Arion Bank

Condensed Consolidated
Interim Financial Statements
1 January - 30 September 2021

Contents

Arion Bank in brief

30.9.2021

15.2%
Return on equity

41.9%
Cost-to-income

25.4%
Capital adequacy ratio

Rating from S&P

Long term: BBB

Short term: A-2

Outlook: Stable

UNEP FINANCE INITIATIVE | PRINCIPLES FOR RESPONSIBLE BANKING

Equal Pay Certification

PRI Principles for Responsible Investment

Arion Bank

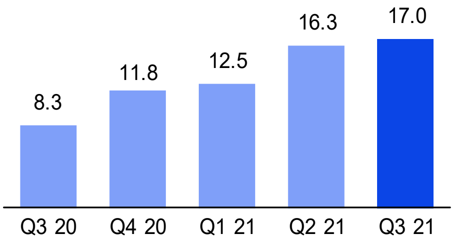
- Arion Bank and subsidiaries form a group which focuses on developing long-term relationships with its clients and is a market leader as a provider of cutting-edge and modern banking services
- The Bank's strategy is to excel by offering smart and reliable financial solutions which create future value for our customers, shareholders and society as a whole
- The diverse service offering at Arion Bank means that the revenue base is broad and the loan portfolio is well diversified between retail and corporate customers. The high percentage of mortgages and the healthy distribution of loans across different sectors reduces credit risk
- The Bank is a market leader in digital solutions and innovation. Numerous new digital solutions have been launched in the past few years, enhancing service to customers and making the Bank's operations more efficient, which in the long term reduces operating expenses across the Bank
- The bank is emphasizing on customer experience in all aspects of the Bank by centralizing shared services to increase cost efficiency and effectiveness. This includes incorporating Vordur insurance into both Reatail and CIB
- Arion Bank has significant excess capital and expects to pay dividend and/or buy-back own shares in excess of ISK 30 billion over the next years in addittion to already foreseeable dividend and buy-back of ISK 21.3 billion included in equity

Key figures

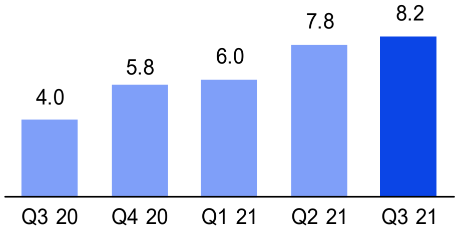
(ISK million)

	9M 2021	9M 2020
Net earnings	22,093	6,708
ROE	15.2%	4.7%
ROE continuing operations	14.6%	6.1%
Net interest margin	2.7%	2.9%
Cost to income ratio	41.9%	49.5%
Operating income / REA	7.6%	6.7%
	30.09.2021	**31.12.2020**
Total assets	1,346,092	1,172,706
Loans to customers	896,940	822,941
Deposits	641,306	568,424
Borrowings	397,031	298,947
Stage 3 gross	2.6%	2.6%
Leverage ratio	12.4%	15.1%
Number of employees	763	776
EUR/ISK	151.10	156.09

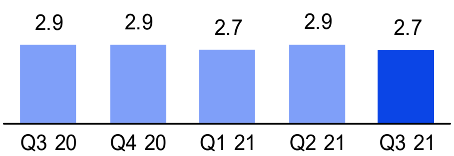
Return on equity (%)



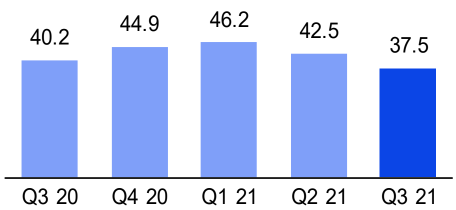
Net earnings (ISK billion)



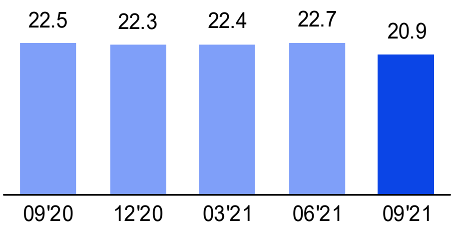
Net interest margin (%)



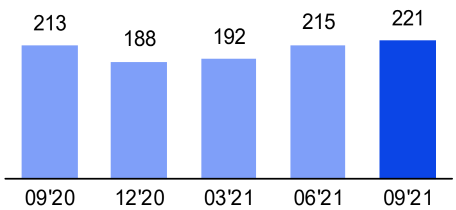
Cost-to-income ratio (%)



CET 1 ratio (%)



LCR ratio (%)



Endorsement and statement
by the Board of Directors and the CEO

The Condensed Consolidated Interim Financial Statements of Arion Bank for the period from 1 January to 30 September 2021 include the Condensed Consolidated Interim Financial Statements of Arion Bank ("the Bank") and its subsidiaries, together referred to as "the Group".

Operations during the period

Net earnings amounted to ISK 8.2 billion for the third quarter and ISK 22.1 billion for the first nine months of the year. Return on equity was 17.0% for the quarter and 15.2% for the first nine months. The cost-to-income ratio was 37.5% for the quarter and 41.9% for the first nine months.

Operating income for the quarter was ISK 14.9 billion, of which core income (net interest income, net commission income and net insurance income) was ISK 12.7 billion, representing a 7.5% increase from the third quarter last year. Net financial income amounted to ISK 1.4 billion and net impairments were positive by ISK 0.7 billion. Operating expenses for the quarter were ISK 5.6 billion, increasing by 6.8% compared with the same period the previous year, mainly due to higher salary expenses. Operating income for the first nine months of 2021 was ISK 43.0 billion, of which core income was ISK 36.5 billion, representing a 19.3% increase from the first nine months of 2020. Operating expenses were ISK 18.0 billion during the first nine months of 2021 and increased slightly compared with the same period the previous year.

The Bank's balance sheet grew by 14.8% from year-end 2020. Loans to customers increased by 9.0%, primarily mortgage lending, whereas loans to corporates increased slightly. Liquid assets increased slightly despite share buybacks and dividend payments during the period, a total of ISK 25.5 billion. On the liability side deposits increased by 12.8%, and deposits play an increasingly significant role in the Bank’s funding mix. Total equity amounted to ISK 194.6 billion at the end of the period. The Group's capital ratio was 25.4% and the CET1 ratio 20.9%. The ratios are determined on the basis of the unaudited net earnings in the quarter, with a deduction of 50% of net earnings as foreseeable dividend in line with the Bank’s dividend policy, and the ISK 10.3 billion buy-back of own shares authorized by the Financial Supervisory Authority of the Central Bank of Iceland. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 24.9% and the CET1 ratio was 20.4%. The Bank’s capital ratios comfortably exceed the total regulatory requirements. The Bank’s liquidity position was also very strong at period end, reflected in an LCR ratio of 221%.

On 1 July 2021 Arion Bank and Rapyd, a company headquartered in Israel, entered into a definitive agreement regarding the sale of the subsidiary Valitor hf. for a purchase price of USD 100 million. The transaction is subject to regulatory approval. If the sale is not completed due to the failure to obtain regulatory approval, the risk is borne by the buyer, a condition applicable until the end of 2023. The sale agreement for Valitor hf. does not affect the Condensed Consolidated Interim 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.

Economic outlook

The Icelandic economy is steadily regaining its footing following a sharp contraction in 2020. The outlook for foreign trade is positive, with tourism prospering, capelin returning in large quantities and other industries, e.g., the intellectual property industry, going from strength to strength. Tourists arriving at Keflavik International Airport in July-September numbered 370,000, which is 45% less than in 2019. However, the trend is upward, with September figures reaching approximately 60% of levels in September 2019.

At the same time the situation in the labour market is improving. Registered unemployment was 5% in September, compared with 9.8% a year ago. The labour market has still some way to go before reaching its previous size. Figures from Statistics Iceland indicate that since June 2019 approximately 6,000 jobs have been lost. New jobs are currently being created in non-tourist areas of the labour market, but the trend in tourism has been reversed, with more jobs created than lost.

Inflation has been more persistent than expected and is still above 4%. Although this persistence has come as a surprise, most analysts expect that inflation has peaked but will remain close to 4.5% until the end of the year. Housing prices are currently the main driving factor behind inflation, as housing prices have been rising rapidly for the last year. Inflation excluding housing prices stands at the target rate of the Central Bank of Iceland (CBI). Persistent inflation has compelled the CBI to raise interest rates by 75 bps since May this year. At the same time the Financial Stability Committee is trying to reduce risk in the housing market. At the end of June the maximum LTV of new mortgages was lowered to 80% from 85%. First time buyers are still allowed to take on a mortgage with 90% LTV. At the end of September a maximum debt service to income ratio of 35% was introduced (40% first time buyers). This new rule will be applied to all new mortgages starting in December 2021. Data from the Central Bank indicates that risk taking has increased among consumer mortgage applicants and the Central Bank is trying to stem the tide. Although there are signs that risk is on the rise, the consumer mortgage market will likely contract this year. Based on monthly new mortgages from January to August we estimate that the mortgage market will be approximately ISK 300 billion in 2021, a contraction of 4% from last year, while housing prices had risen by 16.4% in August YoY.

Outlook for the Bank

Arion Bank is built on robust foundations, characterized by a solid infrastructure, diverse and mature business units, and an excellent talent pool. Combined with a best in class digital offering this serves as a strong base to build on for the future prosperity of the group. 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. The solid operational results over the past year are a testament to this direction setting, while ongoing key strategic projects provide scope for further progress.

A key project over the past couple years has been the realignment of our Corporate and Investment Bank (CIB). Through a renewed strategy of balance sheet velocity, efficient pricing and syndication, the business has turned a corner and is now an important contributor to the group’s earnings.

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 opportunities to further improve our role as a financial aggregator for our clients. To this end a new organizational structure was introduced during the quarter, where a new Customer Experience business unit was formed.

Another key part of the vision of strengthening the role of the group as a financial aggregator is to bring 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.

Capital and funding optimization is another continuous initiative. Deposits growth has been robust over the past years which builds a solid base for the funding profile of the group and will continue to be a core focus of the strategy of the Bank. Another milestone in diversifying our funding profile was achieved in the quarter when the Bank issued its inaugural EUR covered bond. Broadening the investor base for this favorable funding option is an important part of building on the Bank's solid foundations. In terms of capital, significant steps have been taken this year in terms of optimization through share buybacks and dividend payments. Targeting the 17% optimized CET1 capital level will continue to be a strong theme over the coming years.

Employees

The Group had 763 full-time equivalent positions at the end of the period, compared with 776 at the end of 2020. A total of 629 of these positions were at Arion Bank, compared with 648 at the end of 2020.

Funding and liquidity

The Bank's liquidity position is strong, with a liquidity coverage ratio of 221% at the end of September 2021, well above the regulatory minimum of 100%. The Bank successfully finalized a €300 million 5-year covered bond at MS+27 bps at the end of September. This issuance marks the first international covered bond from an Icelandic bank. The covered bond was sold at a 0.27% spread over interbank rates, which is the best funding spread that any Icelandic entity, including the Treasury of Iceland, has achieved in the international markets since the Bank was established 13 years ago.

Due to its funding efforts in Q3 2021 the Bank has a very solid liquidity position and does not need to access the international wholesale markets in the medium term.

Group ownership

At the end of September 2021 Lífeyrissjódur verzlunarmanna was the largest shareholder in Arion Bank with a shareholding of 9.21%. Arion Bank owned 6.63% of its own shares at the end of September 2021. The AGM on 16 March 2021 approved the cancellation of 70 million of the Bank's own shares, totalling ISK 70 million at nominal value. The reduction took place in April. The float of the Bank's shares has been substantial and Icelandic pension funds, insurance and fund management companies along with numerous private investors have added to their shareholdings, whilst large international investors have lowered their stakes. The number of shareholders has grown from around 7,400 at year-end to 10,500 at the end of the quarter, and it is encouraging for the Bank to see the increased interest from retail investors. Further information on Arion Bank's shareholders can be found in Note 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 in addition to the Bank's management buffer.

Arion Bank paid ISK 2.9 billion in dividends in March following the AGM. Based on two share buyback programs authorized by the Financial Supervisory Authority of the Central Bank of Iceland (FSA) in February and July 2021, Arion Bank bought back own shares for ISK 22,668 million during the first nine months of 2021. On 7 October 2021 the FSA authorized Arion Bank to initiate new programs in Iceland and Sweden to purchase own shares (including in the form of SDRs) amounting up to a total of 54.5 million shares or ISK 10 billion, representing around 3.3% of share capital. Following this, the Board of Arion Bank decided to launch a new program as of 28 October. The program will end no later than 16 March 2022.

The Group's capital adequacy ratio on 30 September 2021 was 25.4% and the CET1 ratio 20.9%. The ratios account for the net earnings of the first nine months of 2021 and a deduction is made for foreseeable dividend that represents 50% of net earnings according to the dividend policy, and the ISK 10.3 billion buyback of own shares authorized by the Financial Supervisory Authority of the Central Bank of Iceland.

On 28 June 2021, changes to the EU Capital Requirements Regulation No. 575/2013 through Regulation (EU) 2019/876 (CRR II) were adopted in Iceland through amendments to the Act on Financial Undertakings No. 161/2002 and the Regulation on Prudential Requirements 233/2017. Furthermore, various EU amendments in response to the Covid-19 pandemic have been implemented in Iceland. These changes have a considerable impact on the Bank's capital adequacy and other regulatory definitions as of Q2 2021.

The Bank's total risk-weighted exposure amount (REA) increased by ISK 34.6 billion in the first nine months of 2021 of 4.6%, corresponding to an increase in loans to customers of ISK 74 billion.

As part of the 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%. On 29 September 2021, the Financial Stability 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.

On 12 July 2021, the Central Bank released its decision on the additional capital requirement under Pillar 2 based on the financial figures at year-end 2020. The requirement is 3.2% of REA, an increase by 0.1 percentage points. The Bank's total capital requirement is therefore 18.5% on 30 September 2021. On 30 September 2021, the Bank's own funds were ISK 56.6 billion higher than the total capital requirement, factoring in foreseeable equity release. Surplus capital, based on the Bank's objective of maintaining 17% CET 1, is ISK 30 billion in addition to the foreseeable equity release.

Endorsement and statement
by the Board of Directors and the CEO

Arion Bank issued 54 million warrants on 9 March 2021. The warrants were sold to investors in a private placement in February 2021. The purchase price of the warrants amounted to ISK 15.6 per warrant, resulting in a total sale price of ISK 842.4 million. The purchase price of the warrants was determined using market standard methodology. Approximately 48.5% of the total issue was sold to around 150 employees of the Group and 51.5% to professional investors. Should the owners of the warrants exercise their warrants, the Bank is obliged to issue new shares and sell them to the warrant owners at a predefined price (strike price). If all the warrants were exercised, the Bank's share capital would increase to ISK 1,714 million, and the newly issued shares would represent approximately 3.1% of the Bank's total issued capital, post dilution. The exercise period runs from Q4 2023 to Q3 2024.

Governance

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

Endorsement of the Board of Directors and the Chief Executive Officer

The Condensed Consolidated Interim Financial Statements of Arion Bank for the period ended 30 September 2021 have been prepared in accordance with International Financial Reporting Standard IAS 34 Interim Financial Reporting as adopted by the European Union and additional requirements in the Icelandic Financial Statements Act, Financial Undertakings Act and Rules on Accounting for Credit Institutions.

It is our opinion that the Condensed Consolidated Interim Financial Statements give a true and fair view of the financial performance and cash flow of the Group for the period ended 30 September 2021 and its financial position as at 30 September 2021.

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

The Board of Directors and the CEO have today discussed the Condensed Consolidated Interim Financial Statements of Arion Bank for the period ended 30 September 2021 and confirm them by means of their signatures.

Reykjavík, 27 October 2021

Board of Directors

Brynjólfur Bjarnason, Chairman

Paul Richard Horner, vice Chairman

Gunnar Sturluson

Liv Fiksdahl

Steinunn Kristín Thórdardóttir

Chief Executive Officer

Benedikt Gíslason

Consolidated Interim Income Statement

	Notes	2021 1.1.-30.9.	2020 1.1.-30.9.	2021 1.7.-30.9.	2020 1.7.-30.9.
Interest income		38,734	39,024	12,810	13,145
Interest expense		(15,439)	(15,925)	(4,873)	(5,156)
Net interest income	7	**23,295**	**23,099**	**7,937**	**7,989**
Fee and commission income		12,044	9,695	4,219	3,117
Fee and commission expense		(1,450)	(1,169)	(464)	(355)
Net fee and commission income	8	**10,594**	**8,526**	**3,755**	**2,762**
Net insurance income	9	2,577	2,305	992	1,043
Net financial income	10	5,069	1,383	1,366	692
Share of profit of associates	26	33	22	7	51
Other operating income	11	1,423	716	833	475
Other net operating income		**9,102**	**4,426**	**3,198**	**2,261**
Operating income		**42,991**	**36,051**	**14,890**	**13,012**
Salaries and related expenses	12	(9,745)	(9,211)	(2,899)	(2,504)
Other operating expenses	13	(8,263)	(8,623)	(2,689)	(2,728)
Operating expenses		**(18,008)**	**(17,834)**	**(5,588)**	**(5,232)**
Bank levy	14	(1,171)	(1,038)	(486)	(383)
Net impairment	15	2,610	(5,118)	718	(1,340)
Earnings before income tax		**26,422**	**12,061**	**9,534**	**6,057**
Income tax expense	16	(5,194)	(3,424)	(1,920)	(1,096)
Net earnings from continuing operations		**21,228**	**8,637**	**7,614**	**4,961**
Discontinued operations held for sale, net of income tax	17	865	(1,929)	624	(995)
Net earnings		**22,093**	**6,708**	**8,238**	**3,966**

Attributable to

Shareholders of Arion Bank hf.		22,076	6,716	8,228	3,965
Non-controlling interest		17	(8)	10	1
Net earnings		**22,093**	**6,708**	**8,238**	**3,966**

Earnings per share

	Notes				
	18				
Basic earnings per share attributable to the shareholders of Arion Bank (ISK)		13.68	3.90	5.23	2.31
Diluted earnings per share attributable to the shareholders of Arion Bank (ISK)		12.86	3.90	4.91	2.31

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

Amounts are in ISK millions

Consolidated Interim Statement of Comprehensive Income

	Notes	2021 1.1.-30.9.	2020 1.1.-30.9.	2021 1.7.-30.9.	2020 1.7.-30.9.
Net earnings		**22,093**	**6,708**	**8,238**	**3,966**
Net (loss) gain on financial assets carried at fair value through OCI, net of tax		(1,491)	322	(419)	(295)
Realized net (gain) loss on financial assets carried at fair value through OCI, net of tax, transferred to the Income Statement	10	251	(177)	270	(25)
Changes to reserve for financial instruments at fair value through OCI		**(1,240)**	**145**	**(149)**	**(320)**
Exchange difference on translating foreign subsidiaries		18	203	52	22
Other comprehensive (loss) income that is or may be reclassified subsequently to the Income Statement		**(1,222)**	**348**	**(97)**	**(298)**
Total comprehensive income		**20,871**	**7,056**	**8,141**	**3,668**

Attributable to

Shareholders of Arion Bank	20,854	7,064	8,131	3,667
Non-controlling interest	17	(8)	10	1
Total comprehensive income	**20,871**	**7,056**	**8,141**	**3,668**

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

Amounts are in ISK millions

Consolidated Interim Statement of Financial Position

Assets	Notes	30.9.2021	31.12.2020
Cash and balances with Central Bank	19	70,136	42,136
Loans to credit institutions	20	30,376	28,235
Loans to customers	21	896,940	822,941
Financial instruments	22-24	249,979	227,251
Investment property	24	6,548	6,132
Investments in associates	26	704	891
Intangible assets	27	9,732	9,689
Tax assets	28	2	2
Assets and disposal groups held for sale	29	16,775	16,811
Other assets	30	64,900	18,618
Total Assets		**1,346,092**	**1,172,706**

Liabilities	Notes	30.9.2021	31.12.2020
Due to credit institutions and Central Bank	23	8,484	13,031
Deposits	23	641,306	568,424
Financial liabilities at fair value	23	5,675	5,240
Tax liabilities	28	6,989	4,262
Liabilities associated with disposal groups held for sale	29	16,852	16,183
Other liabilities	31	39,698	32,714
Borrowings	23.32	397,031	298,947
Subordinated liabilities	23.33	35,477	36,060
Total Liabilities		**1,151,512**	**974,861**

Equity	35	30.9.2021	31.12.2020
Share capital and share premium		28,663	51,331
Other reserves		12,023	11,320
Retained earnings		153,214	135,021
Total Shareholders' Equity		**193,900**	**197,672**
Non-controlling interest		680	173
Total Equity		**194,580**	**197,845**
Total Liabilities and Equity		**1,346,092**	**1,172,706**

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

Amounts are in ISK millions

Consolidated Interim Statement of Changes in Equity

			Restricted reserves											
	Share capital	Share premium	Share option	Warrants reserve	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Financial assets at fair value thr. OCI, unrealized	Statutory reserve	Foreign currency trans-lation reserve	Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
Equity 1 January 2021	1,718	49,613	-	-	7,421	694	1,054	(141)	1,637	655	135,021	**197,672**	173	**197,845**
Net earnings											22,076	**22,076**	17	**22,093**
Net fair value loss								(1,491)				**(1,491)**		**(1,491)**
Realized net loss transferred to P/L								251				**251**		**251**
Translation difference										18		**18**		**18**
Total comprehensive income	-	-	-	-	-	-	-	(1,240)	-	18	22,076	**20,854**	17	**20,871**
Dividend paid											(2,857)	**(2,857)**		**(2,857)**
Purchase of treasury stock	(168)	(22,500)										**(22,668)**		**(22,668)**
Share option charge for the period			72									**72**		**72**
Warrants sold				828								**828**		**828**
Increase in non-controlling interests												**-**	490	**490**
Changes in reserves					(1,192)	2,118	99				(1,025)	**-**		**-**
Equity 30 September 2021	1,550	27,113	72	828	6,229	2,812	1,153	(1,381)	1,637	673	153,214	**193,900**	680	**194,580**

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

Amounts are in ISK millions

Consolidated Interim Statement of Changes in Equity

	Share capital	Share premium	Restricted reserves: Share option	Warrants reserve	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Financial assets at fair value thr. OCI, unrealized	Statutory reserve	Foreign currency trans-lation reserve	Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
Equity 1 January 2020	1,773	53,942	-	-	6,127	692	459	135	1,637	443	124,436	**189,644**	181	**189,825**
Net earnings											6,716	**6,716**	(9)	**6,707**
Net fair value gain								322				**322**		**322**
Realized net loss transferred to P/L ...								(177)				**(177)**		**(177)**
Translation difference										203		**203**		**203**
Total comprehensive income	-	-	-	-	-	-	-	145	-	203	6,716	**7,064**	(9)	**7,055**
Purchase of treasury stock	(55)	(4,325)										**(4,380)**		**(4,380)**
Changes in treasury stock	-	(4)										**(4)**		**(4)**
Changes in reserves					1,949	(122)	446				(2,273)	**-**		**-**
Equity 30 September 2020	1,718	49,613	-	-	8,076	570	905	280	1,637	646	128,879	**192,323**	172	**192,495**

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

Amounts are in ISK millions

Consolidated Interim Statement of Cash flows

	2021 1.1.-30.9.	2020 1.1.-30.9.
Operating activities		
Net earnings	22,093	6,708
Non-cash items included in net earnings	(23,061)	(7,175)
Changes in operating assets and liabilities		
Loans to credit institutions, excluding bank accounts	(2,059)	(3,470)
Loans to customers	(74,482)	(13,075)
Financial instruments and financial liabilities at fair value	(12,944)	(96,178)
Deposits	68,822	95,011
Borrowings	49,299	(19,030)
Other changes in operating assets and liabilities	(2,147)	17,656
Interest received	37,510	38,985
Interest paid	(9,832)	(13,909)
Dividend received	83	60
Income tax paid	(2,467)	(4,763)
Net cash from operating activities	**50,815**	**820**
Investing activities		
Acquisition of associates	(30)	(39)
Proceeds from sale of associates	250	96
Acquisition of intangible assets	(842)	(1,613)
Acquisition of property and equipment	(409)	(655)
Proceeds from sale of property and equipment	558	1,259
Net cash to investing activities	**(473)**	**(952)**
Financing activities		
Issued subordinated liabilities	-	12,805
Proceeds from issued warrants	828	-
Purchase of treasury stock	(22,668)	(4,381)
Dividend paid to shareholders of Arion Bank	(2,857)	-
Net cash (to) from in financing activities	**(24,697)**	**8,424**
Net increase in cash and cash equivalents	25,645	8,292
Cash and cash equivalents at beginning of the year	58,284	102,186
Effect of exchange rate changes on cash and cash equivalents	2,261	5,041
Cash and cash equivalents	**86,190**	**115,519**
Cash and cash equivalents		
Cash and balances with Central Bank	70,136	87,517
Bank accounts	22,381	33,938
Mandatory reserve deposit with Central Bank	(6,327)	(5,936)
Cash and cash equivalents	**86,190**	**115,519**
Non-cash changes due to sale of a minority interest		
Proceeds from sale of a minority interest in a subsidiary	490	-
Increase in minority interest due to a sale of a minority interest in a subsidiary	(490)	-

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

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Notes to the Condensed Consolidated Interim Financial Statements

General information

Arion Bank hf., the Parent Company, was established on 18 October 2008 and is incorporated and domiciled in Iceland. The registered office of Arion Bank hf. is located at Borgartún 19, Reykjavík. The Condensed Consolidated Interim Financial Statements for the period ended 30 September 2021 comprise the Parent Company and its subsidiaries (together referred to as "the Group").

1. Basis of preparation

The Condensed Consolidated Interim Financial Statements were approved and authorized for publication by the Board of Directors of Arion Bank on 27 October 2021.

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

Statement of compliance

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

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

Basis of measurement

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

- bonds and debt instruments, shares and equity instruments, short positions in listed bonds and equities and derivatives. For details on the accounting policy, see Note 56 in the Annual Financial Statements 2020;
- investment properties are measured at fair value; and
- non-current assets and disposal groups held for sale are stated at the lower of their carrying amounts and fair value, less cost to sell.

Functional and presentation currency

The Condensed Consolidated Interim Financial Statements are presented in Icelandic krona (ISK), which is the Parent Company's functional currency, rounded to the nearest million, unless otherwise stated. At the end of the period the exchange rate of the ISK against USD was 130.60 and 151.10 for EUR (31.12.2020: USD 127.64 and EUR 156.09).

2. Going concern assumption

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

3. Significant accounting estimates and judgments in applying accounting policies

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

Estimates and assumptions

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

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

Impairment of financial assets

The book value of financial assets which fall under the impairment requirements of IFRS 9 are presented net of expected credit losses in the statement of financial position. On a monthly basis expected credit losses are recalculated for each asset, the calculations being derived from PD, LGD and EAD models. In addition to the model outcomes, the assessment of expected credit losses is based on three key factors: management's assumptions regarding the development of macroeconomic factors over the next three years, how those factors affect each model and how to estimate a significant increase in credit risk. The assumptions for macroeconomic development are incorporated into each model for three scenarios: a base case, an optimistic case and a pessimistic case. Management estimates the probability weight for each scenario used for calculations of the probability weighted expected credit losses. The amount of expected credit losses to be recognized is dependent on the Bank's definition of significant increase in credit risk, which controls the impairment stage each asset is allocated to. Management has estimated factors to measure significant increase in credit risk from origination, by comparison of changes in PD values, annualized lifetime PD values, days past due and watch list. For further information see Note 56 in the Annual Financial Statements 2020.

Macroeconomic outlook

The Icelandic government has announced that it intends to remove all domestic restrictions on 18 November. The tourism sector has recovered significantly and is expected to continue its recovery in 2022.

From the outbreak of the pandemic, Arion Bank has followed the guidelines of the European supervisors and the Central Bank of Iceland and used moderation in the application of impairment calculations considering the level of economic uncertainty. In 2021 it has gradually become clearer that the economy will be able to recover quickly. This has been reflected in the updated economic forecast which is used for the impairment calculations in accordance with IFRS 9.

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	30.9.2021	31.12.2020
Eignabjarg ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Leiguskjól ehf., Lágmúli 6, Reykjavík, Iceland	Rental guarantee	ISK	51.0%	51.0%
SRL slhf., Borgartún 19, Reykjavík, Iceland	Real estate	ISK	100.0%	100.0%
Stefnir hf., Borgartún 19, Reykjavík, Iceland	Asset management	ISK	100.0%	100.0%
Valitor hf., Dalshraun 3, Hafnarfjördur, Iceland	Payment solutions	ISK	100.0%	100.0%
VISA Ísland ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Vördur tryggingar hf., Borgartún 25, Reykjavík, Iceland	Insurance	ISK	100.0%	100.0%

The subsidiaries Eignabjarg ehf. (holding company of Stakksberg ehf. and Sólbjarg ehf.) and Valitor hf. are classified as held for sale in accordance with IFRS 5, see Note 29 for further information.

Amounts are in ISK millions

Operating segment reporting

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

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

5. Operating segments

Markets

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

Corporate & Investment Banking

Corporate & Investment Banking provides companies and investors with comprehensive financial services that meets 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 provides a full range of lending products such as 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 and international banks.

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

Retail Banking

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

Treasury

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

Vördur

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

Subsidiaries

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

Supporting units

Supporting units include the Bank's headquarters which carry out support functions such as the CEO office, Risk Management, Finance (excluding Treasury), 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.

5. Operating segments, continued

1.1.-30.9.2021	Markets and Stefnir	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other sub-sidiaries	Supporting units and elimi-nations	Total
Net interest income	594	8,753	11,424	2,569	67	(90)	(22)	23,295
Net fee and commission income	4,129	3,497	2,991	450	(143)	(530)	200	10,594
Net insurance income	-	-	-	-	2,634	-	(57)	2,577
Net financial income	272	1,075	-	2,352	1,569	(199)	-	5,069
Share of profit of associates	-	(8)	-	-	-	-	41	33
Other operating income	3	16	434	30	24	555	361	1,423
Operating income	4,998	13,333	14,849	5,401	4,151	(264)	523	42,991
Operating expenses	(1,302)	(1,072)	(3,692)	(394)	(1,788)	(167)	(9,593)	(18,008)
Allocated expenses	(1,424)	(1,952)	(4,995)	(743)	(13)	(3)	9,130	-
Bank levy	(52)	(338)	(559)	(222)	-	-	-	(1,171)
Net impairment	-	2,129	1,425	1	-	(601)	(344)	2,610
Earnings (loss) before income tax	2,220	12,100	7,028	4,043	2,350	(1,035)	(284)	26,422
Net seg. rev. from ext. customers	3,438	16,494	24,320	(6,049)	4,032	473	283	42,991
Net seg. rev. from other segments	1,560	(3,161)	(9,471)	11,450	119	(737)	240	-
Operating income	4,998	13,333	14,849	5,401	4,151	(264)	523	42,991
30.09.2021								
Loans to customers	26	351,308	547,224	9	-	3	(1,630)	896,940
Financial instruments	58,346	351	-	165,614	25,343	2,726	(2,401)	249,979
Other external assets	5,445	8,894	2,837	130,763	8,448	36,875	5,911	199,173
Internal assets	26,977	-	-	277,695	-	-	(304,672)	-
Total assets	90,794	360,553	550,061	574,081	33,791	39,604	(302,792)	1,346,092
Deposits	77,832	214,634	291,385	69,613	-	-	(12,158)	641,306
Other external liabilities	5,229	5,007	1,513	451,325	21,205	11,889	14,038	510,206
Internal liabilities	-	83,681	211,131	-	971	8,889	(304,672)	-
Total liabilities	83,061	303,322	504,029	520,938	22,176	20,778	(302,792)	1,151,512
Allocated equity	7,733	57,231	46,032	53,143	11,615	18,826	-	194,580

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

Amounts are in ISK millions

5. Operating segments, continued

1.1.-30.9.2020	Markets and Stefnir	Corporate & Investment Banking	Retail Banking	Treasury	Vördur	Other sub-sidiaries	Supporting units and elimi-nations	Total
Net interest income	578	7,801	11,834	3,194	136	(361)	(83)	23,099
Net fee and commission income	2,837	2,172	3,528	390	(128)	(513)	240	8,526
Net insurance income	-	-	-	-	2,371	-	(66)	2,305
Net financial income	43	-	-	409	1,128	(208)	11	1,383
Share of profit of associates	1	(48)	-	-	-	-	69	22
Other operating income	8	(7)	197	-	5	389	124	716
Operating income	3,467	9,918	15,559	3,993	3,512	(693)	295	36,051
Operating expenses	(1,331)	(969)	(4,051)	(447)	(1,784)	(133)	(9,119)	(17,834)
Allocated expenses	(1,373)	(1,912)	(4,240)	(658)	(21)	(4)	8,208	-
Bank levy	(28)	(312)	(464)	(234)	-	-	-	(1,038)
Net impairment	-	(5,358)	(1,828)	8	-	2,060	-	(5,118)
Earnings (loss) before income tax	735	1,367	4,976	2,662	1,707	1,230	(616)	12,061
Net seg. rev. from ext. customers	2,000	14,679	24,313	(8,630)	3,340	211	138	36,051
Net seg. rev. from other segments	1,467	(4,761)	(8,754)	12,623	172	(904)	157	-
Operating income	3,467	9,918	15,559	3,993	3,512	(693)	295	36,051
30.9.2020								
Loans to customers	17	314,593	497,523	38	-	3	(4,308)	807,866
Financial instruments	32,268	7,576	-	168,808	20,683	5,602	-	234,937
Other external assets	4,345	6,869	3,663	129,668	9,707	34,731	4,430	193,413
Internal assets	36,319	-	-	233,105		7,732	(277,156)	-
Total assets	72,949	329,038	501,186	531,619	30,390	48,068	(277,034)	1,236,216
Deposits	65,350	112,951	333,518	112,553	-	-	(10,728)	613,644
Other external liabilities	2,349	1,256	1,904	368,663	18,981	26,073	10,850	430,076
Internal liabilities	-	155,423	121,733	-	-	-	(277,156)	-
Total liabilities	67,699	269,630	457,155	481,216	18,981	26,073	(277,034)	1,043,720
Allocated equity	5,250	59,408	44,031	50,403	11,409	21,995	-	192,496

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Consolidated Interim Income Statement

6. Operations by quarters

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

2020				
Net interest income	7,253	7,857	7,989	23,099
Net fee and commission income	3,076	2,688	2,762	8,526
Net insurance income	501	761	1,043	2,305
Net financial income	(2,000)	2,691	692	1,383
Share of loss of associates	(24)	(5)	51	22
Other operating income	170	71	475	716
Operating income	8,976	14,063	13,012	36,051
Salaries and related expense	(3,130)	(3,577)	(2,504)	(9,211)
Other operating expense	(3,077)	(2,818)	(2,728)	(8,623)
Operating expenses	(6,207)	(6,395)	(5,232)	(17,834)
Bank levy	(331)	(324)	(383)	(1,038)
Net impairment	(2,860)	(918)	(1,340)	(5,118)
Earnings before income tax	(422)	6,426	6,057	12,061
Income tax expense	(860)	(1,468)	(1,096)	(3,424)
Net earnings from continuing operations	(1,282)	4,958	4,961	8,637
Discontinued operations, net of tax	(889)	(45)	(995)	(1,929)
Net earnings (loss)	(2,171)	4,913	3,966	6,708

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.

Amounts are in ISK millions

7. Net interest income

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

1.1.-30.9.2020	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	1,304	-	-	1,304
Loans to credit institutions	147	-	-	147
Loans to customers	35,362	-	-	35,362
Securities	-	896	1,169	2,065
Other	146	-	-	146
Interest income	36,959	896	1,169	39,024
Interest expense				
Deposits	(5,435)	-	-	(5,435)
Borrowings	(9,092)	-	-	(9,092)
Subordinated liabilities	(1,305)	-	-	(1,305)
Other	(93)	-	-	(93)
Interest expense	(15,925)	-	-	(15,925)
Net interest income	21,034	896	1,169	23,099

Amounts are in ISK millions

7. Net interest income, cont.

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

1.7.-30.9.2020	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	227	-	-	227
Loans to credit institutions	32			32
Loans to customers	11,861	-	-	11,861
Securities	-	322	655	977
Other	48	-	-	48
Interest income	12,168	322	655	13,145
Interest expense				
Deposits	(1,455)	-	-	(1,455)
Borrowings	(3,181)	-	-	(3,181)
Subordinated liabilities	(491)	-	-	(491)
Other	(29)	-	-	(29)
Interest expense	(5,156)	-	-	(5,156)
Net interest income	7,012	322	655	7,989

Interest spread	2021 1.1.-30.9.	2020 1.1.-30.9.	2021 1.7.-30.9.	2020 1.7.-30.9.
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	2.7%	2.9%	2.7%	2.9%

Amounts are in ISK millions

8. Net fee and commission income

	1.1.-30.9.2021			1.1.-30.9.2020		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	3,949	(373)	3,576	3,000	(311)	2,689
Capital markets and corporate finance	1,888	(24)	1,864	964	(18)	946
Lending and financial guarantees	3,348	-	3,348	3,012	-	3,012
Collection and payment services	1,045	(89)	956	978	(84)	894
Cards and payment solution	1,283	(372)	911	1,292	(240)	1,052
Other	531	(592)	(61)	449	(516)	(67)
Net fee and commission income	12,044	(1,450)	10,594	9,695	(1,169)	8,526

	1.7.-30.9.2021			1.7.-30.9.2020		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	1,596	(128)	1,468	982	(93)	889
Capital markets and corporate finance	503	(7)	496	305	(4)	301
Lending and financial guarantees	1,065	-	1,065	944	-	944
Collection and payment services	395	(22)	373	344	(29)	315
Cards and payment solution	494	(150)	344	423	(80)	343
Other	166	(157)	9	119	(149)	(30)
Net fee and commission income	4,219	(464)	3,755	3,117	(355)	2,762

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 1.1.-30.9.	2020 1.1.-30.9.	2021 1.7.-30.9.	2020 1.7.-30.9.
Earned premiums, net of reinsurers' share				
Premiums written	11,056	9,867	3,169	2,860
Premiums written, reinsurers' shares	(368)	(329)	(109)	(123)
Change in provision for unearned premiums	(1,146)	(1,031)	259	298
Earned premiums, net of reinsurers' share	9,542	8,507	3,319	3,035
Claims incurred, net of reinsurers' share				
Claims paid	(6,007)	(5,573)	(1,729)	(1,492)
Claims paid, reinsurers' share	129	59	12	3
Change in provision for claims	(1,078)	(742)	(608)	(526)
Changes in provision for claims, reinsurers' share	(9)	54	(2)	23
Claims incurred, net of reinsurers' share	(6,965)	(6,202)	(2,327)	(1,992)
Net insurance income	2,577	2,305	992	1,043
Combined ratio				
Combined ratio	91.7%	99.4%	85.5%	94.5%

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

10. Net financial income

	2021 1.1.-30.9.	2020 1.1.-30.9.	2021 1.7.-30.9.	2020 1.7.-30.9.
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	5,253	1,233	1,613	576
Gain on prepayments of borrowings	-	79	-	-
Net gain (loss) on fair value hedge of interest rate swap	(29)	(111)	(2)	12
Realized gain (loss) on financial assets carried at fair value through OCI	(339)	239	(365)	35
Net foreign exchange gain (loss)	184	(57)	120	69
Net financial income	5,069	1,383	1,366	692

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

Equity instruments	3,982	(443)	1,331	214
Debt instruments	1,184	1,193	210	133
Derivatives	87	483	72	229
Net gain on financial assets and financial liabilities		-		
mandatorily measured at fair value through profit or loss	5,253	1,233	1,613	576

Net gain (loss) on fair value hedge of interest rate swap

Fair value change of interest rate swaps designated as hedging instruments	(1,045)	382	(314)	(211)
Fair value change on bonds issued by the Group attributable to interest rate risk	1,016	(493)	312	223
Net gain (loss) on fair value hedge of interest rate swap	(29)	(111)	(2)	12

11. Other operating income

Fair value changes on investment property	545	-	545	-
Net gain (loss) on disposal of assets	280	399	(7)	356
Net gain on assets held for sale	188	164	-	48
Other income	410	153	295	71
Other operating income	1,423	716	833	475

Net gain on assets held for sale

Income from real estates and other assets	216	237	4	83
Expense related to real estates and other assets	(28)	(73)	(11)	(35)
Net gain on assets held for sale	188	164	(7)	48

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 1.1.-30.9.	2020 1.1.-30.9.	2021 1.7.-30.9.	2020 1.7.-30.9.
Number of employees				
Average number of full-time equivalent positions during the period	758	793	752	778
Full-time equivalent positions at the end of the period	763	783	763	783
Number of employees at the parent company				
Average number of full-time equivalent positions during the period	627	666	619	651
Full-time equivalent positions at the end of the period	629	655	629	655
Salaries and related expenses				
Salaries	7,614	7,471	2,209	2,033
Share-based payment expenses	72	-	27	-
Defined contribution pension plans	1,127	1,106	327	301
Salary-related expenses	1,093	1,080	336	315
Capitalization of salaries due to implementation of core systems	(161)	(446)	-	(145)
Salaries and related expenses	9,745	9,211	2,899	2,504

Amounts are in ISK millions

12. Personnel and salaries, continued

Salaries and related expenses for the parent company	2021 1.1.-30.9.	2020 1.1.-30.9.	2021 1.7.-30.9.	2020 1.7.-30.9.
Salaries	6,327	6,191	1,844	1,697
Share-based payment expenses	72	-	-	-
Defined contribution pension plans	936	917	273	251
Salary-related expenses	899	894	263	247
Capitalization of salaries due to implementation of core systems	(161)	(446)	-	(145)
Salaries and related expenses for the parent company	8,073	7,556	2,380	2,050

Remuneration programs

During the period the Group made a provision of ISK 70 million (2020: ISK 35 million) for performance plan payments, including salary-related expenses, for which the Bank made no provision (2020: nil). Forty percent of the payment is deferred for three years in accordance with the FSA's rules on remuneration policies for financial undertakings. At the end of the period the Group's accrual for performance plan payments amounted to ISK 143 million (31.12.2020: ISK 232 million), of which the Bank's accrual was nil (31.12.2020: ISK 100 million).

Revised bonus scheme came into effect in 2021. The scheme is in compliance with the FSA's rules on bonus payments to employees of financial institutions. The scheme is split into two parts. Firstly, employees can receive up to 10% of their fixed salary for 2021 in the form of a cash bonus payment. Secondly, a limited group can receive up to 25% of their fixed salary as a bonus in the form of shares in the Bank which will be subject to a three-year lock-up period. The criterion used to determine whether a bonus will be paid for 2021, in part or in full, is whether the Bank's return on equity in 2021 is higher than the weighted ROE of the Bank's main competitors. No accrual was recognised in the Consolidated Interim Income Statement for the period. Given that all criterion will be met the maximum total expense is estimated to be ISK 1,470 million, including salary related expenses, or ISK 630 million due to the group subject to the 10% of their fixed salary and ISK 840 million due to the group subject to the 25% of their fixed salary. Net of tax the total estimated expense is ISK 1,100 million.

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

Share-based payment expense

In 2020 the Board of Directors approved a share option plan for all employees of the Bank. The share option plan is for five years and employees are entitled to buy shares for up to ISK 600,000 each year. The purchase price of ISK 95.5 per share was determined by the Bank's average share price 10 days before the share option agreement was signed, which was 3 February 2021. The employee must remain continuously employed with Arion Bank until the expiring date. The options carry neither rights to dividends nor voting rights and are valued using the Black-Scholes pricing model. A total of 628 employees entered into option agreements on up to 3,945,550 shares per year based on 100% exercise of share options.

A total expense of ISK 72 million is recognised in the Consolidated Interim Income Statement during the period (2020: nil). Estimated remaining expenses due the share option contracts are ISK 216 million and will be expensed over five years.

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

13. Other operating expenses

	2021 1.1.-30.9.	2020 1.1.-30.9.	2021 1.7.-30.9.	2020 1.7.-30.9.
IT expenses	3,555	3,759	1,099	1,271
Professional services	656	693	229	190
Housing expenses	541	731	180	223
Other administration expenses	1,792	1,924	560	617
Depositors' and Investors' Guarantee Fund	411	441	133	68
Depreciation of property and equipment	415	395	152	136
Depreciation of right of use asset	94	98	33	33
Amortization of intangible assets	799	582	303	190
Other operating expenses	8,263	8,623	2,689	2,728

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

Net impairment on financial instruments and value changes on loans	2021 1.1.-30.9.	2020 1.1.-30.9.	2021 1.7.-30.9.	2020 1.7.-30.9.
Net impairment on loans to customers and financial institutions	2,059	(5,650)	408	(1,552)
Net impairment on other financial instruments at FVOCI	1	(8)	(7)	(6)
Other value changes of loans - corporates	63	59	39	1
Other value changes of loans - individuals	487	481	278	217
Net impairment	2,610	(5,118)	718	(1,340)

Net impairment by customer type				
Financial institutions	63	(77)	(21)	15
Individuals	696	(846)	305	(6)
Corporates	1,851	(4,195)	434	(1,349)
Net impairment	2,610	(5,118)	718	(1,340)

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 period.

16. Income tax expense

	2021 1.1.-30.9.	2020 1.1.-30.9.	2021 1.7.-30.9.	2020 1.7.-30.9.
Current tax expense	4,963	3,528	1,832	434
Deferred tax expense (income)	231	(104)	88	662
Income tax expense	5,194	3,424	1,920	1,096

Reconciliation of effective tax rate	2021 1.1.-30.9.		2020 1.1.-30.9.	
Earnings before income tax		26,422		12,061
Income tax using the Icelandic corporate tax rate	20.0%	5,284	20.0%	2,412
Additional 6% tax on Financial Undertakings	3.6%	952	5.3%	639
Non-deductible expenses	0.1%	33	0.2%	24
Tax exempt revenues (loss)	(4.8%)	(1,269)	0.7%	90
Non-deductible taxes (bank levy)	0.9%	234	1.7%	208
Tax incentives not recognized in the Income Statement	(0.9%)	(234)	0.2%	27
Other changes	0.7%	194	0.2%	24
Effective tax rate	19.7%	5,194	28.4%	3,424

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

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

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

Amounts are in ISK millions

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

	2021 1.1.-30.9.	2020 1.1.-30.9.	2021 1.7.-30.9.	2020 1.7.-30.9.
Net gain (loss) from discontinued operations held for sale	861	(1,968)	604	(1,034)
Income tax expense	4	39	20	39
Discontinued operations held for sale, net of income tax	865	(1,929)	624	(995)
Valitor hf.	470	(852)	184	18
Stakksberg ehf.	(55)	394	15	50
Sólbjarg ehf.	450	(1,471)	425	(1,063)
Discontinued operations held for sale, net of income tax	865	(1,929)	624	(995)

The net profit from Valitor's operation was ISK 131 million during the period whereas Valitor's positive contribution to the Group, after taking into account the Group's eliminations, was ISK 470 million. Operating income of Valitor was ISK 3,870 million, or ISK 4,341 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
1.1.-30.9.						
Net earnings attributable to the shareholders of Arion Bank	21,211	8,645	865	(1,929)	22,076	6,716
Weighted average number of outstanding shares (millions)	1,614	1,724	1,614	1,724	1,614	1,724
Weighted average number of outstanding shares including warrants and options (millions)	1,717	1,724	1,717	1,724	1,717	1,724
Basic earnings per share (ISK)	13.14	5.01	0.54	(1.12)	13.68	3.90
Diluted earnings per share ISK)	12.35	5.01	0.50	(1.12)	12.86	3.90
1.7.-30.9.						
Net earnings attributable to the shareholders of Arion Bank	7,604	4,961	624	(995)	8,228	3,966
Weighted average number of outstanding shares (millions)	1,573	1,719	1,573	1,719	1,573	1,719
Weighted average number of outstanding shares including warrants and options (millions)	1,677	1,719	1,677	1,719	1,677	1,719
Basic earnings per share	4.83	2.89	0.40	(0.58)	5.23	2.31
Diluted earnings per share ISK)	4.53	2.89	0.37	(0.58)	4.91	2.31

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Consolidated Interim Statement of Financial Position

19. Cash and balances with Central Bank

	30.9.2021	31.12.2020
Cash on hand	3,792	3,342
Cash with Central Bank	60,017	32,588
Mandatory reserve deposit with Central Bank	6,327	6,206
Cash and balances with Central Bank	70,136	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

	30.9.2021	31.12.2020
Bank accounts	22,381	22,354
Other loans	8,032	5,982
Allowance for impairment	(37)	(101)
Loans to credit institutions	30,376	28,235

21. Loans to customers

	Individuals		Corporates		Total	
30.9.2021	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
Overdrafts	14,439	13,845	15,146	14,567	29,585	28,412
Credit cards	12,709	12,540	1,214	1,166	13,923	13,706
Mortgage loans	440,315	439,825	43,902	43,689	484,217	483,514
Other loans	36,113	35,368	342,066	335,940	378,179	371,308
Loans to customers	503,576	501,578	402,328	395,362	905,904	896,940
31.12.2020						
Overdrafts	12,875	12,176	15,471	14,208	28,346	26,384
Credit cards	12,260	12,062	1,086	1,019	13,346	13,081
Mortgage loans	378,554	377,873	32,175	31,768	410,729	409,641
Other loans	32,122	31,225	350,455	342,610	382,577	373,835
Loans to customers	435,811	433,336	399,187	389,605	834,998	822,941

The total book value of pledged loans that were pledged against amounts borrowed was ISK 288 billion at the end of the period (31.12.2020: ISK 219 billion). Pledged loans comprised mortgage loans to individuals.

Further analysis of loans is provided in Risk management disclosures.

22. Financial instruments

	30.9.2021	31.12.2020
Bonds and debt instruments	163,748	157,744
Shares and equity instruments with variable income	23,648	18,641
Derivatives	4,935	7,284
Securities used for economic hedging	57,648	43,582
Financial instruments	249,979	227,251

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

23. Financial assets and financial liabilities

30.9.2021	Amortized cost	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	70,136	-	-	70,136
Loans to credit institutions	28,259	-	2,117	30,376
Loans to customers	896,940	-	-	896,940
Loans	995,335	-	2,117	997,452
Bonds and debt instruments				
Listed	-	143,688	18,978	162,666
Unlisted	-	-	1,082	1,082
Bonds and debt instruments	-	143,688	20,060	163,748
Shares and equity instruments with variable income				
Listed	-	-	7,987	7,987
Unlisted	-	-	11,555	11,555
Bond funds with variable income, unlisted	-	-	4,106	4,106
Shares and equity instruments with variable income	-	-	23,648	23,648
Derivatives				
OTC derivatives	-	-	3,397	3,397
Derivatives used for hedge accounting	-	-	1,538	1,538
Derivatives	-	-	4,935	4,935
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	26,335	26,335
Shares and equity instruments with variable income, listed	-	-	31,302	16,335
Shares and equity instruments with variable income, unlisted	-	-	11	11
Securities used for economic hedging	-	-	57,648	57,648
Other financial assets				
Accounts receivable	5,475	-	-	5,475
Other financial assets	52,013	-	-	52,013
Other financial assets	57,488	-	-	57,488
Financial assets	1,052,823	143,688	108,408	1,304,919
Financial liabilities				
Due to credit institutions and Central Bank	8,484	-	-	8,484
Deposits	641,306	-	-	641,306
Borrowings	397,031	-	-	397,031
Subordinated liabilities	35,477	-	-	35,477
Short position in bonds	-	-	79	79
Derivatives	-	-	5,397	5,397
Derivatives used for hedge accounting	-	-	199	199
Other financial liabilities	14,079	-	-	14,079
Financial liabilities	1,096,377	-	5,675	1,102,052

Amounts are in ISK millions

23. Financial assets and financial liabilities, continued

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

Amounts are in ISK millions

23. Financial assets and financial liabilities, continued

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

30.9.2021	Fair value through OCI	Manda-torily at fair value thr. P/L	Total
Financial and insurance activities	24,755	7,957	32,712
Public sector	118,933	9,324	128,257
Corporates	-	2,779	2,779
Bonds and debt instruments at fair value	143,688	20,060	163,748
31.12.2020			
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 8.7 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

30.9.2021

Assets at fair value	Level 1	Level 2	Level 3	Total
Loans to credit institutions	-	2,117	-	2,117
Bonds and debt instruments	162,226	1,120	402	163,748
Shares and equity instruments with variable income	5,347	15,372	2,929	23,648
Derivatives	-	3,397	-	3,397
Derivatives used for hedge accounting	-	1,538	-	1,538
Securities used for economic hedging	57,629	19	-	57,648
Investment property	-	-	6,548	6,548
Assets at fair value	225,202	21,446	9,879	256,527
Liabilities at fair value				
Short position in bonds	79	-	-	79
Derivatives	-	5,397	-	5,397
Derivatives used for hedge accounting	-	199	-	199
Liabilities at fair value	79	5,596	-	5,675

Amounts are in ISK millions

24. Fair value hierarchy, continued

31.12.2020

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

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

Transfers from Level 1 to Level 2 amounted to ISK 171 million during the period and from Level 2 to Level 1 ISK 129 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		
30.9.2021	property	Bonds	Shares	Total
Balance at the beginning of the year	6,132	358	1,685	8,175
Net fair value changes	545	11	643	1,199
Additions	3	301	745	1,049
Disposals	(132)	(268)	(144)	(544)
Balance at the end of the period	6,548	402	2,929	9,879
31.12.2020				
Balance at the beginning of the year	7,119	28	1,555	8,702
Net fair value changes	580	9	(59)	530
Additions	17	762	196	975
Disposal	(1,584)	(441)	(7)	(2,032)
Balance at the end of the period	6,132	358	1,685	8,175

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

1.1.-30.9.2021				
Net financial income	-	11	643	654
Other operating income	573	-	-	573
Effects recognized in the Income Statement	573	11	643	1,227
1.1.-30.9.2020				
Net financial income	-	9	(73)	(64)
Effects recognized in the Income Statement	-	9	(73)	(64)

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

24. Fair value hierarchy, continued

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

30.9.2021	Carrying value	Fair value	Unrealized gain (loss)
Financial assets not carried at fair value			
Cash and balances with Central Bank	70,136	70,136	-
Loans to credit institutions	30,376	30,376	-
Loans to customers	896,940	897,882	942
Other financial assets	57,488	57,488	-
Financial assets not carried at fair value	1,054,940	1,055,882	942
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	8,484	8,484	-
Deposits	641,306	641,306	-
Borrowings	397,031	409,726	(12,695)
Subordinated liabilities	35,477	35,860	(383)
Other financial liabilities	14,079	14,079	-
Financial liabilities not carried at fair value	1,096,377	1,109,455	(13,078)
31.12.2020			
Financial assets not carried at fair value			
Cash and balances with Central Bank	42,136	42,136	-
Loans to credit institutions	28,235	28,235	-
Loans to customers	822,941	827,252	4,311
Other financial assets	9,667	9,667	-
Financial assets not carried at fair value	902,979	907,290	4,311
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	13,031	13,031	-
Deposits	568,424	568,424	-
Borrowings	298,947	316,643	(17,696)
Subordinated liabilities	36,060	34,762	1,298
Other financial liabilities	8,011	8,011	-
Financial liabilities not carried at fair value	924,473	940,871	(16,398)

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

Derivatives	Notional	Fair value	
30.9.2021	value	Assets	Liabilities
Forward exchange rate agreements	61,539	780	148
Fair value hedge of interest rate swap	224,604	1,538	199
Interest rate and exchange rate agreements	51,207	2,129	1,078
Bond swap agreements	30,544	272	134
Share swap agreements	29,471	211	3,988
Options - purchased agreements, unlisted	16	5	49
Derivatives	397,381	4,935	5,596
31.12.2020			
Forward exchange rate agreements	72,804	1,140	267
Fair value hedge of interest rate swap	137,636	2,282	-
Interest rate and exchange rate agreements	55,838	3,339	1,022
Bond swap agreements	28,617	100	275
Share swap agreements	13,445	400	2,885
Options - purchased agreements, unlisted	826	11	22
Options - purchased agreements, listed	16	12	-
Derivatives	309,182	7,284	4,471

Amounts are in ISK millions

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 in the Annual Financial Statements 2020.

30.9.2021	Notional	Maturity date	Fair value Assets	Fair value Liabilities	Gain (loss) on FV changes
Interest rates swaps - EUR	45,331	1-5 years	808	-	(363)
Interest rates swaps - EUR	30,220	0-3 months	405	-	(98)
Interest rates swaps - EUR	45,331	1-5 years	-	69	(143)
Interest rates swaps - USD	13,060	1-5 years	285	-	(338)
Interest rates swaps - EUR	45,331	>5-years	40	-	40
Interest rates swaps - EUR	45,331	1-5 years	-	130	(143)
			1,538	199	(1,045)
31.12.2020					
Interest rates swaps - EUR	93,654	1-5 years	1,327	-	(304)
Interest rates swaps - EUR	31,218	6-12 months	139	-	(47)
Interest rates swaps - EUR	-	-	-	-	(45)
Interest rates swaps - USD	12,764	1-5 years	815	-	618
			2,281	-	221

Hedged borrowings and subordinated liabilities

30.9.2021	Book value	Accumulated fair value Assets	Accumulated fair value Liabilities	Gain (loss) on FV changes
EUR 500 million - issued 2017/18 - 5 years	30,422	195	-	84
EUR 300 million - issued 2018 - 3 years	42,451	21	-	361
EUR 300 million - issued 2020 - 4 years	45,139	141	-	145
USD 100 million - issued 2020 - Perpetual	13,301	-	287	323
EUR 300 million - issued 2021 - 4 years	44,981	141	-	143
EUR 300 million - issued 2021 - 5 years	45,135	-	40	(40)
Hedged borrowings and subordinated liabilities	221,429	498	327	1,016
31.12.2020				
EUR 500 million - issued 2016/18 - 5 years	31,071	113	-	48
EUR 300 million - issued 2017 - 3 years	-	-	-	(38)
EUR 300 million - issued 2018 - 3 years	44,276	-	352	264
EUR 300 million - issued 2020 - 4 years	46,655	-	-	-
USD 100 million - issued 2020 - Perpetual	13,498	-	601	(673)
Hedged borrowings and subordinated liabilities	135,500	113	953	(399)

The effectiveness of each hedge is measured regularly with linear regression. The relationship between fair value changes of an interest rate swap on the one hand and a borrowing on the other hand is examined. In all cases the effectiveness is within limits, or between 90-102%.

Amounts are in ISK millions

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				
30.9.2021	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	8,659	(689)	7,970	689	-	8,659	-	7,970
Derivatives	3,624	-	3,624	(172)	-	3,452	1,311	4,935
Total assets	12,283	(689)	11,594	517	-	12,111	1,311	12,905
31.12.2020								
Reverse repurchase agreements	8,229	(433)	7,796	(7,074)	-	722	-	7,796
Derivatives	6,012	-	6,012	(1,167)	-	4,845	1,272	7,284
Total assets	14,241	(433)	13,808	(8,241)	-	5,567	1,272	15,080

Financial liabilities subject to enforceable master netting arrangements and similar arrangements

	Liabilities subject to netting arrangements			Netting potential not recognized in the Balance Sheet				
30.9.2021	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	-	(689)	(689)	689	-	-	-	(689)
Derivatives	1,310	-	1,310	(172)	-	1,138	4,087	5,397
Total liabilities	1,310	(689)	621	517	-	1,138	4,087	4,708
31.12.2020								
Repurchase agreements	7,507	(433)	7,074	(7,074)	-	-	-	7,074
Derivatives	1,167	-	1,167	(1,167)	-	-	3,304	4,471
Total liabilities	8,674	(433)	8,241	(8,241)	-	-	3,304	11,545

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

26. Investments in associates

	30.9.2021	31.12.2020
Carrying amount at the beginning of the year	891	852
Acquisitions / increased share capital	30	39
Disposals	(250)	-
Share of profit of associates and profit from sale	33	-
Investment in associates	704	891

The Group's interest in its principal associates

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

Arion Bank sold its entire shareholding in 220 Fjördur ehf. for ISK 250 million with minor effects on the Consolidated Interim 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

30.9.2021	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	-	-	-	681	681
Additions, capitalized salaries	-	-	-	161	161
Amortization	-	-	(45)	(754)	(799)
Intangible assets	669	2,383	622	6,058	9,732

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

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

28. Tax assets and tax liabilities

	30.9.2021		31.12.2020	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	6,374	-	3,799
Deferred tax	2	615	2	463
Tax assets and tax liabilities	2	6,989	2	4,262

Amounts are in ISK millions

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

Assets and disposal groups held for sale	30.9.2021	31.12.2020
Valitor hf.	11,854	11,885
Stakksberg ehf.	1,661	1,580
Sólbjarg ehf.	2,447	2,323
Disposal groups held for sale	15,962	15,788
Real estate	811	1,019
Other assets	2	4
Assets and disposal groups held for sale	16,775	16,811

Liabilities associated with disposal groups held for sale

Valitor hf.	15,682	14,533
Sólbjarg ehf.	1,170	1,650
Liabilities associated with disposal groups held for sale	16,852	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. Should the sale not be finalised due to failure to obtain regulatory approval, the risk thereto shall be borne by the buyer, valid until end of 2023. The sale agreement for Valitor hf. does not affect the Condensed Consolidated Interim 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.

	30.9.2021	31.12.2020
Loans to credit institutions	14,465	14,127
Loans to customers	1,879	1,878
Financial instruments	9	-
Investments in associates	74	70
Intangible assets	4,305	4,534
Tax assets	436	422
Other assets	2,978	2,104
Assets	24,146	23,135
Elimination within Arion Bank Group	(12,292)	(11,250)
Valitor's contribution to the Group	11,854	11,885
Tax liabilities	25	163
Other liabilities	15,646	14,369
Borrowings	-	96
Liabilities	15,671	14,628
Elimination within Arion Bank Group	11	(95)
Valitor's contribution to the Group	15,682	14,533
Book value of Valitor	8,475	8,507

Sólbjarg ehf., a subsidiary of Eignabjarg ehf.

On 20 June 2019 Arion Bank acquired all shares in TravelCo hf. and its subsidiaries (hereafter "TravelCo") following an enforcement of pledges. TravelCo was established following the collapse of Primera Air ehf. and Primera Travel Group hf. with the purpose of owning and operating tour operators in Scandinavia and Iceland. Sólbjarg ehf (hereafter “Sólbjarg”) is the holding company of the TravelCo group in the beneficial ownership of Arion Bank. Arion Bank completed the sale of Terra Nova Sól ehf., a subsidiary of Sólbjarg, in Q1 2020. The travel industry was hit hard by the Covid-19 pandemic and suffered total loss of income. As a result of the pandemic, the Scandinavian operations entered into financial restructuring in late 2020 and subsequent bankruptcy proceedings. Bravo Tours 1998 A/S was established on the foundation of the Danish operation, TravelCo Nordic A/S and is now in 59.4% ownership of Sólbjarg and 40.6% under Danish ownership. Solbjarg has received several offers in Sólbjarg’s share in Bravo Tours 1998 A/S in recent months and Solbjarg is evaluating its options regarding a potential sale. Heimsferdir ehf., an Icelandic travel agency, is currently under the direct ownership of Sólbjarg. 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’s subsidiaries are classified as held for sale in accordance with IFRS 5.

Amounts are in ISK millions

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

30. Other assets

	30.9.2021	31.12.2020
Property and equipment	4,511	4,792
Right of use asset	757	754
Accounts receivable	5,475	5,222
Unsettled securities trading	49,601	3,888
Investment for life assurance policyholders where risk is held by policyholder	1,213	1,141
Sundry assets	3,343	2,821
Other assets	**64,900**	**18,618**

31. Other liabilities

	30.9.2021	31.12.2020
Accounts payable	527	850
Unsettled securities trading	5,821	272
Depositors' and Investors' Guarantee Fund	135	131
Technical provision	18,374	16,152
Technical provision for life assurance policyholders were investment risk is held by policyholder	1,213	1,141
Withholding tax	197	790
Bank levy	432	1,301
Accrued expenses	2,809	2,888
Prepaid income	1,654	1,516
Impairment of off-balance items	820	1,062
Lease liability	807	787
Sundry liabilities	6,909	5,824
Other liabilities	**39,698**	**32,714**

Technical provision	Technical provision	Reinsurers' share	Total 30.9.2021	Technical provision	Reinsurers' share	Total 31.12.2020
Claims reported and loss adjustment expenses	9,266	(140)	9,126	8,428	(149)	8,279
Claims incurred but not reported	1,931	(82)	1,849	1,691	(82)	1,609
Claims outstanding	11,197	(222)	10,975	10,119	(231)	9,888
Provision for unearned premiums	7,177	(10)	7,167	6,033	(7)	6,026
Own technical provision	18,374	(232)	18,142	16,152	(238)	15,914

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

Amounts are in ISK millions

32. Borrowings

Currency, original nominal value	First issued	Maturity	Maturity type	Terms of interest	30.9.2021	31.12.2020
ARION CBI 21, ISK 10,220 million	2014	2021	At maturity	Fixed, CPI linked, 3.50%	11,015	10,576
ARION CB 22, ISK 46,720 million	2015	2022	At maturity	Fixed, 6.50%	31,059	28,443
ARION CB 24 ISK 40,180 million	2019	2024	At maturity	Fixed, 6.00%	24,605	16,857
ARION CBI 25, ISK 37,940 million	2017	2025	At maturity	Fixed, CPI linked, 3.00%	43,076	41,576
ARION CBI 26 ISK 15,460 million	2019	2026	At maturity	Fixed, CPI linked, 2.00%	17,596	17,030
ARION CBI 29, ISK 25,220 million	2014	2029	At maturity	Fixed, CPI linked, 3.50%	29,753	28,561
ARION CBI 48, ISK 11,680 million	2018	2048	Amortizing	Fixed, CPI linked, 2.50%	10,785	10,721
ARION CB EUR, EUR 300 million *	2021	2026	At maturity	Fixed, EUR 0.05%	45,135	-
Statutory covered bonds					213,024	153,764
EUR 500 million *	2016	2021	At maturity	Fixed, 1.625%	30,421	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%	11,221	11,207
SEK 150 million	2019	2022	At maturity	Floating, 3 month STIBOR +1.33%	2,240	2,338
NOK 250 million	2017	2023	At maturity	Fixed, 3.02%	3,774	3,798
EUR 300 million *	2018	2023	At maturity	Fixed, 1.00%	42,451	44,276
EUR 300 million *	2020	2024	At maturity	Fixed, 0.625 %	45,139	46,655
NOK 250 million	2017	2027	At maturity	Fixed, 3.40%	3,780	3,808
EUR 300 million *	2021	2025	At maturity	Fixed, 0.375%	44,981	-
Senior unsecured bonds					184,007	145,183
Borrowings					397,031	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 397 billion at the end of the period (31.12.2020: ISK 299 billion). The market value of those bonds was ISK 410 billion (31.12.2020: ISK 317 billion). The Group repurchased no own debts during the period.

33. Subordinated liabilities

Currency, original nominal value	Issued	Maturity	First call date	Terms of interest	30.9.2021	31.12.2020
SEK 500 million	2018	2028	22 Nov '23	Floating, 3 month STIBOR +3.10%	7,443	7,765
NOK 300 million	2019	2029	9 Jul '24	Floating, NIBOR +3.65%	4,512	4,508
SEK 225 million	2019	2029	20 Dec '24	Floating, 3 month STIBOR +3.70%	3,354	3,500
ARION T2I 30 ISK 4,800 million	2019	2030	4 Jan '25	Fixed, CPI linked, 3.875%	5,211	5,088
ARION T2 30 ISK 880 million	2019	2030	4 Jan '25	Fixed, 6.75%	892	907
EUR 5 million	2019	2031	6 Mar '26	Fixed, 3.24%	763	794
Tier 2 subordinated liabilities					22,175	22,562
ARION AT1 USD 100 million *	2020	Perpetual	26 Mar '26	Fixed, 6.25%	13,302	13,498
Additional Tier 1 subordinated liabilities					13,302	13,498
Subordinated liabilities					35,477	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.

34. Pledged assets

Pledged assets against liabilities	30.9.2021	31.12.2020
Assets, pledged as collateral against borrowings	322,301	228,358
Assets, pledged as collateral against loans from credit institutions and short positions	8,659	8,150
Pledged assets against liabilities	330,960	236,508
Thereof pledged assets against issued covered bonds held by the Bank	(46,800)	(36,000)
Pledged assets against liabilities on balance	284,160	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 213 billion at the end of the period (31.12.2020: ISK 154 billion).

Amounts are in ISK millions

34. Pledged assets, continued

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 39 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 46.8 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 30.9.2021	Share capital	Own shares	Share premium	Total 31.12.2020
Balance at the beginning of the year ...	1,730	(11)	49,612	51,331	1,814	(41)	53,942	55,715
Share capital reduction	(70)	70	-	-	(84)	84	-	-
Purchase of treasury stock	-	(169)	(22,499)	(22,668)	-	(54)	(4,326)	(4,380)
Employees stock grant	-	-	-	-	-	-	(4)	(4)
Balance at the end of the period	1,660	(110)	27,113	28,663	1,730	(11)	49,612	51,331
Own shares / issued share capital	6.63%				0.69%			

Arion Bank paid ISK 2.9 billion in dividends in March following the AGM. Based on two share buyback programs authorized by the Financial Supervisory Authority of the Central Bank of Iceland (FSA) in February and July 2021, Arion Bank bought back own shares for ISK 22,668 million during the first nine months of 2021. On 7 October 2021 the FSA authorized Arion Bank to initiate new programs in Iceland and Sweden to purchase own shares (including in the form of SDRs) amounting up to a total of 54.5 million shares or ISK 10 billion, representing around 3.3% of share capital. Following this, the Board of Arion Bank decided to launch a new program as of 28 October. The program will end no later than 16 March 2022.

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.

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

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

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

Warrants

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Other information

36. Shareholders of Arion Bank

	30.9.2021	31.12.2020
Lífeyrissjódur verzlunarmanna	9.21%	7.46%
Lífeyrissjódur starfsmanna ríkisins	9.10%	6.03%
Gildi lífeyrissjódur	8.89%	9.92%
Arion banki hf.	6.63%	0.69%
Stoðir hf.	4.73%	4.99%
Birta lífeyrissjódur	3.22%	2.83%
Frjálsi lífeyrissjódurinn	2.88%	2.73%
Íslandsbanki hf.	2.83%	0.38%
Stefnir rekstrarfélag hf.	2.72%	2.13%
Stapi Lífeyrissjódur	2.50%	2.92%
Hvalur hf.	2.22%	1.52%
Brú Lífeyrissjóður	2.12%	0.63%
Kvika banki hf.	1.99%	0.63%
Akta sjóðir	1.95%	0.00%
Kvika eignastýring	1.53%	0.98%
Íslandssjóðir	1.43%	0.69%
Bóksal ehf.	1.39%	0.14%
Almenni lífeyrissjóður	1.33%	0.67%
Festa lífeyrissjóður	1.23%	0.72%
Lífeyrissjóður Vestmannaeyja	1.21%	1.13%
MainFirst Bank AG	1.19%	1.14%
Lífsverk Pension fund	1.19%	1.37%
Landsbankinn hf.	1.14%	0.98%
Landsbréf hf.	0.98%	0.66%
Sjóvá tryggingar	0.85%	0.87%
Eaton Vance funds	0.61%	2.11%
Taconic Capital Advisors	-	23.22%
Sculptor Capital Management	-	6.12%
Lansdowne partners	-	1.12%
Other shareholders with less than 1% shareholding	24.94%	15.23%
	100.0%	100.0%

In the first quarter of 2021 the Bank’s largest shareholder, Taconic Capital Advisors, sold its entire 23.22% shareholding in the Bank to a diverse group of investors, mainly Icelandic pension funds, fund managers and other domestic investors.

At the end of September the Bank's employees held a shareholding of 0.54% in Arion Bank (31.12.2020: 0.53%).

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 period, 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, 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 preparation of a class-action lawsuit

The Consumer Association of Iceland sent a letter to Arion Bank, Íslandsbanki and Landsbanki in April 2020 claiming illegality of contractual terms on variable rate mortgages to individuals. The letter called for revised terms and compensation to borrowers which, according to the Association, have suffered damages. 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 toward 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 approx. 1200 individuals. The Bank has commissioned an outside opinion on its legal position and is currently analysing the potential loan portfolio effect.

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

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 interests. 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. procured that the companies were sold to a company that is not the Bank, but the Bank was the indirectly owner of (the assets were moved to Sólbjarg ehf. after enforcement), without the transaction having had any “reality” and without “real payment” and regardless of whether the Bank continued to effectively retain control of the Icelandic companies. This 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. on 20 June 2019 following a notice of an Event of Default, acceleration and enforcement under a facilities agreement to TravelCo hf. as borrower. 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 Interim Financial Statements that require additional disclosures.

Off balance sheet information

39. Commitments

Financial guarantees, unused credit facilities and undrawn loan commitments	30.9.2021	31.12.2020
Financial guarantees	14,482	20,857
Unused overdrafts	56,178	49,164
Undrawn loan commitments	93,889	64,055
Financial guarantees, unused credit facilities and undrawn loan commitments	164,549	134,076

40. Assets under management and under custody

Assets under management	1,291,149	1,130,978
Assets under custody	1,137,620	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 September 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

30.9.2021	Assets	Liabilities	Net balance
Board of Directors and key Management personnel	154	(327)	(173)
Associates and other related parties	1	(41)	(40)
Balances with related parties	155	(368)	(213)

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

Amounts are in ISK millions

Risk management disclosures

The Group faces various risks arising from its day to day operations and is currently facing a unique set of risks arising from the impact of the Covid-19 pandemic on the Group's operations and its customers. Managing risk is a core activity within the Group. The key to effective risk management is a process of on-going identification of significant risk, quantification of risk exposure, actions to limit risk and constant monitoring of risk. This process of risk management and the ability to evaluate, manage and correctly price the risk encountered is critical to the Group's continuing profitability and this process enables the Group to ensure that the exposure to risk remains within acceptable levels.

Further information on risk management and capital adequacy is provided in the Annual Financial Statements for 2020 and in the Pillar 3 Risk Disclosures for 2020. The Pillar 3 Risk Disclosures 2020 are available on the Bank's website, www.arionbanki.is.

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 andare 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:

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

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

		Collateral				
30.9.2021	Maximum exposure	Cash and securities	Real estate	Vessels	Other collateral	Total collateral
Cash and balances with Central Bank	70,136	-	-	-	-	-
Loans to credit institutions at amortized cost	28,259	-	-	-	-	-
Loans to customers at amortized cost	896,940	31,039	674,559	42,443	72,026	820,067
Individuals	*501,578*	*408*	*457,199*	*16*	*14,423*	*472,046*
Corporates	*395,362*	*30,631*	*217,360*	*42,427*	*57,603*	*348,021*
Real estate activities and construction	*135,576*	*836*	*128,426*	*67*	*3,039*	*132,368*
Fishing industry	*82,226*	*2,064*	*11,267*	*40,563*	*22,329*	*76,223*
Information and communication technology	*9,271*	*11*	*1,155*	*-*	*1,004*	*2,170*
Wholesale and retail trade	*51,027*	*67*	*38,328*	*20*	*6,923*	*45,338*
Financial and insurance activities	*45,670*	*27,363*	*2,111*	*-*	*7,455*	*36,929*
Industry, energy and manufacturing	*28,567*	*36*	*16,248*	*-*	*11,150*	*27,434*
Transportation	*14,354*	*1*	*1,340*	*1,646*	*1,883*	*4,870*
Services	*13,641*	*248*	*8,157*	*124*	*2,984*	*11,513*
Public sector	*5,617*	*5*	*1,932*	*7*	*144*	*2,088*
Agriculture and forestry	*9,413*	*-*	*8,396*	*-*	*692*	*9,088*
Other assets with credit risk	57,488	-	-	-	-	-
Financial guarantees	14,482	1,259	5,391	66	3,460	10,176
Undrawn loan commitments and unused overdrafts	150,067	-	-	-	-	-
Fair value through OCI	143,688	-	-	-	-	-
Government bonds	*118,933*	-	-	-	-	-
Bonds issued by financial institutions and corporates	*24,755*	-	-	-	-	-
Balance at the end of the period	1,361,060	32,298	679,950	42,509	75,486	830,243
31.12.2020						
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 and construction	*127,888*	*273*	*110,453*	*65*	*2,912*	*113,703*
Fishing industry	*81,582*	*244*	*13,655*	*41,206*	*25,665*	*80,770*
Information and communication technology	*20,810*	*44*	*5,184*	*-*	*4,693*	*9,921*
Wholesale and retail trade	*51,599*	*274*	*38,600*	*25*	*10,220*	*49,119*
Financial and insurance activities	*35,749*	*18,295*	*3,267*	*-*	*9,606*	*31,168*
Industry, energy and manufacturing	*31,193*	*14*	*16,214*	*-*	*12,520*	*28,748*
Transportation	*12,740*	*1*	*744*	*1,875*	*2,340*	*4,960*
Services	*13,175*	*33*	*8,615*	*152*	*1,998*	*10,798*
Public sector	*6,786*	*3*	*2,103*	*7*	*228*	*2,341*
Agriculture and forestry	*8,083*	*-*	*7,423*	*-*	*364*	*7,787*
Other assets with credit risk	9,667	-	-	-	-	-
Financial guarantees	20,857	6,200	6,255	35	2,374	14,864
Undrawn loan commitments and unused overdrafts	113,219	-	-	-	-	-
Fair value through OCI	137,655	-	-	-	-	-
Government bonds	*122,743*	-	-	-	-	-
Bonds issued by financial institutions and corporates	*14,912*	-	-	-	-	-
Balance at the end of the period	1,174,710	25,433	606,193	43,373	85,255	760,254

Amounts are in ISK millions

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.

	30.9.2021		31.12.2020	
	Gross carrying amount	Thereof credit impaired	Gross carrying amount	Thereof credit impaired
Less than 50%	124,234	1,136	117,591	883
50-70%	210,152	1,872	169,206	1,559
70-90%	99,111	1,231	84,899	810
90-100%	3,997	365	3,170	216
100-110%	1,048	62	1,004	111
More than 110%	1,773	30	2,609	177
Not classified	-	-	75	-
Balance at the end of the period	440,315	4,696	378,554	3,756

Collateral for financial assets in stage 3

At the end of the period, the gross carrying amount of assets in stage 3 is ISK 23,000 million (31.12.2020: ISK 21,606 million) with ISK 19,557 million in collateral (31.12.2020: ISK 16,097 million), thereof ISK 18,115 million in real estate (31.12.2020: 14,790 million).

Collateral repossessed

During the period, the Group took possession of assets due to foreclosures. The total value of real estate the Group took possession of during the period and still holds at the end of the period is ISK 430 million (31.12.2020: ISK 330 million) and ISK 3 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 has two large exposures at the end of the period, totaling ISK 38.1 billion (11.1% and 11.0% of Tier 1 capital, in total 22.1% of Tier 1 capital) before taking into account eligible credit risk mitigation (31.12.2020: one large exposure, totaling ISK 20.9 billion). The total exposure was ISK 38.0 billion (both exposures 11.0% of Tier 1 capital, in total 22.0% 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 updated at least annually and recalibrated with current data with the aim of maintaining their predictive power. Year-on-year changes in risk classification of loans may in part be due to model refinement. External ratings are primarily used for marketable securities and loans to credit institutions. For further information on the rating scales used, see Note 56 in the Annual Financial Statements 2020.

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

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

30.9.2021	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	70,136	22,380	143,701
Non-investment grade	-	5,916	-
Gross carrying amount	70,136	28,296	143,701
Loss allowance	-	(37)	(13)
Book value	70,136	28,259	143,688

Loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 to 1 (Grades AAA to BBB-)	479,333	1	-	53	479,387
Risk class 2 (Grades BB+ to BB-)	205,082	22,709	-	6	227,797
Risk class 3 (Grades B+ to B-)	106,999	20,652	-	133	127,784
Risk class 4 (Grades CCC+ to CCC-)	14,094	31,263	-	-	45,357
Risk class 5 (DD)	-	-	22,766	235	23,001
Unrated	1,937	641	-	-	2,578
Gross carrying amount	807,445	75,266	22,766	427	905,904
Loss allowance	(1,623)	(2,012)	(5,328)	(1)	(8,964)
Book value	805,822	73,254	17,438	426	896,940
Loans to customers - Individuals					
Risk class 0 to 1 (Grades AAA to BBB-)	374,303	1	-	53	374,357
Risk class 2 (Grades BB+ to BB-)	85,974	5,547	-	6	91,527
Risk class 3 (Grades B+ to B-)	21,253	3,144	-	133	24,530
Risk class 4 (Grades CCC+ to CCC-)	2,372	3,888	-	-	6,260
Risk class 5 (DD)	-	-	6,195	235	6,430
Unrated	102	370	-	-	472
Gross carrying amount	484,004	12,950	6,195	427	503,576
Loss allowance	(548)	(281)	(1,168)	(1)	(1,998)
Book value	483,456	12,669	5,027	426	501,578
Loans to customers - Companies and sovereign					
Risk class 0 to 1 (Grades AAA to BBB-)	105,030	-	-	-	105,030
Risk class 2 (Grades BB+ to BB-)	119,108	17,162	-	-	136,270
Risk class 3 (Grades B+ to B-)	85,746	17,508	-	-	103,254
Risk class 4 (Grades CCC+ to CCC-)	11,722	27,375	-	-	39,097
Risk class 5 (DD)	-	-	16,571	-	16,571
Unrated	1,835	271	-	-	2,106
Gross carrying amount	323,441	62,316	16,571	-	402,328
Loss allowance	(1,075)	(1,731)	(4,160)	-	(6,966)
Book value	322,366	60,585	12,411	-	395,362
Loan commitments, guarantees and unused credit facilities					
Risk class 0 to 1 (Grades AAA to BBB-)	83,637	-	-	-	83,637
Risk class 2 to 4 (Grades BB+ to CCC-)	61,061	6,436	2,193	-	69,690
Unrated	10,740	482	-	-	11,222
Nominal	155,438	6,918	2,193	-	164,549
Loss allowance	(280)	(194)	(347)	-	(821)
Nominal less loss allowance	155,158	6,724	1,846	-	163,728

Amounts are in ISK millions

42. Credit risk, continued

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

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

Notes to the Condensed Consolidated Interim Financial Statements

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		
30.09.2021	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Book value
Loans to credit instit., securities & cash	242,133	(50)	-	-	-	-	242,083
Loans to individuals	484,004	(548)	13,143	(281)	6,429	(1,169)	501,578
Mortgage	*426,224*	*(179)*	*9,395*	*(85)*	*4,696*	*(226)*	439,825
Other	*57,780*	*(369)*	*3,748*	*(196)*	*1,733*	*(943)*	61,753
Loans to corporates and sovereign	323,441	(1,075)	62,316	(1,731)	16,571	(4,160)	395,362
Real estate activities and construction	*116,947*	*(305)*	*15,466*	*(171)*	*4,152*	*(513)*	135,576
Fishing industry	*71,586*	*(107)*	*10,264*	*(55)*	*664*	*(126)*	82,226
Information and communication technology	*8,641*	*(32)*	*622*	*(53)*	*140*	*(47)*	9,271
Wholesale and retail trade	*26,900*	*(122)*	*18,954*	*(1,068)*	*7,946*	*(1,583)*	51,027
Financial and insurance activities	*37,228*	*(296)*	*8,470*	*(41)*	*721*	*(412)*	45,670
Industry, energy and manufacturing	*25,635*	*(60)*	*2,318*	*(10)*	*1,222*	*(538)*	28,567
Transportation	*12,430*	*(53)*	*1,944*	*(129)*	*856*	*(694)*	14,354
Services	*10,286*	*(49)*	*3,261*	*(183)*	*477*	*(151)*	13,641
Public Sector	*5,179*	*(28)*	*372*	*(13)*	*113*	*(6)*	5,617
Agriculture and forestry	*8,609*	*(23)*	*645*	*(8)*	*280*	*(90)*	9,413
Balance at the end of the period	1,049,578	(1,673)	75,459	(2,012)	23,000	(5,329)	1,139,023

31.12.2020							
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	270,454	(1,037)	112,585	(2,910)	16,148	(5,635)	389,605
Real estate activities and construction	*78,573*	*(376)*	*49,366*	*(576)*	*1,500*	*(599)*	*127,888*
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 period	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 requirements

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

Net remeasurement of loss allowance

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

New financial assets, originated or purchased

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

Derecognitions and maturities

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

Write-offs

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

30.9.2021

*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)	(1,318)	1,218	100	-	-
Transfers to Stage 2 (lifetime ECL)	156	(229)	73	-	-
Transfers to Stage 3 (credit impaired financial assets)	57	214	(271)	-	-
Net remeasurement of loss allowance **	2,211	391	(863)	-	1,739
New financial assets, originated or purchased	(1,548)	(342)	(131)	-	(2,021)
Derecognitions and maturities	621	416	1,136	(289)	1,884
Write-offs ***	1	8	1,276	372	1,657
Impairment loss allowance ****	(1,903)	(2,206)	(5,675)	(1)	(9,785)
Impairment loss allowances for assets only carrying 12-month ECL	(50)	-	-	-	(50)
Total impairment loss allowance	(1,953)	(2,206)	(5,675)	(1)	(9,835)

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

** During the period the loss allowance balance for stage 3 loans was raised by ISK 374 million due to unwinding of interest income.

*** During the period an amount of ISK 1,075 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

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)	(1,190)	1,090	100	-	-
Transfers to Stage 2 (lifetime ECL)	147	(220)	73	-	-
Transfers to Stage 3 (credit impaired financial assets)	55	211	(266)	-	-
Net remeasurement of loss allowance	1,956	170	(691)	-	1,435
New financial assets, originated or purchased	(1,210)	(240)	(131)	-	(1,581)
Derecognitions and maturities	462	274	1,135	(289)	1,582
Write-offs	1	8	1,276	372	1,657
Total loss allowance for loans to customers	(1,623)	(2,012)	(5,328)	(1)	(8,964)
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)	(446)	355	91	-	-
Transfers to Stage 2 (lifetime ECL)	87	(123)	36	-	-
Transfers to Stage 3 (credit impaired financial assets)	41	130	(171)	-	-
Net remeasurement of loss allowance	692	(272)	(358)	-	62
New financial assets, originated or purchased	(270)	(48)	(86)	-	(404)
Derecognitions and maturities	154	64	233	(289)	162
Write-offs	1	8	276	372	657
Total loss allowance for loans to individuals	(548)	(281)	(1,168)	(1)	(1,998)
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)	(744)	735	9	-	-
Transfers to Stage 2 (lifetime ECL)	60	(97)	37	-	-
Transfers to Stage 3 (credit impaired financial assets)	14	81	(95)	-	-
Net remeasurement of loss allowance	1,264	442	(333)	-	1,373
New financial assets, originated or purchased	(940)	(192)	(45)	-	(1,177)
Derecognitions and maturities	308	210	902	-	1,420
Write-offs	-	-	1,000	-	1,000
Total loss allowance for loans to companies and sovereign	(1,075)	(1,731)	(4,160)	-	(6,966)
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	(128)	128	-	-	-
Transfers to lifetime ECL	9	(9)	-	-	-
Transfers to credit impaired	2	3	(5)	-	-
Net remeasurement of loss allowance	255	221	(172)	-	304
New financial commitments originated	(338)	(102)	-	-	(440)
Derecognitions and maturities	159	142	1	-	302
Total loss allowance for loan commit., guarantees, unused cr. facilities	(280)	(194)	(347)	-	(821)

Amounts are in ISK millions

42. Credit risk, continued

31.12.2020

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

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

** During the period the loss allowance balance for stage 3 loans was raised by ISK 789 million due to unwinding of interest income.

*** During the period an amount of ISK 2,672 million was written off but is still subject to enforcement activities subject to Icelandic law.

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

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

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

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
Foreign exchange rate differences	(4)	(37)	(244)	-	(285)
Total loss allowance for loans to companies and sovereign	(1,037)	(2,910)	(5,635)	-	(9,582)

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

Macroeconomic forecast

The calculation of expected credit losses under IFRS 9 uses forward-looking information in the form of scenarios where the development of macro-economic variables is predicted. The expected credit loss is a probability-weighted average of the estimated forecasts over three scenarios: base case (65%), pessimistic (15%) and optimistic (20%). The probability weight for the optimistic scenario was increased by 5% in Q2 2021 and the likelihood of the pessimistic scenario decreased by 5%. The macroeconomic forecast and scenario probability weights is done by the Bank's Chief Economist and approved by the Bank's IFRS 9 committee, most recently in September 2021. The following table shows values used for IFRS 9 impairment calculations.

	Base case		
	2021	2022	2023
Unemployment rate	6.4%	6.2%	5.5%
Housing prices	11.5%	5.4%	3.5%
Private consumption	4.2%	4.5%	3.0%
GDP	4.0%	3.9%	2.2%

	Optimistic			Pessimistic		
	2021	2022	2023	2021	2022	2023
Unemployment rate	5.8%	5.2%	4.8%	7.6%	8.2%	6.7%
Housing prices	13.2%	7.4%	4.5%	8.2%	3.4%	2.5%
Private consumption	6.4%	4.8%	2.6%	1.9%	3.9%	3.8%
GDP	6.7%	2.8%	1.9%	2.4%	3.5%	2.8%

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 1.9 billion, ISK 3.9 billion and ISK 7.9 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

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

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

30.9.2021	Tourism dependent	Payment moratoria in Q3 2021	Recipient of govern-ment sponsored loans	All focus groups	Thereof secured by real estate
Individuals	4,027	3,144	163	7,266	6,762
Real estate and construction	26,002	7,075	1,225	29,812	28,755
Services	5,188	1,295	2,315	5,698	2,352
Transportation	8,524	816	897	8,530	345
Industry, energy and manufacturing	162	790	551	1,247	797
Wholesale and retail trades	32,067	17,180	17,683	32,585	28,726
Other sectors	1,332	141	1,070	2,400	1,288
Gross carrying amount	77,302	30,441	23,904	87,538	69,025
Loss allowance	(3,873)	(1,386)	(1,504)	(3,997)	
Book value	73,429	29,055	22,400	83,541	

Book value of Covid-19 impacted loans was ISK 83,541 million or 9.3% of loans to customers (31.12.2020: ISK 102,035 million and 12.4%).

The following table shows loans to customers which have been granted payment moratoria including those loans where the moratoria are no longer active at the period-end.

	Individuals	Companies
Moratoria granted, including loans where the moratoria are no longer active	45,887	79,645
Active moratoria at period-end	1,090	4,097

The exposures to the focus groups were divided into four groups by impact assessment. The largest exposures in tourism were individually assessed into the four impact groups based on summer 2020 performance and outlook. In group 1, no overlay is applied to the credit rating. In groups 2, 3 and 4, the impact is assessed to correspond to a worse rating by 1, 2 and 3 notches, respectively. The average assessed impact was group 3 (two notches) and other customers in the focus group were therefore given that assessment. In Q3 2021, the tourism sector was reassessed and as a result the impact group overlays are no longer used for cases where the Group's general credit risk assessment methodology adequately captures the risks related to the Covid-19 crisis.

	Impact group 1	Impact group 2	Impact group 3	Impact group 4	In default	Total
Individuals	3,865	-	3,295	-	106	7,266
Real estate and construction	24,305	-	5,106	239	162	29,812
Services	3,787	-	1,259	393	259	5,698
Transportation	7,553	-	104	18	855	8,530
Industry, energy and manufacturing	696	-	379	-	172	1,247
Wholesale and retail trades	5,643	207	18,308	1,324	7,103	32,585
Other sectors	622	-	1,031	-	747	2,400
Gross carrying amount	46,471	207	29,482	1,974	9,404	87,538
Loss allowance	(427)	-	(1,186)	(25)	(2,359)	(3,997)
Book value	46,044	207	28,296	1,949	7,045	83,541

The following table shows the effect of the group overlays on the distribution of exposure into risk classes

	Before overlay	After overlay
Risk class 0 and 1 (Grades AAA to BBB-)	17,043	14,363
Risk class 2 (Grades BB+ to BB-)	11,549	9,081
Risk class 3 (Grades B+ to B-)	27,974	27,818
Risk class 4 (Grades CCC+ to CCC-)	21,568	26,872
Risk class 5 (DD)	9,404	9,404
Unrated	-	-
Gross carrying amount	87,538	87,538

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.

Following COVID-19 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 4.4%, has been over the Central Bank's target of 2.5% since June 2020 and is expected to remain over the target until the second half of 2022. The Central Bank has responded by increasing interest rates by 75bps this year with further increases expected. This has resulted in 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.

30.9.2021	Up to 3	3-12	1-5	5-10	Over 10	
Assets	months	months	years	years	years	Total
Balances with Central Bank	66,344	-	-	-	-	66,344
Loans to credit institutions	30,376	-	-	-	-	30,376
Loans to customers	579,266	83,356	216,319	5,049	13,892	897,882
Financial instruments	71,961	30,811	55,202	5,520	254	163,748
Assets	747,947	114,167	271,521	10,569	14,146	1,158,350
Liabilities						
Due to credit institutions and Central Bank	8,484	-	-	-	-	8,484
Deposits	641,306	-	-	-	-	641,306
Borrowings	41,725	44,703	211,106	100,425	11,767	409,726
Subordinated liabilities	16,705	-	19,155	-	-	35,860
Liabilities	708,220	44,703	230,261	100,425	11,767	1,095,376
Derivatives and other off-balance sheet items (net position)	(206,213)	30,262	131,713	49,111	-	4,873
Net interest gap	(166,486)	99,726	172,973	(40,745)	2,379	67,847

Amounts are in ISK millions

43. Market risk, continued

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

Sensitivity analysis of interest rate risk in the banking book

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

	30.9.2021		31.12.2020	
NPV change	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	(2,788)	2,689	(3,849)	3,511
ISK, Non index-linked	2,121	(1,826)	933	(1,002)
Foreign currencies	248	(262)	301	(327)
NII change				
ISK, CPI index-linked	(754)	(43)	(1,032)	309
ISK, Non index-linked	(3,728)	694	(3,414)	668
Foreign currencies	(547)	550	(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.

	30.9.2021		31.12.2020	
Currency	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	241	(219)	117	(105)
ISK, Non index-linked	11	(7)	185	(169)
Foreign currencies	61	(60)	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

30.9.2021	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	8,329	42,917	169,961	221,207
Financial instruments	7,522	2,618	6,633	16,773
Off-balance sheet position	-	-	-	-
Assets, CPI index-linked	15,851	45,535	176,594	237,980
Liabilities, CPI index-linked				
Deposits	85,977	6,946	380	93,303
Borrowings	11,306	44,316	56,603	112,225
Subordinated liabilities	-	-	5,211	5,211
Other	1,129	221	1,331	2,681
Off-balance sheet position	3,454	3,212	-	6,666
Liabilities, CPI index-linked	101,866	54,695	63,525	220,086
Net on-balance sheet position	(82,561)	(5,948)	113,069	24,560
Net off-balance sheet position	(3,454)	(3,212)	-	(6,666)
CPI Balance	(86,015)	(9,160)	113,069	17,894
CPI Balance for prudential consolidation, excluding insurance operations *	(85,179)	(11,557)	106,853	10,118

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

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

Amounts are in ISK millions

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

30.9.2021

Financial assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	68,627	551	443	105	116	46	248	70,136
Loans to credit institutions	5,967	7,203	10,197	3,468	399	736	2,406	30,376
Loans to customers	742,338	103,682	36,103	4,159	4,105	1,970	4,583	896,940
Financial instruments	152,727	57,801	22,347	212	18	16,784	90	249,979
Other financial assets	11,795	45,412	276	1	-	2	2	57,488
Financial assets	981,454	214,649	69,366	7,945	4,638	19,538	7,329	1,304,919
Financial liabilities								
Due to credit inst. and Central Bank	5,592	1,275	1,539	9	50	-	19	8,484
Deposits	556,800	28,713	45,568	2,287	2,338	3,479	2,121	641,306
Financial liabilities at fair value	5,165	318	134	2	-	9	47	5,675
Other financial liabilities	8,157	1,418	3,773	232	220	101	178	14,079
Borrowings	167,889	208,126	-	-	-	18,776	2,240	397,031
Subordinated liabilities	6,104	763	13,301	-	-	4,512	10,797	35,477
Financial liabilities	749,707	240,613	64,315	2,530	2,608	26,877	15,402	1,102,052
Net on-balance sheet position	231,747	(25,964)	5,051	5,415	2,030	(7,339)	(8,073)	
Net off-balance sheet position	(25,148)	27,436	(9,025)	(7,321)	(1,165)	7,332	7,891	
Net position	206,599	1,472	(3,974)	(1,906)	865	(7)	(182)	
Non-financial assets								
Investment property	6,548	-	-	-	-	-	-	6,548
Investments in associates	704	-	-	-	-	-	-	704
Intangible assets	9,732	-	-	-	-	-	-	9,732
Tax assets	2	-	-	-	-	-	-	2
Assets and disposal groups held for sale	13,561	71	40	1,964	1,119	4	16	16,775
Other non financial assets	7,202	138	36	24	-	12	-	7,412
Non-financial assets	37,749	209	76	1,988	1,119	16	16	41,173
Non-financial liabilities and equity								
Tax liabilities	6,989	-	-	-	-	-	-	6,989
Liabilities associated with disposal groups held for sale	14,900	147	56	1,449	171	84	45	16,852
Other non-financial liabilities	25,489	91	35	-	3	-	1	25,619
Shareholders' equity	193,900	-	-	-	-	-	-	193,900
Non-controlling interest	680	-	-	-	-	-	-	680
Non-financial liabilities and equity	241,958	238	91	1,449	174	84	46	244,040
Management reporting of currency risk *	2,390	1,443	(3,989)	(1,367)	1,810	(75)	(212)	

* 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

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

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

Amounts are in ISK millions

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

	30.9.2021		31.12.2020	
Currency	-10%	+10%	-10%	+10%
EUR	(144)	144	(504)	504
USD	399	(399)	(239)	239
GBP	137	(137)	(73)	73
DKK	(181)	181	90	(90)
NOK	8	(8)	17	(17)
Other	21	(21)	(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.

	30.9.2021		31.12.2020	
Equity	-10%	+10%	-10%	+10%
Trading book - listed	(264)	264	(391)	391
Banking book - listed	(425)	425	(382)	382
Banking book - unlisted	(540)	540	(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

Notes to the Condensed Consolidated Interim Financial Statements

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

30.9.2021	On	Up to 3	3-12	1-5	Over 5	With no		Book
Financial assets	demand	months	months	years	years	maturity	Total	value
Cash and balances with CB	14,479	49,337	6,422	-	-	-	70,238	70,136
Loans to credit institutions	20,970	7,310	41	2,137	-	-	30,458	30,376
Loans to customers	4,969	98,410	138,450	313,362	712,083	-	1,267,274	896,940
Financial instruments	31,346	68,316	29,622	62,013	14,525	54,962	260,784	249,979
Derivatives - assets leg	-	*79,881*	*7,705*	*16,301*	*5,607*	-	*109,494*	*103,119*
Derivatives - liabilities leg	-	*(77,062)*	*(7,005)*	*(13,345)*	*(5,235)*	-	*(102,647)*	*(98,184)*
Other financial instruments	*31,346*	*65,497*	*28,922*	*59,057*	*14,153*	*54,962*	*253,937*	*245,044*
Other financial assets	1,134	51,829	3,250	1,273	-	-	57,486	57,488
Financial assets	72,898	275,202	177,785	378,785	726,608	54,962	1,686,240	1,304,919
Financial liabilities								
Due to credit inst. and Central Bank	4,729	3,765	-	-	-	-	8,494	8,484
Deposits	486,271	139,495	9,658	6,176	344	-	641,944	641,306
Financial liabilities at fair value	-	4,634	287	1,821	12	-	6,754	5,675
Derivatives - assets leg	-	*(48,552)*	*(1,485)*	*(5,767)*	*(1,832)*	-	*(57,636)*	*(56,954)*
Derivatives - liabilities leg	-	*53,107*	*1,772*	*7,588*	*1,844*	-	*64,311*	*62,550*
Short position in bonds	-	*79*	-	-	-	-	*79*	*79*
Short position in equity	-	-	-	-	-	-	-	-
Short position in bonds used for hedging	-	-	-	-	-	-	-	-
Other financial liabilities	72	11,315	796	938	958	-	14,079	14,079
Borrowings	-	45,998	50,884	237,267	93,780	-	427,929	397,031
Subordinated liabilities	-	202	1,661	18,989	24,556	-	45,408	35,477
Financial liabilities	491,072	205,409	63,286	265,191	119,650	-	1,144,608	1,102,052
Net position for assets and liab.	(418,174)	69,793	114,499	113,594	606,958	54,962	541,632	202,867
Off-balance sheet items								
Financial guarantees	-	363	4,379	2,234	7,506	-	14,482	14,482
Unused overdraft	-	56,178	-	-	-	-	56,178	56,178
Undrawn loan commitments	-	65,672	5,279	22,938	-	-	93,889	93,889
Off-balance sheet items	-	122,213	9,658	25,172	7,506	-	164,549	164,549
Net contractual cash flow	(418,174)	(52,420)	104,841	88,422	599,452	54,962	377,083	38,318

Amounts are in ISK millions

44. Liquidity and Funding risk, continued

31.12.2020 *Financial assets*	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	With no maturity	Total	Book value
Cash and balances with CB	5,723	30,210	6,299	-	-	-	42,232	42,136
Loans to credit institutions	20,170	8,065	-	-	-	-	28,235	28,235
Loans to customers	4,643	109,363	106,656	307,086	600,174	-	1,127,922	822,941
Financial instruments	32,665	35,485	67,721	52,118	13,778	35,007	236,774	227,251
Derivatives - assets leg	-	*63,147*	*35,669*	*8,328*	*1,116*	-	*108,260*	*105,362*
Derivatives - liabilities leg	-	*(61,599)*	*(32,638)*	*(4,628)*	*(776)*	-	*(99,641)*	*(98,078)*
Other financial instruments	*32,665*	*33,937*	*64,690*	*48,418*	*13,438*	*35,007*	*228,155*	*219,967*
Other financial assets	534	5,413	2,882	838	-	-	9,667	9,667
Financial assets	63,735	188,536	183,558	360,042	613,952	35,007	1,444,830	1,130,230
Financial liabilities								
Due to credit inst. and Central Bank	11,491	1,550	28	-	-	-	13,069	13,031
Deposits	414,052	106,071	32,169	13,717	3,007	-	569,016	568,424
Financial liabilities at fair value	-	4,123	1,116	1,349	44	-	6,632	5,240
Derivatives - assets leg	-	*(46,444)*	*(5,067)*	*(9,196)*	*(413)*	-	*(61,120)*	*(55,928)*
Derivatives - liabilities leg	-	*49,798*	*6,183*	*10,545*	*457*	-	*66,983*	*60,399*
Short position bonds and derivatives	-	*40*	-	-	-	-	*40*	*40*
Short position securities used	-	*63*	-	-	-	-	*63*	*63*
for economic hedging	-	*666*	-	-	-	-	*666*	*666*
Other financial liabilities	82	5,423	112	1,328	1,066	-	8,011	8,011
Borrowings	-	2,803	50,635	212,471	65,633	-	331,542	298,947
Subordinated liabilities	-	1,178	943	19,762	25,586	-	47,469	36,060
Financial liabilities	425,625	121,148	85,003	248,627	95,336	-	975,739	929,713
Net position for assets and liab.	(361,890)	67,388	98,555	111,415	518,616	35,007	469,091	200,517
Off-balance sheet items								
Financial guarantees	-	593	4,539	2,016	13,709	-	20,857	20,857
Unused overdraft	-	49,164	-	-	-	-	49,164	49,164
Undrawn loan commitments	-	51,231	8,910	3,914	-	-	64,055	64,055
Off-balance sheet items	-	100,988	13,449	5,930	13,709	-	134,076	134,076
Net contractual cash flow	(361,890)	(33,600)	85,106	105,485	504,907	35,007	335,015	66,441

Net Stable Funding Ratio

The Net Stable Funding Ratio (NSFR) measures the amount of available stable funding (ASF) 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 a negligible impact on the funding ratio.

	30.09.2021	31.12.2020
Available stable funding	988,348	875,261
Required stable funding	835,401	745,050
Net stable funding ratio	118%	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.

30.9.2021	ISK	Foreign currency	Total
Liquid assets level 1 *	98,397	86,090	184,487
Liquid assets level 2	22,857	-	22,857
Liquid assets	121,254	86,090	207,344
Deposits	119,546	38,770	158,316
Borrowings	1,601	114	1,715
Other cash outflows	8,893	7,584	16,477
Cash outflows	130,040	46,468	176,508
Short-term deposits with other banks **	2,184	23,375	25,559
Other cash inflows	48,098	9,037	57,135
Cash inflows	50,282	32,412	82,694
Liquidity coverage ratio (LCR) ***	152%	612%	221%

31.12.2020	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.

30.9.2021	ISK	USD	EUR	Other	Total
Cash and balances with Central Bank	68,627	443	551	515	70,136
Short-term deposits with financial institutions	2,184	10,433	6,450	6,492	25,559
Domestic bonds eligible as collateral with Central Bank	56,180	-	-	-	56,180
Foreign government bonds	-	18,283	49,918	16,375	84,576
Liquidity reserve	126,991	29,159	56,919	23,382	236,451
31.12.2020					
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					
30.9.2021	Less stable	Weight %	Stable	Weight %	Term deposits*	Total deposits
Individuals	87,138	11%	125,528	5%	75,819	288,485
Small and medium enterprises	89,473	11%	20,026	5%	8,587	118,086
Corporations	59,834	40%	14,397	20%	8,905	83,136
Sovereigns, central banks and PSE	47,441	40%	-	-	2,377	49,818
Pension funds	42,210	100%	-	-	10,138	52,348
Domestic financial entities	45,759	100%	-	-	9,944	55,703
Foreign financial entities	2,214	100%	-	-	-	2,214
Total	374,069		159,951		115,770	649,790
31.12.2020						
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 from 25.4% to 26.8%. The monetization of intangible assets would have a positive effect on capital adequacy.

Own funds	30.9.2021	31.12.2020
Total equity	194,580	197,845
Unaudited interim net earnings	(8,228)	-
Non-controlling interest not eligible for inclusion in CET1 capital	(680)	(173)
Common Equity Tier 1 capital before regulatory adjustments	185,672	197,672
Intangible assets	(9,654)	(13,092)
Cash flow hedges	(1,339)	(2,282)
Additional value adjustments	(262)	(238)
Foreseeable dividend and buyback *	(17,176)	(17,990)
Adjustment under IFRS 9 transitional arrangements as amended	1,379	1,890
Common equity Tier 1 capital	158,620	165,960
Non-controlling interest not eligible for inclusion in CET1 capital	680	173
Additional Tier 1 capital	13,302	13,498
Tier 1 capital	172,602	179,631
Tier 2 instruments	22,175	22,562
Tier 2 instruments of financial sector entities (significant investments)	(1,051)	(1,007)
Tier 2 capital	21,124	21,555
Total own funds	193,726	201,186
Risk-weighted exposure amount (REA)		
Credit risk, loans	593,552	570,554
Credit risk, securities and other	71,200	60,813
Counterparty credit risk	7,832	3,462
Market risk due to currency imbalance	5,748	8,569
Market risk, other	10,862	13,063
Credit valuation adjustment	2,661	842
Operational risk	88,462	88,462
Total risk-weighted exposure amount	780,317	745,765
Capital ratios		
CET1 ratio	20.3%	22.3%
Tier 1 ratio	22.1%	24.1%
Capital adequacy ratio	24.8%	27.0%
Total own funds, including interim profit not eligible for inclusion	197,840	201,186
CET1 ratio, including interim profit not eligible for inclusion	20.9%	22.3%
Tier 1 ratio, including interim profit not eligible for inclusion	22.6%	24.1%
Capital adequacy ratio, including interim profit not eligible for inclusion	25.4%	27.0%

* On 30 September 2021, the foreseeable dividend and buyback is the aggregation of an expected dividend of ISK 7 billion or 50% of audited profits, in line with the dividend policy, and planned buyback of own shares amounting to ISK 10.3 billion based on permission from the FSA 1 July 2021 and 7 October 2021. 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 0.2 percentage points.

Capital ratios of the parent company	30.9.2021	31.12.2020
CET1 ratio	21.2%	22.8%
Tier 1 ratio	22.9%	24.6%
Capital adequacy ratio	25.6%	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

30.9.2021	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	20.3%	22.1%	24.8%

* 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.

	30.9.2021	31.12.2020
On-balance sheet exposures	1,294,546	1,114,450
Derivative exposures	7,076	9,124
Securities financing transaction exposures	689	512
Off-balance sheet exposures	89,800	65,425
Total exposure	1,392,111	1,189,511
Tier 1 capital	172,602	179,631
Leverage ratio	12.4%	15.1%

Amounts are in ISK millions

45. Capital management, continued

Solvency II	30.9.2021	31.12.2020
Excess of assets over liabilities in accordance with Solvency II	8,800	7,397
Subordinated liabilities	1,039	1,000
Foreseeable dividends	-	(800)
Own funds	9,839	7,597
Solvency capital requirements (SCR)	6,389	5,105
SCR ratio	154%	149%

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.

Amounts are in ISK millions

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