Arion Bank

Condensed Consolidated **Interim Financial Statements**

1 January - 30 September 2020

Contents

Arion Bank in brief

9M 2020

4.7%
Return on equity

49.5%
Cost-to-income

27.6%
Capital adequacy ratio

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

FINANCE
UNEP INITIATIVE

Equal Pay Certification

THE ALLBRIGHT.

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

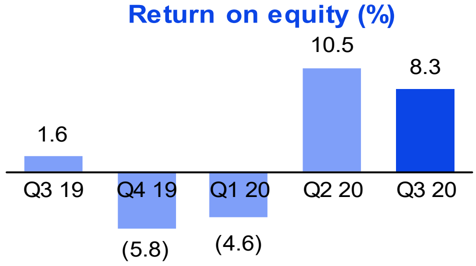
Arion Bank

- Arion Bank is a leading universal relationship bank in Iceland which provides a full range of financial services.
- After a long period of strong economic growth the economy is trending into temporary negative recession due to Covid-19. Developments in Iceland and especially globally will heavily impact the Icelandic economy due to the importance of tourism. However, both fiscal and monitory policy have ammunition to support the economy.
- Arion Bank intends to maintain its leading position in digital banking, which has proven effective during the pandemic.
- The balance sheet is extraordinarily strong which is not efficient in the long term
- The Bank is very well positioned to meet the funding requirements of its customers in both ISK and FX and to provide customers with solutions through the challenging times that lie ahead.

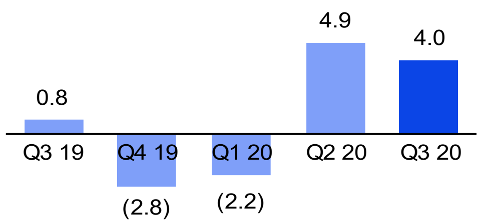
Key figures
(ISK million)

	9M 2020	9M 2019
Net earnings	6,708	3,875
ROE	4.7%	2.6%
ROE continuing operations	6.1%	6.0%
Net interest margin	2.9%	2.7%
Cost to income ratio	49.5%	56.3%
Operating income / REA	6.7%	6.3%
	30.9.2020	**31.12.2019**
Total assets	1,236,216	1,081,855
Loans to customers	807,866	773,955
Deposits	602,842	492,916
Borrowings	308,913	304,745
Stage 3 gross	3.2%	2.7%
Leverage ratio	14.4%	14.1%
Number of employees	783	801
EUR/ISK	162.20	135.83

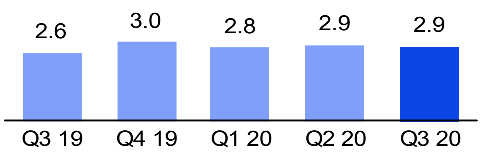
Return on equity (%)



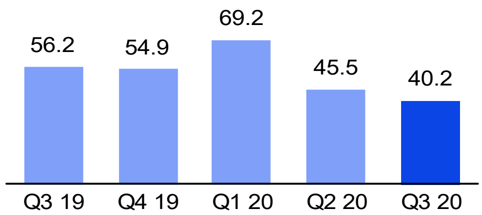
Net earnings (ISK billion)



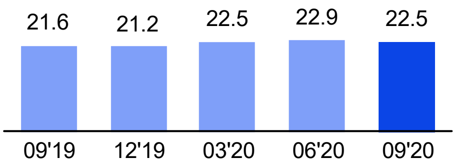
Net interest margin (%)



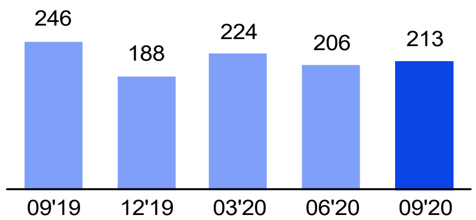
Cost-to-income ratio (%)



CET 1 ratio (%)



LCR ratio (%)



Endorsement and statement
by the Board of Directors and the CEO

The Condensed Consolidated Interim Financial Statements of Arion Bank for the period from 1 January to 30 September 2020 include the Condensed Consolidated Interim Financial Statements of Arion Bank ("the Bank") and its subsidiaries, together referred to as "the Group".

Operations during the period

Arion Bank is delivering on its strategy in a challenging economic environment and reported net earnings of ISK 4,961 million from continuing operations in the third quarter and ISK 8,637 million from continuing operations during the first nine months of the year. Net earnings amounted to ISK 3,966 million for the quarter and ISK 6,708 million for the first nine months. Return on equity was 8.3% for the quarter and 4.7% for the first nine months of 2020. The cost-to-income ratio was 40.2% for the quarter and 49.5% for the first nine months of 2020.

The Bank benefits from diversified income streams. Net interest income increased by 8.2% compared with the third quarter in 2019, whilst interest-bearing assets increased by 0.6%. Net interest margin in the quarter was strong at 2.9%. Net commission income increased by 5% compared with the same period in 2019, mainly due to increased activities in the loan book and loan service agreements. Net financial income was lower than for the third quarter of 2019 and amounted to ISK 692 million. Other operating income amounted to ISK 475 million and was partly due to the sale of a real estate asset in Borgartún 18 that housed one of the Bank's branches. This branch will be moved into the Bank's headquarters at Borgartún 19. Operating expenses are down by 25% compared with the third quarter in 2019. This is partially due to one-off redundancy costs in Q3 2019 but the reduced number of FTEs between years is also a strong factor. Impairments amounted to ISK 1,340 million during the quarter, compared with a positive impairment in the third quarter of 2019. Given the ongoing economic uncertainty due to Covid-19, which is now in its second wave in Iceland, further impairments cannot be excluded if the asset quality outlook turns out to be worse than expected. It is an advantage in this respect that retail mortgages make up 42% of the loan book. The housing market has held up well through the recent economic turmoil, average mortgage LTV's are stable and defaults have not increased. The bank levy decreased by 53% from the same quarter last year, as the levy was reduced from 0.376% to 0.145%, as part of the government's response to the Covid-19 pandemic. Net loss from discontinued operations amounted to ISK 995 million during the quarter, mainly due to valuation changes of HFS legal entities, in this case a foreclosed asset located in Scandinavia.

The Group's Balance sheet increased by 14% during the first nine months of 2020 or by ISK 154 billion, whereas the risk-weighted exposure amount (REA) increased by ISK 8 billion or 1.1%. The increase was mainly in liquid assets, funded by deposit growth and proceeds from the Bank's issuance of AT1. Despite a minor net increase in REA, the underlying changes are extensive, with a significant increase in mortgage lending, which is countered by a contraction of the corporate loan book.

Arion Bank has been supporting its customers and working with the Icelandic authorities to develop government guaranteed loan facilities targeted at corporates that are going through temporary difficulties. At the end of September 2.52% of individual loans (by amount), predominantly mortgages, and 3.36% of corporate loans were in payment moratoria. At the end of September the Bank had made 217 loans with the government guarantee amounting to ISK 1.9 billion.

Total equity amounted to ISK 192,496 million at the end of the period. Total equity increased due to the reported net earnings but decreased by ISK 4.4 billion due to share buy-backs under a buy-back program during the first quarter of 2020. The Group's capital ratio was 27.6% and the CET1 ratio was 22.5%, including net earnings in Q3 and assuming 50% dividend payments of net earnings in line with the dividend policy. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 27.3% and the CET1 ratio was 22.2%. The Bank's capital ratios comfortably exceed the requirements set by law and the Financial Supervisory Authority of the Central Bank. The Bank's liquidity position was also very strong at period end.

In May 2020 Valitor Group sold the operations of Valitor in Denmark, Valitor A/S. The operation of Valitor A/S contributed a net loss for the years 2018 and 2019. The financial effects of the sale of the entity did not have material effects on these Consolidated Interim Financial Statements. The operating performance of Valitor has improved significantly between years, following the structural changes made at the end of 2019 and the sale of omni operations in Denmark and the UK. This improvement of ISK 2.2 billion between years, taking into account group eliminations, is despite the negative effect of Covid-19 in 2020.

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

Outlook

The Covid-19 pandemic has had a widespread effect on Arion Bank and is expected to continue to do so over the coming quarters. It has delayed the planned distribution of capital, as the Central Bank of Iceland has recommended that financial institutions reconsider their proposals on capital distributions in light of the economic uncertainty. Arion Bank is very well capitalized in a European context and has ample room to pay dividends or buy back its own shares. It is an advantage for the Bank to be listed in Reykjavik and Stockholm and to have shareholders who have the ability to support the Bank through a rights issue should the need ever arise. This is important for financial stability in Iceland. The current discussion in Europe on why private investors should want to own bank shares also applies to Iceland and we hope that the European regulators will alter their stance on capital release in the first quarter of 2021. The Bank wants to resume capital distribution as soon as practicable.

Core revenues have been trending in the right direction, and the performance since the outbreak of Covid-19 demonstrates that the Bank can improve on the revenue side even during difficult times. Operating expenses are decreasing and the emphasis will continue to be on reducing them further. The Bank has been able to operate effectively and service its customers, with 85% of its employees working from home at some point. This experience has made the Bank take advantage of various opportunities to streamline its operations and product offering. Arion Bank is however, as before, committed to its strategy of focusing on the profitability of its REA and reducing the cost-to-income ratio.

At this point in time it is impossible to predict how long the Covid-19 crisis will last. The Bank does not, however, rule out the possibility that the current economic environment, coupled with the Bank's very strong capital and liquidity position, might open up opportunities for the efficient use of these resources for either internal or external growth.

Endorsement and statement
by the Board of Directors and the CEO

Economic environment and outlook

According to preliminary figures GDP decreased by 9.3% YoY in the second quarter of 2020, a much stronger result than most analysts expected. Despite Iceland’s dependency on tourism many of the largest economies in the world suffered a greater fall in GDP in Q2 than Iceland. Even though tourist arrivals dropped by 98%, causing a substantial negative impact of external trade on GDP, and unemployment reached unprecedented heights, private consumption proved remarkably resilient. Domestic payment card turnover set a record over the summer months, indicating a continuation of stronger than expected private consumption. However, the outlook has deteriorated due to the renewed spread of the coronavirus and subsequent tighter measures imposed by the government. The consensus among domestic analysts currently stands at 7.8% economic contraction in 2020, followed by 3.7% economic growth in 2021, a softer and more fragile period of growth than previously expected. With new coronavirus cases hitting new heights across the globe, prolonged travel restrictions seem likely. In Iceland strict travel measures are in place, causing many tourism companies to write off the remainder of the year, even the whole winter. The troubles faced by the tourism industry, as well as other industries, has had and will have a deep impact on the labor market. Analysts expect the winter to be especially tough on the labor market, with general unemployment continuing to increase. Even though inflation has increased due to the depreciation of the ISK it is still relatively low in a historical context. What’s more, inflation expectations have remained anchored, providing the monetary policy the scope to keep interest rates low, thus supporting the housing market and households’ balance sheets. Even though the outlook is bleak the economy will benefit from its strong foundations and numerous measures that both the government and the Central Bank have introduced to soften the economic blow.

Funding and liquidity

The Group's liquidity position is strong, with a liquidity coverage ratio of 213%, see Note 44, well above the regulatory minimum of 100%. The Bank's foreseeable refinancing risk is low as it does not have any material redemption of long-term funding until December 2021. The comfortable liquidity position and limited foreseeable refinancing needs mean that the Bank does not need to access the international wholesale funding markets in the near future.

Arion Bank continued to issue covered bonds which are secured under the Covered Bond Act No. 11/2008. During the first nine months of 2020 the Bank issued covered bonds amounting to ISK 5,060 million.

Capital and REA

The Group‘s capital adequacy ratio at 30 September 2020 was 27.6% and the CET1 ratio 22.5%. The Group‘s own funds increased by ISK 27.9 billion from year-end 2019, primarily due to the successful issuance of a USD 100 million Additional Tier 1 capital instrument in February 2020, and as a result of the Board of Directors' decision to propose that no dividends are paid in connection with operations in 2019 in light of the Covid-19 pandemic. This effectively reintroduces the foreseeable ISK 10 billion dividend at year-end 2019 as loss absorbing capital. The Bank is again deducting 50% of net earnings in 2020 from its capital in line with the dividend policy.

On 4 May 2020 the Icelandic Ministry of Finance ratified Regulation (EU) 2017/2395 into Icelandic law. The regulation introduces transitional arrangements for IFRS 9 to allow the regulatory capital impact of expected credit loss to be phased in over time. These arrangements have been available to European banks since 2017. Institutions that elect to make use of these transitional arrangements can in 2020 add back CET1 equivalent to up to 70% of provisions incurred from the application of IFRS9. The Bank has opted to make use of the transitional arrangements, thus reflected in the Group's capital ratios as of 30 September 2020. The transitional arrangements increase the capital ratio by 0.2 percentage points.

The Group‘s risk-weighted exposure amount (REA) increased by ISK 8 billion in the first nine months of 2020. The introduction of the SME supporting factor into the Icelandic capital adequacy regime came into effect on 1 January 2020, reducing REA by ISK 13 billion, providing capital relief for exposures to SMEs below EUR 1.5 million.

As part of the economic measures introduced by the Icelandic authorities, the 2% countercyclical capital buffer has been vacated entirely, which reduces the Group‘s total capital requirement from 20.3% to 18.4%. The Group‘s CET1 capital requirement is reduced from 15.5% to 13.6%. At 30 September 2020 the Group had ISK 65 billion of CET1 capital in excess of regulatory requirements and ISK 40 billion in excess of the Group‘s target CET1 ratio of 17%.

Group ownership

At the end of September 2020 Taconic Capital was the largest shareholder of Arion Bank, with a holding of 23.22%, and Sculptor Capital Management was the second largest with a holding of 9.92%. Arion Bank held 0.69% of its own shares at the end of September 2020. The AGM on 17 March 2020 approved the cancellation of 84 million of the Bank's own shares, totalling ISK 84 million at nominal value. The reduction took place in May 2020. For further information on the shareholders of Arion Bank, see Note 36.

Governance

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

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

Endorsement and statement
by the Board of Directors and the CEO

Endorsement of the Board of Directors and the Chief Executive Officer

The Condensed Consolidated Interim Financial Statements of Arion Bank for the period ended 30 September 2020 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union and additional requirements in the Icelandic Financial Statements Act, Financial Undertakings Act and Rules on Accounting for Credit Institutions.

It is our opinion that the Condensed Consolidated Interim Financial Statements give a true and fair view of the financial performance and cash flow of the Group for the period ended 30 September 2020 and its financial position as at 30 September 2020.

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

The Board of Directors and the CEO have today discussed the Condensed Consolidated Interim Financial Statements of Arion Bank for the period ended 30 September 2020 and confirm them by means of their signatures.

Reykjavík, 28 October 2020

Board of Directors

Brynjólfur Bjarnason, Chairman

Gunnar Sturluson

Liv Fiksdahl

Paul Richard Horner

Renier Lemmens

Sigurbjörg Ásta Jónsdóttir

Steinunn Kristín Thórdardóttir

Chief Executive Officer

Benedikt Gíslason

Consolidated Interim Income Statement

	Notes	2020 1.1.-30.9.	2019 1.1.-30.9.	2020 1.7.-30.9.	2019 1.7.-30.9.
Interest income		39,024	45,001	13,145	13,854
Interest expense		(15,925)	(22,377)	(5,156)	(6,472)
Net interest income	7	**23,099**	**22,624**	**7,989**	**7,382**
Fee and commission income		9,695	8,425	3,117	2,965
Fee and commission expense		(1,169)	(1,090)	(355)	(326)
Net fee and commission income	8	**8,526**	**7,335**	**2,762**	**2,639**
Net insurance income	9	2,305	2,163	1,043	1,087
Net financial income	10	1,383	2,723	692	934
Share of profit of associates	26	22	750	51	30
Other operating income	11	716	677	475	272
Other net operating income		**4,426**	**6,313**	**2,261**	**2,323**
Operating income		**36,051**	**36,272**	**13,012**	**12,344**
Salaries and related expenses	12	(9,211)	(11,565)	(2,504)	(4,130)
Other operating expenses	13	(8,623)	(8,855)	(2,728)	(2,810)
Operating expenses		**(17,834)**	**(20,420)**	**(5,232)**	**(6,940)**
Bank levy	14	(1,038)	(2,627)	(383)	(809)
Net impairment	15	(5,118)	(1,585)	(1,340)	484
Earnings before income tax		**12,061**	**11,640**	**6,057**	**5,079**
Income tax expense	16	(3,424)	(2,791)	(1,096)	(1,278)
Net earnings from continuing operations		**8,637**	**8,849**	**4,961**	**3,801**
Discontinued operations held for sale, net of income tax	17	(1,929)	(4,974)	(995)	(3,040)
Net earnings		**6,708**	**3,875**	**3,966**	**761**

Attributable to

Shareholders of Arion Bank hf.		6,716	3,875	3,965	761
Non-controlling interest		(8)	-	1	-
Net earnings		**6,708**	**3,875**	**3,966**	**761**

Earnings per share

Basic and diluted earnings per share attributable to the shareholders of Arion Bank (ISK)	18	3.90	2.14	2.31	0.42

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

Amounts are in ISK millions

Consolidated Interim Statement of Comprehensive Income

	Notes	2020 1.1.-30.9.	2019 1.1.-30.9.	2020 1.7.-30.9.	2019 1.7.-30.9.
Net earnings		**6,708**	**3,875**	**3,966**	**761**
Net gain (loss) on financial assets carried at fair value through OCI, net of tax		322	527	(295)	218
Realized net loss on financial assets carried at fair value through OCI, net of tax, transferred to the Income Statement	10	(177)	(121)	(25)	(38)
Changes to reserve for financial instruments at fair value through OCI		**145**	**406**	**(320)**	**180**
Exchange difference on translating foreign subsidiaries		203	(5)	22	(167)
Other comprehensive income that is or may be reclassified subsequently to the Income Statement		**348**	**401**	**(298)**	**13**
Total comprehensive income		**7,056**	**4,276**	**3,668**	**774**

Attributable to

Shareholders of Arion Bank	7,064	4,276	3,667	774
Non-controlling interest	(8)	-	1	-
Total comprehensive income	**7,056**	**4,276**	**3,668**	**774**

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	30.9.2020	31.12.2019
Cash and balances with Central Bank	19	87,517	95,717
Loans to credit institutions	20	39,484	17,947
Loans to customers	21	807,866	773,955
Financial instruments	22-24	234,937	117,406
Investment property	24	6,721	7,119
Investments in associates	26	913	852
Intangible assets	27	9,398	8,367
Tax assets	28	2	2
Assets and disposal groups held for sale	29	30,821	43,626
Other assets	30	18,557	16,864
Total Assets		**1,236,216**	**1,081,855**

Liabilities			
Due to credit institutions and Central Bank	23	10,802	5,984
Deposits	23	602,842	492,916
Financial liabilities at fair value	23	3,983	2,570
Tax liabilities	28	3,053	4,404
Liabilities associated with disposal groups held for sale	29	26,193	28,631
Other liabilities	31	51,067	32,697
Borrowings	23,32	308,913	304,745
Subordinated liabilities	23,33	36,867	20,083
Total Liabilities		**1,043,720**	**892,030**

Equity			
Share capital and share premium	35	51,331	55,715
Other reserves		12,114	9,493
Retained earnings		128,879	124,436
Total Shareholders' Equity		**192,324**	**189,644**
Non-controlling interest		172	181
Total Equity		**192,496**	**189,825**
Total Liabilities and Equity		**1,236,216**	**1,081,855**

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

Amounts are in ISK millions

Consolidated Interim Statement of Changes in Equity

			Restricted reserves									
	Share capital	Share premium	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Financial assets at fair value thr. OCI, unrealized	Statutory reserve	Foreign currency trans-lation reserve	Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
Equity 1 January 2020	1,773	53,942	6,127	692	459	135	1,637	443	124,436	**189,644**	181	**189,825**
Net earnings / loss									6,716	**6,716**	(8)	**6,708**
Net fair value gain						322				**322**		**322**
Realized net gain transferred to the Income Statement						(177)				**(177)**		**(177)**
Translation difference								203		**203**		**203**
Total comprehensive income	-	-	-	-	-	145	-	203	6,716	**7,064**	(8)	**7,056**
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)	**1**		**1**
Equity 30 September 2020	1,718	49,613	8,076	570	905	280	1,637	646	128,879	**192,324**	172	**192,496**

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

** In 2018 approximately 4 million shares were allocated to employees at ISK 75 per share, a total of ISK 295 million. In accordance with the employees stock grant program, an employee who resigned within the vesting period of two years, returned the shares to the Bank. The vesting period ended in June 2020.

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

Amounts are in ISK millions

Consolidated Interim Statement of Changes in Equity

			Restricted reserves									
	Share capital	Share premium	Gain in subs. & assoc., unrealized	Gain in securities, unrealized	Capitalized develop-ment cost	Financial assets at fair value thr. OCI unrealized	Statutory reserve	Foreign currency trans-lation reserve	Retained earnings	**Total share-holders' equity**	Non-cont-rolling interest	**Total equity**
Equity 1 January 2019	1,814	57,196	12,373	417	-	87	1,637	308	126,897	**200,729**	130	**200,859**
Net earnings									3,875	**3,875**		**3,875**
Net fair value gain						527				**527**		**527**
Realized net gain transferred to the Income Statement						(121)				**(121)**		**(121)**
Translation difference								(5)		**(5)**		**(5)**
Total comprehensive income	-	-	-	-	-	406	-	(5)	3,875	**4,276**	-	**4,276**
Dividend paid									(9,069)	**(9,069)**		**(9,069)**
Changes in treasury stock *	-	(10)								**(10)**		**(10)**
Changes in reserves			(4,664)	360					4,304	**-**		**-**
Equity 30 June 2019	1,814	57,186	7,709	777	-	493	1,637	303	126,007	**195,926**	130	**196,056**

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

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

Amounts are in ISK millions

Consolidated Interim Statement of Cash flows

Operating activities	2020 1.1.-30.9.	2019 1.1.-30.9.
Net earnings	6,708	3,875
Non-cash items included in net earnings	(7,175)	(10,523)
Changes in operating assets and liabilities:		
Loans to credit institutions, excluding bank accounts	(3,470)	17,562
Loans to customers	(13,075)	27,834
Financial instruments and financial liabilities at fair value	(96,178)	(48,239)
Deposits	95,011	32,217
Borrowings	(19,030)	(11,593)
Other changes in operating assets and liabilities	17,656	(1,314)
Interest received	38,985	38,047
Interest paid	(13,909)	(12,483)
Dividend received	60	125
Income tax paid	(4,763)	(4,055)
Net cash from operating activities	**820**	**31,453**

Investing activities

Proceeds from sale of subsidiaries and associates	96	740
Acquisition of associates	(39)	(19)
Acquisition of intangible assets	(1,613)	(2,253)
Proceeds from sale of property and equipment	1,259	450
Acquisition of property and equipment	(655)	(233)
Net cash used in investing activities	**(952)**	**(1,315)**

Financing activities

Issued subordinated liabilities	12,805	8,914
Purchase of treasury stock	(4,381)	-
Dividend paid to shareholders of Arion Bank	-	(9,069)
Net cash from (used) in financing activities	**8,424**	**(155)**
Net increase in cash and cash equivalents	8,292	29,983
Cash and cash equivalents at beginning of the year	102,186	110,589
Effect of exchange rate changes on cash and cash equivalents	5,041	2,146
Cash and cash equivalents	**115,519**	**142,718**

Cash and cash equivalents

Cash and balances with Central Bank	87,517	121,554
Bank accounts	33,938	31,489
Mandatory reserve deposit with Central Bank	(5,936)	(10,325)
Cash and cash equivalents	**115,519**	**142,718**

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Contents

Notes to the Condensed Consolidated Interim Financial Statements

General information

Arion Bank hf., the Parent Company, was established on 18 October 2008 and is incorporated and domiciled in Iceland. The registered office of Arion Bank hf. is located at Borgartún 19, Reykjavík. The Condensed Consolidated Interim Financial Statements for the period ended 30 September 2020 comprise the Parent Company and its subsidiaries (together referred to as "the Group").

1. Basis of preparation

The Condensed Consolidated Interim Financial Statements were approved and authorized for publication by the Board of Directors of Arion Bank on 28 October 2020.

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

Statement of compliance

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

Basis of measurement

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

- 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 2019;

- investment properties are measured at fair value; and

- non-current assets and disposal groups held for sale are stated at the lower of their carrying amounts and fair value, less cost to sell.

Functional and presentation currency

The Condensed Consolidated Interim Financial Statements are presented in Icelandic krona (ISK), which is the Parent Company's functional currency, rounded to the nearest million, unless otherwise stated. At the end of the period the exchange rate of the ISK against USD was 138.43 and 162.20 for EUR (31.12.2019: USD 121.04 and EUR 135.83).

2. Going concern assumption

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

3. Significant accounting estimates and judgments in applying accounting policies

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

Estimates and assumptions

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

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 2019.

Macroeconomic outlook

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

Unemployment levels and scenarios have been updated from the ones used for Q2 2020 and are more in line with current economic projections. Expected unemployment levels have changed from the ones used for the Q2 impairment calculations. The unemployment forecast is now expected to normalize over a longer time period than previously estimated. Furthermore, the likelihood of the pessimistic scenario has been increased from year-end 2019. Among the steps taken to address the uncertainty and information that is available but not addressed by the models are (1) shortening of the forecasting period, (2) application of expert judgment in cases where economic forecasts are outside the range of the Bank’s macro models, (3) assessment of mitigating effects on default rates in the near-term, (4) adjustment of collateral haircuts to more accurately reflect the realized economic development due to Covid-19, and (5) a management overlay over credit rating scores for specific groups of assets which have been most affected. The scenarios and the weights assigned to them will continue to be reexamined in the coming quarter as uncertainty over the local and global impact of Covid-19 is reduced.

Arion Bank has concluded that credit risk relating to the tourism sector has significantly increased and has taken this into consideration as of Q1 2020 in the provision calculations, which means that all such exposures are in Stage 2 as of Q3 2020, excluding financial assets to entities owned by the government. The extent of the related impact on other industries and supporting businesses is unclear, Arion Bank has taken steps to approximate the effects as mentioned above. Companies that receive the court-determined status of temporary financial restructuring as per Act No. 57/2020 are transferred to Stage 3. The Bank continues to monitor developments closely and will adjust its provisions accordingly.

Assets and disposal groups held for sale

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

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

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.

Notes to the Condensed Consolidated Interim Financial Statements

4. The Group

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

			Equity interest	
	Operating activity	Currency	30.9.2020	31.12.2019
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 Holding hf., Dalshraun 3, Hafnarfjördur, Iceland	Payment solutions	ISK	100.0%	100.0%
VISA Ísland ehf., Borgartún 19, Reykjavík, Iceland	Holding company	ISK	100.0%	100.0%
Vördur tryggingar hf., Borgartún 25, Reykjavík, Iceland	Insurance	ISK	100.0%	100.0%

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Operating segment reporting

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

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

5. Operating segments

Markets

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

Corporate & Investment Banking

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

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

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

Retail Banking

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

Treasury

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

Vördur

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

Subsidiaries

Subsidiaries include the subsidiaries 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 Holding, Stakksberg and Sólbjarg (both subsidiaries of Eignabjarg) are classified as disposal groups held for sale in accordance with IFRS 5.

Supporting units

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

Other information

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

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 (expense)	578	7,801	11,834	3,194	92	(317)	(83)	23,099
Net fee and commission income (exp.) .	2,837	2,172	3,528	390	(91)	(550)	240	8,526
Net insurance income	-	-	-	-	1,318	1,053	(66)	2,305
Net financial income	43	-	-	409	884	36	11	1,383
Share of profit (loss) of associates	1	(48)	-	-	-	-	69	22
Other operating income (loss)	8	(7)	197	-	3	391	124	716
Operating income / loss	3,467	9,918	15,559	3,993	2,206	613	295	36,051
Operating expenses	(1,331)	(969)	(4,051)	(447)	(1,203)	(714)	(9,119)	(17,834)
Allocated expenses	(1,373)	(1,912)	(4,240)	(658)	-	(25)	8,208	-
Bank levy	(28)	(312)	(464)	(233)	-	-	(1)	(1,038)
Net impairment	-	(5,358)	(1,828)	7	-	2,060	1	(5,118)
Earnings / loss before income tax	735	1,367	4,976	2,662	1,003	1,934	(616)	12,061
Net seg. rev. from ext. customers	2,000	14,679	24,313	(8,630)	2,169	1,381	139	36,051
Net seg. rev. from other segments	1,467	(4,761)	(8,754)	12,623	37	(768)	156	-
Operating income / loss	3,467	9,918	15,559	3,993	2,206	613	295	36,051
Depreciation and amortization	1	2	140	-	25	127	780	1,075
Total assets	75,528	329,038	501,186	502,387	30,390	54,723	(257,036)	1,236,216
Total liabilities	67,762	256,013	445,274	481,934	18,981	30,792	(257,036)	1,043,720
Allocated equity	7,766	73,025	55,912	20,453	11,409	23,931	-	192,496
1.1.-30.9.2019								
Net interest income	835	6,734	13,258	2,237	160	(456)	(144)	22,624
Net fee and commission income (exp.) .	3,374	1,325	3,617	(251)	(49)	(751)	70	7,335
Net insurance income	-	-	-	-	2,199	-	(36)	2,163
Net financial income (loss)	132	(228)	(117)	942	1,099	971	(76)	2,723
Share of profit of associates and net impairment	-	-	-	-	-	-	750	750
Other operating income (loss)	14	(14)	330	6	13	51	277	677
Operating income	4,355	7,817	17,088	2,934	3,422	(185)	841	36,272
Operating expenses	(1,443)	(1,180)	(5,132)	(245)	(1,661)	(50)	(10,709)	(20,420)
Allocated expenses	(1,291)	(2,637)	(4,365)	(780)	(9)	(3)	9,085	-
Bank levy	(133)	(625)	(915)	(954)	-	-	-	(2,627)
Net impairment	-	(5,118)	365	14	-	3,154	-	(1,585)
Earnings / loss before income tax	1,488	(1,743)	7,041	969	1,752	2,916	(783)	11,640
Net seg. rev. from ext. customers	1,842	15,609	26,605	(12,891)	3,220	298	885	35,568
Net seg. rev. from other segments	2,513	(7,792)	(9,517)	15,825	202	(483)	(44)	704
Operating income	4,355	7,817	17,088	2,934	3,422	(185)	841	36,272
Depreciation and amortization	2	3	122	-	99	68	763	1,057
Total assets	70,735	315,052	536,349	558,263	26,758	62,367	(356,369)	1,213,155
Total liabilities	63,825	237,575	472,222	548,213	16,869	36,249	(357,854)	1,017,099
Allocated equity	6,910	77,477	64,127	10,050	9,889	26,118	1,485	196,056

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

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Quarterly statements

6. Operations by quarters, unaudited

2020	Q1	Q2	Q3	Total
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) profit 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	(2,171)	4,913	3,966	6,708

2019	Q1	Q2	Q3	Total
Net interest income	7,434	7,808	7,382	22,624
Net fee and commission income	2,218	2,478	2,639	7,335
Net insurance income	253	823	1,087	2,163
Net financial income	766	1,023	934	2,723
Share of profit (loss) of associates	727	(7)	30	750
Other operating income	310	95	272	677
Operating income	11,708	12,220	12,344	36,272
Salaries and related expense	(3,630)	(3,805)	(4,130)	(11,565)
Other operating expense	(3,232)	(2,813)	(2,810)	(8,855)
Operating expenses	(6,862)	(6,618)	(6,940)	(20,420)
Bank levy	(906)	(912)	(809)	(2,627)
Net impairment	(1,081)	(988)	484	(1,585)
Earnings before income tax	2,859	3,702	5,079	11,640
Income tax expense	(622)	(891)	(1,278)	(2,791)
Net earnings from continuing operations	2,237	2,811	3,801	8,849
Discontinued operations, net of tax	(1,219)	(715)	(3,040)	(4,974)
Net earnings	1,018	2,096	761	3,875

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

Notes to the Consolidated Interim Income Statement

7. Net interest income

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	35,509	-	-	35,509
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

1.1.-30.9.2019	Amortized cost	Fair value thr. P/L	Fair value thr. OCI	Total
Interest income				
Cash and balances with Central Bank	3,092	-	-	3,092
Loans	40,869	23	-	40,892
Securities	-	337	555	892
Other	125	-	-	125
Interest income	44,086	360	555	45,001
Interest expense				
Deposits	(9,502)	-	-	(9,502)
Borrowings	(12,517)	-	-	(12,517)
Subordinated liabilities	(267)	-	-	(267)
Other	(91)	-	-	(91)
Interest expense	(22,377)	-	-	(22,377)
Net interest income	21,709	360	555	22,624

Amounts are in ISK millions

7. Net interest income, continued

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	11,893	-	-	11,893
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

1.7.-30.9.2019				
Interest income				
Cash and balances with Central Bank	1,062	-	-	1,062
Loans	12,389	-	-	12,389
Securities	-	137	247	384
Other	19	-	-	19
Interest income	13,470	137	247	13,854
Interest expense				
Deposits	(2,642)	-	-	(2,642)
Borrowings	(3,645)	-	-	(3,645)
Subordinated liabilities	(161)	-	-	(161)
Other	(24)	-	-	(24)
Interest expense	(6,472)	-	-	(6,472)
Net interest income	6,998	137	247	7,382

Interest spread

	2020 1.1.-30.9.	2019 1.1.-30.9.	2020 1.7.-30.9.	2019 1.7.-30.9.
Interest spread (the ratio of net interest income to the average carrying amount of interest bearing assets)	2.9%	2.7%	2.9%	2.6%

Amounts are in ISK millions

8. Net fee and commission income

	1.1.-30.9.2020			1.1.-30.9.2019		
	Income	Expense	Net income	Income	Expense	Net income
Asset management	3,000	(311)	2,689	2,932	(373)	2,559
Capital markets and corporate finance	964	(18)	946	1,407	-	1,407
Lending and financial guarantees	3,012	-	3,012	1,170	(71)	1,099
Collection and payment services	978	(84)	894	1,180	(139)	1,041
Cards and payment solution	1,292	(240)	1,052	685	(29)	656
Other	449	(516)	(67)	1,051	(478)	573
Net fee and commission income	9,695	(1,169)	8,526	8,425	(1,090)	7,335

	1.7.-30.9.2020			1.7.-30.9.2019		
Asset management	982	(93)	889	1,031	(118)	913
Capital markets and corporate finance	305	(4)	301	428	(5)	423
Lending and financial guarantees	944	-	944	501	-	501
Collection and payment services	344	(29)	315	401	(22)	379
Cards and payment solution	423	(80)	343	447	(31)	416
Other	119	(149)	(30)	157	(150)	7
Net fee and commission income	3,117	(355)	2,762	2,965	(326)	2,639

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

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

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

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

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

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

9. Net insurance income

	2020 1.1.-30.9.	2019 1.1.-30.9.	2020 1.7.-30.9.	2019 1.7.-30.9.
Earned premiums, net of reinsurers' share				
Premiums written	9,867	9,402	2,860	2,589
Premiums written, reinsurers' shares	(329)	(291)	(123)	(105)
Change in provision for unearned premiums	(1,031)	(849)	298	366
Earned premiums, net of reinsurers' share	8,507	8,262	3,035	2,850
Claims incurred, net of reinsurers' share				
Claims paid	(5,573)	(5,185)	(1,492)	(1,558)
Claims paid, reinsurers' share	59	144	3	29
Change in provision for claims	(742)	(986)	(526)	(214)
Changes in provision for claims, reinsurers' share	54	(72)	23	(20)
Claims incurred, net of reinsurers' share	(6,202)	(6,099)	(1,992)	(1,763)
Net insurance income	2,305	2,163	1,043	1,087

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

10. Net financial income

	2020 1.1.-30.9.	2019 1.1.-30.9.	2020 1.7.-30.9.	2019 1.7.-30.9.
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	1,233	2,440	576	(149)
Gain (loss) on prepayments of borrowings	79	(188)	-	-
Net (loss) gain on fair value hedge of interest rate swap	(111)	49	12	204
Realized gain on financial assets carried at fair value through OCI	239	164	35	52
Net foreign exchange (loss) gain	(57)	258	69	827
Net financial income	1,383	2,723	692	934

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

Equity instruments	(443)	1,460	214	(335)
Debt instruments	1,193	961	133	262
Derivatives	483	65	229	(76)
Loans	-	(46)	-	-
Net gain on financial assets and financial liabilities mandatorily measured at fair value through profit or loss	1,233	2,440	576	(149)

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

Fair value change of interest rate swaps designated as hedging instruments	382	1,432	(211)	345
Fair value change on bonds issued by the Group attributable to interest rate risk	(493)	(1,383)	223	(141)
Net (loss) gain on fair value hedge of interest rate swap	(111)	49	12	204

11. Other operating income

Net gain on assets held for sale	164	289	48	164
Other income	552	388	427	108
Other operating income	716	677	475	272

Net gain on assets held for sale

Income from real estates and other assets	237	378	83	187
Expense related to real estates and other assets	(73)	(89)	(35)	(23)
Net gain on assets held for sale	164	289	48	164

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

Number of employees	2020 1.1.-30.9.	2019 1.1.-30.9.	2020 1.7.-30.9.	2019 1.7.-30.9.
Average number of full-time equivalent positions during the period	793	887	778	854
Full-time equivalent positions at the end of the period	783	802	783	802

Number of employees at the parent company

Average number of full-time equivalent positions during the period	666	778	651	742
Full-time equivalent positions at the end of the period	655	689	655	689

Salaries and related expenses

Salaries	7,471	9,203	2,033	3,273
Defined contribution pension plans	1,106	1,319	301	465
Salary-related expenses	1,080	1,360	315	510
Capitalization of salaries due to implementation of core systems	(446)	(317)	(145)	(118)
Salaries and related expenses	9,211	11,565	2,504	4,130

Salaries and related expenses for the parent company

Salaries	6,191	8,113	1,697	2,949
Defined contribution pension plans	917	1,162	251	422
Salary-related expenses	894	1,193	247	444
Capitalization of salaries due to implementation of core systems	(446)	(317)	(145)	(118)
Salaries and related expenses for the parent company	7,556	10,151	2,050	3,697

Amounts are in ISK millions

12. Personnel and salaries, continued

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

During the period the Group made a provision of ISK 53 million (9M 2019: ISK 19 million) for performance plan payments, including salary-related expenses, for which the Bank made no provision (9M 2019: nil). Forty percent of the payment is deferred for three years in accordance with FSA rules on remuneration policies for financial undertakings. At the end of the period the Group's accrual for performance plan payments amounted to ISK 209 million (31.12.2019: ISK 371 million), of which the Bank's accrual amounts to ISK 100 million (31.12.2019: ISK 239 million).

13. Other operating expenses

	2020 1.1.-30.9.	2019 1.1.-30.9.	2020 1.7.-30.9.	2019 1.7.-30.9.
IT expenses	3,759	3,215	1,271	1,075
Professional services	693	872	190	314
Housing expenses	731	795	223	250
Other administration expenses	1,924	2,346	617	636
Depositors' and Investors' Guarantee Fund	441	570	68	175
Depreciation of property and equipment	395	399	136	131
Depreciation of right of use asset	98	96	33	32
Amortization of intangible assets	582	562	190	197
Other operating expenses	8,623	8,855	2,728	2,810

14. Bank levy

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

15. Net impairment

Net impairment on financial instruments	2020 1.1.-30.9.	2019 1.1.-30.9.	2020 1.7.-30.9.	2019 1.7.-30.9.
Net change in impairment of cash and balances with Central Bank	-	2	-	-
Net change in impairment of loans to credit institutions	(77)	13	15	1
Net change in impairment of loans to corporates	(3,057)	(1,234)	(1,020)	922
Net change in impairment of loans to individuals	(542)	364	292	(21)
Write offs on loans and receivables to corporates	(680)	(983)	(203)	(309)
Write offs on loans and receivables to individuals	(846)	(956)	(539)	(280)
Payments on loans and receivables previously written off from corporates	2	20	-	1
Payments on loans and receivables previously written off from individuals	61	123	24	46
Net change in impairment of financial instruments at FVOCI	(8)	1	(6)	1
Net change in impairment of loan commitments, guarantees and unused credit facilities	(511)	183	(121)	(129)
Net impairment on financial instruments	(5,658)	(2,467)	(1,558)	232
Other value changes of loans				
Increase in book value of loans to corporates	59	76	1	16
Increase in book value of loans to individuals	481	806	217	236
Other value changes of loans	540	882	218	252
Net impairment	(5,118)	(1,585)	(1,340)	484

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

16. Income tax expense

	2020 1.1.-30.9.	2019 1.1.-30.9.	2020 1.7.-30.9.	2019 1.7.-30.9.
Current tax expense	3,528	2,598	434	1,150
Deferred tax expense	(104)	193	662	128
Income tax expense	3,424	2,791	1,096	1,278

Reconciliation of effective tax rate

	2020 1.1.-30.9.		2019 1.1.-30.9.	
Earnings before tax		12,061		11,640
Income tax using the Icelandic corporate tax rate	20.0%	2,412	20.0%	2,328
Additional 6% tax on Financial Undertakings	5.3%	639	3.9%	456
Non-deductible expenses	0.2%	24	0.0%	3
Tax exempt revenues (loss)	0.7%	90	(6.3%)	(731)
Non-deductible taxes (bank levy)	1.7%	208	4.5%	525
Tax incentives not recognized in the Income Statement	0.2%	27	0.9%	110
Other changes	0.2%	24	0.9%	100
Effective tax rate	28.4%	3,424	24.0%	2,791

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 (2019: 0.376%).

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

	2020 1.1.-30.9.	2019 1.1.-30.9.	2020 1.7.-30.9.	2019 1.7.-30.9.
Net loss from discontinued operations held for sale	(1,968)	(5,292)	(1,034)	(2,914)
Income tax expense	39	318	39	(126)
Discontinued operations held for sale, net of income tax	(1,929)	(4,974)	(995)	(3,040)
Valitor Holding hf.	(852)	(2,905)	18	(971)
Stakksberg ehf.	394	(1,453)	50	(1,453)
Sólbjarg ehf.	(1,471)	(616)	(1,063)	(616)
Discontinued operations held for sale, net of income tax	(1,929)	(4,974)	(995)	(3,040)

The operating loss of Valitor was ISK 1,270 million for the first nine months of 2020 whereas Valitor's negative contribution to the Group, after taking into account the Group's eliminations, was ISK 694 million. Operating income of Valitor was ISK 4,450 million for the first nine months of 2020, or ISK 5,026 million, after taking into account the Group's eliminations. In the same period in 2019 the operation of Valitor was greatly affected by the ISK 1,200 million Valitor paid to Sunshine Press Production and Datacell in damages. When Arion Bank acquired a 38.62% shareholding in Valitor in 2014, the Bank signed an agreement with the seller (Landsbankinn) which stipulated that the seller would bear a part of the liability which Valitor might potentially be subject to in relation to the compensatory damages. Hence, Landsbankinn was liable to pay part of the damages. The total effect of the damages was ISK 595 million, net of tax. The operating loss of Valitor for the first nine months of 2019 was ISK 4,048 million, whereas Valitor's negative contribution to the Group, after taking into account the Group's eliminations, was ISK 2,905 million.

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

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

18. Earnings per share

	Continued operations		Discontinued operations		Net Earnings	
	2020 1.1.-30.9.	2019 1.1.-30.9.	2020 1.1.-30.9.	2019 1.1.-30.9.	2020 1.1.-30.9.	2019 1.1.-30.9.
Net earnings attributable to the shareholders of Arion Bank	8,645	8,849	(1,929)	(4,974)	6,716	3,875
Weighted average number of outstanding shares	1,724	1,814	1,724	1,814	1,724	1,814
Basic earnings per share	5.01	4.88	(1.12)	(2.74)	3.90	2.14
	1.7.-30.9.	1.7.-30.9.	1.7.-30.9.	1.7.-30.9.	1.7.-30.9.	1.7.-30.9.
Net earnings attributable to the shareholders of Arion Bank	4,961	3,801	(995)	(3,040)	3,966	761
Weighted average number of outstanding shares	1,719	1,814	1,719	1,814	1,719	1,814
Basic earnings per share	2.89	2.10	(0.58)	(1.68)	2.31	0.42

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Notes to the Consolidated Interim Statement of Financial Position

19. Cash and balances with Central Bank

	30.9.2020	31.12.2019
Cash on hand	4,284	4,206
Cash with Central Bank	77,297	81,543
Mandatory reserve deposit with Central Bank	5,936	9,968
Cash and balances with Central Bank	87,517	95,717

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

20. Loans to credit institutions

	30.9.2020	31.12.2019
Bank accounts	33,938	16,437
Other loans	5,546	1,510
Loans to credit institutions	39,484	17,947

21. Loans to customers

	Individuals		Corporates		Total	
30.9.2020	Gross carrying amount	Book value	Gross carrying amount	Book value	Gross carrying amount	Book value
Overdrafts	14,513	13,465	15,819	14,924	30,332	28,389
Credit cards	11,222	10,899	1,097	1,013	12,319	11,912
Mortgage loans	359,145	358,579	29,066	28,692	388,211	387,271
Other loans	32,669	31,377	358,058	348,917	390,727	380,294
Loans to customers	417,549	414,320	404,040	393,546	821,589	807,866
31.12.2019						
Overdrafts	14,421	13,720	18,709	17,780	33,130	31,500
Credit cards	13,028	12,786	1,373	1,281	14,401	14,067
Mortgage loans	310,562	310,195	23,475	23,211	334,037	333,406
Other loans	33,105	31,868	368,453	363,114	401,558	394,982
Loans to customers	371,116	368,569	412,010	405,386	783,126	773,955

The total book value of pledged loans that were pledged against amounts borrowed was ISK 180 billion at the end of the period (31.12.2019: ISK 182 billion). Pledged loans comprised mortgage loans to individuals.

Further analysis of loans is provided in Risk management disclosures.

22. Financial instruments

	30.9.2020	31.12.2019
Bonds and debt instruments	171,905	65,874
Shares and equity instruments with variable income	21,900	21,600
Derivatives	11,242	6,617
Securities used for economic hedging	29,890	23,315
Financial instruments	234,937	117,406

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

23. Financial assets and financial liabilities

30.9.2020	Amortized cost	Fair value through OCI	Mandatorily at fair value thr. P/L	Total
Financial assets				
Loans				
Cash and balances with Central Bank	87,517	-	-	87,517
Loans to credit institutions	39,484	-	-	39,484
Loans to customers	807,866	-	-	807,866
Loans	934,867	-	-	934,867
Bonds and debt instruments				
Listed	-	151,347	17,984	169,331
Unlisted	-	1,585	989	2,574
Bonds and debt instruments	-	152,932	18,973	171,905
Shares and equity instruments with variable income				
Listed	-	-	10,230	10,230
Unlisted	-	-	5,982	5,982
Bond funds with variable income, unlisted	-	-	5,688	5,688
Shares and equity instruments with variable income	-	-	21,900	21,900
Derivatives				
OTC derivatives	-	-	7,775	7,775
Derivatives used for hedge accounting	-	-	3,467	3,467
Derivatives	-	-	11,242	11,242
Securities used for economic hedging				
Bonds and debt instruments, listed	-	-	19,635	19,635
Shares and equity instruments with variable income, listed	-	-	10,255	10,255
Securities used for economic hedging	-	-	29,890	29,890
Other financial assets				
Accounts receivable	5,185	-	-	5,185
Other financial assets	5,827	-	-	5,827
Other financial assets	11,012	-	-	11,012
Financial assets	945,879	152,932	82,005	1,180,816
Financial liabilities				
Due to credit institutions and Central Bank	10,802	-	-	10,802
Deposits	602,842	-	-	602,842
Borrowings	308,913	-	-	308,913
Subordinated liabilities	36,867	-	-	36,867
Short position in bonds	-	-	816	816
Short position in equity	-	-	47	47
Short position in bonds used for economic hedging	-	-	527	527
Derivatives	-	-	2,593	2,593
Other financial liabilities	24,221	-	-	24,221
Financial liabilities	983,645	-	3,983	987,628

Amounts are in ISK millions

23. Financial assets and financial liabilities, continued

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

Amounts are in ISK millions

23. Financial assets and financial liabilities, continued

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

30.9.2020	FVOCI	Mandatorily FVPL	Total
Financial and insurance activities	14,317	8,858	23,175
Public sector	130,350	8,584	138,934
Corporates	8,265	1,531	9,796
Bonds and debt instruments at fair value	152,932	18,973	171,905

31.12.2019	FVOCI	Mandatorily FVPL	Total
Financial and insurance activities	417	5,613	6,030
Public sector	41,417	7,259	48,676
Corporates	7,060	4,108	11,168
Bonds and debt instruments at fair value	48,894	16,980	65,874

The total amount of pledged bonds was ISK 7.7 billion at the end of the period (31.12.2019: ISK 6.0 billion). Pledged bonds comprised Icelandic Government Bonds and Financial Institutions Bonds that were pledged against funding received and included in Due to credit institutions and Central Bank as well as short positions included in Financial liabilities at fair value.

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

30.9.2020

Assets at fair value	Level 1	Level 2	Level 3	Total
Bonds and debt instruments	162,013	9,668	224	171,905
Shares and equity instruments with variable income	4,860	15,362	1,678	21,900
Derivatives	-	7,775	-	7,775
Derivatives used for hedge accounting	-	3,467	-	3,467
Securities used for economic hedging	29,890	-	-	29,890
Investment property	-	-	6,721	6,721
Assets at fair value	196,763	36,272	8,623	241,658
Liabilities at fair value				
Short position in bonds	816	-	-	816
Short position in bonds used for economic hedging	527	-	-	527
Short position in equity	47	-	-	47
Derivatives	-	2,593	-	2,593
Liabilities at fair value	1,390	2,593	-	3,983

Amounts are in ISK millions

24. Fair value hierarchy, continued

31.12.2019

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

Transfers from Level 2 to Level 1 amounted to ISK 85 million at the end of the period (31.12.2019: Transfers from Level 1 to Level 2 amounted to ISK 20 million).

Fair value of assets and liabilities

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

Methods for establishing fair value

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

In some cases, the carrying value of an asset in Note 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

Notes to the Condensed Consolidated Interim Financial Statements

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		
30.9.2020	property	Bonds	Shares	Total
Balance at the beginning of the year	7,119	28	1,555	8,702
Net fair value changes	-	9	(73)	(64)
Additions	13	444	196	653
Disposals	(411)	(257)	-	653
Balance at the end of the period	6,721	224	1,678	9,944
31.12.2019				
Balance at the beginning of the year	7,092	42	1,329	8,463
Net fair value changes	-	20	62	82
Additions	30	5	281	316
Disposal	(3)	(27)	(117)	(147)
Transfers out of Level 3	-	(12)	-	(12)
Balance at the end of the period	7,119	28	1,555	8,702

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

	Financial assets		
1.1.-30.9.2020	Bonds	Shares	Total
Net financial income	9	(73)	(64)
Effects recognized in the Income Statement	9	(73)	(64)
1.1.-30.9.2019			
Net financial income	20	84	104
Effects recognized in the Income Statement	20	84	104

Amounts are in ISK millions

24. Fair value hierarchy, continued

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

30.9.2020	Carrying value	Fair value	Unrealized gain (loss)
Financial assets not carried at fair value			
Cash and balances with Central Bank	87,517	87,517	-
Loans to credit institutions	39,484	39,484	-
Loans to customers	807,866	811,995	4,129
Other financial assets	11,012	11,012	-
Financial assets not carried at fair value	945,879	950,008	4,129
Financial liabilities not carried at fair value			
Due to credit institutions and Central Bank	10,802	10,802	-
Deposits	602,842	602,842	-
Borrowings	308,913	327,248	(18,335)
Subordinated liabilities	36,867	34,830	2,037
Other financial liabilities	24,221	24,221	-
Financial liabilities not carried at fair value	983,645	999,943	(16,298)

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

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

Amounts are in ISK millions

24. Fair value hierarchy, continued

Derivatives

30.9.2020	Notional value	Fair value Assets	Fair value Liabilities
Forward exchange rate agreements	85,553	1,537	765
Fair value hedge of interest rate swap	143,603	3,466	-
Interest rate and exchange rate agreements	73,153	4,143	1,040
Bond swap agreements	19,485	16	479
Share swap agreements	14,408	2,080	304
Options - purchased agreements, unlisted	16	-	5
Derivatives	336,218	11,242	2,593

31.12.2019	Notional value	Fair value Assets	Fair value Liabilities
Forward exchange rate agreements	90,121	1,196	407
Fair value hedge of interest rate swap	114,337	1,616	-
Interest rate and exchange rate agreements	65,823	2,312	1,168
Bond swap agreements	9,936	46	48
Share swap agreements	12,710	1,447	431
Derivatives	292,927	6,617	2,054

Fair value hedge of interest rate swap

The Group applies fair value hedge accounting only with respect to interest rate swaps, whereby the Group pays floating rate interest and receives fixed rate interest, with identical cash flows to the borrowings. The interest rate swaps are hedging the exposure of changes in the fair value of certain fixed-rate euro bonds, see Note 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 2019.

30.9.2020	Notional	Maturity date	Fair value Assets	Fair value Liabilities	Gain (loss) on FV changes
Interest rates swaps - EUR	124,320	1-5 years	2,733	-	(300)
Interest rates swaps - EUR	-	0-3 months	-	-	(5)
Interest rates swaps - USD	13,823	>5 years	734	-	686
31.12.2019					
Interest rates swaps - EUR	108,667	1-5 years	1,608	-	457
Interest rates swaps - EUR	5,670	0-3 months	8	-	302

Hedged borrowings and subordinated liabilities

30.9.2020	Book value	Accumulated fair value Assets	Accumulated fair value Liabilities	Gain (loss) on FV changes
EUR 500 million - issued 2017/18 - 5 years	81,825	266	-	84
EUR 300 million - issued 2017 - 3 years	-	-	-	(38)
EUR 300 million - issued 2018 - 3 years	46,201	-	694	240
USD 100 million - issued 2020 - Perpetual	14,480	-	720	(779)
Hedged borrowings and subordinated liabilities	142,506	266	1,414	(493)

31.12.2019	Book value	Accumulated fair value Assets	Accumulated fair value Liabilities	Gain (loss) on FV changes
EUR 500 million - issued 2016/18 - 5 years	67,713	157	-	(410)
EUR 300 million - issued 2017 - 3 years	5,635	33	-	(199)
EUR 300 million - issued 2018 - 3 years	41,601	-	756	(295)
Hedged borrowings	114,949	190	756	(904)

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

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				
30.9.2020	Gross assets before nettings	Nettings with gross liabilities	Assets recognized on Balance Sheet, net	Financial liabilities	Collateral received	Assets after consideration of netting potential	Assets not subject to enforceable netting arr-angements	Total assets recognized on Balance Sheet, net
Reverse repurchase agreements	10,058	(396)	9,662	(8,679)	-	983	-	9,662
Derivatives	7,515	-	7,515	(1,159)	-	6,356	3,727	11,242
Total assets	17,573	(396)	17,177	(9,838)	-	7,339	3,727	20,904
31.12.2019								
Reverse repurchase agreements	6,539	(44)	6,495	(5,921)	-	574	-	6,495
Derivatives	4,601	-	4,601	(713)	-	3,888	2,016	6,617
Total assets	11,140	(44)	11,096	(6,634)	-	4,462	2,016	13,112

Financial liabilities subject to enforceable master netting arrangements and similar arrangements

	Liabilities subject to netting arrangements			Netting potential not recognized in the Balance Sheet				
30.9.2020	Gross liabilities before nettings	Nettings with gross assets	Liabilities recognized on Balance Sheet, net	Financial assets	Collateral pledged	Liabilities after consideration of netting potential	Liabilities not subject to enforceable netting arr-angements	Total liabilities recognized on balance sheet
Repurchase agreements	9,075	(396)	8,679	(8,679)	-	-	-	8,679
Derivatives	1,766	-	1,766	(1,159)	-	607	827	2,593
Total liabilities	10,841	(396)	10,445	(9,838)	-	607	827	11,272
31.12.2019								
Repurchase agreements	5,965	(44)	5,921	(5,921)	-	-	-	5,921
Derivatives	761	-	761	(713)	-	48	1,293	2,054
Total liabilities	6,726	(44)	6,682	(6,634)	-	48	1,293	7,975

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

26. Investments in associates

	30.9.2020	31.12.2019
Carrying amount at the beginning of the year	852	818
Acquisitions	39	18
Disposals	-	(740)
Share of profit (loss) of associates and profit from sale	22	756
Investment in associates	913	852

The Group's interest in its principal associates

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

Amounts are in ISK millions

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

30.9.2020	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	-	-	-	1,167	1,167
Additions, capitalized salaries	-	-	-	446	446
Amortization	-	-	(45)	(537)	(582)
Intangible assets	669	2,383	682	5,664	9,398
31.12.2019					
Balance at the beginning of the year	669	2,383	787	2,558	6,397
Additions	-	-	-	2,291	2,291
Additions, capitalized salaries	-	-	-	459	459
Amortization	-	-	(60)	(720)	(780)
Intangible assets	669	2,383	727	4,588	8,367

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

28. Tax assets and tax liabilities

	30.9.2020		31.12.2019	
	Assets	Liabilities	Assets	Liabilities
Current tax	-	2,108	-	3,461
Deferred tax	2	945	2	943
Tax assets and tax liabilities	2	3,053	2	4,404

Amounts are in ISK millions

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

Assets and disposal groups held for sale	30.9.2020	31.12.2019
Valitor Holding hf.	18,135	30,657
Stakksberg ehf.	3,237	2,711
Sólbjarg ehf.	7,888	8,676
Disposal groups held for sale	29,260	42,044
Real estate	1,560	1,553
Other assets	1	29
Assets and disposal groups held for sale	30,821	43,626

Liabilities associated with disposal groups held for sale		
Valitor Holding hf.	18,694	22,052
Sólbjarg ehf.	7,499	6,579
Liabilities associated with disposal groups held for sale	26,193	28,631

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

Valitor Holding hf.

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

	30.9.2020	31.12.2019
Cash and balances with Central Bank	-	9,363
Loans to credit institutions	18,484	12,563
Loans to customers	1,927	2,061
Financial instruments	-	28
Investments in associates	68	66
Intangible assets	4,634	4,720
Tax assets	308	293
Other assets	2,238	2,986
Assets	27,659	32,080
Elimination within Arion Bank Group	(9,524)	(1,423)
Valitor's contribution to the Group	18,135	30,657
Due to credit institutions and Central Bank	-	2
Financial liabilities at fair value	-	26
Tax liabilities	52	321
Other liabilities	18,642	21,712
Borrowings	116	3,500
Liabilities	18,810	25,561
Elimination within Arion Bank Group	(116)	(3,509)
Valitor's contribution to the Group	18,694	22,052
Book value of Valitor	8,849	6,519

In May 2020 Valitor Group sold the operations of Valitor in Denmark, Valitor A/S. The operation of Valitor A/S contributed a net loss for the years 2018 and 2019. The financial effects of the sale of the entity did not have material effects on these Consolidated Interim Financial Statements.

Sólbjarg ehf., a subsidiary of Eignabjarg ehf.

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

Amounts are in ISK millions

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

Stakksberg ehf., a subsidiary of Eignabjarg ehf.

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

30. Other assets

	30.9.2020	31.12.2019
Property and equipment	4,637	5,243
Right of use asset	811	902
Accounts receivable	5,185	3,617
Unsettled securities trading	3,694	3,178
Investment for life assurance policyholders where risk is held by policyholder	1,064	1,008
Sundry assets	3,166	2,916
Other assets	18,557	16,864

31. Other liabilities

	30.9.2020	31.12.2019
Accounts payable	564	654
Unsettled securities trading	16,004	365
Depositors' and Investors' Guarantee Fund	129	167
Technical provision	16,476	14,709
Technical provision for life assurance policyholders were investment risk is held by policyholder	1,064	1,008
Withholding tax	192	1,492
Bank levy	4,022	2,984
Accrued expenses	2,631	3,441
Prepaid income	1,497	1,573
Impairment of off-balance items	1,012	481
Lease liability	834	914
Sundry liabilities	6,642	4,909
Other liabilities	51,067	32,697

Technical provision	Technical provision	Reinsurers' share	Total 30.9.2020	Technical provision	Reinsurers' share	Total 31.12.2019
Claims reported and loss adjustment expenses	8,329	(275)	8,054	7,742	(221)	7,521
Claims incurred but not reported	1,581	(82)	1,499	1,426	(82)	1,344
Claims outstanding	9,910	(357)	9,553	9,168	(303)	8,865
Provision for unearned premiums	6,566	(7)	6,559	5,541	(4)	5,537
Own technical provision	16,476	(364)	16,112	14,709	(307)	14,402

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

32. Borrowings

Currency, original nominal value	First issued	Maturity	Maturity type	Terms of interest	30.9.2020	31.12.2019
ARION CBI 21, ISK 10,220 million	2014	2021	At maturity	Fixed, CPI linked, 3.50%	10,579	10,176
ARION CB 22, ISK 28,720 million	2015	2022	At maturity	Fixed, 6.50%	27,706	28,264
ARION CB 24 ISK 20,180 million	2019	2024	At maturity	Fixed, 6.00%	17,132	16,060
ARION CBI 25, ISK 37,940 million	2017	2025	At maturity	Fixed, CPI linked, 3.00%	41,469	40,213
ARION CBI 26 ISK 15,460 million	2019	2026	At maturity	Fixed, CPI linked, 2.00%	17,060	12,320
ARION CBI 29, ISK 25,220 million	2014	2029	At maturity	Fixed, CPI linked, 3.50%	28,570	27,689
ARION CBI 48, ISK 11,680 million	2018	2048	Amortizing	Fixed, CPI linked, 2.50%	10,553	10,647
Statutory covered bonds					153,069	145,369
NOK 800 million	2015	2020	At maturity	Floating, NIBOR +2.95%	-	11,143
NOK 320 million	2016	2020	At maturity	Floating, NIBOR +1.95%	4,754	4,439
EUR 300 million *	2017	2020	At maturity	Fixed, 0.75%	-	5,635
SEK 300 million	2017	2020	At maturity	Floating, 3 month STIBOR +1.35%	-	2,598
SEK 250 million	2017	2020	At maturity	Floating, 3 month STIBOR +0.75%	-	3,241
EUR 500 million *	2016	2021	At maturity	Fixed, 1.625%	81,825	67,713
EUR 13 million	2019	2021	At maturity	Floating, 3. EURIBOR +0.58%	2,109	1,765
NOK 750 million	2019	2022	At maturity	Floating, NIBOR +1.82%	11,131	10,382
SEK 150 million	2019	2022	At maturity	Floating, 3 month STIBOR +1.33%	2,326	1,949
NOK 250 million	2017	2023	At maturity	Fixed, 3.02%	3,746	3,512
EUR 300 million *	2018	2023	At maturity	Fixed, 1.00%	46,201	41,601
NOK 250 million	2017	2027	At maturity	Fixed, 3.40%	3,752	3,521
Senior unsecured bonds					155,844	157,499
Bills issued					-	1,680
Other borrowings					-	197
Other loans / bills					-	1,877
Borrowings					308,913	304,745

* The Group applies fair value hedge accounting to these bond issuances and uses certain foreign currency denominated interest rate swaps as hedging instruments, see Note 24.

The book value of listed bonds was ISK 309 billion at the end of the period (31.12.2019: ISK 303 billion). The market value of those bonds was ISK 327 billion (31.12.2019: ISK 315 billion). The Group repurchased ISK 4 billion own debts during the period (31.12.2019: ISK 39 billion).

33. Subordinated liabilities

Currency, original nominal value	Issued	Maturity	First Call date	Terms of interest	30.9.2020	31.12.2019
SEK 500 million	2018	2028	22 Nov '23	Floating, 3 month STIBOR +3.10%	7,722	6,472
NOK 300 million	2019	2029	9 Jul '24	Floating, NIBOR +3.65%	4,479	4,183
SEK 225 million	2019	2029	20 Dec '24	Floating, 3 month STIBOR +3.70%	3,481	2,918
ARION T2I 30 ISK 4.800 million	2019	2030	4 Jan '25	Fixed, CPI linked, 3.875%	4,995	4,913
ARION T2 30 ISK 880 million	2019	2030	4 Jan '25	Fixed, 6.75%	892	907
EUR 5 million	2019	2031	6 Mar '26	Fixed, 3.24%	818	690
Tier 2 subordinated liabilities					22,387	20,083
ARION AT1 USD 100 million	2020	Perpetual	26 Feb '25	Fixed, 6.250%	14,480	-
Additional Tier 1 subordinated liabilities					14,480	-
Subordinated liabilities					36,867	20,083

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

Amounts are in ISK millions

34. Pledged assets

Pledged assets against liabilities	30.9.2020	31.12.2019
Assets, pledged as collateral against borrowings	190,810	186,902
Assets, pledged as collateral against loans from credit institutions and short positions	7,692	6,023
Pledged assets against liabilities	198,502	192,925

The Group has pledged assets against borrowings, both issued covered bonds and other issued bonds and loan agreements. The total value of those pledged assets was ISK 191 billion at the end of the period (31.12.2019: ISK 187 billion). Pledged loans comprised mortgage loans to individuals. The book value of those borrowings was ISK 153 billion at the end of the period (31.12.2019: ISK 145 billion).

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

35. Equity

Share capital and share premium

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

	Share capital	Share premium	Total 30.9.2020	Share capital	Share premium	Total 31.12.2019
Shares outstanding at the beginning of the year	1,773	53,942	55,715	1,814	57,196	59,010
Purchase of treasury stock	(54)	(4,326)	(4,380)	(41)	(3,242)	(3,283)
Employees stock grant	-	(4)	(4)	-	(12)	(12)
Shares outstanding at the end of the period	1,719	49,612	51,331	1,773	53,942	55,715
Own shares at period-end	11			41		
- as proportion of issued share capital	0.7%			2.3%		

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

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

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Other information

36. Shareholders of Arion Bank

	30.9.2020	31.12.2019
Taconic Capital (through TCA New Sidecar s.á.r.l.)	23.22%	23.53%
Sculptor Capital Management	9.92%	9.53%
Gildi lífeyrissjódur	9.62%	8.79%
Lífeyrissjódur verzlunarmanna	5.78%	3.67%
Lífeyrissjódur starfsmanna ríkisins	5.03%	3.47%
Stodir hf.	4.99%	4.96%
Goldman Sachs International	2.97%	3.72%
Stapi lífeyrissjódur	2.67%	1.89%
Eaton Vance funds	2.60%	3.23%
Birta lífeyrissjódur	2.54%	1.32%
Frjálsi lífeyrissjódurinn	2.42%	2.18%
Lansdowne partners	2.39%	5.02%
Stefnir rekstrarfélag hf.	1.70%	2.46%
Hvalur hf.	1.52%	1.45%
Íslandsbanki hf.	1.21%	1.00%
MainFirst Bank AG	1.14%	1.09%
Lífsverk Pension fund	1.11%	0.75%
Júpíter rekstrarfélag hf.	0.72%	1.10%
Arion banki hf.	0.69%	2.27%
Other shareholders with less than 1% shareholding	17.77%	18.57%
	100.0%	100.0%

The Bank's employees held a shareholding of 0.51% in Arion Bank at period end (31.12.2009: 0.43%).

At the AGM in March 2020 a motion was passed to reduce the company's share capital by ISK 84 million at nominal value, by cancelling the company's own shares. The reduction took place in May 2020. Shareholdings changed accordingly.

Shareholding of Arion Bank's employees was 0.69% at the end of the period.

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

Administrative fine from Central Bank of Iceland

On 17 July 2020 the Financial Supervisory Authority of the Central Bank of Iceland (FME) published its decision to impose an administrative fine on Arion Bank of ISK 87.7 million due to the Bank´s breach of obligation to disclose insider information in a timely manner. The decision has been published on FME´s website. On 6 October Arion Bank filed a claim to the district court of Reykjavik demanding that FME´s decision will be annulled.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

38. Events after the reporting period

On 9 October 2020 TravelCo Nordic A/S, a subsidiary of Sólbjarg ehf., entered a restructuring process according to Danish law in an attempt to secure operations. The Bank in cooperation with the Bravo Tours management and Danish investors reached an agreement with trustees and will continue the operations of Bravo Tours.

Off balance sheet information

39. Commitments

Financial guarantees, unused credit facilities and undrawn loan commitments	30.9.2020	31.12.2019
Financial guarantees	16,379	15,097
Unused overdrafts	48,074	44,923
Undrawn loan commitments	72,694	54,101
Financial guarantees, unused credit facilities and undrawn loan commitments	137,147	114,121

40. Assets under management and under custody

Assets under management	1,100,026	1,013,101
Assets under custody	906,990	1,370,946

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

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

Related party

41. Related party

The Group has a related party relationship with an entity with an influence over the Group as the largest shareholder of Arion Bank, which is at the end of the period Taconic Capital (23.22%).

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

30.9.2020	Assets	Liabilities	Net balance
Board of Directors and key Management personnel	95	(574)	(479)
Associates and other related parties	-	(70)	(70)
Balances with related parties	95	(644)	(549)

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

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Risk management disclosures

The Group faces various risks arising from its day to day operations and in 2020 the Group is 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 therefore a core activity within the Group. The key to effective risk management is a process of on-going identification of significant risk, quantification of risk exposure, actions to limit risk and constant monitoring of risk. This process of risk management and the ability to evaluate, manage and correctly price the risk encountered is critical to the Group's continuing profitability 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 2019 and in the Pillar 3 Risk Disclosures for 2019. The Pillar 3 Risk Disclosures 2019 are available on the Bank's website, www.arionbanki.is.

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

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

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

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

Exposure to credit risk

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

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

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

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

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				
30.9.2020	Maximum exposure	Cash and securities	Real estate	Vessels	Other collateral	Total collateral
Cash and balances with Central Bank	87,517	-	-	-	-	-
Loans to credit institutions	39,484	-	-	-	-	-
Loans to customers at amortized cost	807,866	21,585	584,454	44,408	86,202	736,649
Individuals	*414,320*	*19*	*374,313*	*1*	*12,560*	*386,893*
Corporates	*393,546*	*21,566*	*210,141*	*44,407*	*73,642*	*349,756*
Real estate activities and construction	*130,156*	*1,039*	*120,052*	*63*	*2,597*	*123,751*
Fishing industry	*86,883*	*254*	*12,733*	*43,855*	*29,537*	*86,379*
Information and communication technology	*19,721*	*176*	*1,496*	*-*	*4,523*	*6,195*
Wholesale and retail trade	*52,216*	*200*	*37,832*	*26*	*10,996*	*49,054*
Financial and insurance activities	*32,034*	*19,803*	*2,010*	*-*	*9,334*	*31,147*
Industry, energy and manufacturing	*30,178*	*26*	*16,623*	*-*	*11,306*	*27,955*
Transportation	*13,483*	*8*	*844*	*314*	*2,936*	*4,102*
Services	*12,704*	*46*	*8,690*	*149*	*1,839*	*10,724*
Public sector	*8,053*	*14*	*2,237*	*-*	*239*	*2,490*
Agriculture and forestry	*8,118*	*-*	*7,624*	*-*	*335*	*7,959*
Other assets with credit risk	11,012	-	-	-	-	-
Financial guarantees	16,379	2,098	6,520	42	3,767	12,427
Undrawn loan commitments and unused overdrafts	120,768	-	-	-	-	-
Fair value through OCI	152,932	-	-	-	-	-
Government bonds	*130,350*	-	-	-	-	-
Corporate and finance bonds	*22,582*	-	-	-	-	-
Balance at the end of the period	1,235,958	23,683	590,974	44,450	89,969	749,076
31.12.2019						
Cash and balances with Central Bank	95,717	-	-	-	-	-
Loans to credit institutions	17,947	-	-	-	-	-
Loans to customers at amortized cost	773,955	20,792	544,723	54,601	73,091	693,207
Individuals	*368,569*	*198*	*328,243*	*13*	*10,996*	*339,450*
Corporates	*405,386*	*20,594*	*216,480*	*54,588*	*62,095*	*353,757*
Real estate activities and construction	*129,856*	*1,972*	*113,465*	*55*	*8,022*	*123,514*
Fishing industry	*82,941*	*17*	*12,365*	*54,121*	*9,946*	*76,449*
Information and communication technology	*19,102*	*375*	*3,529*	*-*	*4,308*	*8,212*
Wholesale and retail trade	*54,989*	*375*	*32,508*	*7*	*15,980*	*48,870*
Financial and insurance activities	*33,669*	*17,726*	*7,254*	*-*	*7,622*	*32,602*
Industry, energy and manufacturing	*39,909*	*60*	*28,183*	*-*	*6,711*	*34,954*
Transportation	*11,066*	*-*	*1,048*	*313*	*3,285*	*4,646*
Services	*17,580*	*61*	*9,137*	*92*	*5,669*	*14,959*
Public sector	*8,617*	*4*	*2,194*	*-*	*289*	*2,487*
Agriculture and forestry	*7,657*	*4*	*6,797*	*-*	*263*	*7,064*
Other assets with credit risk	8,675	-	-	-	-	-
Financial guarantees	15,097	2,232	6,322	1,403	2,262	12,219
Undrawn loan commitments and unused overdrafts	99,024	-	-	-	-	-
Fair value through OCI	48,894	-	-	-	-	-
Government bonds	*41,417*	-	-	-	-	-
Corporate and finance bonds	*7,477*	-	-	-	-	-
Balance at the end of the year	1,059,309	23,024	551,045	56,004	75,353	705,426

Amounts are in ISK millions

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

	30.9.2020		31.12.2019	
	Gross carrying amount	Thereof credit impaired	Gross carrying amount	Thereof credit impaired
Less than 50%	113,388	1,395	119,734	1,283
50-70%	152,533	2,394	130,257	2,546
70-90%	94,790	1,149	63,099	1,131
90-100%	10,959	347	7,369	170
100-110%	3,467	34	2,658	60
More than 110%	12,930	747	10,873	698
Not classified	144	-	47	-
Balance at the end of the period	388,211	6,066	334,037	5,888

At the end of the period the gross carrying amount of assets in stage 3 are ISK 25,542 million (31.12.2019: ISK 20,155 million) with ISK 18,607 million in collateral (31.12.2019: ISK 13,618 million), there of ISK 16,325 million in real estates (31.12.2019: 11,791 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 664 million (30.9.2019: ISK 464 million) and ISK 7 million in other assets (30.9.2019: ISK 17 million). The assets are held for sale, see Note 29.

Credit quality

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

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

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

Amounts are in ISK millions

42. Credit risk, continued

Credit quality profile by rating class

30.9.2020	Cash and balances with CB	Loans to credit institutions	Financial instru-ments at FVOCI
Loans to credit institutions, securities and cash			
Investment grade	87,517	33,251	152,946
Non-investment grade	-	6,326	-
Gross carrying amount	87,517	39,577	152,946
Loss allowance	-	(93)	(14)
Book value	87,517	39,484	152,932

Loans to customers	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 to 1 (Grades AAA to BBB-)	382,808	8,565	-	40	391,413
Risk class 2 (Grades BB+ to BB-)	175,893	37,338	-	109	213,340
Risk class 3 (Grades B+ to B-)	68,921	59,429	-	27	128,377
Risk class 4 (Grades CCC+ to CCC-)	12,260	48,426	-	85	60,771
Risk class 5 (DD)	-	-	25,542	320	25,862
Unrated	1,631	195	-	-	1,826
Gross carrying amount	641,513	153,953	25,542	581	821,589
Loss allowance	(1,914)	(3,549)	(8,175)	(85)	(13,723)
Book value	639,599	150,404	17,367	496	807,866
Loans to customers - Individuals					
Risk class 0 to 1 (Grades AAA to BBB-)	292,532	1,489	-	40	294,061
Risk class 2 (Grades BB+ to BB-)	76,316	8,645	-	109	85,070
Risk class 3 (Grades B+ to B-)	16,603	5,995	-	27	22,625
Risk class 4 (Grades CCC+ to CCC-)	3,410	5,750	-	85	9,245
Risk class 5 (DD)	-	-	6,107	320	6,427
Unrated	119	2	-	-	121
Gross carrying amount	388,980	21,881	6,107	581	417,549
Loss allowance	(982)	(624)	(1,538)	(85)	(3,229)
Book value	387,998	21,257	4,569	496	414,320
Loans to customers - Companies and sovereign					
Risk class 0 to 1 (Grades AAA to BBB-)	90,276	7,076	-	-	97,352
Risk class 2 (Grades BB+ to BB-)	99,577	28,693	-	-	128,270
Risk class 3 (Grades B+ to B-)	52,318	53,434	-	-	105,752
Risk class 4 (Grades CCC+ to CCC-)	8,850	42,676	-	-	51,526
Risk class 5 (DD)	-	-	19,435	-	19,435
Unrated	1,512	193	-	-	1,705
Gross carrying amount	252,533	132,072	19,435	-	404,040
Loss allowance	(932)	(2,925)	(6,637)	-	(10,494)
Book value	251,601	129,147	12,798	-	393,546

Loan commitments, guarantees and unused credit facilities	Stage 1	Stage 2	Stage 3	POCI	Total
Risk class 0 to 1 (Grades AAA to BBB-)	61,747	432	-	-	62,179
Risk class 2 to 4 (Grades BB+ to CCC-)	37,725	21,172	1,803	-	60,700
Unrated	14,266	2	-	-	14,268
Gross carrying amount	113,738	21,606	1,803	-	137,147
Loss allowance	(306)	(661)	(45)	-	(1,012)
Book value	113,432	20,945	1,758	-	136,135

Amounts are in ISK millions

42. Credit risk, continued

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

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

Amounts are in ISK millions

42. Credit risk, continued

Sector split, Gross carrying value against loss allowance

	Stage 1		Stage 2		Stage 3			
30.9.2020	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Gross Carrying amount	Loss allowance	Total Loss allowance	Book value
Loans to credit instit., securities & cash ...	280,041	(107)	-	-	-	-	(107)	279,934
Individuals ...	388,980	(982)	22,142	(624)	6,427	(1,623)	(3,229)	414,320
Mortgage ...	*337,262*	*(222)*	*17,587*	*(187)*	*4,294*	*(155)*	*(564)*	*358,579*
Other ...	*51,718*	*(760)*	*4,555*	*(437)*	*2,133*	*(1,468)*	*(2,665)*	*55,741*
Companies and sovereign ...	252,533	(932)	132,072	(2,925)	19,435	(6,637)	(10,494)	393,546
Real estate activities and construction .	*80,009*	*(298)*	*49,167*	*(538)*	*2,683*	*(867)*	*(1,703)*	*130,156*
Fishing industry ...	*70,830*	*(130)*	*15,718*	*(128)*	*1,056*	*(463)*	*(721)*	*86,883*
Information and communication technolo[g	*18,847*	*(43)*	*835*	*(46)*	*367*	*(239)*	*(328)*	*19,721*
Wholesale and retail trade ...	*14,920*	*(55)*	*31,362*	*(1,442)*	*9,155*	*(1,724)*	*(3,221)*	*52,216*
Financial and insurance activities ...	*22,869*	*(122)*	*8,727*	*(115)*	*839*	*(164)*	*(401)*	*32,034*
Industry, energy and manufacturing ...	*21,251*	*(65)*	*8,389*	*(146)*	*1,528*	*(779)*	*(990)*	*30,178*
Transportation ...	*3,598*	*(62)*	*9,723*	*(197)*	*1,202*	*(781)*	*(1,040)*	*13,483*
Services ...	*5,942*	*(31)*	*6,604*	*(293)*	*1,809*	*(1,327)*	*(1,651)*	*12,704*
Public Sector ...	*7,687*	*(104)*	*345*	*(5)*	*164*	*(34)*	*(143)*	*8,053*
Agriculture and forestry ...	*6,580*	*(22)*	*1,202*	*(15)*	*632*	*(259)*	*(296)*	*8,118*
Balance at the end of the period ...	921,554	(2,021)	154,214	(3,549)	25,862	(8,260)	(13,830)	1,087,800

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

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 their impairment requirements. The reconciliation includes:

Transfers of financial assets between impairment requirements

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

Net remeasurement of loss allowance

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

New financial assets

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

Derecognitions and maturities

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

Write-offs

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

Foreign exchange

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

Macroeconomic outlook

Regarding macroeconomic outlook, see Note 3, Significant accounting estimates and judgements.

30.9.2020

*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)	2,515	(2,274)	(241)	-	-
Transfers to Stage 2 (lifetime ECL)	(818)	840	(22)	-	-
Transfers to Stage 3 (credit impaired financial assets)	(66)	(733)	799	-	-
Net remeasurement of loss allowance **	(1,187)	5,088	1,863	18	5,782
New financial assets, originated or purchased	1,039	327	1,013	-	2,379
Derecognitions and maturities	(427)	(310)	(1,454)	-	(2,191)
Write-offs ***	-	(2)	(1,266)	(148)	(1,416)
Foreign exchange difference	27	108	387	6	528
Impairment loss allowance ******	**2,220**	**4,210**	**8,220**	**85**	**14,735**
Impairment loss allowances for assets only carrying 12-month ECL	107	-	-	-	107
Total impairment loss allowance	**2,327**	**4,210**	**8,220**	**85**	**14,842**

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

** During the period the loss allowance balance for stage 3 loans was raised by ISK 491 million due to unwinding of interest income.

*** During the period an amount of ISK 878 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	974	921	7,067	209	9,171
Transfers of financial assets:					
Transfers to Stage 1 (12-month ECL)	2,287	(2,053)	(234)	-	-
Transfers to Stage 2 (lifetime ECL)	(776)	798	(22)	-	-
Transfers to Stage 3 (credit impaired financial assets)	(64)	(730)	794	-	-
Net remeasurement of loss allowance	(1,070)	4,579	1,873	18	5,400
New financial assets, originated or purchased	790	201	1,010	-	2,001
Derecognitions and maturities	(246)	(271)	(1,425)	-	(1,942)
Write-offs	-	(2)	(1,266)	(148)	(1,416)
Foreign exchange differences	19	106	378	6	509
Total loss allowance for loans to customers	1,914	3,549	8,175	85	13,723

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)	1,095	(972)	(123)	-	-
Transfers to Stage 2 (lifetime ECL)	(369)	387	(18)	-	-
Transfers to Stage 3 (credit impaired financial assets)	(42)	(272)	314	-	-
Net remeasurement of loss allowance	(246)	1,213	670	18	1,655
New financial assets, originated or purchased	228	17	9	-	254
Derecognitions and maturities	(103)	(66)	(341)	-	(510)
Write-offs	-	(2)	(618)	(148)	(768)
Foreign exchange differences	1	-	43	6	50
Total loss allowance for individuals	982	624	1,537	85	3,229

Impairment loss allowance for loans to customers - Companies and sovereign	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	556	602	5,466	-	6,624
Transfers of financial assets					
Transfers to Stage 1 (12-month ECL)	1,192	(1,081)	(111)	-	-
Transfers to Stage 2 (lifetime ECL)	(407)	411	(4)	-	-
Transfers to Stage 3 (credit impaired financial assets)	(22)	(458)	480	-	-
Net remeasurement of loss allowance	(824)	3,366	1,203	-	3,745
New financial assets, originated or purchased	562	184	1,001	-	1,747
Derecognitions and maturities	(143)	(205)	(1,084)	-	(1,432)
Write-offs	-	-	(648)	-	(648)
Foreign exchange differences	18	107	334	-	459
Total loss allowance for companies and sovereign	932	2,926	6,637	-	10,494

Impairment loss allowance for loan commitments, guarantees and unused credit facilities	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at the beginning of the year	163	245	74	-	482
Transfers					
Transfers to 12-month ECL	228	(221)	(7)	-	-
Transfers to lifetime ECL	(42)	42	-	-	-
Transfers to credit impaired	(2)	(3)	5	-	-
Net remeasurement of loss allowance	(117)	509	(10)	-	382
New financial commitments originated	249	126	3	-	378
Derecognitions and maturities	(181)	(39)	(29)	-	(249)
Foreign exchange differences	8	2	9	-	19
Total loss allowance for loan commit., guarantees, unused cr. facilitie	306	661	45	-	1,012

Large exposures

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

The Group has one large exposure at the end of the period, totaling ISK 22.0 billion (11.0% of eligible capital) before taking into account eligible credit risk mitigation (31.12.2019: two large exposures, totaling ISK 36.8 billion). The total exposure is ISK 21.8 billion (11.0% of eligible capital) after taking into account eligible credit risk mitigation.

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

42. 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 of 2020; 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.

30.09.2020	Tourism dependent	Payment moratoria in Q3 2020	Recipient of government sponsored loans	All focus groups	Thereof secured by real estate
Individuals	3,856	29,035	2	32,268	30,938
Real estate and construction	25,417	27,382	1,207	46,305	44,072
Services	4,940	4,432	1,057	7,194	3,658
Transportation	9,558	1,187	977	9,682	420
Industry, energy and manufacturing	24	6,491	415	6,728	4,508
Wholesale and retail trades	31,161	29,079	4,509	38,511	30,801
Other sectors	426	7,437	723	7,997	4,008
Gross carrying amount	75,382	105,043	8,890	148,685	118,405
Loss allowance	(5,017)	(2,434)	(264)	(6,279)	
Book value	70,365	102,609	8,626	142,406	

The following table shows loans from loans to customers which have been granted moratoria in the first nine months of 2020 or have active moratoria at 30 September 2020.

	Individuals	Companies
Moratoria granted in the first nine months of 2020	51,560	64,882
Active moratoria at 30 September 2020	10,538	13,578

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

	Impact group 1	Impact group 2	Impact group 3	Impact group 4	Total
Individuals	-	-	32,269	-	32,269
Real estate and construction	-	1,892	41,736	2,677	46,305
Services	-	190	6,632	372	7,194
Transportation	6,636	367	1,748	930	9,681
Industry, energy and manufacturing	-	-	6,728	-	6,728
Wholesale and retail trades	-	-	31,669	6,842	38,511
Other sectors	-	-	7,997	-	7,997
Gross carrying amount	6,636	2,449	128,779	10,821	148,685
Loss allowance	(31)	(62)	(5,915)	(271)	(6,279)
Book value	6,605	2,387	122,864	10,550	142,406

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

	Before impact assessment	After impact assessment
Risk class 0 to 1 (Grades AAA to BBB-)	44,116	18,223
Risk class 2 (Grades BB+ to BB-)	39,869	34,616
Risk class 3 (Grades B+ to B-)	38,797	53,058
Risk class 4 (Grades CCC+ to CCC-)	12,976	29,861
Risk class 5 (DD)	11,948	11,948
Unrated	979	979
Gross carrying amount	148,685	148,685

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

Interest rate risk

Interest rate risk arises from the possibility that changes in market rates adversely affect net interest income and fair value of interest-bearing instruments on the Group's balance sheet. The Group's operations are subject to interest rate risk due to mismatches in the fixing of interest rates between assets and liabilities, resulting in a 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. The sale of the Arion Bank Mortgage Institutional Fund mortgage portfolio, executed in October 2019, with resulting full prepayment of the remaining matched structural covered bonds issuance, significantly shortened the interest fixing profile of the Bank for indexed rates.

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

Interest rate risk in the banking book

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

30.9.2020	Up to 3	3-12	1-5	5-10	Over 10	
Assets	months	months	years	years	years	Total
Balances with Central Bank	83,233	-	-	-	-	83,233
Loans to credit institutions	39,484	-	-	-	-	39,484
Loans to customers	569,339	55,551	160,166	4,442	22,497	811,995
Financial instruments	46,742	60,765	39,362	1,756	4,331	152,956
Assets	738,798	116,316	199,528	6,198	26,828	1,087,668
Liabilities						
Due to credit institutions and Central Bank	10,802	-	-	-	-	10,802
Deposits	558,293	32,190	9,661	1,542	1,156	602,842
Borrowings	20,126	-	240,417	54,974	11,731	327,248
Subordinated liabilities	15,501	-	18,330	999	-	34,830
Liabilities	604,722	32,190	268,408	57,515	12,887	975,722
Derivatives and other off-balance sheet items (net position)	(123,758)	-	129,603	862	-	6,707
Net interest gap	10,318	84,126	60,723	(50,455)	13,941	118,653

Amounts are in ISK millions

43. Market risk, continued

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

Sensitivity analysis of interest rate risk in the banking book

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

	30.9.2020		31.12.2019	
NPV change	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	(3,635)	3,631	(3,198)	2,651
ISK, Non index-linked	1,049	(1,024)	(135)	210
Foreign currencies	704	(711)	365	(392)
NII change				
ISK, CPI index-linked	(1,190)	562	(751)	719
ISK, Non index-linked	(3,152)	562	(1,078)	434
Foreign currencies	34	(34)	200	(200)

Sensitivity analysis of interest rate risk in the trading book

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

	30.9.2020		31.12.2019	
Currency	-100 bps	+100 bps	-100 bps	+100 bps
ISK, CPI index-linked	148	(132)	83	(74)
ISK, Non index-linked	75	(72)	107	(100)
Foreign currencies	16	(16)	(77)	73

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

30.9.2020	Up to 1 year	1 to 5 years	Over 5 years	Total
Assets, CPI index-linked				
Loans to customers	16,738	49,969	200,543	267,250
Financial instruments	14,593	-	-	14,593
Off-balance sheet position	(340)	(1,094)	-	(1,434)
Assets, CPI index-linked	30,991	48,875	200,543	280,409
Liabilities, CPI index-linked				
Deposits	74,835	13,421	2,697	90,953
Borrowings	271	53,201	54,759	108,231
Subordinated liabilities	-	-	4,995	4,995
Other	1,080	209	1,426	2,715
Off-balance sheet position	1,000	5,484	70	6,554
Liabilities, CPI index-linked	77,186	72,315	63,947	213,448
Net on-balance sheet position	(44,855)	(16,862)	136,666	74,949
Net off-balance sheet position	(1,340)	(6,578)	(70)	(7,988)
CPI Balance	(46,195)	(23,440)	136,596	66,961
CPI Balance for prudential consolidation, which excludes insurance operations *	(46,263)	(25,739)	132,381	60,377

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

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

Amounts are in ISK millions

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

30.9.2020

Financial assets	ISK	EUR	USD	GBP	DKK	NOK	Other	Total
Cash and balances with CB	85,493	715	469	226	145	93	376	87,517
Loans to credit institutions	5,883	17,913	9,351	842	1,831	520	3,144	39,484
Loans to customers	641,679	114,037	35,859	5,507	4,882	-	5,902	807,866
Financial instruments	155,583	26,467	52,248	28	-	571	40	234,937
Other financial assets	10,373	220	333	-	1	8	77	11,012
Financial assets	899,011	159,352	98,260	6,603	6,859	1,192	9,539	1,180,816
Financial liabilities								
Due to credit inst. and Central Bank	5,079	2,145	3,563	14	-	-	1	10,802
Deposits	517,857	32,335	42,631	2,163	2,572	2,859	2,425	602,842
Financial liabilities at fair value	2,921	726	248	50	-	4	34	3,983
Other financial liabilities	16,407	5,465	1,263	193	512	438	(58)	24,220
Borrowings	153,068	130,136	-	-	-	23,383	2,326	308,913
Subordinated liabilities	5,887	818	14,480	-	-	4,479	11,203	36,867
Financial liabilities	701,219	171,625	62,185	2,420	3,084	31,163	15,931	987,627
Net on-balance sheet position	197,792	(12,273)	36,075	4,183	3,775	(29,971)	(6,392)	
Net off-balance sheet position	(4,627)	10,005	(34,396)	(4,235)	(3,265)	29,873	6,645	
Net position	193,165	(2,268)	1,679	(52)	510	(98)	253	
Non-financial assets								
Investment property	6,721	-	-	-	-	-	-	6,721
Investments in associates	913	-	-	-	-	-	-	913
Intangible assets	9,398	-	-	-	-	-	-	9,398
Tax assets	2	-	-	-	-	-	-	2
Assets and disposal groups held for sale	12,778	11,336	519	4,509	362	507	810	30,821
Other non financial assets	7,393	168	25	23	-	12	(76)	7,545
Non-financial assets	37,205	11,504	544	4,532	362	519	734	55,400
Non-financial liabilities and equity								
Tax liabilities	3,053	-	-	-	-	-	-	3,053
Liabilities associated with disposal groups held for sale	9,543	10,845	128	3,062	1,002	818	795	26,193
Other non-financial liabilities	26,404	133	86	-	5	-	219	26,847
Shareholders' equity	192,324	-	-	-	-	-	-	192,324
Non-controlling interest	172	-	-	-	-	-	-	172
Non-financial liabilities and equity	231,496	10,978	214	3,062	1,007	818	1,014	248,589
Intangible assets of Valitor in foreign operation excluded *	(1,534)	-	-	1,534	-	-	-	
Management reporting of currency risk **	(2,660)	(1,742)	2,009	2,952	(135)	(397)	(27)	

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

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

Amounts are in ISK millions

43. Market risk, continued

31.12.2019

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

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

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

Amounts are in ISK millions

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 Interim Income Statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). A negative amount in the table reflects a potential net reduction in the Consolidated Interim Income Statement or equity, while a positive amount reflects a net potential increase. An equivalent decrease in each of the below currencies against the ISK would have resulted in an equivalent but opposite impact (+10% denotes a depreciation of the ISK).

	30.9.2020		31.12.2019	
Currency	-10%	+10%	-10%	+10%
EUR	174	(174)	128	(128)
USD	(201)	201	252	(252)
GBP	(295)	295	22	(22)
DKK	14	(14)	375	(375)
NOK	40	(40)	66	(66)
Other	3	(3)	147	(147)

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

	30.9.2020		31.12.2019	
Equity	-10%	+10%	-10%	+10%
Trading book - listed	(285)	285	(301)	301
Banking book - listed	(526)	526	(486)	486
Banking book - unlisted	(287)	287	(296)	296

Derivatives

Derivatives are a part of the Group's customer product offering. The types of derivatives currently offered are forward contracts, swaps and options. Eligible underlying market factors are interest rates, foreign exchange rates, equities and commodities. Exposure limits, hedging requirements and collateral requirements are determined in accordance with the Group's risk appetite and monitored by Risk Management on a daily basis. The Group also uses derivatives to hedge market risk on its balance sheet. Note 24 provides a breakdown of the Group's derivative positions by type.

Amounts are in ISK millions

44. Liquidity and Funding risk

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

A primary source of funding for the Group is from deposits from individuals, businesses and financial undertakings. The Group's liquidity risk stems from the fact that the maturity of loans exceeds the maturity of deposits, of which 72% 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

30.9.2020	On	Up to 3	3-12	1-5	Over 5	With no		Book
Financial assets	demand	months	months	years	years	maturity	Total	value
Cash and balances with CB	22,644	58,946	6,025	-	-	-	87,615	87,517
Loans to credit institutions	31,972	7,512	-	-	-	-	39,484	39,484
Loans to customers	7,181	120,408	101,901	298,554	582,169	-	1,110,213	807,866
Financial instruments	25,210	52,712	63,913	57,632	15,004	32,155	246,626	234,937
Derivatives - assets leg	-	*43,148*	*17,292*	*50,595*	*11,239*	-	*122,274*	*117,071*
Derivatives - liabilities leg	-	*(38,929)*	*(17,909)*	*(41,681)*	*(10,876)*	-	*(109,395)*	*(105,829)*
Other financial instruments	*25,210*	*48,493*	*64,530*	*48,718*	*14,641*	*32,155*	*233,747*	*223,695*
Other financial assets	520	6,728	2,926	838	-	-	11,012	11,012
Financial assets	87,527	246,306	174,765	357,024	597,173	32,155	1,494,950	1,180,816
Financial liabilities								
Due to credit inst. and Central Bank	9,180	1,668	-	-	-	-	10,848	10,802
Deposits	438,246	65,999	83,479	13,801	2,992	-	604,517	602,842
Financial liabilities at fair value	6	3,750	838	2,007	45	-	6,646	3,983
Derivatives - assets leg	*(44)*	*(60,520)*	*(4,109)*	*(9,166)*	*(433)*	-	*(74,272)*	*(68,358)*
Derivatives - liabilities leg	*50*	*62,880*	*4,947*	*11,173*	*478*	-	*79,528*	*70,951*
Short position in bonds	-	*816*	-	-	-	-	*816*	*816*
Short position in equity	-	*47*	-	-	-	-	*47*	*47*
Short position in bonds used for hedging	-	*527*	-	-	-	-	*527*	*527*
Other financial liabilities	114	20,316	370	1,336	2,085	-	24,221	24,221
Borrowings	-	10,823	7,846	260,025	65,818	-	344,512	308,913
Subordinated liabilities	-	207	1,708	21,153	25,568	-	48,636	36,867
Financial liabilities	447,546	102,763	94,241	298,322	96,508	-	1,039,380	987,628
Net position for assets and liab.	(360,019)	143,543	80,524	58,702	500,665	32,155	455,570	193,188
Off-balance sheet items								
Financial guarantees	-	946	4,267	3,373	7,793	-	16,379	16,378
Unused overdraft	-	48,074	-	-	-	-	48,074	48,074
Undrawn loan commitments	-	61,805	8,851	2,038	-	-	72,694	72,694
Off-balance sheet items	-	110,825	13,118	5,411	7,793	-	137,147	137,146
Net contractual cash flow	(360,019)	32,718	67,406	53,291	492,872	32,155	318,423	56,042

Amounts are in ISK millions

44. Liquidity and Funding risk, continued

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

Net Stable Funding Ratio

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

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

30.9.2020	ISK	Foreign currency	Total
Available stable funding	704,637	196,308	900,945
Required stable funding	596,935	137,595	734,530
Foreign currency balance		(3,342)	
Net stable funding ratio	118%	140%	123%

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

Amounts are in ISK millions

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.

The following table shows the breakdown for the Group's LCR calculations. The ratio at 30 September 2020 is based on consolidated figures for the Bank and Valitor Holding hf. The ratio at 31 December 2019 is based on consolidated figures for the Bank and Valitor Holding hf.

30.9.2020	ISK	Foreign currency	Total
Liquid assets level 1 *	151,438	53,087	204,525
Liquid assets level 2	605	-	605
Liquid assets	152,043	53,087	205,130
Deposits	113,853	36,845	150,698
Borrowings	1,358	60	1,418
Other cash outflows	7,454	12,734	20,188
Cash outflows	122,665	49,639	172,304
Short-term deposits with other banks **	1,528	27,184	28,712
Other cash inflows	35,065	12,045	47,110
Cash inflows	36,593	39,229	75,822
Liquidity coverage ratio (LCR) ***	177%	428%	213%

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

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

30.9.2020	ISK	USD	EUR	Other	Total
Cash and balances with Central Bank	85,493	469	715	840	87,517
Short-term deposits in other banks	1,528	8,781	12,242	6,161	28,712
Domestic bonds eligible as collateral at the Central Bank	69,012	-	-	-	69,012
Foreign government bonds	-	38,057	13,004	-	51,061
Liquidity reserve	156,033	47,307	25,961	7,001	236,302
31.12.2019					
Cash and balances with Central Bank	103,726	286	534	534	105,080
Short-term deposits in other banks	-	5,410	5,771	7,004	18,185
Domestic bonds eligible as collateral at the Central Bank	11,878	-	-	-	11,878
Foreign government bonds	-	13,930	12,234	1,373	27,537
Liquidity reserve	115,604	19,626	18,539	8,911	162,680

LCR deposit categorization

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

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

LCR categorization - amounts and LCR outflow weights	Deposits maturing within 30 days					
30.9.2020	Less Stable	Weight %	Stable	Weight %	Term deposits*	Total deposits
Individuals	86,595	11%	112,185	5%	74,890	273,670
Small and medium enterprises	51,002	11%	16,756	5%	5,782	73,540
Operational relationship	-	25%	-	5%	-	-
Corporations	68,066	40%	4,148	20%	7,828	80,042
Sovereigns, central banks and PSE	71,631	40%	-	-	11,971	83,602
Pension funds	47,215	100%	-	-	15,258	62,473
Domestic financial entities	20,821	100%	-	-	17,218	38,039
Foreign financial entities	2,278	100%	-	-	-	2,278
Total	347,608		133,089		132,947	613,644
31.12.2019						
Individuals	130,942	10%	52,735	5%	74,580	258,257
Small and medium enterprises	50,339	10%	4,998	5%	6,156	61,493
Corporations	56,694	40%	829	20%	7,170	64,693
Sovereigns, central banks and PSE	13,501	40%	-	-	716	14,217
Pension funds	34,024	100%	-	-	16,431	50,455
Domestic financial entities	20,857	100%	-	-	27,051	47,908
Foreign financial entities	1,877	100%	-	-	-	1,877
Total	308,234		58,562		132,104	498,900

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

Amounts are in ISK millions

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 the regulatory requirement, including capital buffers and Pillar 2 requirements.

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

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

On 4 May 2020 the Icelandic Ministry of Finance ratified Regulation (EU) 2017/2395 into Icelandic law. The regulation introduces transitional arrangements for IFRS9 to allow the regulatory capital impact of expected credit loss to be phased in over time. These arrangements have been available to European banks since 2017. Institutions that elect to make use of these transitional arrangements can in 2020 add back CET1 equivalent to up to 70% of provisions incurred from the application of IFRS9. The Bank has opted to make use of the transitional arrangements, thus reflected in the Group's capital ratios as of 30 September 2020. The transitional arrangements increase the capital adequacy ratio by 0.2 percentage points.

Own funds	30.9.2020	31.12.2019
Total equity	192,496	189,825
Unaudited interim net earnings	(3,965)	-
Deductions related to the consolidated situation	(11,410)	(10,159)
Non-controlling interest not eligible for inclusion in CET1 capital	(172)	(181)
Common Equity Tier 1 capital before regulatory adjustments	176,949	179,485
Intangible assets	(11,671)	(10,604)
Tax assets	(310)	(296)
Cash flow hedges	(3,467)	(1,616)
Additional value adjustments	(242)	(125)
Foreseeable dividend *	(1,375)	(14,153)
Adjustment under IFRS 9 transitional arrangements	1,977	-
Common equity Tier 1 capital	161,861	152,691
Non-controlling interest not eligible for inclusion in CET1 capital	172	181
Additional Tier 1 capital	14,480	-
Tier 1 capital	176,513	152,872
Tier 2 capital	22,387	20,083
Total own funds	198,900	172,955
Risk-weighted exposure amount (REA)		
Credit risk, loans	568,345	561,602
Credit risk, securities and other	52,564	49,163
Counterparty credit risk	4,791	3,347
Market risk due to currency imbalance	2,552	10,070
Market risk, other	14,777	10,609
Credit valuation adjustment	1,618	1,477
Operational risk	83,487	83,487
Total risk-weighted exposure amount	728,134	719,755
Capital ratios		
CET1 ratio	22.2%	21.2%
Tier 1 ratio	24.2%	21.2%
Capital adequacy ratio	27.3%	24.0%
Total own funds, including interim profit not eligible for inclusion	200,882	172,955
CET1 ratio, including interim profit not eligible for inclusion	22.5%	21.2%
Tier 1 ratio, including interim profit not eligible for inclusion	24.5%	21.2%
Capital adequacy ratio, including interim profit not eligible for inclusion	27.6%	24.0%

* On 31 December 2019, the foreseeable dividend was the aggregation of the Bank's planned equity reduction in Q1 2020 through dividend distribution and buy-back of own shares. Due to the Covid-19 crisis, the plan was halted and no dividend is to be paid for the fiscal year 2019 according to an approval at the extended AGM on May 14 2020. However, in line with the Bank's dividend policy, it is foreseen that 50% of profits will be paid out. Thus, the amount shown on 30 September 2020 is 50% of H1 2020 profits since the 6M interim financial statements are the most recent to be audited / reviewed by the Bank's auditors.

Amounts are in ISK millions

45. Capital management, continued

Valitor Holding hf. is classified as held for sale in these Consolidated Interim Financial Statements. This does not affect the Group's capital adequacy calculations. For disclosure, assuming a cash sale of the subsidiary at book value, the Group's capital adequacy ratio would increase from 27.6% to 28.8%. The sale of Valitor would result in reduction in the Group's regulatory own funds adjustments, with positive effect on capital adequacy.

Capital ratios of the parent company	30.9.2020	31.12.2019
CET1 ratio	24.5%	23.5%
Tier 1 ratio	26.5%	23.5%
Capital adequacy ratio	29.5%	26.2%

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

Capital buffer requirement, % of REA	18.3.2020	1.2.2020	31.12.2019
Capital conservation buffer	2.50%	2.50%	2.50%
Capital buffer for systematically important institutions	2.00%	2.00%	2.00%
Systemic risk buffer *	3.00%	3.00%	3.00%
Countercyclical capital buffer *	-	2.00%	1.75%
Combined capital buffer requirement	7.50%	9.50%	9.25%

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

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

Capital requirement, % of REA

30.9.2020	CET1	Tier 1	Total
Pillar 1 capital requirement	4.5%	6.0%	8.0%
Pillar 2R capital requirement **	1.7%	2.3%	3.1%
Combined buffer requirement *	7.3%	7.3%	7.3%
Regulatory capital requirement	13.6%	15.6%	18.4%
Available capital	22.2%	24.2%	27.3%

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

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

Leverage ratio

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

	30.9.2020	31.12.2019
On-balance sheet exposures	1,176,825	1,022,521
Derivative exposures	13,083	10,217
Securities financing transaction exposures	2,871	577
Off-balance sheet exposures	66,612	52,299
Total exposure	1,259,391	1,085,614
Tier 1 capital	180,478	152,872
Leverage ratio	14.3%	14.1%

Amounts are in ISK millions

Notes to the Condensed Consolidated Interim Financial Statements

Arion Bank
Borgartún 19, 105 Reykjavík
Id.: 581008-0150