, Iceland	Payment solutions	ISK	100.0%	100.0%
VISA Ísland ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Vördur tryggingar hf., Borgartún 19, Reykjavík, Iceland	Insurance	ISK	100.0%	100.0%

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, see Note 29 for further information.

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

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

Operating segment reporting

Segment information is presented in respect of the Group's operating segments and is based on the Group's management and internal reporting structure. The business units are segmented according to customers, products and services characteristics. Segment performance is evaluated based on earnings before tax.

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

5. Operating segments

Markets & Stefnir

Markets & Stefnir comprise Asset Management and Capital Markets. Asset Management manages financial assets on behalf of its customers according to a pre-determined investment strategy. Asset Management also administers pension funds. Asset management comprises Institutional Asset Management, Private Banking and Pension Fund Administration. The operation of Stefnir hf. is presented under the segment. Stefnir hf. is an independently operating financial company owned by Arion Bank and manages a broad range of mutual funds, investment funds and institutional investor funds. Arion Bank also offers comprehensive selection off funds from some of the leading international fund management companies. Capital Markets is a securities brokerage and brokers listed securities transactions for the Bank’s international and domestic clients on all the world’s major securities exchanges.

Corporate & Investment Banking

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

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

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

Retail Banking

Retail Banking provides a diverse range of financial services in 15 branches and service points across Iceland and offers digital solutions both in the Arion app and online banking. These services include deposits and loans, savings, payment cards, pensions, insurance, securities and funds. In order to improve efficiency the branch network is split into four regions, and smaller branches can therefore benefit from the strength of larger units within each region. Retail Banking has more than 100,000 customers.

Treasury

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

Vördur

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

Other subsidiaries

Subsidiaries include the subsidiaries SRL slhf., which holds the main part of investment property of the Group and the holding companies VISA Ísland ehf. and other smaller entities of the Group. The subsidiaries 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), IT and Customer Experience. The information presented relating to the supporting units does not represent an operating segment. A significant proportion of expenses from support functions is allocated to operating segments in a separate line in the operating segment overview.

Notes to the Consolidated Financial Statements

5. Operating segments, continued

2021	Markets and Stefnir	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other sub- sidiaries	Supporting units and elimi- nations	Total
Income Statement								
Net interest income	965	12,854	15,658	2,653	84	(120)	(31)	32,063
Net fee and commission income	5,642	5,027	4,061	614	(179)	(791)	299	14,673
Net insurance income	-	-	-	-	3,504	-	(62)	3,442
Net financial income	326	1,246	-	2,948	2,125	(436)	11	6,220
Share of (loss) profit of associates	-	(8)	-	-	-	-	30	22
Other operating income	4	14	507	43	33	397	807	1,805
Operating income	6,937	19,133	20,226	6,258	5,567	(950)	1,054	58,225
Operating expenses	(1,966)	(1,792)	(5,147)	(605)	(2,591)	(222)	(13,552)	(25,875)
Allocated expenses	(1,982)	(2,743)	(6,873)	(1,036)	(15)	(5)	12,654	-
Bank levy	(68)	(436)	(709)	(303)	-	-	-	(1,516)
Net impairment	-	2,267	1,874	2	-	(443)	(531)	3,169
Earnings (loss) before income tax	2,921	16,429	9,371	4,316	2,961	(1,620)	(375)	34,003
Net seg. rev. from ext. customers	4,570	23,190	33,227	(9,029)	5,435	118	714	58,225
Net seg. rev. from other segments	2,367	(4,057)	(13,001)	15,287	132	(1,068)	340	-
Operating income	6,937	19,133	20,226	6,258	5,567	(950)	1,054	58,225
Balance Sheet								
Loans to customers	15	364,925	572,117	-	-	4	(824)	936,237
Financial instruments	47,474	171	-	151,445	26,099	2,796	(2,328)	225,657
Other external assets	5,500	7,056	2,732	74,141	8,180	35,992	18,369	151,970
Internal assets	27,845	-	-	273,762	-	-	(301,607)	-
Total assets	80,834	372,152	574,849	499,348	34,279	38,792	(286,390)	1,313,864
Deposits	68,124	235,378	303,719	61,112	-	-	(12,857)	655,476
Other external liabilities	4,997	5,733	1,366	390,526	21,205	11,889	28,074	463,790
Internal liabilities	-	69,756	222,567	-	993	8,291	(301,607)	-
Total liabilities	73,121	310,867	527,652	451,638	22,198	20,180	(286,390)	1,119,266
Allocated equity	7,713	61,285	47,197	47,710	12,081	18,612	-	194,598

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 Consolidated Financial Statements

5. Operating segments, continued

2020 *Income Statement*	Markets and Stefnir	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other sub-sidiaries	Supporting units and elimi-nations	Total
Net interest income	976	10,518	15,414	4,631	172	(389)	(164)	31,158
Net fee and commission income	3,962	3,110	4,575	550	(171)	(647)	263	11,642
Net insurance income	-	-	-	-	3,145	-	(74)	3,071
Net financial income	142	(144)	-	964	1,735	38	10	2,745
Share of profit (loss) of associates	1	(48)	-	-	-	(1)	48	-
Other operating income	13	102	237	-	(12)	1,599	209	2,148
Operating income	5,094	13,538	20,226	6,145	4,869	600	292	50,764
Operating expenses	(1,828)	(1,301)	(5,423)	(608)	(2,449)	(179)	(12,653)	(24,441)
Allocated expenses	(1,780)	(2,634)	(5,880)	(1,127)	(21)	(6)	11,448	-
Bank levy	(35)	(387)	(579)	(300)	-	-	-	(1,301)
Net impairment	-	(6,043)	(1,114)	(4)	-	4,546	(2,429)	(5,044)
Earnings (loss) before income tax	1,451	3,173	7,230	4,106	2,399	4,961	(3,342)	19,978
Net seg. rev. from ext. customers	3,261	19,642	32,209	(10,850)	2,135	4,218	149	50,764
Net seg. rev. from other segments	1,833	(6,104)	(11,983)	16,995	2,734	(3,618)	143	-
Operating income	5,094	13,538	20,226	6,145	4,869	600	292	50,764
Balance Sheet								
Loans to customers	41	308,657	515,115	66	-	4	(942)	822,941
Financial instruments	43,809	434	-	159,825	22,450	2,869	(2,136)	227,251
Other external assets	3,298	6,640	3,197	69,380	5,889	38,290	(4,180)	122,514
Internal assets	32,045	-	-	238,218	1,894	1,322	(273,479)	-
Total assets	79,193	315,731	518,312	467,489	30,233	42,485	(280,737)	1,172,706
Deposits	64,657	103,648	346,224	64,565	-	-	(10,670)	568,424
Other external liabilities	6,698	2,790	4,778	349,329	19,694	19,736	3,412	406,437
Internal liabilities	-	149,973	123,506	-	-	-	(273,479)	-
Total liabilities	71,355	256,411	474,508	413,894	19,694	19,736	(280,737)	974,861
Allocated equity	7,838	59,320	43,804	53,595	10,539	22,749	-	197,845

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 Consolidated Financial Statements

Quarterly statements

6. Operations by quarters, unaudited

2021	Q1	Q2	Q3	Q4	Total
Net interest income	7,342	8,016	7,937	8,768	32,063
Net fee and commission income	3,277	3,562	3,755	4,079	14,673
Net insurance income	671	914	992	865	3,442
Net financial income	1,500	2,203	1,366	1,151	6,220
Share of profit (loss) of associates	1	25	7	(11)	22
Other operating income	306	284	833	382	1,805
Operating income	13,097	15,004	14,890	15,234	58,225
Salaries and related expense	(3,271)	(3,575)	(2,899)	(4,893)	(14,638)
Other operating expense	(2,777)	(2,797)	(2,689)	(2,974)	(11,237)
Operating expenses	(6,048)	(6,372)	(5,588)	(7,867)	(25,875)
Bank levy	(330)	(355)	(486)	(345)	(1,516)
Net impairment	1,080	812	718	559	3,169
Earnings before income tax	7,799	9,089	9,534	7,581	34,003
Income tax expense	(1,866)	(1,408)	(1,920)	(1,588)	(6,782)
Net earnings from continuing operations	5,933	7,681	7,614	5,993	27,221
Discontinued operations, net of tax	106	135	624	529	1,394
Net earnings	6,039	7,816	8,238	6,522	28,615

2020					
Net interest income	7,253	7,857	7,989	8,059	31,158
Net fee and commission income	3,076	2,688	2,762	3,116	11,642
Net insurance income	501	761	1,043	766	3,071
Net financial income	(2,000)	2,691	692	1,362	2,745
Share of profit (loss) of associates	(24)	(5)	51	(22)	-
Other operating income	170	71	475	1,432	2,148
Operating income	8,976	14,063	13,012	14,713	50,764
Salaries and related expense	(3,130)	(3,577)	(2,504)	(3,121)	(12,332)
Other operating expense	(3,077)	(2,818)	(2,728)	(3,486)	(12,109)
Operating expenses	(6,207)	(6,395)	(5,232)	(6,607)	(24,441)
Bank levy	(331)	(324)	(383)	(263)	(1,301)
Net impairment	(2,860)	(918)	(1,340)	74	(5,044)
Earnings before income tax	(422)	6,426	6,057	7,917	19,978
Income tax expense	(860)	(1,468)	(1,096)	193	(3,231)
Net earnings from continuing operations	(1,282)	4,958	4,961	8,110	16,747
Discontinued operations, net of tax	(889)	(45)	(995)	(2,349)	(4,278)
Net earnings (loss)	(2,171)	4,913	3,966	5,761	12,469

The half-year results were reviewed by the Bank's auditors. Other quarterly statements and the split between quarters were not audited or reviewed by the Bank's auditors.

Arion Bank Consolidated Financial Statements 2021 26 Amounts are in ISK millions

Notes to the Consolidated Income Statement

7. Net interest income

2021	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	573	-	-	573
Loans to credit institutions	73	49	-	122
Loans to customers	49,044	-	-	49,044
Securities	-	1,387	2,642	4,029
Other	190	-	-	190
Interest income	49,880	1,436	2,642	53,958
Interest expense				
Deposits	(6,820)	-	-	(6,820)
Borrowings	(13,065)	-	-	(13,065)
Subordinated liabilities	(1,891)	-	-	(1,891)
Other	(119)	-	-	(119)
Interest expense	(21,895)	-	-	(21,895)
Net interest income	27,985	1,436	2,642	32,063

2020	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	1,435	-	-	1,435
Loans to credit institutions	188	-	-	188
Loans to customers	46,804	-	-	46,804
Securities	-	1,249	1,889	3,138
Other	165	-	-	165
Interest income	48,592	1,249	1,889	51,730
Interest expense				
Deposits	(6,644)	-	-	(6,644)
Borrowings	(12,030)	-	-	(12,030)
Subordinated liabilities	(1,780)	-	-	(1,780)
Other	(118)	-	-	(118)
Interest expense	(20,572)	-	-	(20,572)
Net interest income	28,020	1,249	1,889	31,158

Net interest income calculated using the effective interest rate method were ISK 49,739 million during the year (2020: ISK 48,427 million).

Interest spread	2021	2020
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	2.8%	2.9%

Amounts are in ISK millions

8. Net fee and commission income

	2021			2020		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	5,430	(552)	4,878	4,095	(426)	3,669
Capital markets and corporate finance	2,565	(40)	2,525	1,437	(27)	1,410
Lending and financial guarantees	4,686	-	4,686	4,084	-	4,084
Collection and payment services	1,461	(113)	1,348	1,308	(109)	1,199
Cards and payment solution	1,777	(520)	1,257	1,666	(304)	1,362
Other	787	(808)	(21)	635	(717)	(82)
Net fee and commission income	16,706	(2,033)	14,673	13,225	(1,583)	11,642

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

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

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

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

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

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

9. Net insurance income

	2021	2020
Earned premiums, net of reinsurers' share		
Premiums written	14,032	12,456
Premiums written, reinsurers' shares	(486)	(478)
Change in provision for unearned premiums	(644)	(497)
Earned premiums, net of reinsurers' share	12,902	11,481
Claims incurred, net of reinsurers' share		
Claims paid	(8,186)	(7,595)
Claims paid, reinsurers' share	157	208
Change in provision for claims	(1,374)	(951)
Changes in provision for claims, reinsurers' share	(57)	(72)
Claims incurred, net of reinsurers' share	(9,460)	(8,410)
Net insurance income	3,442	3,071
Combined ratio		
Combined ratio	93.2%	94.4%

Amounts are in ISK millions

10. Net financial income

	2021	2020
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	6,589	4,033
Loss on prepayments of borrowings	-	(700)
Net loss on fair value hedge of interest rate swap	(216)	(178)
Realized (loss) gain on financial assets carried at fair value through OCI	(453)	151
Net foreign exchange gain (loss)	300	(561)
Net financial income	6,220	2,745

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

Equity instruments	5,126	2,613
Debt instruments	1,246	885
Derivatives	217	535
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	6,589	4,033

Net loss on fair value hedge of interest rate swap

Fair value change of interest rate swaps designated as hedging instruments	(2,262)	221
Fair value change on bonds issued by the Group attributable to interest rate risk	2,046	(399)
Net loss on fair value hedge of interest rate swap	(216)	(178)

11. Other operating income

Fair value changes on investment property	545	580
Realised gain on investment property	28	327
Net gain on disposal of assets	542	722
Net gain on assets held for sale	227	312
Other income	463	207
Other operating income	1,805	2,148

Net gain on assets held for sale

Income from real estates and other assets	259	413
Expense related to real estates and other assets	(32)	(101)
Net gain on assets held for sale	227	312

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

12. Personnel and salaries

	2021	2020
Number of employees		
Average number of full-time equivalent positions during the year	758	789
Full-time equivalent positions at the end of the year	751	776
Number of employees at the parent company		
Average number of full-time equivalent positions during the year	627	661
Full-time equivalent positions at the end of the year	619	648
Salaries and related expenses		
Salaries	10,216	10,064
Incentive scheme	1,215	54
Share-based payment expenses	99	-
Defined contribution pension plans	1,692	1,498
Salary-related expenses	1,577	1,310
Capitalization of salaries due to implementation of core systems	(161)	(594)
Salaries and related expenses	14,638	12,332

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

12. Personnel and salaries, continued

Salaries and related expenses for the parent company

	2021	2020
Salaries	8,528	8,327
Incentive scheme	1,000	-
Share-based payment expenses	99	-
Defined contribution pension plans	1,410	1,233
Salary-related expenses	1,343	1,066
Capitalization of salaries due to implementation of core systems	(161)	(594)
Salaries and related expenses for the parent company	12,219	10,032

Remuneration to the Board of Directors

	2021				2020			
	Fixed remuner-ation*	Additional remuner-ation**	Pension contribution	Total	Fixed remuner-ation*	Additional remuner-ation**	Pension contribution	Total
Brynjólfur Bjarnason, Chairman	11.8	6.8	1.7	20.3	11.7	6.1	2.1	19.9
Paul Richard Horner, Vice Chairman	10.9	7.0	-	17.9	11.7	4.5	-	16.2
Gunnar Sturluson, Director	5.9	7.0	1.0	13.9	5.9	4.3	1.3	11.5
Liv Fiksdahl, Director	8.1	7.7	-	15.8	11.7	2.6	-	14.3
Steinunn Kristín Thórdardóttir, Director	8.1	7.0	1.3	16.3	11.7	4.9	1.4	18.0
Renier Lemmens, Director until 16.3.2021	2.5	1.5	0.3	4.3	11.7	5.0	0.3	17.0
Herdís Fjeldsted, Director until 26.3.2020	-	-	-	-	2.2	1.3	1.3	4.8
Alternate directors of the Board	0.7	1.4	0.1	2.3	2.7	3.3	0.8	6.8
Total remuneration	48.0	38.5	4.4	90.9	69.3	32.1	7.2	108.6

* Fixed remuneration represents Board Member compensation for their attendance at meetings of the Board of Directors.

** Additional remuneration represents Board Member compensation for their participation in Board Committees.

Remuneration to key management personnel

	2021				2020			
	Salaries	Performance-based payments	Pension contribution	Total	Salaries	Performance-based payments	Pension contribution	Total
Benedikt Gíslason, CEO	61.0	-	8.8	69.8	57.1	-	8.4	65.5
Eight members of the Executive Committee (7 until 6.9.2021)	279.8	3.5	36.8	320.1	222.4	4.8	39.2	- 266.4
Former members of the Executive Comm.	32.0	2.0	4.6	38.7	20.6	-	5.3	25.9
Total remuneration	372.8	5.5	50.2	428.5	300.1	4.8	52.8	357.8

Performance based payments in 2021 are deferred payments based on the Group's performance in 2017 (2020: performance in 2016).

Board Members receive remuneration for their involvement in board committees. In addition to 14 Board meetings (2020: 12) during the year 11 Board Credit Committee meetings (2020: 13), 5 Board Audit Committee meetings (2020: 7), 8 Board Risk Committee meetings (2020: 12), 4 Board Remuneration Committee meetings (2020: 5) and 6 Board Tech committee meetings (2020: 1) were held.

The 2021 Annual General Meeting of the Bank held on 16 March 2021 approved the monthly salaries for 2021 for the Chairman, Vice Chairman and for other Board Members of amounts ISK 981,400, ISK 736,200 and ISK 490,900 (2020: ISK 981,400; 736,200; 490,900) respectively. It was also approved that the salary of Alternate Board Members would be ISK 248,600 (2020: ISK 248,600) per meeting, up to a maximum of ISK 490,900 (2020: ISK 490,900) per month. Board members residing outside of Iceland receive ISK 300,000 for each Board meeting they attend in person. In addition, it was approved to pay Board Members who serve on board committees of the Bank a maximum of ISK 196,300 (2020: ISK 196,300) per month for each committee they serve on and the Chairman of the board committees ISK 255,000 (2020: ISK 255,000).

Amounts are in ISK millions

12. Personnel and salaries, continued

Incentive schemes

In 2021 the Group made a provision of ISK 1,580 million (2020: ISK 70 million) for the incentive scheme, including salary-related expenses, for which the Bank made provision of ISK 1,300 million (2020: nil). Forty percent of the payment is deferred for three years if it exceeds 10% of the employee's annual salary without any incentive schemes payments, in accordance with FME rules on remuneration policy for financial undertakings. At the end of the year the Group's accrual for the incentive scheme payments amounted to ISK 1,638 million (31.12.2020: ISK 143 million), of which the Bank's accrual was ISK 1,300 million (31.12.2020: nil).

Revised incentive scheme for Arion Bank hf. and Vördur came into effect in 2021. The scheme is in compliance with the FSA's rules on remuneration policy for financial institutions. The scheme is split into two parts. Firstly, employees can receive up to 10% of their fixed salary for 2021 in the form of a cash payment. Secondly, a limited group can receive up to 25% of their fixed salary as a payment in the form of shares in the Bank which will be subject to a three-year lock-up period. The key metric used to determine whether incentive scheme payments will be paid by the Bank 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. Other supporting metrics are for example ROE and cost-to-income ratio vs target, compliance, staff NPS etc. Corresponding metrics are for incentive scheme payment at Vördur, i.e. higher ROE than the Icelandic competitors and other internal measures. Stefnir hf. has a special incentive scheme where other criteria are used as a basis.

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 99 million is recognised in the Consolidated Income Statement during the year (2020: nil). Estimated remaining expenses due the share option contracts are ISK 161 million and will be expensed over the next four years.

The Board of Directors approved an amendment to the Bank's share option program in January 2022, based on authorization of the 2021 AGM. The amendment pertains to the increase of employee annual maximum purchase price from ISK 600 thousand to ISK 1.5 million from 2023 to 2026 in line with changes to Article 10 of the Income Tax Act no. 90/2003. As the updated option agreements have not been finalized the final total cost of the addition is not available.

13. Other operating expenses

	2021	2020
IT expenses	4,686	5,241
Professional services	937	970
Housing expenses	718	1,142
Other administration expenses	2,414	2,595
Depositors' and Investors' Guarantee Fund	558	569
Depreciation of property and equipment	565	617
Depreciation of right of use asset	128	133
Amortization of intangible assets	1,231	842
Other operating expenses	11,237	12,109

Auditor's fee

	2021	2020
Audit and review of the Consolidated Financial Statements for the relevant fiscal year	151	135
Other audit related services for the relevant fiscal year	9	15
Other services from auditors	15	-
Auditor's fee	175	150

Amounts are in ISK millions

14. 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.

15. Net impairment

	2021	2020
Net impairment on financial instruments and value changes on loans		
Net impairment on loans to customers and financial institutions	2,538	(5,741)
Net impairment on other financial instruments at FVOCI	-	(6)
Other value changes of loans - corporates	71	67
Other value changes of loans - individuals	560	636
Net impairment	3,169	(5,044)
Net impairment by customer type		
Financial institutions	101	(85)
Individuals	917	(262)
Corporates	2,151	(4,697)
Net impairment	3,169	(5,044)

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

16. Income tax expense

	2021	2020
Current tax expense	6,607	3,632
Deferred tax expense (income)	175	(401)
Income tax expense	6,782	3,231

Reconciliation of effective tax rate	2021		2020	
Earnings before income tax		34,003		19,978
Income tax using the Icelandic corporate tax rate	20.0%	6,801	20.0%	3,996
Additional 6% tax on Financial Undertakings	4.1%	1,411	3.3%	669
Non-deductible expenses	0.1%	24	0.2%	43
Tax exempt revenues (loss)	(4.3%)	(1,455)	(7.4%)	(1,484)
Non-deductible taxes (Bank levy)	0.9%	303	1.3%	260
Tax incentives not recognized in the Income Statement	(1.0%)	(350)	(0.4%)	(78)
Other changes	0.1%	48	(0.9%)	(175)
Effective tax rate	19.9%	6,782	16.2%	3,231

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

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

Amounts are in ISK millions

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

	2021	2020
Net gain (loss) from discontinued operations held for sale	1,415	(4,275)
Income tax expense	(21)	(3)
Discontinued operations held for sale, net of income tax	1,394	(4,278)
Valitor hf.	903	(1,298)
Stakksberg ehf.	(211)	(1,425)
Sólbjarg ehf.	702	(1,555)
Discontinued operations held for sale, net of income tax	1,394	(4,278)

The net profit from Valitor's operation was ISK 320 million during the year whereas Valitor's positive contribution to the Group, after taking into account the Group's eliminations, was ISK 903 million. Operating income of Valitor was ISK 5,285 million, or ISK 6,023 million after taking into account the Group's eliminations.

Operating effects of Sólbjarg are mainly due to a binding offer of sale of assets held by the company.

For further information about Valitor hf., Stakksberg ehf. and Sólbjarg ehf., see Note 29.

18. 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	2020	2021	2020	2021	2020
Net earnings attributable to the shareholders of Arion Bank	27,211	16,754	1,394	(4,278)	28,605	12,476
Weighted average number of outstanding shares (millions)	1,593	1,723	1,593	1,723	1,593	1,723
Weighted average number of outstanding shares including warrants and options (millions)	1,690	1,723	1,690	1,723	1,690	1,723
Basic earnings per share (ISK)	17.08	9.72	0.88	(2.48)	17.96	7.24
Diluted earnings per share ISK)	16.10	9.72	0.82	(2.48)	16.93	7.24

Notes to the Consolidated Financial Statements

Notes to the Consolidated Statement of Financial Position

19. Cash and balances with Central Bank

	2021	2020
Cash on hand	3,556	3,342
Cash with Central Bank	58,966	32,588
Mandatory reserve deposit with Central Bank	6,535	6,206
Cash and balances with Central Bank	69,057	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%.

20. Loans to credit institutions

	2021	2020
Bank accounts	28,156	22,354
Other loans	2,116	5,982
Allowance for impairment	-	(101)
Loans to credit institutions	30,272	28,235

21. Loans to customers

	Individuals		Corporates		Total	
2021	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
Overdrafts	14,255	13,691	18,301	17,785	32,556	31,476
Credit cards	13,192	13,037	1,449	1,409	14,641	14,446
Mortgage loans	463,895	463,457	41,588	41,420	505,483	504,877
Construction loans	-	-	17,798	17,775	17,798	17,775
Capital lease	4,471	4,451	3,882	3,843	8,353	8,294
Other loans	32,573	31,862	332,433	327,507	365,006	359,369
Loans to customers	528,386	526,498	415,451	409,739	943,837	936,237
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
Construction loans	-	-	39,160	39,514	39,160	39,514
Capital lease	3,713	3,700	4,192	4,112	7,905	7,812
Other loans	28,409	27,525	307,103	298,984	335,512	326,509
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 267 billion at the end of the year (31.12.2020: ISK 219 billion). Pledged loans comprised mortgage loans to individuals.

Further analysis of loans is provided in Risk management disclosures.

22. Financial instruments

	2021	2020
Bonds and debt instruments	151,852	157,744
Shares and equity instruments with variable income	25,063	18,641
Derivatives	2,905	7,284
Securities used for economic hedging	45,837	43,582
Financial instruments	225,657	227,251

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

23. Financial assets and financial liabilities

2021	Amortized cost	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	69,057	-	-	69,057
Loans to credit institutions	28,156	-	2,116	30,272
Loans to customers	936,237	-	-	936,237
Loans	1,033,450	-	2,116	1,035,566
Bonds and debt instruments				
Listed	-	133,825	17,344	151,169
Unlisted	-	-	683	683
Bonds and debt instruments	-	133,825	18,027	151,852
Shares and equity instruments with variable income				
Listed	-	-	7,707	7,707
Unlisted	-	-	13,079	13,079
Bond funds with variable income, unlisted	-	-	4,277	4,277
Shares and equity instruments with variable income	-	-	25,063	25,063
Derivatives				
OTC derivatives	-	-	1,805	1,805
Derivatives used for hedge accounting	-	-	1,100	1,100
Derivatives	-	-	2,905	2,905
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	14,044	14,044
Shares and equity instruments with variable income, listed	-	-	31,793	31,793
Securities used for economic hedging	-	-	45,837	45,837
Other financial assets				
Accounts receivable	5,104	-	-	5,104
Other financial assets	7,617	-	-	7,617
Other financial assets	12,721	-	-	12,721
Financial assets	1,046,171	133,825	93,948	1,273,944
Financial liabilities				
Due to credit institutions and Central Bank	5,000	-	-	5,000
Deposits	655,476	-	-	655,476
Borrowings	356,637	-	-	356,637
Subordinated liabilities	35,088	-	-	35,088
Short position in bonds	-	-	-	-
Derivatives	-	-	4,974	4,974
Derivatives used for hedge accounting	-	-	903	903
Other financial liabilities	8,685	-	-	8,685
Financial liabilities	1,060,886	-	5,877	1,066,763

Amounts are in ISK millions

23. Financial assets and financial liabilities, continued

2020	Amortized cost	Fair value through OCI	Mandatorily 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

23. Financial assets and financial liabilities, continued

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

2021	Fair value through OCI	Mandatorily at fair value thr. P/L	Total
Financial and insurance activities	21,001	7,561	28,562
Public sector	112,824	8,325	121,149
Corporates	-	2,141	2,141
Bonds and debt instruments at fair value	133,825	18,027	151,852
2020			
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 8.6 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.

24. 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

2021

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

Amounts are in ISK millions

24. Fair value hierarchy, continued

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				
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

Transfers from Level 1 to Level 2 amounted to ISK 172 million during the year and from Level 2 to Level 1 ISK 122 million (2020: Transfers from Level 2 to Level 1 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 23 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

24. 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		
2021	property	Bonds	Shares	Total
Balance at the beginning of the year	6,132	358	1,685	8,175
Net fair value changes	545	12	664	1,221
Additions	15	301	1,655	1,971
Disposals	(132)	(574)	(196)	(902)
Balance at the end of the period	6,560	97	3,808	10,465
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 period	6,132	358	1,685	8,175

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

2021				
Net financial income	-	12	664	676
Other operating income	573	-	-	573
Effects recognized in the Income Statement	573	12	664	1,249
2020				
Net financial income	-	9	(59)	(50)
Other operating income	912	-	-	912
Effects recognized in the Income Statement	912	9	(59)	862

Amounts are in ISK millions

24. Fair value hierarchy, continued

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

2021	Carrying value	Fair value	Unrealized gain (loss)
Financial assets not carried at fair value			
Cash and balances with Central Bank	69,057	69,057	-
Loans to credit institutions	30,272	30,272	-
Loans to customers	936,237	937,179	942
Other financial assets	12,721	12,721	-
Financial assets not carried at fair value	1,048,287	1,049,229	942
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	5,000	5,000	-
Deposits	655,476	655,476	-
Borrowings	356,637	367,470	(10,833)
Subordinated liabilities	35,088	35,590	(502)
Other financial liabilities	8,685	8,685	-
Financial liabilities not carried at fair value	1,060,886	1,072,221	(11,335)
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	
2021	value	Assets	Liabilities
Forward exchange rate agreements	59,089	229	444
Fair value hedge of interest rate swap	190,095	1,100	903
Interest rate and exchange rate agreements	51,426	692	874
Bond swap agreements	10,947	359	20
Share swap agreements	31,029	348	3,530
Options - purchased agreements, unlisted	22	177	106
Derivatives	342,608	2,905	5,877
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

24. 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 32, 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.

2021	Notional	Maturity date	Fair value Assets	Fair value Liabilities	Gain (loss) on FV changes
Interest rates swaps - EUR	44,280	1-5 years	802	-	(463)
Interest rates swaps - EUR	-	-	-	-	(122)
Interest rates swaps - EUR	44,280	1-5 years	-	151	(301)
Interest rates swaps - USD	12,975	1-5 years	298	-	(526)
Interest rates swaps - EUR	44,280	1-5 years	-	350	(388)
Interest rates swaps - EUR	44,280	1-5 years	-	402	(462)
			1,100	903	(2,262)
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
			2,281	-	221

Hedged borrowings and subordinated liabilities

2021	Book value	Accumulated fair value Assets	Accumulated fair value Liabilities	Gain (loss) on FV changes
EUR 500 million - issued 2017/18 - 5 years	-	-	-	(106)
EUR 300 million - issued 2018 - 3 years	41,491	119	-	461
EUR 300 million - issued 2020 - 4 years	44,021	293	-	306
USD 100 million - issued 2020 - Perpetual	13,224	-	82	526
EUR 300 million - issued 2021 - 4 years	43,681	455	-	468
EUR 300 million - issued 2021 - 5 years	43,624	382	-	391
Hedged borrowings and subordinated liabilities	186,041	1,249	82	2,046
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 87-112%.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

25. 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				
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	8,560	(720)	7,840	720	-	8,560	-	7,840
Derivatives	1,689	-	1,689	(830)	-	859	1,216	2,905
Total assets	10,249	(720)	9,529	(110)	-	9,419	1,216	10,745
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				
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	-	(720)	(720)	720	-	-	-	(720)
Derivatives	2,000	-	2,000	(830)	-	1,170	3,877	5,877
Total liabilities	2,000	(720)	1,280	(110)	-	1,170	3,877	5,157
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.

26. Investments in associates

	2021	2020
Carrying amount at the beginning of the year	891	852
Acquisitions / increased share capital	111	39
Disposals	(356)	-
Share of profit of associates and profit from sale	22	-
Investment in associates	668	891

The Group's interest in its principal associates

Audkenni hf., Borgartún 31, Reykjavík, Iceland	25.4%	25.4%
Reiknistofa bankanna hf., Katrínartún 2, Reykjavík, Iceland	23.0%	20.0%
SER eignarhaldsfélag ehf., Borgartún 19, Reykjavík	35.3%	35.3%
JCC ehf., Sundaborg 15, Reykjavík, Iceland	-	33.3%
220 Fjördur ehf., Fjardargata 13-15, Hafnarfjördur, Iceland	-	37.4%

Arion Bank sold its entire shareholdings in the associates 220 Fjördur ehf. and JCC ehf. with minor effects on the Consolidated Income Statement.

Amounts are in ISK millions

27. 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

2021	Goodwill	Infra-structure	Customer relationship and related agreements	Software	Total
Balance at the beginning of the year	669	2,383	667	5,970	9,689
Additions	-	-	-	844	844
Additions, capitalized salaries	-	-	-	161	161
Amortization	-	-	(60)	(1,171)	(1,231)
Intangible assets	669	2,383	607	5,804	9,463
2020					
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.

Amounts are in ISK millions

27. Intangible assets, continued

Impairment testing

The methodology for impairment testing on the Infrastructure and Customer relationship, which is part of intangible assets, is based on discounted cash flow model which uses inputs that consider features of the business and the environment.

The model used, to determine the recoverable amount, is most sensitive to changes in the forecast earnings available to shareholders over a five-year period, the cost of equity and to changes in the growth rate. As a result of this analysis no impairment was recognized in 2020 (2019: nil).

	2021		2020	
Discount and growth rates	Discount rates	Growth rates	Discount rates	Growth rates
Asset Management operation	13.0%	2.5%	10.0%	2.5%
Insurance operation	13.0%	2.5%	11.0%	2.5%

28. Tax assets and tax liabilities

	2021		2020	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	6,543	-	3,799
Deferred tax	2	559	2	463
Tax assets and tax liabilities	2	7,102	2	4,262

Deferred tax assets and tax liabilities are attributable to the following:

	2021 Assets	2021 Liabilities	2020 Assets	2020 Liabilities
Foreign currency denominated assets and liabilities	2	-	26	-
Investment property and property and equipment	-	(728)	-	(542)
Financial assets	562	-	613	-
Other assets and liabilities	57	(259)	205	(325)
Deferred tax related to foreign exchange gain	-	(191)	-	(438)
Tax loss carry forward	-	-	-	-
	621	(1,178)	844	(1,305)
Set-off of deferred tax assets together with tax liabilities of the same taxable entities	(619)	619	(842)	842
Deferred tax assets and tax liabilities	2	(559)	2	(463)

Deferred tax assets are recognized for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgement is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits, together with future tax planning strategies.

The Group has ISK 235 million (31.12.2020: ISK 672 million) of tax losses carried forward. These losses relate to subsidiaries that have a history of losses, do not expire, and may not be used to offset taxable income elsewhere in the Group. The subsidiaries neither have any taxable temporary difference nor any tax planning opportunities available that could partly support the recognition of these losses as deferred tax assets. On this basis, the Group has determined that it cannot recognize deferred tax assets on the tax losses carried forward. If the Group was able to recognize all unrecognized deferred tax assets, profit and equity would have increased by ISK 47 million (2020: ISK 134 million).

Changes in deferred tax assets and tax liabilities

2021	At 1 Jan.	Recognized through equity	Recognized in profit or loss	At 31 Dec.
Foreign currency denominated assets and liabilities	26	-	(24)	2
Investment property and property and equipment	(542)	-	(186)	(728)
Financial assets	613	-	(51)	562
Other assets and liabilities	(120)	350	(432)	(202)
Deferred foreign exchange differences	(438)	-	247	(191)
Change in deferred tax assets and tax liabilities	(461)	350	(446)	(557)

2020	At 1 Jan.	Recognized through equity	Recognized in profit or loss	At 31 Dec.
Foreign currency denominated assets and liabilities	(270)	-	296	26
Investment property and property and equipment	(261)	-	(281)	(542)
Financial assets	248	-	365	613
Other assets and liabilities	(210)	78	12	(120)
Deferred foreign exchange differences	(449)	-	11	(438)
Tax loss carry forward	1	-	(1)	-
Change in deferred tax assets and tax liabilities	(941)	78	402	(461)

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

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

Assets and disposal groups held for sale	2021	2020
Valitor hf.	12,294	11,885
Stakksberg ehf.	1,548	1,580
Sólbjarg ehf.	1,671	2,323
Disposal groups held for sale	15,513	15,788
Real estate	500	1,019
Other assets	34	4
Assets and disposal groups held for sale	16,047	16,811

Liabilities associated with disposal groups held for sale		
Valitor hf.	15,564	14,533
Sólbjarg ehf.	1,371	1,650
Liabilities associated with disposal groups held for sale	16,935	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%. 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.

On 1 July 2021 Arion Bank and Rapyd entered into a definitive agreement regarding the sale of Valitor hf. for a purchase price of USD 100 million. The transaction is subject to regulatory approval and the parties have agreed on a deadline for obtaining this approval of 1 May 2022. Should the sale not be finalized due to failure to obtain regulatory approval, the risk shall be borne by the buyer, valid for two years. The sale agreement for Valitor hf. does not affect the Consolidated Financial Statements for the period, in accordance with IFRS. Arion Bank expects to recognize a net profit of approximately ISK 3.5 billion from the sale when all conditions precedent have been met.

	2021	2020
Loans to credit institutions	14,842	14,127
Loans to customers	1,885	1,878
Financial instruments	16	-
Investments in associates	-	70
Intangible assets	4,261	4,534
Tax assets	407	422
Other assets	2,805	2,104
Assets	24,216	23,135
Elimination within Arion Bank Group	(11,922)	(11,250)
Valitor's contribution to the Group	12,294	11,885
Tax liabilities	21	163
Financial liabilities at fair value	20	-
Other liabilities	15,528	14,369
Borrowings	-	96
Liabilities	15,569	14,628
Elimination within Arion Bank Group	(5)	(95)
Valitor's contribution to the Group	15,564	14,533
Book value of Valitor	8,647	8,507

Sólbjarg ehf., a subsidiary of Eignabjarg ehf.

Sólbjarg ehf. is a holding company of the former TravelCo hf. tour operator group which included Terra Nova Sól ehf., Heimsferðir ehf. and TravelCo Nordic/Bravo Tours. In Q1 2020 Sólbjarg completed the sale of Terra Nova Sól ehf. A sales and purchase agreement was signed with Ferðaskrifstofa Íslands ehf. in December 2020 for the sale of all operations of Heimsferðir ehf. The sale is subject to the approval of the Icelandic Competition Authorities. Pending the approval, Sólbjarg will be a minority shareholder in Ferðaskrifstofa Íslands ehf. Sólbjarg ehf. completed the sale of its 59.4% share in the danish operator Bravo Tours 1998 A/S in Q4 2021.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

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

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

In January 2022 a letter of intent was signed with a potential buyer for this asset and due diligence is in progress which is expected to be completed by mid-year. What the result of the due diligence will be is as yet unknown.

30. Other assets

	2021	2020
Property and equipment	4,298	4,792
Right of use asset	823	754
Accounts receivable	5,104	5,222
Unsettled securities trading	5,113	3,888
Investment for life assurance policyholders where risk is held by policyholder	1,281	1,141
Sundry assets	3,282	2,821
Other assets	**19,901**	**18,618**

Property and equipment	Real estate	Equip-ment	Total 2021	Total 2020
Gross carrying amount at the beginning of the year	4,608	7,464	12,072	12,324
Additions	-	583	583	1,115
Disposals	(641)	(70)	(711)	(1,366)
Gross carrying amount at the end of the year	3,967	7,977	11,944	12,073
Accumulated depreciation at the beginning of the year	(1,959)	(5,322)	(7,281)	(7,081)
Depreciation	(97)	(468)	(565)	(617)
Disposals	173	27	200	417
Accumulated depreciation at the end of the year	(1,883)	(5,763)	(7,646)	(7,281)
Property and equipment	2,084	2,214	4,298	4,792

The official real estate value (Registers Iceland) amounted to ISK 4,097 million at the end of the year (2020: ISK 4,561 million) and the insurance value amounts to ISK 7,489 million (2020: ISK 8,856 million).

Right-of-use asset	2021	2020
Balance at the beginning of the year	754	902
New lease agreements	185	9
Lease agreements terminated	-	(42)
Indexation	18	18
Depreciation	(134)	(133)
Right-of-use asset	823	754

Right-of-use asset consists of real estates for own use.

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

31. Other liabilities

	2021	2020
Accounts payable	818	850
Unsettled securities trading	1,259	272
Depositors' and Investors' Guarantee Fund	138	131
Technical provision	18,170	16,152
Technical provision for life assurance policyholders were investment risk is held by policyholder	1,281	1,141
Withholding tax	810	790
Bank levy	1,516	1,301
Accrued expenses	4,200	2,888
Prepaid income	1,476	1,516
Impairment of off-balance items	711	1,062
Lease liability	878	787
Sundry liabilities	5,894	5,824
Other liabilities	37,151	32,714

Technical provision	Technical provision	Reinsurers' share	Total 2021	Technical provision	Reinsurers' share	Total 2020
Claims reported and loss adjustment expenses	9,473	(110)	9,363	8,428	(149)	8,279
Claims incurred but not reported	2,021	(64)	1,957	1,691	(82)	1,609
Claims outstanding	11,494	(174)	11,320	10,119	(231)	9,888
Provision for unearned premiums	6,676	(12)	6,664	6,033	(7)	6,026
Own technical provision	18,170	(186)	17,984	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.

Lease liability	2021	2020
Balance at the beginning of the year	787	914
New and amended lease agreements	183	9
Lease agreements terminated	-	(43)
Indexation	31	25
Interest expense	20	42
Lease payments	(143)	(160)
Lease liability	878	787

Amounts are in ISK millions

32. Borrowings

Currency, original nominal value	First issued	Maturity	Maturity type	Terms of interest	2021	2020
ARION CBI 21, ISK 10,220 million	2014	2021	At maturity	Fixed, CPI linked, 3.50%	-	10,576
ARION CB 22, ISK 46,720 million	2015	2022	At maturity	Fixed, 6.50%	31,508	28,443
ARION CB 24 ISK 40,180 million	2019	2024	At maturity	Fixed, 6.00%	26,004	16,857
ARION CBI 25, ISK 37,940 million	2017	2025	At maturity	Fixed, CPI linked, 3.00%	43,341	41,576
ARION CBI 26 ISK 15,460 million	2019	2026	At maturity	Fixed, CPI linked, 2.00%	17,747	17,030
ARION CBI 29, ISK 25,220 million	2014	2029	At maturity	Fixed, CPI linked, 3.50%	29,902	28,561
ARION CBI 48, ISK 11,680 million	2018	2048	Amortizing	Fixed, CPI linked, 2.50%	11,017	10,721
ARION CB EUR 300 million *	2021	2026	At maturity	Fixed, EUR 0.05%	43,624	-
Statutory covered bonds					203,143	153,764
EUR 500 million *	2016	2021	At maturity	Fixed, 1.625%	-	31,071
EUR 13 million	2019	2021	At maturity	Floating, 3. EURIBOR +0.58%	-	2,030
NOK 750 million	2019	2022	At maturity	Floating, NIBOR +1.82%	11,096	11,207
SEK 150 million	2019	2022	At maturity	Floating, 3 month STIBOR +1.33%	2,159	2,338
NOK 250 million	2017	2023	At maturity	Fixed, 3.02%	3,757	3,798
EUR 300 million *	2018	2023	At maturity	Fixed, 1.00%	41,491	44,276
EUR 300 million *	2020	2024	At maturity	Fixed, 0.625 %	44,021	46,655
NOK 250 million	2017	2027	At maturity	Fixed, 3.40%	3,766	3,808
EUR 300 million *	2021	2025	At maturity	Fixed, 0.375%	43,680	-
ARION 26 1222 GB, ISK 3,640 million .	2021	2026	At maturity	Fixed, 4.70%	3,524	-
Senior unsecured bonds					153,494	145,183
Borrowings					356,637	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 24.

The book value of listed bonds was ISK 357 billion at the end of the period (31.12.2020: ISK 299 billion). The market value of those bonds was ISK 367 billion (31.12.2020: ISK 317 billion). The Group repurchased no own debts during the year (2020: ISK 54 billion).

33. Subordinated liabilities

Currency, original nominal value	Issued	Maturity	First call date	Terms of interest	2021	2020
SEK 500 million	2018	2028	22 Nov '23	Floating, 3 month STIBOR +3.10% .	7,174	7,765
NOK 300 million	2019	2029	9 Jul '24	Floating, NIBOR +3.65%	4,461	4,508
SEK 225 million	2019	2029	20 Dec '24	Floating, 3 month STIBOR +3.70% .	3,232	3,500
ARION T2I 30 ISK 4,800 million	2019	2030	4 Jan '25	Fixed, CPI linked, 3.875%	5,337	5,088
ARION T2 30 ISK 880 million	2019	2030	4 Jan '25	Fixed, 6.75%	907	907
EUR 5 million	2019	2031	6 Mar '26	Fixed, 3.24%	752	794
Tier 2 subordinated liabilities					21,863	22,562
ARION AT1 USD 100 million *	2020	Perpetual	26 Mar '26	Fixed, 6.25%	13,225	13,498
Additional Tier 1 subordinated liabilities					13,225	13,498
Subordinated liabilities					35,088	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 24.

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

Amounts are in ISK millions

34. Pledged assets

Pledged assets against liabilities	2021	2020
Assets, pledged as collateral against borrowings	287,449	228,358
Assets, pledged as collateral against loans from credit institutions and short positions	8,560	8,150
Pledged assets against liabilities	296,009	236,508
Thereof pledged assets against issued covered bonds held by the Bank	(43,182)	(36,000)
Pledged assets against liabilities on balance	252,827	200,508

The Group has pledged assets against borrowings, both issued covered bonds and other issued bonds and loan agreements. Pledged loans comprised mortgage loans to individuals. The book value of those borrowings was ISK 203 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 36 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 assets against those covered bonds are ISK 43.2 billion (31.12.2020: ISK 36.0 billion).

35. Equity

Share capital and share premium

According to the Bank's Articles of Association, total share capital amounts to ISK 1,660 million, with par value of ISK 1 per share. The holders of ordinary shares are entitled to receive dividends as approved by the AGM and are entitled to one vote per share at

	Share capital	Own shares	Share premium	Total 2021	Share capital	Own shares	Share premium	Total 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	(70)	70	-	-	(84)	84	-	-
Purchase of treasury stock	-	(201)	(28,446)	(28,647)	-	(54)	(4,326)	(4,380)
Employees stock grant	-	-	-	-	-	-	(4)	(4)
Balance at the end of the year	1,660	(142)	21,166	22,684	1,730	(11)	49,612	51,331
Own shares / issued share capital		8.54%				0.69%		

Based on three share buyback programs authorized by the Financial Supervisory Authority of the Central Bank of Iceland (FSA) in 2021, Arion Bank bought back own shares for ISK 28,647 million in 2021. At year end ISK 4.3 billion was remaining of the ongoing buyback program launched in October 2021, which will end no later than 16 March 2022. Buybacks in 2020 were based on authorisation from the FSA from 2019 and 2020.

At the AGM in March 2021 a motion was passed to reduce the Bank’s share capital by ISK 70 million at 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, divided into an equal number of shares and with one vote attached to each share. At the AGM in March 2020 a motion was passed to reduce the Bank's share capital by ISK 84 million at nominal value, totalling 84 million shares, by cancelling the company's own shares.

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

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

Other information

36. Shareholders of Arion Bank

	2021	2020
Lífeyrissjódur starfsmanna ríkisins	9.10%	6.03%
Gildi lífeyrissjódur	8.83%	9.92%
Lífeyrissjódur verzlunarmanna	8.81%	7.46%
Arion banki hf.	8.54%	0.69%
Stodir hf.	4.73%	4.99%
Birta lífeyrissjódur	3.16%	2.83%
Frjálsi lífeyrissjódurinn	2.88%	2.73%
Stefnir rekstrarfélag hf.	2.88%	2.13%
Stapi lífeyrissjódur	2.71%	2.92%
Brú lífeyrissjódur	2.35%	0.63%
Íslandsbanki hf.	2.22%	0.38%
Hvalur hf.	2.22%	1.52%
Kvika banki hf.	2.20%	0.63%
Almenni lífeyrissjódurinn	1.33%	0.67%
Kvika eignastýring	1.31%	0.98%
Bóksal ehf.	1.26%	0.14%
Festa lífeyrissjódur	1.23%	0.72%
MainFirst Bank AG	1.19%	1.14%
Lífsverk Pension fund	1.07%	1.37%
Lífeyrissjódur Vestmannaeyja	0.98%	1.13%
Eaton Vance funds	0.61%	2.11%
Taconic Capital Advisors	0.00%	23.22%
Sculptor Capital Management	0.00%	6.12%
Lansdowne partners	0.00%	1.12%
Other shareholders with less than 1% shareholding	30.39%	18.43%
	100.0%	100.0%

In 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.

At the end of the year the Bank's employees held a shareholding of 0.51% in Arion Bank (31.12.2020: 0.53%). The Board of Directors and the members of the Bank's Executive Committee shareholding is as follows:

	2021		2020	
	Warrants / options	Number of shares	Warrants	Number of shares
Steinunn Kristín Thórdardóttir, Director	-	12,000	-	-
Alternate directors of the Board	-	13,000	-	13,000
Benedikt Gíslason, CEO	992,953	2,300,000	-	2,300,000
Seven members of the Executive Committee (2020: seven)	4,482,724	1,633,076	-	1,633,076

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

Amounts are in ISK millions

37. Legal matters

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

Contingent liabilities

Legal proceedings regarding damages

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

Consumer Association's class-action lawsuit

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

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

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

Administrative fine from Central Bank of Iceland

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

Other legal proceedings

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

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

38. Events after the reporting period

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

Off balance sheet information

39. Commitments

Financial guarantees, unused credit facilities and undrawn loan commitments	2021	2020
Financial guarantees	15,858	20,857
Unused overdrafts	63,108	49,164
Undrawn loan commitments	108,691	64,055
Financial guarantees, unused credit facilities and undrawn loan commitments	187,657	134,076

40. Assets under management and under custody

Assets under management	1,351,573	1,130,978
Assets under custody	1,148,203	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

41. Related party

At year end 2020 the Group defined a related party relationship with the largest shareholder of Arion Bank, Taconic Capital. In 2021 Taconic Capital sold its entire shareholding in Arion Bank to a diverse group of investors. At the end of December 2021 no shareholder was defined as related party with an influence over the Group.

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	Assets	Liabilities	Net balance
2021			
Board of Directors and key Management personnel	139	(284)	(145)
Associates and other related parties	530	(311)	219
Balances with related parties	669	(595)	74
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)

Transactions with related parties	Interest income	Interest expense	Other income	Other expense
2021				
Board of Directors and key Management personnel	25	(1)	420	-
Associates and other related parties	-	(1)	5	(1,812)
Transactions with related parties	25	(2)	425	(1,812)
2020				
Board of Directors and key Management personnel	8	(9)	19	(408)
Associates and other related parties	-	-	-	(1,565)
Transactions with related parties	8	(9)	19	(1,973)

Amounts are in ISK millions

Risk management disclosures

The Group faces various risks arising from its day to day operations. Managing risk is a core activity within the Group. The key to effective risk management is a process of on-going identification of significant risk, quantification of risk exposure, actions to limit risk and constant monitoring of risk. This process of risk management and the ability to evaluate, manage and correctly price the risk encountered is critical to the Group's continuing profitability and this process enables the Group to ensure that the exposure to risk remains within acceptable levels.

The Board of Directors is ultimately responsible for the Group's risk management framework and for ensuring that satisfactory risk policies and governance for controlling the Group's risk exposure are in place. The Board allocates risk management of subsidiaries to the relevant subsidiary. For the parent company (the Bank) the Board sets its risk appetite, which is translated into exposure limits and targets monitored by the Bank's Risk Management division.

The Chief Executive Officer (CEO) is responsible for sustaining an effective risk management framework, processes and controls as well as maintaining a high level of risk awareness among employees, making risk everyone's business.

The Bank operates several committees to manage risk. The Board Risk Committee (BRIC) is responsible for supervising the Bank's risk management framework, risk appetite and the internal capital and liquidity adequacy assessment processes (ICAAP/ILAAP). The Board Credit Committee (BCC) is the Bank's supreme authority in matters relating to credit risk exposures, including investments and underwriting activities. On the management level the CEO has established five primary risk committees. The Asset and Liability Committee (ALCO) is responsible for managing asset-liability mismatches, liquidity and funding risk, market risk, capital adequacy, and decides on underwriting and investment exposures. The Operational Risk Committee (ORCO) is responsible for managing operational risk, which includes information security, financial crimes, regulatory compliance and data management. The Arion Credit Committee (ACC) administers the Bank's credit rules and decides on the origination of credit while the Arion Composition and Debt Cancellation Committee (ADC) is the principal authority for debt cancellation, debt restructuring and composition agreements. ACC and ADC operate within limits set by the BCC. The Sustainability Committee ensures that the Bank's strategy and decision making are aligned with the Bank's commitments in relation to the environmental, social and governance (ESG) agenda. The committee oversees the Bank's Green Financing Framework.

The Bank's Internal Audit conducts independent reviews of the Bank's and several subsidiaries' operations, risk management framework, processes and measurements. Internal Audit discusses its results with management and reports its findings and recommendations to the Board Audit Committee (BAC).

The Bank's Compliance function is headed by the Compliance Officer. It is independent and centralized and reports directly to the CEO. The Compliance function manages the Bank's conduct and compliance risk, including risk relating to data protection and financial crime.

The Bank's Risk Management division is headed by the Chief Risk Officer. It is independent and centralized and reports directly to the CEO. The division is divided into three units: Risk Analysis, which is responsible for the quantification of risk on a portfolio level, including risk modeling and reporting; Risk Monitoring and Framework, which facilitates and monitors the management of risk and controls in the first line of defense; and Credit Analysis, which supports the Bank's credit transaction process and participates in credit decisions. The Bank's Security Officer and the Bank's Pension Risk Officer are part of the Risk Management division.

Arion Bank is a small bank in international context but classified as systemically important in Iceland. The Group operates in a small economy which is subject to sectoral concentration, fluctuations in capital flows, and exchange rate volatility. The Group’s most significant risks are credit risk, concentration risk, liquidity risk, interest rate risk, cyber risk, third party risk and business risk. These risk factors are to the largest extent encountered within the parent company. Through the Bank's subsidiaries, the Group bears risk arising from insurance activities, card payment solutions and fund management. Operational risk is the predominant risk for the latter two.

Further information on risk management and capital adequacy is provided in the Pillar 3 Risk Disclosures which are available on the Bank's website, www.arionbanki.is.

42. Credit risk

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

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

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

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

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

Exposure to credit risk

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

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

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

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

42. 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

2021	Maximum exposure	Collateral: Cash and securities	Real estate	Vessels	Other collateral	Total collateral
Cash and balances with Central Bank	69,057	-	-	-	-	-
Loans to credit institutions at amortized cost	28,156	-	-	-	-	-
Loans to customers at amortized cost	936,237	29,159	704,442	42,797	85,030	861,428
Individuals	*526,498*	*712*	*481,088*	*15*	*15,139*	*496,954*
Corporates	*409,739*	*28,447*	*223,354*	*42,782*	*69,891*	*364,474*
Real estate activities	*90,321*	*329*	*87,256*	*-*	*1,752*	*89,337*
Construction	*37,010*	*486*	*33,597*	*48*	*1,876*	*36,007*
Fishing industry	*78,094*	*1,967*	*12,850*	*40,999*	*21,056*	*76,872*
Information and communication technology	*16,736*	*939*	*1,219*	*-*	*1,684*	*3,842*
Wholesale and retail trade	*65,298*	*154*	*49,874*	*29*	*9,107*	*59,164*
Financial and insurance activities	*45,798*	*24,433*	*1,814*	*-*	*12,877*	*39,124*
Industry, energy and manufacturing	*27,919*	*7*	*15,206*	*-*	*11,040*	*26,253*
Transportation	*14,162*	*-*	*1,556*	*1,556*	*3,395*	*6,507*
Services	*17,269*	*119*	*8,559*	*143*	*6,235*	*15,056*
Public sector	*6,918*	*13*	*2,120*	*7*	*193*	*2,333*
Agriculture and forestry	*10,214*	*-*	*9,303*	*-*	*676*	*9,979*
Other assets with credit risk	12,721	-	-	-	-	-
Financial guarantees	15,858	1,184	5,618	41	3,888	10,731
Undrawn loan commitments and unused overdrafts	171,799	-	-	-	-	-
Fair value through OCI	133,825	-	-	-	-	-
Government bonds	*112,824*	-	-	-	-	-
Bonds issued by financial institutions and corporates	*21,001*	-	-	-	-	-
Balance at the end of the year	1,367,653	30,343	710,060	42,838	88,918	872,159

2020	Maximum exposure	Collateral: Cash and securities	Real estate	Vessels	Other collateral	Total collateral
Cash and balances with Central Bank	42,136	-	-	-	-	-
Loans to credit institutions at amortized cost	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	*76,617*	*195*	*62,157*	*19*	*1,117*	*63,488*
Construction	*51,271*	*78*	*48,296*	*46*	*1,795*	*50,215*
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*	-	-	-	-	-
Bonds issued by financial institutions and corporates	*14,912*	-	-	-	-	-
Balance at the end of the year	1,174,710	25,433	606,193	43,373	85,255	760,254

Amounts are in ISK millions

42. 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 to individuals. LTV is calculated as the ratio of the gross carrying amount of the loan to the value of the collateral without adjusting for possible costs of obtaining and selling the collateral.

	2021		2020	
	Gross carrying amount	Thereof credit impaired	Gross carrying amount	Thereof credit impaired
Less than 50%	137,392	1,194	117,591	883
50-70%	233,904	1,975	169,206	1,559
70-90%	88,276	1,112	84,899	810
90-100%	1,821	209	3,170	216
100-110%	753	50	1,004	111
More than 110%	1,716	-	2,609	177
Not classified	33	-	75	-
Balance at the end of the year	463,895	4,540	378,554	3,756

Collateral for financial assets in stage 3

At the end of the year, the gross carrying amount of assets in stage 3 was ISK 17,703 million (31.12.2020: ISK 21,606 million) with ISK 14,421 million in collateral (31.12.2020: ISK 16,097 million), thereof ISK 12,875 million in real estate (31.12.2020: 14,790 million).

Collateral repossessed

During the year, the Group took possession of assets due to foreclosures. The total value of real estate the Group took possession of during the year and still holds at the end of the year is ISK 422 million (31.12.2020: ISK 330 million) and ISK 34 million in other assets (31.12.2020: ISK 4 million). The assets are held for sale, see Note 29.

Large exposures

A large exposure is defined as an exposure to a group of financially related borrowers which is equal to or exceeds 10% of the Group's Tier 1 capital according to the Financial Undertakings Act No. 161/2002 and Regulation No. 233/2017 on Prudential Requirements. The definition changed on 28 June 2021 with the adoption of CRR II in Iceland, which specifies Tier 1 capital as benchmark instead of eligible capital. The legal maximum for individual large exposures is 25% of Tier 1 capital, net of eligible credit risk mitigation.

The Group had one large exposure at the end of the year, totaling ISK 19.9 billion (11,5% of Tier 1 capital) before taking into account eligible credit risk mitigation (31.12.2020: one large exposure of ISK 20.9 billion or 10.4% of Tier 1 capital). The total exposure is ISK 19.7 billion (11.4% of Tier 1 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 validated annually and recalibrated and updated with current data with the aim of maintaining their predictive power. Year-on-year changes in risk classification of loans may in part be due to model refinement. External ratings are primarily used for marketable securities and loans to credit institutions. For further information on the rating scales used, see Note 56.

The following tables show financial instruments subject to the impairment requirements of IFRS 9 broken down by rating scale, where risk class 5, DD, denotes the highest risk. Assets carried at fair value through profit and loss are not subject to the impairment requirements of IFRS 9. The tables below sum up the gross carrying amount of assets by rating class and impairment stage. The gross carrying amount net of loss allowance is the book value of the underlying assets. For off-balance sheet exposures, the nominal amount is shown. FVOCI stands for fair value through other comprehensive income.

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

Amounts are in ISK millions

42. Credit risk, continued

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

2021	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	69,057	28,125	133,838
Non-investment grade	-	31	-
Gross carrying amount	69,057	28,156	133,838
Loss allowance	-	-	(13)
Book value	69,057	28,156	133,825

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

Amounts are in ISK millions

42. Credit risk, continued

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 - (Grades AAA to A-)	147,816	207	-	-	148,023
Risk class 1 - (Grades BBB+ to BBB-)	274,237	2,093	-	40	276,370
Risk class 2 - (Grades BB+ to BB-)	174,857	28,364	-	54	203,275
Risk class 3 to 4 - (Grades B+ to CCC-)	83,702	98,619	-	153	182,474
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 - (Grades AAA to A-)	107,395	207	-	-	107,602
Risk class 1 - (Grades BBB+ to BBB-)	210,503	1,292	-	40	211,835
Risk class 2 - (Grades BB+ to BB-)	75,261	6,865	-	54	82,180
Risk class 3 to 4 - (Grades B+ to CCC-)	19,531	8,940	-	153	28,624
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 - (Grades AAA to A-)	40,421	-	-	-	40,421
Risk class 1 - (Grades BBB+ to BBB-)	63,734	801	-	-	64,535
Risk class 2 - (Grades BB+ to BB-)	99,596	21,499	-	-	121,095
Risk class 3 to 4 - (Grades B+ to CCC-)	64,171	89,679	-	-	153,850
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
Nominal	114,519	18,122	1,435	-	134,076
Loss allowance	(239)	(577)	(171)	-	(987)
Nominal less loss allowance	114,280	17,545	1,264	-	133,089

Amounts are in ISK millions

42. 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		
2021	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Book value
Loans to credit instit., securities & cash	231,051	(13)	-	-	-	-	231,038
Loans to individuals	508,428	(490)	13,777	(246)	6,181	(1,152)	526,498
Mortgage	*450,305*	*(127)*	*9,055*	*(84)*	*4,536*	*(228)*	463,457
Other	*58,123*	*(363)*	*4,722*	*(162)*	*1,645*	*(924)*	63,041
Loans to corporates and sovereign	352,500	(823)	51,429	(1,560)	11,522	(3,329)	409,739
Real estate activities	*80,318*	*(160)*	*7,092*	*(45)*	*3,472*	*(356)*	90,321
Construction	*34,382*	*(49)*	*2,411*	*(24)*	*317*	*(27)*	37,010
Fishing industry	*69,632*	*(58)*	*8,193*	*(199)*	*653*	*(127)*	78,094
Information and communication technology	*15,949*	*(58)*	*792*	*(39)*	*128*	*(36)*	16,736
Wholesale and retail trade	*46,824*	*(162)*	*17,362*	*(1,032)*	*3,420*	*(1,114)*	65,298
Financial and insurance activities	*37,275*	*(135)*	*8,411*	*(45)*	*733*	*(441)*	45,798
Industry, energy and manufacturing	*25,937*	*(49)*	*1,900*	*(10)*	*170*	*(29)*	27,919
Transportation	*12,474*	*(32)*	*1,065*	*(2)*	*1,649*	*(992)*	14,162
Services	*14,125*	*(70)*	*2,796*	*(153)*	*721*	*(150)*	17,269
Public Sector	*6,499*	*(29)*	*343*	*(4)*	*110*	*(1)*	6,918
Agriculture and forestry	*9,085*	*(21)*	*1,064*	*(7)*	*149*	*(56)*	10,214
Balance at the end of the year	1,091,979	(1,326)	65,206	(1,806)	17,703	(4,481)	1,167,275

2020	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Book value
Loans to credit instit., securities & cash	208,139	(113)	-	-	-	-	208,026
Loans to individuals	412,799	(807)	17,554	(395)	5,458	(1,273)	433,336
Mortgage	*360,964*	*(365)*	*13,833*	*(141)*	*3,756*	*(174)*	*377,873*
Other	*51,835*	*(442)*	*3,721*	*(254)*	*1,702*	*(1,099)*	*55,463*
Loans to corporates and sovereign	270,454	(1,037)	112,585	(2,910)	16,148	(5,635)	389,605
Real estate activities	*53,092*	*(155)*	*23,345*	*(376)*	*1,265*	*(554)*	*76,617*
Construction	*25,483*	*(221)*	*26,021*	*(200)*	*235*	*(45)*	*51,273*
Fishing industry	*73,520*	*(232)*	*7,832*	*(9)*	*675*	*(204)*	*81,582*
Information and communication technology	*20,131*	*(31)*	*680*	*(66)*	*170*	*(74)*	*20,810*
Wholesale and retail trade	*14,917*	*(54)*	*30,925*	*(1,459)*	*8,851*	*(1,581)*	*51,599*
Financial and insurance activities	*27,835*	*(132)*	*7,791*	*(102)*	*703*	*(346)*	*35,749*
Industry, energy and manufacturing	*25,653*	*(70)*	*5,253*	*(132)*	*1,214*	*(725)*	*31,193*
Transportation	*9,910*	*(40)*	*2,846*	*(155)*	*1,166*	*(987)*	*12,740*
Services	*6,357*	*(26)*	*6,775*	*(387)*	*1,284*	*(828)*	*13,175*
Public Sector	*6,429*	*(40)*	*282*	*(4)*	*164*	*(45)*	*6,786*
Agriculture and forestry	*7,129*	*(36)*	*835*	*(20)*	*421*	*(246)*	*8,083*
Balance at the end of the year	891,392	(1,957)	130,139	(3,305)	21,606	(6,908)	1,030,967

Amounts are in ISK millions

42. Credit risk, continued

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

Transfers of financial assets between impairment stages

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

Net remeasurement of loss allowance

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

New financial assets, originated or purchased

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

Derecognitions and maturities

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

Write-offs

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

2021

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

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

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

*** During the year an amount of ISK 2,059 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

Notes to the Condensed Consolidated Interim Financial Statements

42. 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	(1,844)	(3,305)	(6,824)	(84)	(12,057)
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	(1,585)	1,309	276	-	-
Transfers to Stage 2 (lifetime ECL)	190	(281)	92	(1)	-
Transfers to Stage 3 (credit impaired financial assets)	58	377	(435)	-	-
Net remeasurement of loss allowance	2,774	21	(1,164)	-	1,631
New financial assets, originated or purchased	(1,481)	(267)	(327)	-	(2,075)
Derecognitions and maturities	569	330	1,523	(289)	2,133
Write-offs	6	10	2,379	373	2,768
Total loss allowance for loans to customers	**(1,313)**	**(1,806)**	**(4,480)**	**(1)**	**(7,600)**
Impairment loss allowance for loans to customers - Individuals					
Balance at the beginning of the year	(807)	(395)	(1,189)	(84)	(2,475)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(614)	454	160	-	-
Transfers to Stage 2 (lifetime ECL)	112	(162)	51	(1)	-
Transfers to Stage 3 (credit impaired financial assets)	43	157	(200)	-	-
Net remeasurement of loss allowance	921	(333)	(472)	-	116
New financial assets, originated or purchased	(341)	(67)	(107)	-	(515)
Derecognitions and maturities	190	90	284	(289)	275
Write-offs	6	10	322	373	711
Total loss allowance for loans to individuals	**(490)**	**(246)**	**(1,151)**	**(1)**	**(1,888)**
Impairment loss allowance for loans to customers - Companies and sovereign					
Balance at the beginning of the year	(1,037)	(2,910)	(5,635)	-	(9,582)
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	(971)	855	116	-	-
Transfers to Stage 2 (lifetime ECL)	78	(119)	41	-	-
Transfers to Stage 3 (credit impaired financial assets)	15	220	(235)	-	-
Net remeasurement of loss allowance	1,853	354	(692)	-	1,515
New financial assets, originated or purchased	(1,140)	(200)	(220)	-	(1,560)
Derecognitions and maturities	379	240	1,239	-	1,858
Write-offs	-	-	2,057	-	2,057
Total loss allowance for loans to companies and sovereign	**(823)**	**(1,560)**	**(3,329)**	**-**	**(5,712)**
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	(156)	156	-	-	-
Transfers to lifetime ECL	12	(12)	-	-	-
Transfers to credit impaired	2	5	(7)	-	-
Net remeasurement of loss allowance	363	222	(168)	-	417
New financial commitments originated	(488)	(107)	-	-	(595)
Derecognitions and maturities	213	222	2	-	437
Total loss allowance for loan commit., guarantees, unused cr. facilitie	**(293)**	**(91)**	**(344)**	**-**	**(728)**

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

42. Credit risk, continued

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
Impairment loss allowance ****	(2,072)	(3,847)	(6,709)	(80)	(12,708)
Impairment loss allowances for assets only carrying 12-month ECL	(113)	-	-	-	(113)
Total impairment loss allowance	(2,185)	(3,847)	(6,709)	(80)	(12,821)

* 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 year the loss allowance balance for stage 3 loans was raised by ISK 640 million due to unwinding of interest income.

*** During the year an amount of ISK 3,312 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
Total loss allowance for loans to customers	(1,839)	(3,268)	(6,546)	(80)	(11,733)

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
Total loss allowance for loans to individuals	(806)	(395)	(1,155)	(80)	(2,436)

Amounts are in ISK millions

42. 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
Total loss allowance for loans to companies and sovereign	(1,033)	(2,873)	(5,391)	-	(9,297)

	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
Total loss allowance for loan commit., guarantees, unused cr. facilitie	(233)	(579)	(163)	-	(975)

Macroeconomic forecast

The calculation of expected credit losses under IFRS 9 uses forward-looking information in the form of scenarios where the development of macro-economic variables is predicted. The expected credit loss is a probability-weighted average of the estimated forecasts over three scenarios: base case (60%), pessimistic (20%) and optimistic (20%) (31.12.2020: 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		
	2022	2023	2024
Unemployment rate	4.8%	4.5%	4.1%
Housing prices	10.2%	5.0%	4.4%
Private consumption	4.1%	3.3%	3.2%
GDP	5.8%	3.1%	2.3%

	Optimistic			Pessimistic		
	2022	2023	2024	2022	2023	2024
Unemployment rate	3.8%	3.8%	3.7%	6.8%	5.7%	4.7%
Housing prices	13.0%	5.5%	4.9%	3.4%	2.5%	3.4%
Private consumption	4.8%	4.1%	3.8%	3.9%	2.9%	3.0%
GDP	6.8%	3.4%	2.3%	5.3%	2.5%	2.3%

Sensitivity analysis

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

42. Credit risk, continued

Forbearance

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

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

	Stage 1		Stage 2		Stage 3		Total	
2021	Gross carrying amount	Loss allowance	Gross carrying carrying	Loss allowance	Gross carrying carrying	Loss allowance	Gross carrying carrying	Loss allowance
Individuals	10,972	(20)	1,962	(28)	2,695	(445)	15,629	(493)
Companies	10,912	(54)	17,440	(1,353)	7,104	(2,526)	35,456	(3,933)
Tourism	5,495	(40)	15,710	(1,148)	5,155	(2,055)	26,360	(3,243)
Other than tourism	5,417	(14)	1,730	(205)	1,949	(471)	9,096	(690)
Total	21,884	(74)	19,402	(1,381)	9,799	(2,971)	51,085	(4,426)
2020								
Individuals	10,549	(71)	3,995	(53)	2,155	(410)	16,699	(534)
Companies	4,106	(20)	28,747	(1,319)	9,513	(2,301)	42,366	(3,640)
Tourism			23,874	(1,178)	6,771	(1,067)	30,645	(2,245)
Other than tourism	4,106	(20)	4,873	(141)	2,742	(1,234)	11,721	(1,395)
Total	14,655	(91)	32,742	(1,372)	11,668	(2,711)	59,065	(4,174)

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 fourth quarter leading up to the reporting date; and iii) Recipients of loans through government sponsored loan schemes initiated as a consequence of the pandemic. The exposure to these groups is shown in the following table, broken down by industry sector. 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.

2021	Tourism dependent	Payment moratoria in Q4	Recipient of govern-ment sponsored loans	All focus groups	Thereof secured by real estate
Individuals	4,212	612	161	4,917	4,535
Real estate and construction	10,545	2,627	1,176	11,058	10,870
Services	5,838	33	2,315	6,353	2,251
Transportation	8,679	-	867	8,685	358
Industry, energy and manufacturing	152	550	536	1,119	826
Wholesale and retail trades	43,766	12,588	18,336	44,527	39,681
Other sectors	1,347	-	1,065	2,409	1,282
Gross carrying amount	74,539	16,410	24,456	79,068	59,803
Loss allowance	(3,614)	(955)	(1,675)	(3,683)	
Book value	70,925	15,455	22,781	75,385	
2020					
Individuals	3,912	12,598	130	16,496	15,704
Real estate and construction	25,549	13,858	1,667	33,327	32,980
Services	5,593	1,311	2,384	6,366	2,897
Transportation	9,166	1,013	905	9,173	262
Industry, energy and manufacturing	27	2,622	496	3,014	1,917
Wholesale and retail trades	32,717	20,842	17,831	33,568	30,349
Other sectors	934	4,151	1,032	5,615	2,278
Gross carrying amount	77,898	56,395	24,445	107,559	86,387
Loss allowance	(5,148)	(1,583)	(1,354)	(5,524)	
Book value	72,750	54,812	23,091	102,035	

Book value of Covid-19 impacted loans was ISK 75,385 million or 8.1% of loans to customers (31.12.2020: ISK 102,035 million and 12.4%).

Amounts are in ISK millions

43. Market risk

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

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

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

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

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

Interest rate risk

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

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

At the beginning of the COVID-19 pandemic, the Icelandic Central Bank lowered interest rates to historic lows which resulted in sharp increase in demand for non-indexed mortgages with floating rates in 2020 and first half of 2021. Inflation in Iceland, currently at 5.1%, has exceeded the Central Bank’s target of 2.5% since June 2020 and is expected to remain over the target until the first half of 2023. The Central Bank has responded by increasing interest rates by 125bps in 2021 with further increases expected. This has resulted in a sharp increase in demand for non-indexed fixed rate mortgages in recent months with corresponding increase in interest rate risk for nominal rates.

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.

2021 *Assets*	Up to 3 months	3-12 months	1-5 years	5-10 years	Over 10 years	Total
Balances with Central Bank	65,501	-	-	-	-	65,501
Loans to credit institutions	30,272	-	-	-	-	30,272
Loans to customers	578,253	107,607	235,275	4,920	11,124	937,179
Financial instruments	42,731	64,162	39,278	5,431	249	151,851
Assets	716,757	171,769	274,553	10,351	11,373	1,184,803
Liabilities						
Due to credit institutions and Central Bank	5,000	-	-	-	-	5,000
Deposits	655,476	-	-	-	-	655,476
Borrowings	11,308	34,217	275,315	34,665	11,965	367,470
Subordinated liabilities	-	-	35,860	-	-	35,860
Liabilities	671,784	34,217	311,175	34,665	11,965	1,063,806
Derivatives and other off-balance sheet items (net position)	(196,457)	(5)	193,205	3,766	-	509
Net interest gap	(151,484)	137,547	156,583	(20,548)	(592)	121,506

Amounts are in ISK millions

43. Market risk, continued

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.

	2021		2020	
NPV change	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	(2,250)	2,418	(3,849)	3,511
ISK, Non index-linked	2,308	(2,322)	933	(1,002)
Foreign currencies	338	(461)	301	(327)
NII change				
ISK, CPI index-linked	(881)	85	(1,032)	309
ISK, Non index-linked	(3,808)	774	(3,414)	668
Foreign currencies	(12)	15	(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.

	2021		2020	
Currency	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	93	(85)	117	(105)
ISK, Non index-linked	(41)	43	185	(169)
Foreign currencies	74	(74)	34	(34)

Amounts are in ISK millions

43. 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

2021	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	7,500	41,730	172,662	221,892
Financial instruments	5,753	2,541	7,549	15,843
Off-balance sheet position	-	-	-	-
Assets, CPI index-linked	13,253	44,271	180,211	237,735
Liabilities, CPI index-linked				
Deposits	84,902	9,296	3,036	97,234
Borrowings	297	62,355	39,355	102,007
Subordinated liabilities	-	-	5,337	5,337
Other	1,134	222	1,316	2,672
Off-balance sheet position	1,221	3,246	-	4,467
Liabilities, CPI index-linked	87,554	75,119	49,044	211,717
Net on-balance sheet position	(73,080)	(27,602)	131,167	30,485
Net off-balance sheet position	(1,221)	(3,246)	-	(4,467)
CPI Balance	(74,301)	(30,848)	131,167	26,018
CPI Balance for prudential consolidation, excluding insurance operations *	(73,444)	(33,167)	124,030	17,419

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)	-	(487)
Assets, CPI index-linked	27,283	49,267	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

Notes to the Condensed Consolidated Interim Financial Statements

43. 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

2021								
Financial assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	67,690	608	280	154	75	34	216	69,057
Loans to credit institutions	523	8,145	7,499	6,820	3,647	1,313	2,325	30,272
Loans to customers	780,384	99,748	39,007	768	10,820	1,629	3,881	936,237
Financial instruments	133,340	53,847	18,657	216	9	19,553	35	225,657
Other financial assets	11,936	280	93	1	8	2	400	12,720
Financial assets	993,873	162,628	65,536	7,959	14,559	22,531	6,857	1,273,943
Financial liabilities								
Due to credit inst. and Central Bank	3,982	81	845	9	49	-	34	5,000
Deposits	573,316	26,542	37,278	2,559	10,529	3,030	2,222	655,476
Financial liabilities at fair value	4,463	991	86	135	97	89	16	5,877
Other financial liabilities	4,559	359	2,755	157	604	36	215	8,685
Borrowings	163,044	172,815	-	-	-	18,619	2,159	356,637
Subordinated liabilities	6,245	752	13,224	-	-	4,461	10,406	35,088
Financial liabilities	755,609	201,540	54,188	2,860	11,279	26,235	15,052	1,066,763
Net on-balance sheet position	238,264	(38,912)	11,348	5,099	3,280	(3,704)	(8,195)	
Net off-balance sheet position	(27,584)	40,030	(15,587)	(6,577)	(1,889)	3,703	7,904	
Net position	210,680	1,118	(4,239)	(1,478)	1,391	(1)	(291)	
Non-financial assets								
Investment property	6,560	-	-	-	-	-	-	6,560
Investments in associates	668	-	-	-	-	-	-	668
Intangible assets	9,463	-	-	-	-	-	-	9,463
Tax assets	2	-	-	-	-	-	-	2
Assets and disposal groups held for sale	13,975	78	25	1,903	3	1	62	16,047
Other non financial assets	6,915	124	35	78	-	26	3	7,181
Non-financial assets	37,583	202	60	1,981	3	27	65	39,921
Non-financial liabilities and equity								
Tax liabilities	7,102	-	-	-	-	-	-	7,102
Liabilities associated with disposal groups held for sale	16,136	129	50	174	304	77	65	16,935
Other non-financial liabilities	28,366	81	30	-	3	-	(14)	28,466
Shareholders' equity	193,925	-	-	-	-	-	-	193,925
Non-controlling interest	673	-	-	-	-	-	-	673
Non-financial liabilities and equity	246,202	210	80	174	307	77	51	247,101
Management reporting of currency risk *	2,061	1,110	(4,259)	329	1,087	(51)	(277)	

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

Amounts are in ISK millions

43. Market risk, continued

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

43. Market risk, continued

Sensitivity analysis for currency risk

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

	2021		2020	
Currency	-10%	+10%	-10%	+10%
EUR	(111)	111	(504)	504
USD	426	(426)	(239)	239
GBP	(33)	33	(73)	73
DKK	(109)	109	90	(90)
NOK	5	(5)	17	(17)
Other	28	(28)	(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 30 and 23 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.

	2021		2020	
Equity	-10%	+10%	-10%	+10%
Trading book - listed	(266)	266	(391)	391
Banking book - listed	(414)	414	(382)	382
Banking book - unlisted	(662)	662	(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 24 provides a breakdown of the Group's derivative positions by type.

Amounts are in ISK millions

44. Liquidity and Funding risk

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

A primary source of funding for the Group is deposits from individuals, businesses and financial undertakings. The Group's liquidity risk stems from the fact that the maturity of loans exceeds the maturity of deposits, of which 76% 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

2021 *Financial assets*	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity	Total	Book value
Cash and balances with CB	25,975	36,547	6,633	-	-	-	69,155	69,057
Loans to credit institutions	25,663	2,509	51	2,123	-	-	30,346	30,272
Loans to customers	3,033	100,588	137,323	345,777	790,442	-	1,377,163	936,237
Financial instruments	16,091	39,164	60,412	46,502	14,898	56,857	233,924	225,657
Derivatives - assets leg	-	*33,562*	*10,841*	*35,105*	*1,100*	-	*80,608*	*74,952*
Derivatives - liabilities leg	-	*(32,614)*	*(10,779)*	*(31,674)*	*(985)*	-	*(76,052)*	*(72,047)*
Other financial instruments	*16,091*	*38,216*	*60,350*	*43,071*	*14,783*	*56,857*	*229,368*	*222,752*
Other financial assets	679	6,720	3,734	1,588	-	-	12,721	12,721
Financial assets	71,441	185,528	208,153	395,990	805,340	56,857	1,723,309	1,273,944
Financial liabilities								
Due to credit inst. and Central Bank	3,230	1,811	-	-	-	-	5,041	5,000
Deposits	499,362	63,407	80,999	9,557	3,152	-	656,477	655,476
Financial liabilities at fair value	-	3,943	537	2,644	4	-	7,128	5,877
Derivatives - assets leg	-	*(53,896)*	*(3,855)*	*(5,590)*	*(519)*	-	*(63,860)*	*(63,483)*
Derivatives - liabilities leg	-	*57,839*	*4,392*	*8,234*	*523*	-	*70,988*	*69,360*
Other financial liabilities	74	6,010	725	1,033	843	-	8,685	8,685
Borrowings	-	13,996	40,498	258,049	73,001	-	385,544	356,637
Subordinated liabilities	-	1,192	946	42,763	1	-	44,902	35,088
Financial liabilities	502,666	90,359	123,705	314,046	77,001	-	1,107,777	1,066,763
Net position for assets and liab.	(431,225)	95,169	84,448	81,944	728,339	56,857	615,532	207,181
Off-balance sheet items								
Financial guarantees	-	974	5,501	1,942	7,441	-	15,858	15,858
Unused overdraft	-	63,108	-	-	-	-	63,108	63,108
Undrawn loan commitments	-	62,529	23,636	22,410	116	-	108,691	108,691
Off-balance sheet items	-	126,611	29,137	24,352	7,557	-	187,657	187,657
Net contractual cash flow	(431,225)	(31,442)	55,311	57,592	720,782	56,857	427,875	19,524

Amounts are in ISK millions

44. Liquidity and Funding risk, continued

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	58,226	84,196	9,321	3,221	-	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 in bonds	-	*40*	-	-	-	-	*40*	*40*
Short position in equity	-	*63*	-	-	-	-	*63*	*63*
Short position in bonds used for 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	73,303	137,030	244,231	95,550	-	975,739	929,713
Net position for assets and liab.	(361,890)	115,233	46,528	115,811	518,402	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)	14,245	33,079	109,881	504,693	35,007	335,015	66,441

Net Stable Funding Ratio

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

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

	2021	2020
Available stable funding	1,001,543	875,261
Required stable funding	827,953	745,050
Net stable funding ratio	121%	117%

Amounts are in ISK millions

44. Liquidity and Funding risk, continued

Liquidity coverage ratio

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

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

The Bank complies with the Central Bank of Iceland's liquidity rules No. 266/2017, which effectively adopt the liquidity rules of the EU Capital Requirements Regulation (CRR). The Bank is required to maintain a 100% minimum LCR ratio for both the aggregate position in all foreign currencies and all currencies. For LCR in ISK, the requirement is 30% in 2021, 40% in 2022 and 50% as of 2023.

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

2021	ISK	Foreign currency	Total
Liquid assets level 1 *	96,563	83,777	180,340
Liquid assets level 2	16,406	-	16,406
Liquid assets	112,969	83,777	196,746
Deposits	107,698	34,682	142,380
Borrowings	433	55	488
Other cash outflows	10,157	6,882	17,039
Cash outflows	118,288	41,619	159,907
Short-term deposits with other banks **	2,287	25,246	27,533
Other cash inflows	32,799	2,575	35,374
Cash inflows	35,086	27,821	62,907
Liquidity coverage ratio (LCR) ***	136%	607%	203%

2020	ISK	Foreign currency	Total
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 receive 93% weight.

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

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

Amounts are in ISK millions

44. Liquidity and Funding risk, continued

Composition of liquid assets

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

2021	ISK	USD	EUR	Other	Total
Cash and balances with Central Bank	67,690	280	608	479	69,057
Short-term deposits with financial institutions	2,287	7,170	6,176	11,900	27,533
Domestic bonds eligible as collateral with Central Bank	48,178	-	-	-	48,178
Foreign government bonds	-	14,272	49,016	19,117	82,405
Liquidity reserve	118,155	21,722	55,800	31,496	227,173

2020	ISK	USD	EUR	Other	Total
Cash and balances with Central Bank	40,996	270	407	463	42,136
Short-term deposits with financial institutions	3,179	4,467	7,765	7,268	22,679
Domestic bonds eligible as collateral with 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					
2021	Less stable	Weight %	Stable	Weight %	Term deposits*	Total deposits
Individuals	89,425	11%	125,515	5%	91,170	306,110
Small and medium enterprises	84,557	11%	18,210	5%	9,122	111,889
Corporations	73,261	40%	2,797	20%	16,213	92,271
Sovereigns, central banks and PSE	31,041	40%	-	-	786	31,827
Pension funds	42,334	100%	-	-	13,448	55,782
Domestic financial entities	45,662	100%	-	-	15,641	61,303
Foreign financial entities	1,294	100%	-	-	-	1,294
Total	367,574		146,522		146,380	660,476
2020						
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

45. Capital management

Capital adequacy

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

The Group's capital ratios are calculated in accordance with the Icelandic Financial Undertakings Act No. 161/2002 and Regulation No. 233/2017 on prudential requirements with later changes. Iceland has adopted the EU Capital Requirements Directive and Regulation and the CRD V / CRR II amendments were adopted on 28 June 2021. The primary impact on capital adequacy was the expansion of the SME supporting factor, which resulted in an ISK 14 billion decrease in total risk-weighted exposure amount. Other changes are smaller. The Group applies the standardized approach to calculate capital requirements for credit risk, including counterparty credit risk, credit valuation adjustment, market risk and operational risk.

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

Valitor hf. is classified as held for sale in these Consolidated Financial Statements. For disclosure, assuming an authorized adjustment of Valitor's contribution to operational risk REA in accordance with Article 317 (4) of CRR, a sale at USD 100 million in accordance with the publicly disclosed definitive agreement with Rapyd would result in an increase in capital ratio from 23.8% to 25.0%.

Own funds	2021	2020
Total equity	194,598	197,845
Non-controlling interest not eligible for inclusion in CET1 capital	(673)	(173)
Common Equity Tier 1 capital before regulatory adjustments	193,925	197,672
Intangible assets	(8,435)	(13,092)
Cash flow hedges	(197)	(2,282)
Additional value adjustments	(240)	(238)
Foreseeable dividend and buyback *	(26,773)	(17,990)
Adjustment under IFRS 9 transitional arrangements as amended	920	1,890
Common equity Tier 1 capital	159,200	165,960
Non-controlling interest eligible for inclusion in T1 capital	133	173
Additional Tier 1 capital	13,225	13,498
Tier 1 capital	172,558	179,631
Tier 2 instruments	21,863	22,562
Tier 2 instruments of financial sector entities (significant investments)	(1,056)	(1,007)
Tier 2 capital	20,807	21,555
Total own funds	193,365	201,186
Risk-weighted exposure amount (REA)		
Credit risk, loans	623,395	570,554
Credit risk, securities and other	69,553	60,813
Counterparty credit risk	7,761	3,462
Market risk due to currency imbalance	4,691	8,569
Market risk, other	8,958	13,063
Credit valuation adjustment	2,379	842
Operational risk	96,085	88,462
Total risk-weighted exposure amount	812,822	745,765
Capital ratios		
CET1 ratio	19.6%	22.3%
Tier 1 ratio	21.2%	24.1%
Capital adequacy ratio	23.8%	27.0%

* On 31 December 2021, the foreseeable dividend and buyback is the aggregation of an expected dividend of ISK 22.5 billion and the remainder of the current buyback program amounting to ISK 4.3 billion based on permission from the FSA from 7 October 2021. The dividend amount is beyond the target of 50% of audited profits set in the Bank's dividend policy and represents a step towards the normalization of own funds. 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.

Amounts are in ISK millions

45. Capital management, continued

On 23 December 2020, the Icelandic Ministry of Finance ratified art 1 para 7 of Regulation (EU) 2020/873 into Icelandic law. The regulation modifies the transitional arrangements for IFRS 9 to allow the regulatory capital impact of the increase in expected credit loss due to the Covid-19 pandemic to be phased in over time. Institutions that elect to make use of these transitional arrangements can in 2021 add back CET1 equivalent to up to 100% of provisions incurred between 1 January 2020 and the reporting date from the application of IFRS9 to performing facilities. The Bank has opted to make use of the transitional arrangements, thus reflected in the Group's capital ratios. The transitional arrangements increase the capital adequacy ratio by 0.1 percentage points.

Capital ratios of the parent company	2021	2020
CET1 ratio	20.2%	22.8%
Tier 1 ratio	21.9%	24.6%
Capital adequacy ratio	24.4%	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. The FSC has announced that the countercyclical capital buffer will increase to 2% on 29 September 2022.

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

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

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

Capital requirement, % of REA

2021	CET1	Tier 1	Total
Pillar 1 capital requirement	4.5%	6.0%	8.0%
Pillar 2R capital requirement **	1.8%	2.4%	3.2%
Combined buffer requirement *	7.3%	7.3%	7.3%
Regulatory capital requirement	13.6%	15.7%	18.5%
Available capital	19.6%	21.2%	23.8%

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

** The SREP result based on the Group's Financial Statement at 31 December 2020. The Pillar 2 requirement is 3.2% 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.

	2021	2020
On-balance sheet exposures	1,256,916	1,114,450
Derivative exposures	4,796	9,124
Securities financing transaction exposures	720	512
Off-balance sheet exposures	102,016	65,425
Total exposure	1,364,448	1,189,511
Tier 1 capital	172,558	179,631
Leverage ratio	12.6%	15.1%

Amounts are in ISK millions

45. Capital management, continued

Solvency II	2021	2020
Excess of assets over liabilities in accordance with Solvency II	9,090	7,397
Subordinated liabilities	1,069	1,000
Foreseeable dividends	-	(800)
Own funds	10,159	7,597
Solvency capital requirements (SCR)	6,775	5,105
SCR ratio	149.9%	148.8%

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

46. 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.

47. Sustainability risk

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

The Green Financing Framework

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

Green Financing Instruments	2021
Deposits	8,209
Borrowings	47,148
Book value	55,357

Identified eligible green assets by category	
Sustainable fishery and aquaculture	42,245
Clean transportation	2,255
Green buildings	55,881
Pollution prevention and control and wastewater management	5,591
Book value	105,972

Amounts are in ISK millions

Notes to the Consolidated Financial Statements

Significant accounting policies

The accounting policies adopted in the preparation of these Consolidated Financial Statements are consistent with those followed in the preparation of the Annual Financial Statements for the year ended 31 December 2020, except for when there have been made amendmends to current IFRS valid from 1 January 2021, Icelandic Act on Financial Statements, Act on Financial Undertakings and rules on Accounting for Credit Institutions. A number of new standards and interpretations were effective from 1 January 2021 but they do not have a material effect on these Consolidated Financial Statements.

47. 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 Consolidated Financial Statements are prepared on a going concern basis.

48. Principles underlying the consolidation

Subsidiaries

Subsidiaries are entities controlled by the Group. The Financial Statements of subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases. The Financial Statements of the subsidiaries are prepared for the same reporting period as the parent entity, using consistent accounting policies.

Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date, i.e. when control is transferred to the Group. The Group controls an investee if, and only if, the Group has:

- power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect its returns.

Generally, there is a presumption that a majority of voting rights result in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including (i) the contractual arrangement with the other vote holders of the investee, (ii) rights arising from other contractual arrangements and (iii) the Group's voting rights and potential voting rights. The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.

The Group measures goodwill at the acquisition date as:

- the fair value of the consideration transferred; plus
- the recognized amount of any non-controlling interests in the acquiree; less
- if the business combination is achieved in stages, the fair value of the pre-existing equity interest in the acquiree; less
- the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

When the excess is negative, a bargain purchase gain is recognized immediately in profit or loss.

Transaction costs incurred are expensed and included in administration expense.

Non-controlling interests

Non-controlling interests represent the portion of profit or loss and equity not owned, directly or indirectly, by the Group; such interests are presented separately in the Income Statement and are included in equity in the Statement of Financial Position, separately from equity attributable to owners of the Group.

For each business combination, the Group elects to measure any non-controlling interests in the acquiree either:

- at fair value; or
- at their proportionate share of the acquiree's identifiable net assets, which are generally at fair value.

Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

48. Principles underlying the consolidation, continued

Loss of control

On the loss of control, the Group derecognizes the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control is recognized in profit or loss.

Transactions eliminated on consolidation

Intragroup balances, income and expenses arising from intragroup transactions, are eliminated in preparing the Consolidated Financial Statements. This also applies to subsidiaries classified as disposal groups held for sale.

Funds management

The Group manages and administers assets held in unit trusts and investment vehicles on behalf of investors. The Financial Statements of these entities are not included in these Consolidated Financial Statements except when the Group controls the entity.

When assessing whether to consolidate investment funds, the Group reviews all facts and circumstances to determine whether the Group, as fund manager, is acting as agent or principal. The Group is deemed to be a principal, and hence controls and consolidates a fund, when the Group acts as fund manager and cannot be removed without cause, has variable returns through significant holdings, and is able to influence the returns of the funds by exercising its power. The Group is defined as agent in all instances.

49. Associates

Associates are those entities over which the Group has a significant influence, i.e. the power to participate in the financial and operating policy decisions of the associates but not control or joint control over those policies. Significant influence generally exists when the Group holds 20% or more of the voting power, including potential voting rights, unless it can be clearly demonstrated that this is not the case. Investments in associates are initially recognized at cost. The carrying amount of investments in associates includes intangible assets and accumulated impairment loss.

The considerations made in determining significant influence are similar to those necessary to determine control over subsidiaries.

The Group's investments in its associate are accounted for using the equity method.

The Financial Statements include the Group's share of the total recognized income and expenses of associates from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its carrying value of associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the Group resumes recognizing its share of those profits only after its share of the profits equals the share of losses not recognized.

Upon loss of significant influence over the associate, the Group measures and recognizes any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognized in profit or loss.

Impairment on investments in associates

After applying the equity method to account for investments in associates, the Group determines whether it is necessary to recognize any impairment loss with respect to its investments in associates. The Group first determines whether there is any objective evidence that an investment in an associate is impaired. If such evidence exists, the Group then tests the entire carrying amount of the investment for impairment, by comparing its recoverable amount, which is the higher of value in use and fair value less costs to sell, with its carrying amount. The recoverable amount of an investment in an associate is assessed for each associate, unless the associate does not generate cash inflows from continuing use that are largely independent of those from other assets of the Group. The excess of the carrying amount over the recoverable amount is recognized in the Income statement as an impairment loss. Impairment losses are subsequently reversed through the Income Statement if the reasons for the impairment loss no longer apply.

50. Foreign currency

Items included in the Consolidated Financial Statements of each of the Group's subsidiaries are measured using the functional currency of the respective entity.

Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. All differences arising on settlement or translation of monetary items are taken to the Income Statement. Non-monetary assets and liabilities denominated in foreign currencies are reported at historic cost.

51. Interest

Interest income and expense are recognized in the Income Statement using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and financial liability and is not revised subsequently.

The calculation of the effective interest rate includes all transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Interest income and expense presented in the Income Statement include Income and expenses of assets and liabilities carried at:

- amortized cost;
- fair value through profit and loss (FVTPL); and
- fair value through other comprehensive income (FVOCI).

52. Fee and commission

The Group provides various services to its clients and earns income therefrom, such as income from Corporate Banking, Retail Banking, Capital Markets, Corporate Finance, Asset Management and Private Banking. Fees earned from services that are provided over a certain period of time are recognized as the services are provided, i.e. point in time. Fees earned from transaction type services are recognized when the service has been completed, i.e. point in time. Fees that are performance linked are recognized when the performance criteria are fulfilled, i.e. point in time.

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

53. Net financial income

Net financial income comprises Dividend income, Net gain on financial assets and liabilities at fair value and Net foreign exchange gain.

i) Dividend income is recognized when the right to receive dividend is established. Usually this is the ex-dividend date for equity securities.

ii) Net gain on financial assets and liabilities at fair value comprises all realized and unrealized fair value changes, except for interest (which is included in Interest income and Interest expense) and foreign exchange gain and losses (which are included in Net foreign exchange gains as described below).

iii) Net foreign exchange gain comprise all foreign exchange differences arising on the settlement of foreign currency monetary assets and liabilities and on translating foreign currency monetary assets and liabilities at rates different from those at which they were translated on initial recognition during the year or in previous Consolidated Financial Statements.

Net foreign exchange gain also include foreign exchange differences arising on translating non-monetary assets and liabilities which are measured at fair value in foreign currencies and whose other gain and loss are also recognized in profit or loss.

54. Net insurance income

Premiums recognized as income comprise the premiums contracted during the fiscal year including premiums transferred from last years but excluding next periods premiums, which are recognized as provision for unearned premiums. Provision for unearned premiums is a part of the technical provision in the Statement of Financial Position.

Claims recognized in the Income Statement are the periods claims including increases or decreases due to claims from previous fiscal years. Outstanding claims included in technical provision in the Statement of Financial Position are the total amount of reported but unpaid claims as well as actuarial provision for claims occurred but unreported.

55. Income tax expense

Tax expense comprises current and deferred tax. Income tax for the year has been calculated and recognized in the Consolidated Financial Statements.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Taxable profit may differ from earnings before tax as reported in the Income Statement as it may exclude income or expense that is deductible in other years and it excludes income or expense that are never taxable or deductible.

Current and deferred tax relating to items recognized directly in equity is recognized in equity and not in the statement of profit or loss.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities and the realization of foreign exchange gain or loss, for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantively enacted at the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realized. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from the initial recognition (other than in a business combination) of assets and liabilities in transaction that affects neither the taxable profit nor the accounting profit. In addition, tax liabilities are not recognized if the temporary difference arises from the initial recognition of goodwill.

56. Financial assets and financial liabilities

Recognition and initial measurement

The Group initially recognizes financial assets and financial liabilities on the date that they are originated at the fair value of consideration paid. Regular-way purchases and sales of financial assets are recognized on the trade date at which the Group commits to purchase or sell assets. All other financial assets and liabilities are recognized on the trade date, which is the date that the Group becomes a party to the contractual provision of the instrument.

A financial asset or financial liability is measured initially at fair value and for an item not at fair value through profit or loss, transaction cost that are directly attributable to its acquisition or issue.

Derecognition

Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or when the Group has transferred substantially all risks and rewards of ownership.

Financial liabilities are derecognized when the obligation of the Group specified in the contract is discharged or cancelled or expires.

Debt instruments

Debt instruments, including loans and debt securities, are classified into one of the following measurement categories:

- amortized cost;
- fair value through profit and loss (FVTPL); or
- fair value through other comprehensive income (FVOCI).

A debt instrument is measured at amortized cost only if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to collect contractual cash flows; and
- its contractual cash flows are solely payments of principal and interest on the principal amount outstanding (here after SPPI).

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to collect contractual cash flows and selling financial assets; and
- its contractual cash flows are SPPI.

All other debt instruments are carried at FVTPL.

56. Financial assets and financial liabilities, continued

Business model assessment

Business model assessment involves determining whether financial assets are managed in order to generate cash flows from collection of contractual cash flows, selling financial assets or both. The Group assesses the business model at a portfolio level reflective of how groups of assets are managed together to achieve a particular business objective. For the assessment of business models the Group takes into consideration the following factors:

- how the performance of assets in a portfolio is evaluated and reported to group heads and other key decision makers within the Group's business lines;
- the risks that affect the performance of assets held within a business model and how those risks are managed;
- whether the assets are held for trading purposes, i.e. assets that the Group acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is manage together for short-term profit or position taking;
- how compensation is determined for the Group's business lines' management that oversee the assets; and
- the frequency and volume of sales in prior periods and expectations about future sales activity.

Cash flow characteristics assessment

The contractual cash flow characteristics assessment involves assessing the contractual features of an instrument to determine if they give rise to cash flows that are consistent with a basic lending arrangement. Contractual cash flows that are consistent with a basic lending arrangement are considered SPPI.

Interest is defined as consideration for the time value of money, the banks funding costs, the credit risk associated with the principal amount outstanding and other costs (e.g liquidity risk and administrative costs), as well as a profit margin. Indexation of loans to the Consumer Price Index (CPI) are considered part of interest as CPI guarantees the time value of money of the original outstanding balance. Principal may change over the life of the instruments due to repayments. Indexation on principal accumulates over time.

In performing this assessment, the Group takes into consideration contractual features that could change the amount or timing of contractual cash flows, such that the cash flows are no longer consistent with a basic lending arrangement. If the Group identifies any contractual features that could modify the cash flows of the instruments such that they are no longer consistent with a basic lending arrangement, the related financial assets is classified at FVTPL.

Debt instruments measured at amortized cost

Debt instrument are measured at amortized cost if they are held within a business model whose objective is to hold for collection of contractual cash flows where those cash flows represent solely payments of principal and interest. After initial measurement, debt instruments in this category are carried at amortized cost using the effective interest rate method. The effective interest rate is the rate that discounts contractual cash payments or receipt through the contractual lifetime of the financial asset to the gross carrying amount of a financial asset. Amortized cost is calculated taking into account any discount or premium on acquisition, transaction cost and fees that are an integral part of the effective interest rate. Amortization is included in interest income in the Consolidated Income Statement.

Impairment on debt instruments measured at amortized cost is calculated using the expected credit loss (ECL) approach. Loans and debt securities measured at amortized cost are presented net of allowance for credit losses in the Consolidated Statement of Financial Position.

Debt instruments measured at FVOCI

Debt instrument are measured at FVOCI if they are held within a business model whose objective is to hold for collection of contractual cash flows and/or selling financial assets, where the assets' cash flows represent payments that are solely payments of principal and interest. Subsequent to initial recognition, unrealized gains and losses on debt instruments measured at FVOCI are recorded in Other Comprehensive Income (OCI). At realization the accumulated profit or loss recognized in OCI in previous periods is recycled to the Consolidated Income Statement. Foreign exchange gains and losses of the debt instrument are recognized in the Consolidated Income Statement. Interest income from received payments are recognized in interest income in the Consolidated Income Statement upon payment.

Impairment on debt instruments measured at FVOCI is calculated using the expected credit loss approach. The ECL on debt instruments measured at FVOCI does not reduce the carrying amount of the asset in the Statement of Financial Position, which remains at its fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortized cost is recognized in OCI with a corresponding charge to net impairment in the Consolidated Statement of Comprehensive Income. The accumulated allowance recognized in OCI is recycled to the Consolidated Statement of Comprehensive Income upon derecognition of the debt instrument.

56. Financial assets and financial liabilities, continued

Debt instruments measured at FVTPL

Debt instrument are measured at FVTPL if they are held for short term gain, held as part of a portfolio managed on a fair value basis or the cash flows do not represent payments that are solely payments of principal and interest. These instruments are measured at fair value in the Consolidated Statement of Financial Position. Realized and unrealized gains and losses are recognized as part of Net financial income in the Consolidated Income Statement.

Purchased loans

All purchased loans are initially measured at fair value on the date of acquisition. As a result no allowance for credit losses would be recorded in the Consolidated Statement of Financial Positions on the date of acquisition. Purchased loans may fit into either of the two categories: Performing loans or Purchased or Originated Credit Impaired (POCI) loans.

Purchased performing loans are reflected in Stage 1 and will follow the same accounting as other performing loans. They will be subject to a 12-month allowance for credit losses which is recorded as provision for credit losses in the Consolidated Income Statement. The fair value adjustments set up for these loans on the date of acquisition is amortized into interest income over the life of these loans.

POCI loans do not have allowance at initial recognition but subsequently the allowance will reflect the changes in the lifetime expected losses. At recognition the discount of each POCI loan is split up into two categories, impairment discount and interest discount or premium. Interest is calculated with a credit adjusted effective interest rate and is posted to interest income. Periodically the Group recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original credit adjusted effective interest rate, any changes in the expected cash flows since the date of acquisition are recorded as a charge/recovery in net impairment in the Consolidated Income Statement at the end of all reporting periods subsequent to the date of acquisition.

Equity instruments

Equity instruments are measured at FVTPL.

For equity instruments measured at FVTPL, changes in fair value are recognized as part of Financial income in the Consolidated Income Statement.

The Group can elect to classify non-trading equity instruments at FVOCI. This election will be used for certain equity instruments for strategic or longer term investment purposes. The FVOCI election is made upon initial recognition, on an instrument-by-instrument basis and once made is irrevocable. Gains and losses on these instruments including when derecognized/sold are recorded in OCI and are not subsequently reclassified to the Consolidated Income Statement. Dividends received are recorded in Financial income in the Consolidated Income Statement. Any transaction costs incurred upon purchase of the security are added to the cost basis of the security and are not reclassified to the Consolidated Income Statement of the security.

Offsetting

Financial assets and liabilities are set off and the net amount reported in the Statement of Financial Position when, and only when, the Group has a legal right to offset the recognized amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains or losses arising from a group of similar transactions such as in the Group's trading activity.

56. Financial assets and financial liabilities, continued

Expected credit losses

Expected credit loss (ECL) is established for all financial assets, except for financial assets classified or designated as FVTPL and equity instruments designated as FVOCI, which are not subject to impairment assessment. Assets subject to impairment assessment are primarily debt instruments (including loans to customers) measured at amortized cost or FVOCI. ECL on financial assets is presented in Net impairment. Other financial assets carried at amortized cost are presented net of ECL in the Group's Consolidated Statement of Financial Position. Off-balance sheet items subject to impairment assessment include financial guarantees and undrawn loan commitments. ECL for Off-balance sheet items is separately calculated and included in Other Liabilities.

The Group measures the ECL on each balance sheet date according to a three-stage expected credit loss impairment model:

Stage	Criteria	Assessment of expected credit loss, and effective interest rates.
1	Exposures not impaired and with no significant increase in credit risk	12 month expected credit loss is recorded. The expected credit loss is computed using a probability of default occurring over the next 12 months. For those instruments with a remaining maturity of less than 12 months, a probability of default corresponding to remaining term to maturity is used. The effective interest rate is calculated on the gross carrying amount.
2	Exposures not impaired with significant increase in credit risk subsequent to origination.	Lifetime expected credit loss is recorded, based on the probability of default over the remaining estimated life of the financial instrument. Effective interest rate is calculated on the gross carrying amount.
3	Exposures in default / Credit impaired	Lifetime expected credit loss is recorded. Effective interest rate is calculated on the book value.

The ECL is an unbiased discounted probability-weighted estimate of the cash shortfalls expected to result from defaults occurring in the next 12 months or, in cases where credit risk has significantly increased, in the expected lifetime of an exposure. For guarantees and loan commitments, credit loss estimates consider the portion of the commitment that is expected to be paid out or expected to be drawn over the relevant time period, contingent on significant financial difficulty.

Increases or decreases in the required ECL attributable to purchases and new originations, derecognitions or maturities, and remeasurements due to changes in loss expectations or state migrations are recorded in net impairment. Write-offs and recoveries of amounts previously written off are recorded against ECL.

The ECL represents an unbiased estimate of expected credit losses on our financial assets as at the balance sheet date. Judgement is required in making assumptions and estimations when calculating the ECL, including movements between the three stages and the application of forward looking scenarios. The underlying assumptions and estimates may results in changes to the provisions from period to period that significantly affect our results of operations.

Definition of default

The Group considers a financial assets to be in default when:

- the asset is more than 90 days past due, or
- the borrower is considered to be unlikely to pay.

In assessing whether a borrower is unlikely to pay, the Group considers both qualitative and quantitative indicators, e.g. overdue status, debt and equity ratios, market circumstances and other data developed internally or obtained from external sources.

For corporate counterparties it is assumed that if one exposure is in default, all other exposures to that counterparty are also in default (cross-default). For individuals however, each exposure portfolio is assessed separately, meaning that if an individual is in default on a loan belonging to one portfolio, their other exposures, belonging to other portfolios, are not automatically assumed to be in default. However, default in other portfolios are considered when assessing unlikeliness to pay. The Bank now defines six different exposure portfolios for individuals and has different statistical credit risk model for each of them - mortgages, consumer loans, auto loans, guarantees, loans to individuals for work purposes and other loans.

Probability of default and credit risk rating

The Group allocates to each exposure a credit risk rating (e.g. A+, A, A-, BBB+, etc.) based on the calculated 12 month probability of default ('the PD'). The PD is assessed through the Group's credit rating models or based on external ratings if available. The Group's credit rating models are statistical models based on a variety of information that has been determined to be predictive of default. These include demographic, behavioral, financial and economic data, coupled with qualitative expert judgement for large corporate exposures. Factors vary depending on the nature of the exposure and the profile of the borrower. The PD estimates used for the purpose of calculating IFRS 9 impairments are point-in-time, i.e. dependent on the economic cycle. The Group's credit rating models are subject to annual performance tests and are recalibrated on a regular basis if needed.

56. Financial assets and financial liabilities, continued

The Group's rating scale is shown below, including mapping of external ratings. The lower bounds are inclusive.

Risk class	Rating	Lower PD	Upper PD	S&P / Fitch	Moody's	Description
0	AAA	0.000%	0.006%	AAA	Aaa	Investment Grade
	AA+	0.006%	0.018%	AA+	Aa1	
	AA	0.018%	0.029%	AA	Aa2	
	AA-	0.029%	0.045%	AA-	Aa3	
	A+	0.045%	0.070%	A+	A1	
	A	0.070%	0.110%	A	A2	
	A-	0.110%	0.170%	A-	A3	
1	BBB+	0.170%	0.260%	BBB+	Baa1	Investment Grade
	BBB	0.260%	0.410%	BBB	Baa2	
	BBB-	0.410%	0.640%	BBB-	Baa3	
2	BB+	0.640%	0.990%	BB+	Ba1	Non-investment Grade
	BB	0.990%	1.540%	BB	Ba2	
	BB-	1.540%	2.400%	BB-	Ba3	
3	B+	2.400%	3.730%	B+	B1	Non-investment Grade
	B	3.730%	5.800%	B	B2	
	B-	5.800%	9.010%	B-	B3	
4	CCC+	9.010%	14.000%			Non-investment Grade
	CCC	14.000%	31.000%			
	CCC-	31.000%	99.990%			
5	DD	99.99%	100.00%	D	C	Default / Impaired

The Group uses external ratings for counterparties that receive such ratings from recognized rating agencies such as Moody's, Standard & Poor's and Fitch. The Group's internal rating scale was originally calibrated to match historical default rates shown in publications of the aforementioned rating agencies and using smoothing techniques. External ratings are primarily used to assess expected losses for counterparties of marketable securities, money market and deposit accounts positions which fall under the Impairment requirements of IFRS 9. The Bank's ECL is broken down by investment grade and non-investment grade classes for such exposures, as per the definition of the corresponding rating agency.

Each exposure is allocated a credit risk rating at initial recognition. The calculations are based on available information at the time of origination. Exposures are continuously monitored and revaluated using the models described above and this may result in transitions between risk ratings.

Probability of default

The Group's PDs and PD term structures are based on both quantitative and qualitative factors and in some cases external ratings are used. PD's are re-assessed on a regular basis with different frequencies depending on the type of counterparty and/or exposure.

In addition to calculating PD and allocating a credit risk rating to each exposure, the Group calculates the lifetime probability of default (LPD), which is an assessment of the probability that a default event occurs over the lifetime of the exposure. The LPD incorporates management's view of possible future macroeconomic developments and the likelihood of rating transitions over the lifetime of the exposure. For the determination of LPD, the Bank calculates PD term structures – which effectively provides the probability of default for any given time period, one for each rating grade, PD model and economic scenario. The annualized lifetime probability of default (ALPD) of an exposure is the fixed 12 month PD (without transitions) that corresponds to the exposure's LPD. The credit risk rating that corresponds to the ALPD is defined as the lifetime credit risk rating.

The assessed 12 months PDs are the basis for the determination of the term structure of PDs for exposures. The Group applies transition models, developed on the basis of historical data, to predict the development of risk grades for periods that exceed one year. The Group has separated transition behavior due to specific and general risk and applies its macro-economic forecasts to the latter. The analysis of credit rating transitions due to general risk includes the identification and calibration of relationships between changes in default rates and changes in key macro-economic factors. Unemployment rate is the predominant predictive variable. Among other indicators examined are GDP growth, private consumption expenditure, inflation, development of housing prices and benchmark interest rates.

Assumptions on key macro-economic indicators are on an ongoing basis estimated based on internal and external information available at each time. The Group formulates a 'base case' view of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios. The Group uses these forecasts to adjust its estimates of lifetime probability of default and other factors that affect the lifetime expected credit loss.

56. Financial assets and financial liabilities, continued

The Bank has six different exposure specific PD models for individuals: mortgages, consumer loans, auto loans, guarantees, loans to individuals for work purposes and other loans. The Bank has a different model or rating logic for the following corporate portfolios – large corporates, retail SMEs, holding companies, financial institutions (external ratings), municipalities, state related entities and cooperatives.

Loss given default

Each credit facility is assigned an LGD. The LGD is an assessment of loss conditional on a default occurrence. The Group splits LGD into three components; the probability of cure, the expected recovery from liquidation of collateral, and the recovery rate for the unsecured part of the exposure. The cure rate is modeled on the Group's historical data of assets returning to performing status after being in default without loss. The expected recovery is the outcome of the Group's collateral allocation algorithm which takes into account the seniority of debt and collateral type. Haircuts are applied to different types of collaterals based on expert judgment, supported by historical data, and take into account costs and the time value of money. Different haircuts are applied for different macro-economic scenarios in the ECL calculations. In some instances, assets are considered to be fully covered by collateral after haircut application and therefore carry no ECL. The recovery rate for the unsecured part of the exposure is based on expert judgment, taking into account historical loss experience.

The cut-off period for cure is taken to be 18 months from default, which means that a return to non-default after that period is not considered a cure. Furthermore, cure is defined on a portfolio level instead of on a loan level i.e. the same level as the PD models. In this version, statistical cure rate models have been created for the largest portfolios – mortgages, consumer loans and large corporates and retail SMEs. As the explanatory variables in the statistical cure rate models can be related to variables in PD models, this change prompts a consideration of PD-cure correlation. The correlation effects are taken into account in the Bank's ECL calculations. Furthermore, long-run average cure rate models using macro-economic variables have been created. The models can be used to assess cure rate under different economic conditions to be able to apply different cure rates for different economic scenarios given different economic conditions.

Exposure at default

The EAD represents the expected exposure at the event of a default. For a given exposure, the Group derives the EAD from the contractual amortization schedule and takes into account the likelihood of pre-payments, drawdowns, rollovers, extensions and use of unused allowance in the period leading up to default. These behavioral estimates, which are based on historical observations and forward-looking forecasts, apply differently to each type of exposure.

Significant increase in credit risk

The assessment of significant increase in credit risk requires significant judgment. In determining whether the risk of default for an exposure has increased significantly since initial recognition, the Group considers relevant, reasonable and supportable information on an ongoing basis. Assumptions are drawn based on the Group's historical experience and expert judgement including forward-looking expectations. If a debt investment security has low credit risk and is considered investment grade at the reporting date, the Group determines that the credit risk on the asset has not increased significantly since initial recognition.

For a given exposure, the Group considers a significant increase in credit risk to have occurred if one of the following holds:

- the exposure's credit risk rating on reporting date is not in risk class 0 or 1 and has deteriorated by more than one risk rating compared to the credit risk rating at origination;
- the exposure's lifetime credit risk rating on reporting date is not in risk class 0 or 1 and has deteriorated by more than one risk grade (two or more) compared to the lifetime credit risk rating at origination. As the Group does not have the benefit of hindsight, this comparison is only used for exposures that originate on or after 1 January 2018;
- the number of days in arrears exceeds 30 days; or
- the exposure is on the Group's watch list.

The Group monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that the criteria is capable of identifying significant increases in credit risk before an exposure is in default and there is no unwarranted volatility in loss allowance from transfers between 12-month ECL (stage 1) and lifetime ECL (stage 2).

56. Financial assets and financial liabilities, continued

Exposures in default

Exposures in default at each reporting date, according to the Group's definition, are considered to be credit impaired.

The amount of the loss impaired is the difference between the assets' gross carrying value and the present value of estimated future cash flow. In some instances, the impairment of exposures is zero due to collateral coverage.

Impairment losses are recognized in net impairment, see note 42. Any decreases in impairment loss amounts are reversed through net impairment.

Expected credit loss measurement

The expected credit loss (ECL) calculations are based on three main components:

- probability of default (PD),
- loss given default (LGD); and
- exposure at default (EAD).

Each component is derived from internally generated models, apart from external credit ratings. The models are developed with statistical methods and/or expert judgement supported by historical data and adjusted for expected macro-economic effects.

The Group measures ECL considering the risk of default over the maximum contractual period (including any extension periods) over which it is exposed to credit risk. The maximum contractual period extends to the date at which the Group has the right to require repayment of an advance or terminate a loan commitment or guarantee. However, for overdrafts and credit card facilities that include both a loan and an undrawn commitment component, the Group measures ECL over a period longer than the maximum contractual period if the Group's procedures for extensions do not limit the Group's exposure to credit losses to the contractual period. These facilities do not have a fixed term or repayment structure. The Group can cancel them with immediate effect but this contractual right is not enforced in the normal day-to-day management, but only when the Group becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that the Group expects to take and that serve to mitigate ECL. These include a reduction in limits, cancellation of the facility and/or turning the outstanding balance into a loan with fixed repayment terms. The ECL calculations involve discounting using the exposures' effective interest rates.

Forward looking scenarios

The ECL for an exposure is the weighted average of the expected credit loss for different macro-economic scenarios provided by the Group's management. The Group currently considers three scenarios: 'base case', 'optimistic' and 'pessimistic' and assigns its best estimate of the likelihood of occurrence to each one. The development of macro-economic variables and the corresponding weights are based on expert judgement supported by historical data. The Group incorporates forward-looking macro-economic information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition (via the lifetime credit risk rating comparison) and its measurement of ECL as the PD term structures, LGD and EAD include macro-economic adjustments for each of the scenarios.

The predominant macro-economic variable used across all portfolios is the unemployment rate in Iceland, as measured by the Directorate of Labor. Among other variables considered are GDP growth, private consumption expenditure, inflation, development of housing prices and benchmark interest rates. The average cure is also correlated with unemployment rate, depending on portfolio, and collateral haircuts are adjusted for different scenarios. Exit and pre-payment rates, which affects EAD, are dependent on refinancing spreads and due to the correlation between interest rates and unemployment rate they are adjusted for different scenarios.

Write-off of loans

Loans are written off, either partially or in full, when there is no realistic prospect of recovery i.e. the bankruptcy of the borrower or an ineffective attachment or distraint. Collateralized loans are generally written of when the realization of collateral have been received. After write-off, exposures continue to be subject to collection activities in accordance with Icelandic law.

56. Financial assets and financial liabilities, continued

Modifications

The original terms of a financial asset may be renegotiated or otherwise modified, resulting in changes to the contractual terms of the financial asset that affect the contractual cash flow. The treatment of such modifications is primarily based on the process undertaken to execute the renegotiation and the nature and extent of changes made. Modifications which are performed for credit reasons, primarily related to troubled debt restructurings, are generally treated as modifications of the original financial asset unless modifications are significant. Significant modifications are generally considered to be an expiry of the original cash flows; accordingly, such renegotiations are treated as a derecognition of the original financial asset and recognition of a new financial asset.

If a modification of terms does not result in derecognition of the financial asset, the carrying amount of the financial asset is recalculated as the present value of the renegotiated or modified contractual cash flows, discounted at the original effective interest rate and gain or loss is recognized. The financial asset continues to be subject to the same assessments for significant increase in credit risk relative to initial recognition and credit-impairment, as described above. A modified financial asset will migrate out of Stage 3 if the conditions that led to it being identified as credit-impaired are no longer present and relate objectively to an event occurring after the original credit-impairment was recognized. A modified financial asset will migrate out of Stage 2 when it no longer satisfies the relative thresholds set to identify significant increase in credit risk, which are based on changes in its PD, lifetime PD, days past due and other qualitative considerations.

If a modification of terms results in derecognition of the original financial asset and recognition of the new financial asset, the new financial asset will generally be recorded in Stage 1, unless it is determined to be credit-impaired at the time of renegotiation. For the purposes of assessing for significant increase in credit risk, the date of initial recognition for the new financial asset is the date of modification.

57. Hedge accounting

From the applying of IFRS 9 from 1 January 2018, the Group has chosen to continue to apply the hedge accounting requirements of IAS 39, in line with exemption from IFRS 9. However, the Group will provide the expanded disclosures on hedge accounting introduced by IFRS 9's amendments to IFRS 7, as the accounting policy election does not provide an exemption from the new disclosure requirements under IFRS 7.

The Group applies fair value hedge accounting with respect to designated hedging relationship of certain fixed-rate foreign currency denominated notes issued by the Bank as the hedged items and certain foreign currency denominated interest rate swaps as the hedging instruments. The Group recognizes the changes in fair value of the interest rate swaps together with changes in the fair value of bonds attributable to interest rate risk immediately in profit or loss in the line item of Note 10, Net gain on fair value hedge of interest rate swap. Calculated accrued interest on both swaps and bonds are included in the line item of Note 7, Interest expense.

Other derivatives, not designated in a qualifying hedge relationship, are used to manage its exposure to foreign currency, interest rate, equity market and credit risk. The financial instruments used include, but are not limited to, interest rate swaps, cross-currency swaps, forward contracts, futures, options, credit swaps and equity swaps.

On initial designation of the hedges, the Group formally documented the relationship between the hedging instruments and hedged items, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationships. The Group makes an assessment, both at inception of the hedge relationships and on an ongoing basis, of whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value of the hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within the range of 80–125%.

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

58. Cash and cash equivalents

Cash and cash equivalents in the Statement of Cash Flows consist of cash, demand deposits with the Central Bank and demand deposits with other credit institutions. Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition. Cash and cash equivalents are carried at amortized cost in the Statement of Financial position.

59. Loans

Loans are financial instruments with fixed or determinable payments that are not quoted in an active market and that the Group does not intend to sell immediately or in the near term. Loans include loans provided by the Group to credit institutions and to its customers, participation in loans from other lenders and purchased loans.

Loans are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortized cost using the effective interest method.

When the Group is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of the asset to the lessee, the arrangement is classified as a capital lease and a receivable equal to the net investment in the lease is recognized and presented within loans.

When the Group purchases an asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date reverse repo or stock borrowing, the arrangement is accounted for as a loan, and the underlying asset is not recognized in the Group's Consolidated Financial Statements.

60. Derivatives

A derivative is a financial instrument or other contract, the value of which changes in response to a change in an underlying variable, such as share, commodity or bond prices, an index value or an exchange or interest rate, which requires no initial net investment or initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors and which is settled at a future date.

Derivatives are recognized at fair value. Fair value changes are recognized in the Income Statement. Changes in fair values of derivatives are split into interest income, foreign exchange differences and net financial gain or loss. Interest income is recognized on an accrual basis. Derivatives with positive fair values are recognized as Financial instruments and derivatives with negative fair values are recognized as Financial liabilities at fair value.

61. Intangible assets

Goodwill and infrastructure

Goodwill and infrastructure that arises on the acquisition of subsidiaries is presented with intangible assets. Subsequent to initial recognition goodwill and infrastructure is measured at cost less accumulated impairment losses.

Customer relationship and related agreements

Customer relationship and related agreements are measured at cost less any accumulated impairment losses.

Software

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

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

Amortization of intangible assets

Amortization of intangible assets is recognized in the Income Statement on a straight-line basis over the estimated useful life, from the date that it is available for use. The estimated useful life of intangible assets for the current and comparative periods is three to ten years.

62. Investment property

An investment property is a property which is held either to earn rental income or for capital appreciation or for both.

Investment property is initially measured at cost and subsequently at fair value. Gains or losses arising from changes in the fair values of investment properties are included in the Income Statement.

63. Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets, other than assets held for sale, investment property and deferred tax assets, are reviewed at each reporting date to determine, whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. The recoverable amount of intangible assets is assessed annually.

An impairment loss is recognized if the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognized in profit or loss.

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

An impairment loss in respect of other assets, where impairment losses have been recognized in prior periods, are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

64. Deposits

Deposits are initially measured at fair value plus transaction costs, and subsequently measured at their amortized cost using the effective interest method.

65. Borrowings

Borrowings are measured at amortized cost with any difference between cost and redemption amount being recognized in the Income Statement over the period of the borrowings on an effective interest basis. Accrued interest is included in the carrying amount of the borrowings.

66. Subordinated liabilities

Subordinated liabilities are financial liabilities in the form of subordinated capital which, in case of the Group's voluntary or compulsory winding-up, will not be repaid until after the claims of ordinary creditors have been met. In the calculation of the capital ratio, they are included within both Tier 1 and Tier 2, based on terms of each instrument. The Group may only retire subordinated liabilities with the permission of the FSA.

Subordinated liabilities are recognized initially at fair value less attributable transaction costs. Subsequent to initial recognition, subordinated liabilities are stated at principal amount due plus accrued interest, which is recognized in the Income Statement based on the contractual terms of the borrowing.

67. Assets and disposal groups held for sale

The Group classifies a Asset or disposal group as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case the asset or disposal group must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such asset or disposal group and the sale must be highly probable.

Immediately before classification as held for sale, the measurement of the qualifying assets and all assets and liabilities in a disposal group is brought up-to-date in accordance with applicable IFRS. Then, on initial classification as held for sale, Assets and disposal groups are recognized at the lower of carrying amount and fair value less costs to sell. Impairment losses on initial classification as held for sale are included in the Income Statement, even when there is a revaluation. The same applies to gains and losses on subsequent remeasurement. Revaluation through the reversal of impairment in subsequent periods is limited so that the carrying amount of the held for sale, Assets or disposal groups does not exceed the carrying amount that would have been determined had no impairment loss been recognized in prior years.

68. Other assets and other liabilities

Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses. When parts of an item of property and equipment have different useful lives, they are accounted for as separate items of property and equipment.

Subsequent expenditure is capitalized only when it is probable that the future economic benefits of the expenditure will flow to the Group. Ongoing repairs and maintenance are expensed as incurred.

The depreciable amount of property and equipment is determined after deducting its residual value. Depreciation is charged to the Income Statement on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. The estimated useful lives are as follows:

Real estates	33 years
Equipment	3-15 years

The depreciation methods, useful lives and residual values are reassessed annually.

Right-of-use asset and lease liability

The Group assesses whether a contract is or contains a lease, at inception of the contract. The Group recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases and leases of low value assets. For these leases, the Group recognises the lease payments as an operating expense on a straight-line basis over the term of the lease. The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by using the Group's incremental borrowing rate. The right-of-use assets comprise the initial measurement of the corresponding lease liability. They are subsequently measured at cost less accumulated depreciation.

Other assets and other liabilities

Other assets and other liabilities are stated at cost less impairment.

Technical provision

Estimate is made in accordance with Solvency II rules. Data from the company's claim system are extrapolated to predict the final amount of the claims that will be paid at the end of the reporting period with corresponding expected payments from reporting date until the settlement of claims that occurred prior to the reporting date. In addition, estimation of settlement cost, risk and other factors is made in accordance with the instructions in Solvency II rules. This approach is consistent with the valuation of insurance liabilities in IFRS 4.

69. Equity

Share capital and share premium

Par value of issued share capital is ISK 1 per share. The holders of ordinary shares are entitled to receive dividends as approved by the AGM and are entitled to one vote per share at shareholders' meetings.

Treasury shares

The consideration paid for the purchase of own shares is deducted from the shareholders equity as treasury shares. No gain or loss is recognised in the Income Statement on purchase or sale of treasury stock.

Dividends

Dividends on shares are recognized in equity in the period in which they are approved by Arion Bank's shareholders.

Option reserve

The option reserve represents the cumulative charge to the Income Statement for options for employees to purchase shares in Arion Bank. The stock option plan is set up in accordance with article 10 in Act on income tax No. 90/2003.

Warrants reserve

The warrants reserve represents the consideration received for outstanding warrants.

Reserve for investments in subsidiaries and associates

According to the Financial Statements Act No. 3/2006 the difference between share of profit of subsidiary or associate in excess of dividend payment or dividend payment pending, shall be transferred to a restricted shareholding equity reserve, net of tax, which is not subject to dividend payments. When shareholding in subsidiary or associate is sold or written off the shareholding equity reserve shall be released and the amount transferred to retained earnings.

Reserve for investments in securities

According to the Financial Statements Act No. 3/2006 fair value changes of financial assets from the initial reporting, shall be transferred from retained earnings to a fair value equity reserve, net of tax. The fair value equity reserve is not subject to dividend payments. The fair value equity reserve shall be released in accordance with fair value changes recognized when financial asset is sold or redeemed or the assumptions for the fair value change is no longer in force.

69. Equity, continued

Reserve due to capitalized development cost

According to the Financial Statements Act No. 3/2006 entities that capitalize development costs shall transfer a corresponding amount from retained earnings to a separate reserve. The reserve is not subject to dividend payments. The reserve shall be eliminated in an amount corresponding to the annual depreciation of the capitalized development cost. The reserve shall be released if the asset is sold or fully depreciated.

Financial assets at fair value through OCI

Unrealized fair value changes net of tax for assets held at fair value through other comprehensive income. The fair value reserve is released in correlation with realization of gains or losses of financial assets at derecognition.

Statutory reserve

According to the Icelandic Companies Act No. 2/1995 at least 10% of the profit of the Group which is not devoted to meeting losses from previous years and is not contributed to other legal reserves must be contributed to the statutory reserve until it amounts to 10% of the share capital. When that limit has been reached the contribution must be at least 5% of the profit until the statutory reserve amounts to 25% of the share capital of the Bank.

Foreign currency translation reserve

The foreign currency translation reserve comprises all foreign exchange differences arising from the translation of the Consolidated Financial Statements of foreign operations.

70. Earnings per share

The Group presents basic and diluted earnings per share (EPS). Basic earnings per share is calculated by dividing the net earnings attributable to the shareholders of Arion Bank hf. by the weighted average number of ordinary shares outstanding during the year. Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding during the year to assume conversion of all dilutive potential ordinary shares, which comprise share options granted to employees and issued warrants.

71. Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognized in the Consolidated Financial Statements at fair value, being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amount initially recognized less, when appropriate, cumulative amortization recognized in the Income Statement, and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee. Any increase in the liability relating to financial guarantees is recorded in the Income Statement. The premium received is recognized in the Income Statement in Net fees and commission income on a straight line basis over the life of the guarantee.

72. Fiduciary activities

The Group provides asset custody, asset management, investment management and advisory services to its clients. These services require the Group to make decisions on the treatment, acquisition or disposal of financial instruments. Assets in the Group's custody are not reported in its Statement of Financial Position.

73. Employee benefits

All entities with employees within the Group have defined contribution plans. The entities pay fixed contributions to publicly or privately administered pension plans on a mandatory and contractual basis. The Group has no further payment obligations once these contributions have been paid. The contributions are recognized as an expense in the Income Statement when they become due. The Group does not operate any pension fund which confers pension rights.

Share-based payment expense

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 payments granted to employees is recognized as an salary expense, with a corresponding increase in equity, over the contratual period. The amount recognized as an expense is adjusted to reflect the number of shares that are expected to be exercised at the vesting date.

74. Standards issued but not yet effective

New standards, amendments to standards and interpretations have been issued but are not yet effective for the year ended 31 December 2021, and have not been applied in preparing these Consolidated Financial Statements. Relevant to the Group's reporting is IFRS 17 Insurance contracts.

IFRS 17 Insurance Contracts

IFRS 17 Insurance Contracts, is comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance). The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. IFRS 17 is effective for reporting periods beginning on or after 1 January 2023, with comparative figures required. This standard will be applicable to the Group's subsidiary Vördur and based on analysis performed to assess the impacts of the implementation of the standard it is considered to have minor impacts on the Statement of Comprehensive Income of the Group.

5-year overview

Income Statement

	2021	2020	2019	2018	2017
Net interest income	32,063	31,158	30,317	29,319	28,920
Net fee and commission income	14,673	11,642	9,950	10,350	10,211
Net insurance income	3,442	3,071	2,886	2,589	2,093
Net financial income	6,220	2,745	3,212	2,302	4,045
Share of profit of associates and net impairment	22	-	756	27	(927)
Other operating income	1,805	2,148	877	1,584	2,521
Operating income	58,225	50,764	47,998	46,171	46,863
Salaries and related expense	(14,638)	(12,332)	(14,641)	(14,278)	(13,602)
Other operating expense	(11,237)	(12,109)	(12,222)	(12,000)	(9,291)
Operating expenses	(25,875)	(24,441)	(26,863)	(26,278)	(22,893)
Bank levy	(1,516)	(1,301)	(2,984)	(3,386)	(3,172)
Net impairment	3,169	(5,044)	(382)	(3,525)	312
Earnings before income tax	34,003	19,978	17,769	12,982	21,110
Income tax expense	(6,782)	(3,231)	(3,714)	(4,046)	(5,966)
Net earnings from continuing operations	27,221	16,747	14,055	8,936	15,144
Discontinued operations, net of tax	1,394	(4,278)	(12,955)	(1,159)	(725)
Net earnings	28,615	12,469	1,100	7,777	14,419

Statement of Financial Position

Assets

	2021	2020	2019	2018	2017
Cash and balances with Central Bank	69,057	42,136	95,717	83,139	139,819
Loans to credit institutions	30,272	28,235	17,947	56,322	86,609
Loans to customers	936,237	822,941	773,955	833,826	765,101
Financial instruments	225,657	227,251	117,406	114,557	109,450
Investment property	6,560	6,132	7,119	7,092	6,613
Investments in associates	668	891	852	818	760
Intangible assets	9,463	9,689	8,367	6,397	13,848
Tax assets	2	2	2	90	450
Assets and disposal groups held for sale	16,047	16,811	43,626	48,584	8,138
Other assets	19,901	18,618	16,864	13,502	16,966
Total Assets	1,313,864	1,172,706	1,081,855	1,164,327	1,147,754

Liabilities and Equity

	2021	2020	2019	2018	2017
Due to credit institutions and Central Bank	5,000	13,031	5,984	9,204	7,370
Deposits	655,476	568,424	492,916	466,067	462,161
Financial liabilities at fair value	5,877	5,240	2,570	2,320	3,601
Tax liabilities	7,102	4,262	4,404	5,119	6,828
Liabilities associated with disposal groups held for sale	16,935	16,183	28,631	26,337	-
Other liabilities	37,151	32,714	32,697	30,107	57,062
Borrowings	356,637	298,947	304,745	417,782	384,998
Subordinated liabilities	35,088	36,060	20,083	6,532	-
Total liabilities	1,119,266	974,861	892,030	963,468	922,020
Shareholders' equity	193,925	197,672	189,644	200,729	225,606
Non-controlling interest	673	173	181	130	128
Total equity	194,598	197,845	189,825	200,859	225,734
Total Liabilities and Equity	1,313,864	1,172,706	1,081,855	1,164,327	1,147,754

Valitor hf. was classified as disposal group held for sale in 2018, see Note 29.

Amounts are in ISK millions

Appendix

Unaudited

Corporate Governance Statement of Arion Bank

for 2021

Arion Bank (Arion Bank or the Bank) is an Icelandic public limited company whose shares are listed on Nasdaq Iceland and Nasdaq Stockholm. Here the Board submits its Corporate Governance Statement for 2021. Corporate governance is focused on how responsibilities are allocated among the various bodies of the Bank and how systems for decision making are constructed, in accordance with prevailing laws and regulations. Arion Bank's shareholders exercise governance principally by electing the Board of Directors, which in turn appoint the CEO and monitor the Bank's conduct of business. The CEO is responsible for the day-to-day operations of the Bank and represents the Bank in all matters concerning normal operations. The CEO must in this respect comply with the relevant legislation, the Bank's Articles of Association and the policies and instructions laid down by the Board. The CEO is responsible for the implementation of the Bank´s policies.

Fundamentals to corporate governance at Arion Bank are, on the one hand, the Articles of Association which are approved by shareholders, and, on the other, policies and other documents adopted by the Board of Directors. These include the Board's Rules of Procedure, and the Rules of Procedure of the Board's Sub-Committees, and policies regarding the Bank's operations and enterprise risk management architecture. These policies are revised every year, and whenever deemed necessary. Even more important is the Bank's corporate culture, strategy, and operational procedures. Good corporate governance and corporate culture helps to foster open and honest relations between the Board of Directors, shareholders, customers, and other stakeholders, such as the Bank's employees and the public. Corporate governance also provides the foundations for responsible management and decision-making, with the objective of generating sustainable long-term value creation. The Board of Directors places great importance on good corporate governance and re-evaluates its governance practices regularly on the basis of recognized guidelines on corporate governance.

A central part of governance for financial institutions involves managing risks which will invariably arise in operations. Risk management is described further in later in this statement, the Bank's Annual Report and in the Bank's Pillar 3 report. Establishing and maintaining effective risk management and controls constitutes a key challenge in the Bank's activity and to the Bank's overall soundness.

This Corporate Governance Statement is based on the legislation, regulations and recognized guidelines which are in force at the time the Bank's financial statement is adopted by the Board of Directors.

Excellence in corporate governance

Arion Bank has been recognized as a company which has achieved excellence in corporate governance, following a formal assessment based on the Icelandic Guidelines on Corporate Governance issued by the Icelandic Chamber of Commerce, SA – Business Iceland and Nasdaq Iceland, initially in December 2015 and again in April 2019. This recognition was granted following an in-depth assessment by an independent party of corporate governance at the Bank, including governance by the Board of Directors, Sub-Committees and management.

Compliance with guidelines on good corporate governance

When it comes to governance arrangements, Arion Bank applies the European Banking Authority (EBA) Guidelines on Internal Governance (EBA/GL/2017/11), in line with requirements found in Regulation (EU) 1093/2010 and Act 24/2017, on European Financial Supervision. EBA has published revised Guidelines on Internal Governance (EBA/GL/2021/05), which apply to the Bank's operations as of 31 December 2021. These Guidelines are available on the website of the Financial Supervisory Authority of the Central Bank of Iceland.

Furthermore, according to the Financial Undertakings Act No. 161/2002 Arion Bank is obliged to comply with recognized guidelines on corporate governance. The Bank complies with the sixth edition of the Icelandic Guidelines on Corporate Governance issued by Iceland Chamber of Commerce, SA – Business Iceland and Nasdaq Iceland, published in February 2021 and in force as of 1 July 2021. According to the guidelines a company shall state whether it has deviated from the guidelines, if so, which parts and also explain why it has done so.

The Bank complies with the guidelines with two deviations:

Article 5.1.2. states that the rules of procedure of sub-committees of the Board shall be posted on the Bank's website. The rules of the Board Credit Committee have not been published on the Bank's website with respect to their nature.

The final sub-paragraph of article 5.4.5 states that the role of a remuneration committee shall include taking an independent stance on the effect of wages on the Company's risk exposure and risk management, in cooperation with the Company's Audit Committee. In line with, *inter alia*, the EBA Guidelines on Internal Governance and article 78(3) of the Act on Financial Undertakings, this role falls to the Board's Remuneration Committee in cooperation with the Board's Risk Committee.

The role of the Nomination Committee at Arion Bank is to promote good corporate governance and to facilitate informed decision-making by shareholders when selecting Board members to ensure that Board members have wide and versatile qualifications and experience. The Committee has an advisory role regarding the election of Board members and makes a proposal on their remuneration. At the Bank's annual general meeting on 16 March 2021, two members of the Nomination Committee were appointed, Júlíus Þorfinnsson and Vitaliy Ardislamov. According to the Rules of Procedure for the Nomination Committee, the third member of the Committee shall be the Chairman of the Board of Directors or another Board Member appointed by the Board.

Legal framework for the Bank's operation

Arion Bank is a financial institution which operates in accordance with the Financial Undertakings Act No. 161/2002. Acts of law which also apply to the Bank's operations include e.g. the Act on Markets for Financial Instruments No. 115/2021, to Act on Undertakings for Collective Investment in Transferable Securities (UCITS) No. 116/2021 and Act on Alternative Investment Fund Managers No. 45/2020, Act on Payment Services No. 114/2021, Act on Measures Against Money Laundering and Terrorist Financing No. 140/2018, Act on Consumer Mortgages No. 118/2016, Consumer Loans Act No. 33/2013, Competition Act No. 44/2005 and Public Limited Companies Act No. 2/1995.

Arion Bank is a strongly capitalized bank, the purpose of which is to excel by offering smart and reliable financial solutions which create future value for our customers, shareholders, and society as a whole. As noted, the Bank is listed on Nasdaq Iceland and Nasdaq Stockholm. The Bank has also issued financial instruments which have been admitted for trading on regulated securities markets in Iceland and Luxembourg. The Bank is, therefore, subject to the disclosure requirements of issuers pursuant to the Act on Markets for Financial Instruments and the rules of the relevant stock exchanges.

The Financial Supervisory Authority of the Central Bank of Iceland (FSA) supervises the operations of Arion Bank in accordance with the provisions of Act No. 87/1998 on the Official Supervision of Financial Operations. Further information on the FSA and an overview of the legal and regulatory framework applicable to the Bank, as well as FSA guidelines and guidelines issued by European Financial Supervisory institutions, can be seen on the FSA's website, www.cb.is/financial-supervision/.

Numerous other pieces of legislation apply to the operations of financial undertakings.

Internal controls, auditing and accounting

Internal control

The Bank is committed to the highest standards of corporate governance and regards internal control as an integral part of its risk management system. An effective internal control system is built to mitigate risk to acceptable levels by facilitating enlightened decision making, thus supporting the Bank in achieving its objectives and enabling the creation and preservation of value.

The objective of the Bank's system of internal controls is to ensure:

- The Bank's policies, objectives and plans are achieved within set risk appetite and threshold.
- The actions of the Board of Directors, management and employees comply with the Bank's policies, standards, processes and all relevant laws and regulations.
- The Bank's assets and resources, including its people, systems, and data are adequately protected.
- Data and information published either internally or externally is accurate, reliable, and timely.
- The risks that are inherent in the Bank's operations are managed.
- Practical controls and processes have been established that require and encourage the Board, management, and employees to carry out their duties and responsibilities in an efficient and effective manner.

The key components of the internal control framework are Control Environment, Risk Assessments, Control Activities, Information and Communication, and Monitoring Activities. These components are interrelated with all operations of the Bank.

Control Environment includes the governance and management function of the Bank, as well as the attitude of senior management towards internal control and its importance. The key principles relating to control environment include:

- Integrity and ethical values
- The attitude of senior management and tone from the top
- Organisational structure
- Assignment of authority and responsibility
- Employee skills, human resources policy and its implementation.

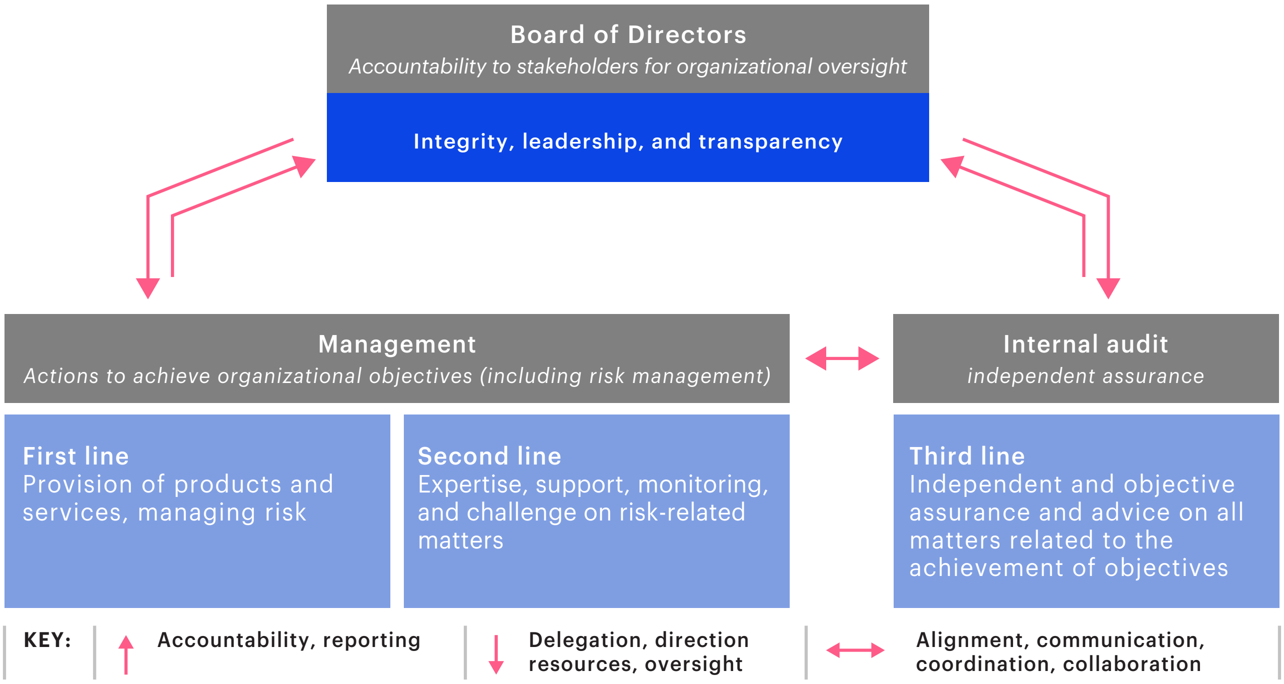
Risk Assessment is a process of identifying internal and external factors that can affect the objectives of the Bank and assess their impact and importance. It forms a basis for determining how risk should be managed so that risk-taking is in accordance with risk appetite.

Control Activities are the actions performed at all levels within the Bank and are intended to mitigate risks to acceptable levels while achieving objectives. Information is necessary for the Bank to carry out its internal control responsibilities. Communication occurs both internally and externally and provides the Bank with relevant, quality information needed to carry out day-to-day controls. Monitoring Activities are the ongoing or separate evaluations that are used to ascertain whether each of the five components of internal controls is present and functioning.

Arion Bank looks to the Three Lines Model for organizing internal controls. All lines work together to contribute to the creation and protection of value. Alignment of activities is achieved through communication, cooperation, and collaboration. This ensures the reliability, coherence, and transparency of information needed for risk-based decision making.

The first line is made up of people who have day-to-day supervision of operations and its organization. They are responsible for establishing and maintaining effective internal controls and managing risk in day-to-day operations. This involves identifying and evaluating risk and putting in place appropriate countermeasures to reduce risk. The first line is responsible for supervising the implementation of internal rules and processes in compliance with the law, regulations and the Bank's strategy and it must ensure that all actions are in compliance with established procedures and that corrective action is taken if any deficiencies are detected.

The second line is set up to ensure that the first line has established adequate internal controls



which work as intended. Risk Management and Compliance are the main participants in the second line, although other units may also be assigned specific monitoring roles.

The third line is Internal Audit, which provides independent and objective assurance and advice on the adequacy and effectiveness of governance, risk management and controls, through systematic and disciplined processes, expertise and insight. It reports its findings to management and the Board of Directors to promote and facilitate continuous improvement.

Internal audit is accountable to the Board of Directors, as independence from management is critical to its objectivity, authority, and credibility.

Compliance

Compliance is an independent control function which reports directly to the CEO and works in accordance with a special charter from the Board.

The main role of Compliance is to ensure that the Bank has in place proactive measures to reduce the risk of rules being breached in the course of its activities. Compliance is also responsible for coordinating the Bank's measures against money laundering and terrorist financing to reduce the risk of the Bank's services being used for illegal purposes. Furthermore, the Compliance Officer has the role of the Bank's Data Protection Officer. The Bank has adopted a data protection statement which can be seen on the Bank's website.

The duties of Compliance are carried out under a risk-based compliance plan approved by the Board of Directors, including a monitoring and training schedule for employees which addresses the laws and rules under which the Bank operates. Compliance provides the Board of Directors with a quarterly report on its activities.

Further information can be found on the Bank's website.

Risk Management

A central feature of the activities of all financial companies is carefully calculated risk-taking according to a predetermined strategy. Arion Bank thus takes risk compatible with its risk appetite, which is regularly reviewed and approved by the Board of Directors. The Bank's risk appetite, set by the Board, is translated into exposure limits and targets that are monitored by Risk Management. The Board is responsible for Arion Bank's internal capital adequacy assessment process, the main objective of which is to ensure that Arion Bank understands its risk profile and has systems in place to assess, quantify and monitor its total risk exposure.

The Bank's Risk Management division is headed by the Chief Risk Officer. It is independent and centralized and reports directly to the CEO and operates in accordance with a special charter from the Board. Risk Management comprises three departments whose role is to analyze, monitor and regularly report to the CEO and Board of Directors on the risks faced by the Bank.

Further information on risk management and capital management is contained in the Bank´s annual report and the Bank's risk report.

Internal Audit

The Internal Auditor is appointed by the Board of Directors and reports directly to the Board. The Board sets the Internal Auditor a charter which sets out the responsibilities associated with the position and the scope of the work. The role of the Internal Auditor is to provide independent and objective assurance and advice designed to add value and improve the Bank's operations. The scope of the audit is the Bank, its subsidiaries and pension funds serviced by Arion Bank.

The internal audit department will govern itself by adherence to the mandatory elements of The Institute of Internal Auditors' International Professional Practices Framework, including the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the International Standards for the Professional Practice of Internal Auditing, and the Definition of Internal Auditing. The chief internal auditor will report periodically to senior management, the Bank's Audit Committee and the Board of Directors regarding the internal audit department's conformance to the Code of Ethics and the Standards.

Accounting and auditing

The Bank's Finance division is responsible for preparing the accounts and this is done in accordance with the International Financial Reporting Standards (IFRS). The Bank publishes its financial statement on a quarterly basis and management statements are generally submitted to the Board ten times a year. The Board Audit Committee examines the annual financial statement and interim financial statements, while the external auditors review and audit the accounts twice a year. The Board Audit Committee gives its opinion on the accounts to the Board of Directors, which then approves and endorses the accounts.

Cornerstones and code of ethics

Arion Bank's cornerstones is the name used to describe the Bank's core values. The cornerstones are designed to provide guidance when making decisions and in everything else employees say and do. They refer to the Bank's role, attitude, and conduct. Arion Bank's cornerstones are: We find solutions, we make a difference, we get things done, and, we say what we mean.

The management and employees of Arion Bank are conscious of the fact that the Bank's activities affect different stakeholders and society at large. The Bank's code of ethics is designed to serve as a key to responsible decision-making at Arion Bank. The code of ethics is approved by the Board of Directors.

Sustainability Risk

Sustainability risk refers to the risk of certain activities or practices compromising the ability of future generations or segments of society to meet their own needs, e.g. due to negative effects on the environment, natural or cultural resources or social conditions.

Sustainability risk is a driver of other risk types, such as credit risk and market risk. It can materialize in the short term, the medium term, and the long term. Environmental risks comprise of transition risks and physical risks and the Bank assesses both inside-out risks (the impact from the Bank's operations) and outside-in risks (impact through the Bank's credit and investment portfolios).

Climate and environmental risks are assessed in the Bank's Internal Capital Adequacy Assessment Process and considered in the Bank's stress testing program.

Arion Bank has been a partner of Festa, the Icelandic Center for Corporate Social Responsibility, for several years and since 2014 has been a signatory to the CEO Statement of Support for the Women's Empowerment Principles (UN Women and UN Global Compact). In 2015 the Bank signed the City of Reykjavík and Festa's Declaration on Climate Change and has published its environmental accounts since 2016. Arion Bank has been a signatory to the UN Global Compact, the UN's initiative to encourage businesses to adopt sustainable and socially responsible practices, since the end of 2016. The Bank has also complied with the UN's Principles for Responsible Banking (UN PRI) since the end of 2017. In September 2019 the Bank became a signatory to the UN Principles for Responsible Banking (UN PRB), the goal of which is to align banking with international goals and commitments such as the UN Sustainable Development Goals and the Paris Climate Agreement.

Arion Bank's activities are governed by the provisions of the Annual Accounts Act on non-financial reporting, which, among other things, apply to the status and influence of the company in respect of environmental, social and human resources issues. Non-financial reporting in the annual report is based on the Global Reporting Initiative, GRI Core and the ESG reporting guide for the Nasdaq Nordic and Baltic exchanges.

The Board of Directors has the ultimate responsibility for ensuring effective management of sustainability risk. The CEO establishes and maintains an appropriate formal framework for managing and mitigating sustainability risks. The framework must be in accordance with the Bank's risk appetite and regulatory requirements.

Further information on sustainability at Arion Bank can be found in the Bank's 2021 Annual Report. Further information can be found on the Bank's website.

Board of Directors and committees

The main duty of the Board of Directors of Arion Bank is to manage the Bank between shareholders' meetings according to applicable laws, regulations, and articles of association. The Board tends to those operations of the Bank which are not considered part of the day-to-day business, i.e. it makes decisions on issues which are unusual or of a significant nature. One of the Board's main duties is to supervise the Bank's activities. The Board's work, duties and role are defined in detail in the rules of procedure of the Board of Directors, which have been established on the basis of the EBA Guidelines on Internal Governance, Article 54 of the Financial Undertakings Act, Article 70 of the Public Limited Companies Act No. 2/1995, FSA Guidelines No. 1/2010, and the articles of association of the Bank. The rules of procedure of the Board of Directors can be found on the Bank's website.

The Board of Directors appoints a Chief Executive Officer who is responsible for the day-to-day operations in accordance with a strategy set out by the Board. The Board of Directors and the Chief Executive Officer shall carry out their duties with integrity and ensure that the Bank is run in a sound and reasonable manner in the interests of the customers, the community, the shareholders and the Bank itself, cf. Article 1 (1) of the Financial Undertakings Act. The Chief Executive Officer shall ensure that the Board receives sufficient support to carry out its duties.

The Board of Directors is generally elected for a term of one year at the Bank's annual general meeting. At Arion Bank's annual general meeting on 16 March 2021, five Directors and two Alternates were elected to the Board of Directors.

The elected Board Directors have diverse backgrounds and extensive skills, experience, and expertise. When electing the Board care is taken to ensure at least 40% representation of each gender among directors and alternates. Currently the Board consists of three men and two women.

Information on the independence of Directors is published on the Bank's website before the annual general meeting or a shareholders' meeting where a Board member is to be elected. The minutes of the annual general meeting and shareholders' meetings are also published on the Bank's website.

The Board of Directors meets at least ten times a year. In 2021 the Board met on 14 occasions. The Chairman of the Board is responsible for ensuring that the Board performs its role in an efficient and organized manner. The Chairman chairs Board meetings and ensures that there is enough time allocated to the discussion of important issues and that strategy issues are discussed thoroughly. The Chairman is not permitted to undertake any other work for the Bank unless part of the normal duties of the Chairman.

According to the Board's Rules of Procedure the Board is permitted to establish committees to discuss particular areas of the Bank's operations. No later than one month following the annual general meeting the Board appoints members to each of its sub-committees and assesses whether it is necessary to appoint external members to certain committees in order to bring in a greater level of expertise. One of the committee members in the Board Audit Committee, Heimir Þorsteinsson, is not a Board member and is independent of the Bank and its shareholders. The Board sub-committees are as follows

Board Audit Committee (BAC): The BAC´s main role is to contribute to the high-quality statutory auditing of the Bank and monitor the effectiveness of the Bank's internal quality control, risk management systems and internal audit function, with regard to the Bank's financial reporting. The Committee met five times in 2021.

- Board Risk Committee (BRIC): The Committee's main role is, inter alia, to evaluate the Bank's risk policy and risk appetite and to have a thorough knowledge of the risk assessments and methods used to manage risk employed by the Bank. Committee members should have the qualifications and experience necessary to be able to discharge their duties including forming the Bank's risk policy and risk appetite. The Committee met eight times in 2021.

- Board Credit Committee (BCC): Its main task is to attend to credit issues which exceed the credit limits of its sub-committees. The Committee met ten times in 2021.
- Board Remuneration Committee (BRC): The Committee's main role is to prepare a remuneration policy for the Bank on an annual basis. It also advises the Board on remuneration to the CEO, Managing Directors, the Compliance Officer and the Chief Internal Auditor, and on the Bank's incentive scheme and other work-related payments. The Bank's remuneration policy shall be examined and approved by a shareholders' meeting annually. The Committee met four times in 2021.
- Board Tech Committee (BTC): The Board has setup a temporary, *ad hoc*, tech committee, whose main role is to advice the Board of Directors and the Bank's Senior Management on the Bank's near to medium term development of the Bank's IT function, including IT strategy. The Committee met five times in 2021.

Board member		**Board (14)**	**BAC (5)**	**BRIC (8)**	**BCC (10)**	**BRC (4)**	**BTC (5)**
Brynjólfur Bjarnason	1. Jan. - 31. Des.	14	5	-	10	4	-
Paul Horner[1]	1. Jan. - 31. Des.	14	4[1]	8	10	-	-
Gunnar Sturluson[2]	1. Jan. - 31. Des.	14	5	5[2]	10	-	-
Liv Fiksdahl[3]	1. Jan. - 31. Des.	14	4[3]	-	-	4	5
Renier Lemmens[4]	1. Jan. - 31. Des.	3	1	3	-	-	2
Steinunn Kr. Þórðardóttir[5,6]	1. Jan. - 31. Des.	14	-	8	4[5]	-	3[6]
Sigurbjörg Á. Jónsdóttir	1. Jan. - 31. Des.	3	1	-	-	1	-
Þröstur Ríkharðsson	1. Jan. - 31. Des.	-	-	-	-	-	-
Heimir Þorsteinsson[7]	1. Jan. - 31. Des.	-	5	-	-	-	-

Sub-committees regularly inform the Board of their activities. Furthermore, the Board has access to all material used by the sub-committees and their minutes.

Below is an overview of the attendance of individual Directors and committee member.

The Board carries out an annual performance appraisal, at which it assesses its work, the Board composition with respect to experience and skills, working procedures and methods, the performance of the CEO, their achievements and the work of the subcommittees with respect to the aforementioned. This appraisal was last performed by the Board during the period October to December 2021.

[1] Paul Horner was appointed to the BAC on 15 April 2021. He has attended all BAC meetings since his appointment.

[2] Gunnar Sturluson was appointed to the BRIC on 15 April 2021. He has attended all BRIC meetings since his appointment.

[3] Liv Fiksdahl was appointed to the BAC on 15 April 2021. She has attended all BAC meeting since her appointment.

[4] Renier Lemmens left the Board of Directors at the Bank's AGM in March 2021.

[5] Steinunn Kr. Þórðardóttir was member of the BCC until 15 April 2021. She attended all BCC meeting until she left the Committee.

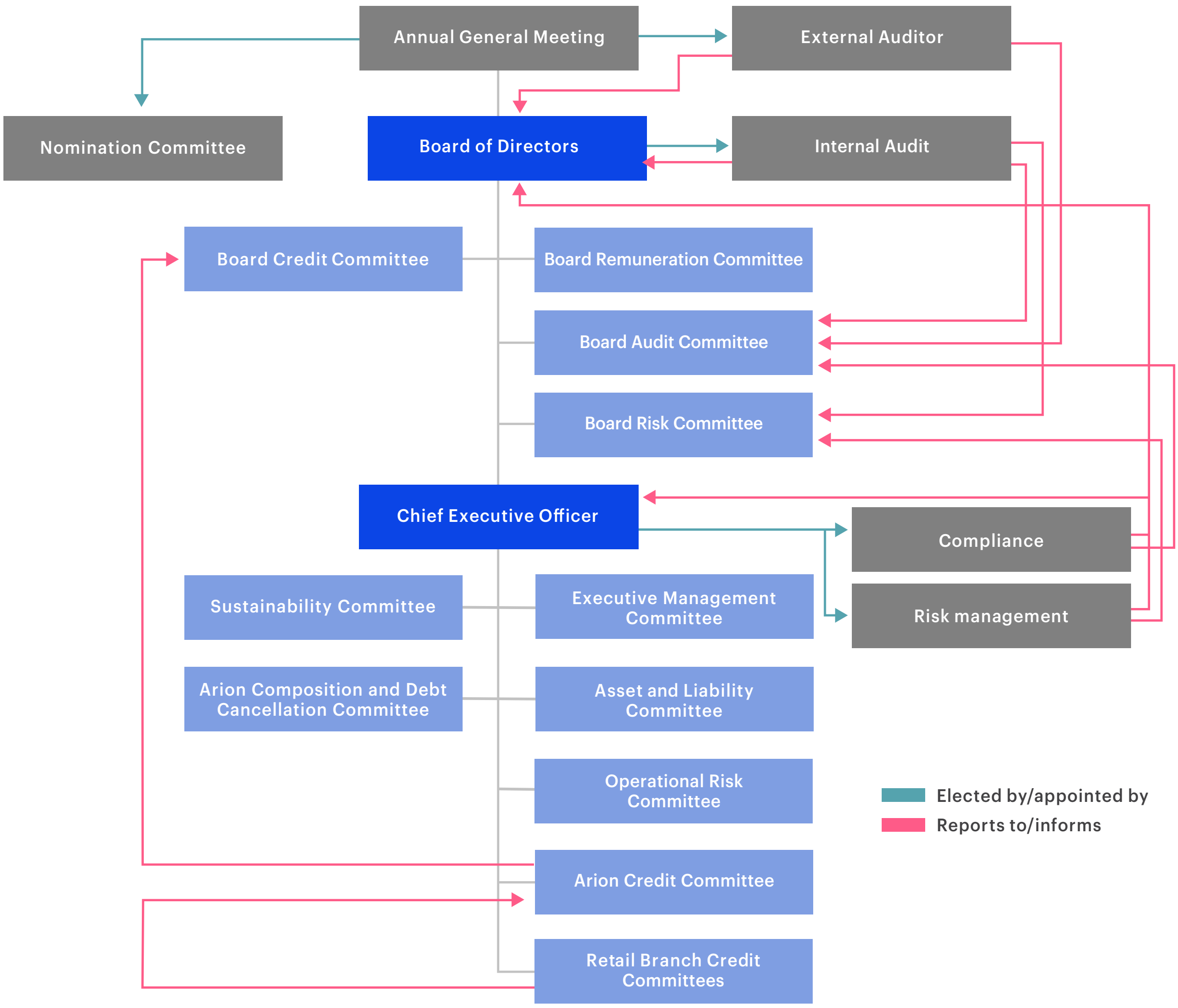
[6] Steinunn Kr. Þórðardóttir was appointed to the BTC on 15 April 2021. She has attended all BAC meeting since her appointment.

[7] Heimir Þorsteinsson is certified public accountant and appointed as an external member of the BAC.

The Board of Directors of Arion bank

Brynjólfur Bjarnason
Paul Horner
Gunnar Sturluson
Liv Fiksdahl
Steinunn Kristín Þórðardóttir

ARION BANK GOVERNANCE OVERVIEW



Brynjólfur Bjarnason, Chairman

Brynjólfur was born in 1946. He was first elected as a Director at a shareholders' meeting on 20 November 2014. He is not a shareholder in Arion Bank and is an independent Director. Brynjólfur is Chairman of the Board, and sits on the Board Remuneration Committee, the Board Credit Committee and the Board Audit Committee.

Brynjólfur graduated with an MBA from the University of Minnesota in 1973 and a cand. oecon. degree in business studies from the University of Iceland in 1971.

He was managing director of the Enterprise Investment Fund from 2012 to 2014. Between 2007 and 2010 he was the chief executive officer of Skipti. Brynjólfur was chief executive officer of Síminn from 2002 to 2007 and chief executive officer of Grandi hf. from 1984 to 2002. Between 1976 and 1983 he was managing director of the publisher AB bókaútgáfa. He was also head of the economics department of VSÍ from 1973 to 1976. Brynjólfur has broad experience as a director and has served on numerous boards and been chairman of several.

Brynjólfur is an Alternate on the Board of Fergusson ehf. and a board member of Marinvest ehf. og ISAL hf.

Paul Horner

Paul was born in 1962. He is not a shareholder in Arion Bank and is an independent candidate. Paul is Vice Chairman of the Board, Chairman of the Board Credit Committee and member of the Board Risk Committee and the Board Audit Committee.

Paul graduated with M.A. Honours in music from the University of Oxford in 1983 and is an associate of the UK Chartered Institute of Bankers.

Paul has extensive experience of Risk and General Management in Retail, Commercial, Investment and Private Banking, gained across various International markets

Paul held various Executive and Risk Management roles at Barclays PLC between 1988 and 2003. In 2003 Paul joined The Royal Bank of Scotland Group and served as an Executive and Senior Manager of Royal Bank of Scotland PLC and was appointed to various senior Risk and General Management Roles until June 2019. In 2012 to 2017, Paul was the Chief Risk Officer of Coutts & Co Ltd. and CEO of Coutts & Co Ltd, Zurich, in 2016-2017. In 2018 Paul was Chief Risk Officer of Ulster Bank DAC, Dublin, and a Non-Executive Director at Coutts & Co Ltd. in Zurich from 2018-2021.

Paul serves as on the board of AIB Group P.L.C, and is member of the AIB audit committee, operational resilience committee and chairs the risk committee. He serves on the Board of LHV (UK) Ltd and as a member of its risk, audit and nominations committees. At the time of publication of this statement, subject to pending approval by the UK regulator, he will also chair the risk committee.

Gunnar Sturluson

Gunnar was born in 1967. He was first elected as a Director at a shareholders' meeting on 9 August 2019. He is not a shareholder of Arion Bank and is an independent Director. Gunnar is a member of the Board Credit Committee and Chairman of the Board Audit Committee.

Gunnar graduated as Cand. Jur from the University of Iceland in 1992, gained an LL.M. degree in Law from the University in Amsterdam in 1995 and received a license to practice before the District Court in Iceland in 1993 and before the Supreme Court in 1999.

Gunnar practiced law at the law firm Málflutningsskrifstofan in 1992-1999 and became partner in 1995. He joined Logos Legal Services in 2000 as a partner and was managing partner in 2001-2013. Gunnar lectured in competition law in 1995-2007 at the University of Iceland, Faculty of Law.

Gunnar has held various directorships, including the board of directors at Gamma hf. in 2017-2019, chairman of the board of directors of the Icelandic National Broadcasting Service (RÚV) 2016-2017, director at the Nordic Arbitration Center, president of the International Federation of Icelandic Horse Associations, chairman of the board of directors of the Icelandic Dance Company 2013-2016 and was voted by the Icelandic parliament to serve on the National Electoral Commission in 2013-2017.

Liv Fiksdahl

Liv was born in 1965. She was first elected as a Director at Arion Bank's Annual General Meeting on 20 March 2019. She is not a shareholder in Arion Bank and is an independent Director. Liv is chairman of the Board Remuneration Committee and the Board Tech Committee and member of the Board Audit Committee.

Liv holds a degree in Finance and Management from Trondheim Business School (today NTNU) in 1986. In 2018, Liv completed programs at Stanford University in Big Data, strategic decisions and analysis, and the Innovative Technology Leader. She has also completed an Advanced Management Program for executives in management, innovation and technology at Massachusetts Institute of Technology.

Liv is a Vice President (associated) within Financial Services at Capgemini Invent, Norway, and serves on the boards of Posten Norge AS and Intrum AB. Liv has held various senior roles at DNB and was part of the executive management team for 10 years, and her most recent role was as the Group EVP, CIO/COO, for IT & Operations. Liv has a broad experience from DNB and has held different positions across the value-chain within the bank. Before DNB she had Key Account roles for corporate clients within Danske Bank/Fokus Bank, and Svenska Handelsbanken. Liv has served on numerous boards, including Scandinavian Airlines SAS AB, BankAxept, Sparebankforeningen, Doorstep, Finans Norge and Trondheim Kommune Bystyret.

Steinunn Kristín Thórdardóttir

Steinunn was born in 1972. She was first elected as a Director at a shareholders' meeting on 30th November 2017. She is a shareholder in Arion Bank (her shareholding is 12000 shares) and is an independent Director. Steinunn is the chairman of the Board Risk Committee and a member of the Board Remuneration Committee and the Board Tech Committee.

Steinunn holds a master's degree in international management from Thunderbird, Arizona, and a BA in international business and politics from University of South Carolina.

Steinunn is CFO of Arundo Analytics AS in Oslo, Norway. Steinunn was previously a partner and CEO of Beringer Finance Norway in 2015-2017 and interim CEO of Beringer Finance in Iceland and global head of food and seafood in 2017. She founded Akton AS and Acton Capital AS, a management consulting and investment company in Norway , where she worked with investments and consulting in the role of a managing director. Steinunn worked at Íslandsbanki (later Glitnir) as the managing director and head of the bank's UK operation and prior to that she was an executive director heading the International Corporate Credit and Syndications.

Steinunn has previously held several directorships in Europe and was a board member of the Icelandic State Financial Investment (ISFI). Steinunn is the chairman of the board of Acton Capital AS and Akton AS and a board member of Cloud Insurance AS. She is also a board member of the Norwegian-Icelandic Chamber of Commerce. Steinunn is a member of the nomination committee of Síminn.

Alternate directors:

Sigurbjörg Ásta Jónsdóttir, lawyer, and Þröstur Ríkharðsson, Supreme Court attorney.

More information on the Board of Directors can be found on the Bank's website.

Communication between the shareholders and the Board of Directors

The main venue at which the Board and the Bank report information to the shareholders and propose decisions to be made is at legally convened shareholders' meetings. The Bank provides an effective and accessible arrangement for communications between shareholders and the Board of Directors between those meetings. Any information sensitive to the market will be released through a MAR press release. As part of the investor relations program, Arion Bank has also arranged quarterly meetings where the CEO, CFO and Investor Relations present the interim financial results.

Chief Executive Officer

Benedikt Gíslason

Benedikt was born in 1974. Benedikt was appointed CEO on 1 July 2019.

Benedikt joined FBA (later Íslandsbanki) in 1998, held a variety of managerial positions at Straumur-Burðarás, was managing director of capital markets at FL Group and was managing director of the investment banking division of MP Bank. Benedikt worked as a senior advisor for Iceland's Ministry of Finance and Economic Affairs and was vice-chairman of a government task force on the liberalization of the capital controls between 2013 and 2016. He served on the board of directors of Kaupthing from 2016 to 2018 and was an advisor to Kaupthing on matters relating to Arion Bank. Benedikt was elected to the Board of Directors of Arion Bank in September 2018 and served on the Board until his appointment as CEO.

Benedikt gained a C.Sc. in mechanical and industrial engineering from the University of Iceland in 1998.

Executive Committee

The Bank's Executive Committee consists of the following people and the CEO:

- Ásgeir H. Reykfjörð Gylfason, Deputy CEO and Managing Director of Corporate and Investment Banking
- Birna H. Káradóttir, General Counsel
- Ida Brá Benediktsdóttir, Managing Director of Retail Banking
- Margrét Sveinsdóttir, Managing Director of Markets
- Ólafur Hrafn Höskuldsson, Chief Financial Officer
- Steinunn Hlíf Sigurðardóttir, Managing Director of Customer Experience
- Styrmir Sigurjónsson, Managing Director of Information Technology & CTO
- Úlfar F. Stefánsson, Chief Risk Officer

More information on the Executive Committee can be found on the Bank's website.

Information on violations of laws and regulations and legal cases

Arion Bank has not been denied registration, authorization, membership or permission to conduct certain business, activity or operations. The Bank has not been subject to withdrawal, revocation or dismissal of registration, authorization, membership or permission. Information on the main legal cases relating to Arion Bank can be found in the notes to the annual financial statement.

The Board of Directors annually reviews and approves the Corporate Governance Statement. This Corporate Governance Statement was examined and approved at a meeting of the Board of Directors on 9 February 2022.

Arion Bank Ltd.
Borgartun 19
105 Reykjavik
Iceland
Id.: 581008-0150